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cutting through complexity

ADVISORY

Focus on the Prospects of the Private Medical Services Market in Russia for 2015–2017

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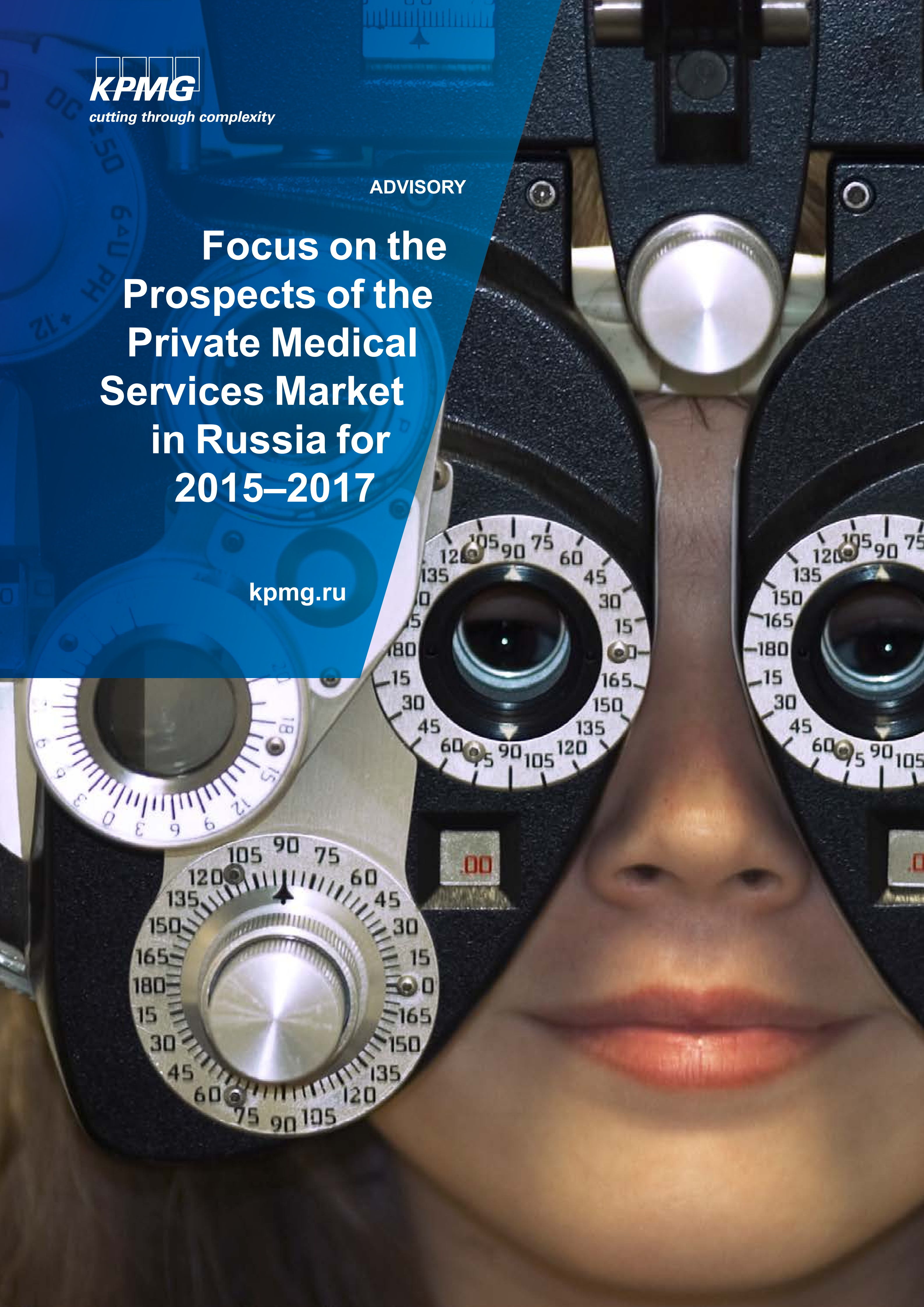

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Introduction

In this study, we have provided our opinion on the effect of current economic trends and the government's healthcare policy on the market for private medical services in Russia.

On the basis of the data collected and interviews with experts, we have identified a number of areas where the market positions for private healthcare institutions will be maintained and expanded, noting trends in the competitive environment, and also opportunities for private-public partnerships.

A key goal of the study was to indicate the main trends for the next one or two years, and we believe that you will find it useful.

We offer the results of our analysis for you to study in more detail.

We would also like to thank our colleagues who contributed to the performance of this work.

Best regards,

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Main conclusions

1 Due to the current economic situation, healthcare spending by both the state and patients themselves will decrease. We expect that aggregate healthcare spending as a share of GDP will fall, while healthcare costs as a percentage of patients' income will rise.

2 The expected reduction in the number of patients in the paid medical services segment is the result of a drop in the solvent demand of the public and a reduction in corporate supplementary medical insurance programs. At the same time, we believe that it is likely that demand for certain paid medical services will be maintained, as a result of the forced reorientation of demand among market channels.

3 The substantial weakening of the rouble exchange rate, and also the limitations on travel abroad for some categories of citizens will expand opportunities for the development in Russia of medical service segments that had previously been popular among Russians abroad.

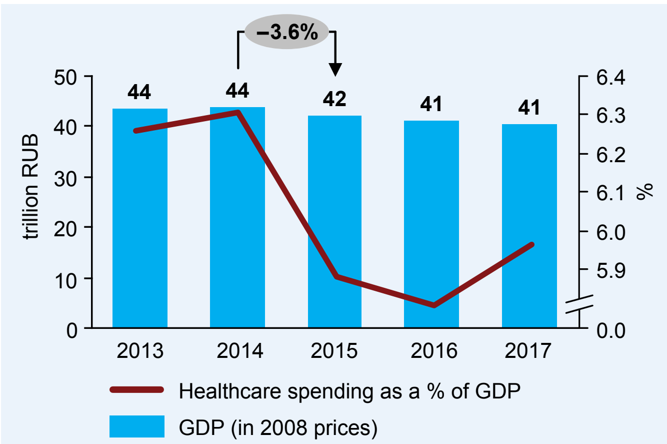
4 The potential for public-private partnerships in healthcare remains, and the Russian healthcare development strategy up to 2030 foresees a greater role for such partnerships. However, in the current economic environment, concession projects involving significant investment obligations on the part of the concessionaire will give way to other forms of PPP.

The Russian economic situation and its effect on the private medical services market

Healthcare expenditures as a share of Russian GDP will fall below 6% in the period 2015–2017. At the same time, total healthcare expenditures by Russians as a percentage of aggregate disposable income will rise from 4.3% in 2013 to 5.4% in 2017.

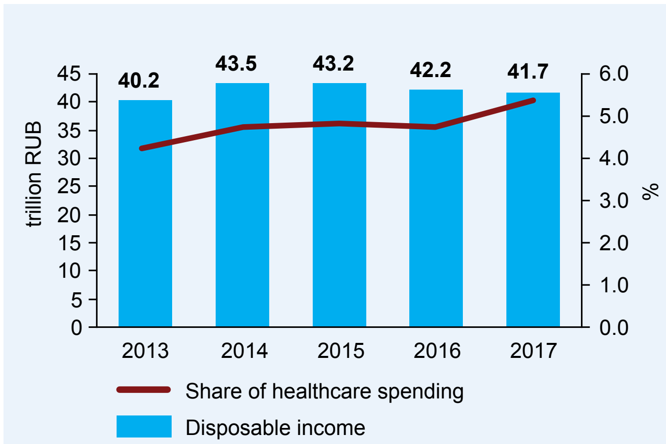
- The difficulties that the Russian economy has encountered as a result of geopolitical events and the fall in global energy prices are expected to lead to a 3.6% contraction in GDP in 2015
- Taken together with increased inflation, this state of affairs rules out any expectation of increased healthcare spending in real terms. The share of aggregate healthcare spending will fall below 6% of GDP.
- In recent years, the consumption of medical services, including paid medical services, has been growing in Russia. We expect that the observed changes in consumer behavior (concern for health and willingness to pay for medical services) will continue.
- The retention of these consumer behavior trends will lead to an increase in healthcare spending as a share of the disposable income of the public. The estimated increase in the period up to 2017 will be 1.1 percentage points compared to the 2013 level.

Real GDP of Russia, 2013–2017



Sources: FSSS, HSE, EIU, KPMG analysis

Aggregate disposable income of the Russian population and share of healthcare spending, %



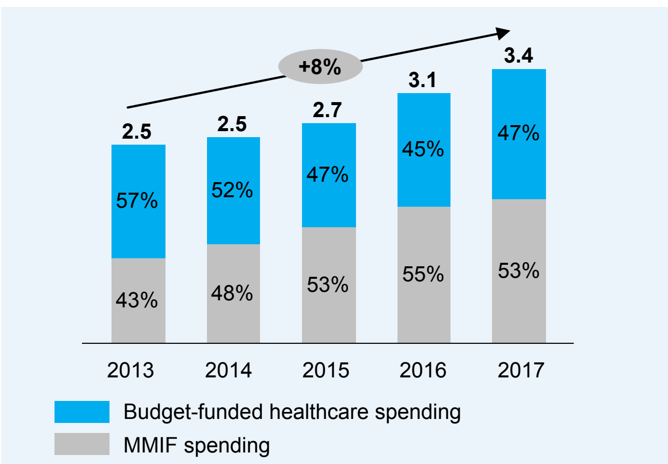
Sources: EIU, Gaidar Forum, RBC, KPMG analysis

Size and structure of healthcare spending

No fundamental changes will occur in the financing of healthcare in Russia: increases in government spending will not exceed the rate of inflation, but will rise faster than the growth of spending in the private sector.

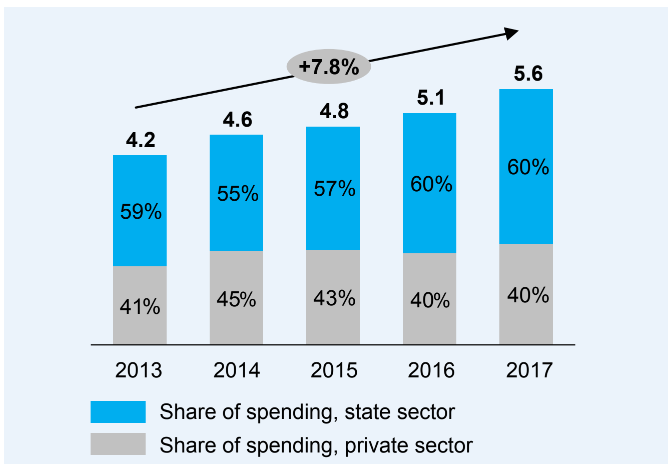
- State spending on healthcare will continue to grow in nominal terms, but the rate of growth will not exceed inflation.
- The share of the federal budget in state healthcare spending will contract in 2015 due to the reallocation of funds from the federal and regional budgets in favor of the Mandatory Medical Insurance Fund as part of the transition to a system of single-source financing.
- The income of the MMIF is also expected to grow compared to 2014 due to an increase in contributions for the unemployed from the consolidated budgets of the constituent entities of the Russian Federation.
- The increase in healthcare spending by the state sector will exceed the rate of spending growth in the private sector, which will lead to a reduction in the latter's share in overall healthcare spending.

State healthcare spending in Russia



Sources: EIU, Rosstat, KPMG analysis

Amount and structure of healthcare spending



Sources: EIU, Rosstat, KPMG analysis

Market trends

1

Given the turbulent economic environment, the previous increase in demand for the services of private healthcare institutions will give way to a decrease. However, we do not expect the public to turn away en masse from paid medical services.

Against a background of increasing standards of living and state investments in medicine in recent years, changes have been observed in the consumer behavior of Russians, who have begun to make more frequent use of both state and private healthcare institutions. The share of patients who are prepared to pay official surcharges for medical services has increased. In the current economic climate, this trend will continue due to the re-orientation of patients to less expensive services and the use of grey-market arrangements for paying for medical services.

- Russians have begun to seek medical assistance more frequently, and are ever more prepared to make legal payments for medical services. According to the study Healthcare Index-2014, conducted by Opora Russia together with the HSE and VTsIOM, in 2013 39% of patients used private clinics and 72% used government clinics; in 2014 these figures were 47% and 77%, respectively.
- At the same time, the government undertook a number of measures aimed at reforming the healthcare sector to improve its accessibility and quality. The package of services included in mandatory medical insurance was expanded, and significant funds were allocated to purchase new medical equipment.
- In 2014, the share of those who were “absolutely satisfied” or “rather satisfied” with the quality of state healthcare institutions increased from 39% to 50%. The share of those who likewise assessed the work of private healthcare institutions did not change substantially: from 69% to 70%.
- According to the same study, the number of patients who were prepared to pay official surcharges for higher-quality medical assistance rose from 20% to 31%.
- The economic decline and reduction in real incomes will restrain purchasing power. However, in our view the trends in the aforementioned changes in consumer behavior will continue, but the price factor will become more significant in the selection of healthcare institution.
- Under conditions of a reduction in the disposable income of the public, we expect a trend toward an increase in the grey sector of medical services in the mandatory medical insurance channel, as a way to more inexpensively obtain services of relatively better quality compared to legal paid medicine. Price competition between private and state health care institutions in the segment of legal paid medical services will also increase.

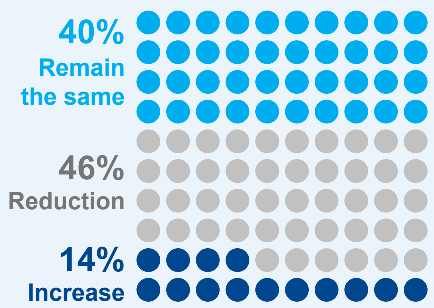
Market trends

2

We expect a reduction in the number of persons with voluntary medical insurance (VMI), a decrease in VMI packages and an increase in the share of state healthcare institutions in these packages, which, in our opinion, will be a positive factor in the growth in demand for certain paid medical services.

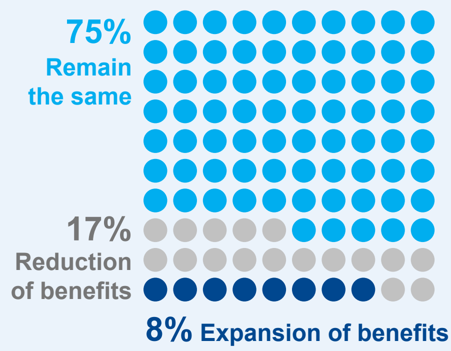
- Based on the results of KPMG's research performed in January of this year with the participation of 114 leading international and domestic companies working in the finance, retail, oil & gas, automotive, information, telecommunications and other sectors in the Russian Federation, 46% of the companies surveyed stated that they planned to reduce staff.

Plans to change staffing numbers in 2015, %



Source: KPMG analysis

Plans to change the corporate benefits packagein 2015, %



Source: KPMG analysis

- However, the number of companies that plan to reduce the corporate benefits package is relatively small – only 17% of those surveyed. This is explained by the fact that many companies have already implemented their plans regarding the corporate benefits package in 2015. We believe that many more companies will be forced to reduce their corporate benefits package when planning expenses for 2016.
- The average cost of a VMI package is RUB 50 thousand (source: the publication Expert), while the average wage level of consumers of medical services in Moscow equals RUB 58 thousand (source: BusinesStat). These data make it possible to conclude that if a patient withdraws from the VMI program provided by his/her employer, there is slim chance of this patient independently purchasing a VMI package.
- It should be noted that pursuant to the data of the Healthcare Index-2014 study, the level of patient satisfaction with private clinics is 20% higher than the level of satisfaction with state-run healthcare institutions. Moreover, the healthcare reforms currently underway in the state sector could already impact the quality and accessibility of medical services in state-run healthcare institutions in the medium term.
- We expect demand for paid medical services to remain the same among patients who have withdrawn from corporate VMI programs but are unwilling to turn to state-run healthcare institutions under an MMI program. As a result, state-run and private healthcare institutions will compete for this category of patients.

3

The current economic situation expands the possibilities for development of those segments of medical services in Russia that were previously popular with Russians abroad.

- Medical tourism includes both life-saving areas of medicine (for example, transplants) and areas of medicine that are not directly related to saving lives (for example, cosmetic medicine, plastic surgery, childbirth support, and some diagnostic procedures).
- A wide range of medical services are provided in Russia today. Nevertheless, according to the data from various sources from 15 thousand (Rossiyskaya gazeta) to 70 thousand (Nezavisimaya gazeta) Russians travel abroad for medical treatment every year.
- Not all areas of medical services are adequately represented on the Russian medical market today. For example, postoperative care is a relatively undeveloped area in Russia.
- The development of some areas, such as pediatric organ transplants, is restricted by the specifics of Russian national law. In other cases, the reason behind the lack of demand for the medical services provided in Russia is the level of organization of work with patients.
- There are currently factors that curb the growth in medical tourism, in particular travel restrictions on certain categories of citizens and the depreciation of the rouble exchange rate. These factors have both short- and long-term effects on the demand for paid medical services in Russia:
  - a reduction in the number of medical tourists in areas unrelated to the saving of lives is expected in the short-term, which will help to increase demand for these services in Russia
  - a growth in demand for life-saving areas of medicine is possible in the long term. However, for the time being the current economic situation will hold back the reorientation of demand for such medical services in favor of “import substitution”.

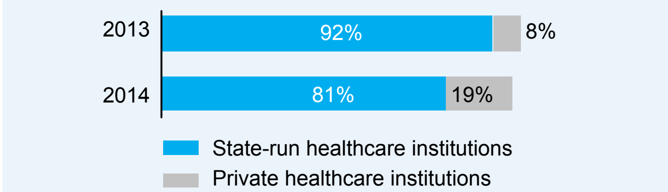
Market trends

4

The areas for public-private partnership in healthcare will remain over the medium term, but their implementation under the current conditions is complicated by unfavorable economic factors.

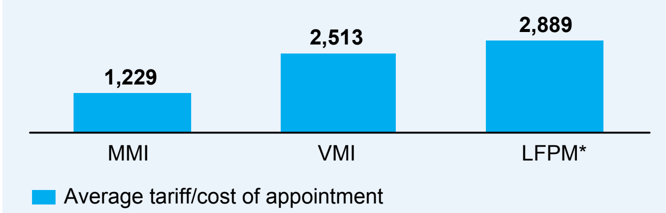
- The participation of private healthcare institutions in MMI was made possible by the implementation of reforms to MMI in 2010-2015. Despite the low margin, the number of private healthcare institutions working in MMI increased significantly in previous years. Under the current economic conditions, the rate of growth will slow, but not cease altogether. The instability of the Russian economy will affect other areas of public-private partnership more severely, in particular one should not expect an increase in the number of concession agreements with investment commitments.
- The main types of healthcare PPP include the work of private healthcare institutions in MMI, concession agreements and the provision by state-run healthcare institutions of services through outsourcing. The practice of concluding concession agreements assumes the attraction of significant investments and considerable capital expenditures by private healthcare institutions. The average amount of investments under concession agreements is RUB 200-300 million (source: Businesstat).
- The MMI reforms in 2010-2015 contained a number of fundamental transformations granting private healthcare institutions the possibility to work in the MMI field: the inclusion of private clinics in the MMI system, the freedom for individuals to choose their insurer, out-patient clinics and doctors, the transition to single-source financing of MMI, and a new procedure for payment of expenses under MMI.
- The work of private healthcare institutions under the MMI program has a low margin due to the relatively low tariffs. However, despite this fact, by 2014 the number of non-state medical organizations working in the mandatory medical insurance system had increased significantly. Whereas in 2013 their share equaled around 8%, by 2014 this share had already increased to 19%. These organization are found in nearly all regions of Russia.

Work of private healthcare institutions in the MMI sector, %



Source: MMIF

Tariffs for services by channel, RUB ‘000, 2014



** Out of pocket (legal) medicine*

Source: Businesstat, KPMG analysis, 2014

- In the current economic situation, a growth in the number of private healthcare institutions in the MMI field could slow, since inflationary pressure will not allow MMI tariffs to increase at a faster rate and thereby become attractive. The reason for this is the budget deficits of the MMIF (according to the data of Expert) and high inflation.
- In our opinion, private healthcare institutions will not abandon the MMI field, but the influx of new participants will slow. The implementation of new concession projects for public-private partnership in healthcare is unlikely under conditions of limited access to foreign sources of financing, the high cost of domestic borrowings, and the significant depreciation of the rouble.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