Not so free zone?

The Shanghai FTZ's first wholly foreign-owned hospital faces the same restrictions as in the rest of the nation. What the authorities will do to simplify the process, and the project's fate will determine global access to this industry

The freedoms of China's free trade zone (FTZ) are not quite extending to its first medical venture, and investors would do well to wait and watch before putting their money at risk.

Germany's Artemed Group and Hong Kong's Silver Mountain Capital have agreed to establish the first wholly foreign-invested hospital in the Shanghai FTZ. While the letter of intent has been signed and the companies are going ahead, there is a lack of clarity on whether the zone's tax breaks will extend to the hospital, if there will be an adequate supply of land and even how exacting regulators will be.

"The most difficult issue with the FTZ is coordinating with the various regulatory departments for projects, as everything is new and unclear," said Nicolas Zhu, a partner at CMS, adding that the project is yet to be approved. "Hospitals are purely service companies, so we don't know whether they will get customs or VAT duty exemptions. In any case, as far as we know, only one land site has been set aside for the medical industry and we don't know whether there will be room for more. "

Tread with caution

China started the Shanghai Free Trade Zone in September last year, pledging a more business-friendly regulatory framework and capital-flow rules. As of the end of August 2014, 1,612 new foreign companies had set up in the area, Li Jun, deputy secretary general of the zone's administration, said on September 3.

Restrictions such as a minimum investment of Rmb20 million and maximum operation period of 20 years have been lifted for hospitals in the FTZ, but they still remain on the negative list. This means that any sector not specifically mentioned as off-limits or restricted will be permitted in the zone.

"This isn't a simple filing with the Administration for Industry and Commerce, because hospitals need special permissions," said Hogan Lovells partner Philip Cheng. "This process has not been simplified specifically for the FTZ."

The success of the pilot project will determine whether foreign investment into the medical sector will be liberalised throughout the rest of China. On September 12, wholly foreign-invested hospitals were opened to more pilot cities, including the Beijing, Tianjin, Shanghai, Jiangsu, Fujian, Guangdong and Hainan provinces.

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The benefit of JVs

Traditionally, foreign medical companies have preferred not to go it alone. Most have pursued joint ventures, since it can be helpful to have a domestic partner that has served local patients, dealt with government bodies and understands the business and environment.

The French private maternity hospital company Noalys Group cooperates with a government-funded hospital in Shanghai and private hospitals in various other cities in China. Parkway Health, a member of the IHH Group, manages the Shanghai International Medical Centre, the first international private hospital funded jointly by private and government capital.

"Getting a local partner goes a long way," Cheng said. "Breaking into China's medical care market isn't going to be easy."

One way of getting in would be through M&A. The Circular that announced the expansion of the FTZ medical pilot scheme to more cities mentions the possibility of acquiring an existing hospital, which eliminates the need to build one. This would allow the market to gauge the complications, risks and benefits of setting up a foreign-owned hospital sooner.

Not enough space?

In the FTZ, the limited allocation of land for the industry has provoked scepticism among practitioners, who say that expanding the program is one potential answer. "We're also looking at Japanese and Australian investors to go in there as well," said Cheng. The lack of space means that the zone will probably have one medical center, with a concentration of institutions catering to different groups, he added.

"What the FTZ and the government want to do is run this pilot test and set up a wholly foreign-invested hospital with this model, and if this works, they will open it to all of Shanghai," said Zhu. "The purpose of the expansion of the pilot is to speed up the process and allow the government to gauge the social impact of the establishment of wholly foreign-invested hospitals."

By Katherine Jo