

Healthcare globalization: Impact on payor, provider, pharmaceuticals and life sciences

To stay competitive in today’s financial environment, payors, providers, pharmaceuticals and healthcare companies are increasingly reaching outside the United States for skills and services. As profit margins in the healthcare industry feel more pressure, lower middle market companies are forced to look for new areas to grow their top line and cut their cost structure. Many are looking to globalize their businesses. The experience of several Baird Private Equity companies in China and India illustrate the challenges and opportunities of healthcare globalization, and prove that these markets are equally accessible and potentially beneficial to lower middle market companies as they are to MNCs.

It is sometimes said that healthcare is a moral enterprise and not a commercial one. However, there are realistic, monetary aspects to providing healthcare that must be considered.

- A majority of hospitals lose money serving Medicare and Medicaid patients; one-third lose money on operations.
- The shortage of registered nurses in the U.S. could reach as high as 500,000 by 2025.
- According to the Tufts Center for the Study of Drug Development, the average R&D cost of developing and bringing a new drug to market has increased from \$54 million in 1979 to \$1.2 billion in 2006.
- If the speed of development of a blockbuster drug is reduced by one month, this equals roughly \$100 million in additional sales at a 40% profit margin.

Globalization of healthcare presents an opportunity to overcome some of these challenges. Lower middle market companies that leverage the global skill pool will benefit through cost savings, access to talent, reduced time to market and increased process efficiency.

CASE STUDY – FRONTAGE LABORATORIES

Baird Capital Partners Asia invested in Frontage Laboratories Inc. (“Frontage”) in early 2008. **Frontage is a leading provider of R&D outsourcing to pharmaceutical and biotechnology companies in the U.S. and China.** With operations in Pennsylvania and Shanghai, China, Frontage has been operating in China for 3 years and offers U.S. firms access to the Chinese talent pool and market. It also offers Chinese pharmaceutical firms access to the U.S. drug market.

Today, the Shanghai operation is a meaningful driver of Frontage’s growth.

Frontage recently expanded a research and development agreement with Beijing Second Pharmaceuticals, the ethical drug division of Beijing Pharmaceutical Group (“Beijing Pharma”). The agreement works to accelerate Beijing Pharma’s entrance into the international generic drug market. Frontage will also collaborate with Beijing Pharma to develop 12 ANDA products over the next 3-5 years, which will be marketed in China, Europe and the U.S. One of the products developed through the relationship was filed with the U.S. FDA in 2008. Several more products are targeted for filings in 2009.

Some of the key healthcare segments leveraging globalization are outlined below:

Sector definition	Globalization drivers	Remarks
Information Technology outsourcing	Cost arbitrage, process excellence, talent availability, time-zone	The total IT off-shoring market for healthcare is estimated to be \$6.5-\$6.7 billion. Off-shoring is expected to save 30-

	advantage	40% of the existing cost.
Business process outsourcing	Cost arbitrage, process excellence, talent availability, time-zone advantage	The total BPO off-shoring market for healthcare is estimated to be \$3-3.5 billion. Processes include claims processing, coding & billing, etc.
Medical staffing: Doctors, nurses and allied staff	Skill shortage/talent availability	According to the Department of Labor, the current national nursing shortage exceeds 126,000.
Medical tourism: Patients travelling to low-cost countries	Long waiting times, low cost, improved quality of care in low-cost countries	Thailand is the largest market. Malaysia, Singapore and India are close seconds. Estimates suggest that around 150,000 tourists came to India in 2004.
Clinical trials	Reduced time to market, availability of patients (treatment naïve), low cost	\$30 billion of U.S. drug sales at 10 top U.S. pharmaceutical companies were at risk from patents that expired between 2003 and 2007. Mounting development requirements due to these expirations makes the option of speeding this process through globalization very attractive.
Contract manufacturing of drugs/APIs	Low cost	According to PwC, The API market for 2010 is pegged at \$12.7 billion, driven by India and China. Off-shore countries supply new, still patented molecules, reflecting maturity.
Medical equipment: Product design	Reduced time to market, compliance to FDA regulations, low cost	This includes pre-manufacturing, design and analysis activities

While globalization of healthcare presents several benefits, companies need to be cognizant of the potential risks and mitigation strategies associated with it. Some of the major risks associated with globalization include data and IP protection, managing operations in a global team environment, managing cultural differences and customer communications.

In order to make the globalization initiative successful, the following should be considered:

- Prepare the organization internally for the change in operations. Help them understand the benefits.
- Select the right off-shoring partner. Look for one that is culturally aligned and provides overall value in terms of business and process expertise, operations best practices, as well as data protection and information security practices - not just cost-effectiveness.
- Set-up a governance and communication framework with the off-shore partner to manage the relationship effectively.

Globalization can be good medicine for ailing lower middle market healthcare company margins, but companies must execute well by managing risk effectively. The mindset has to be that of "cautious optimism."