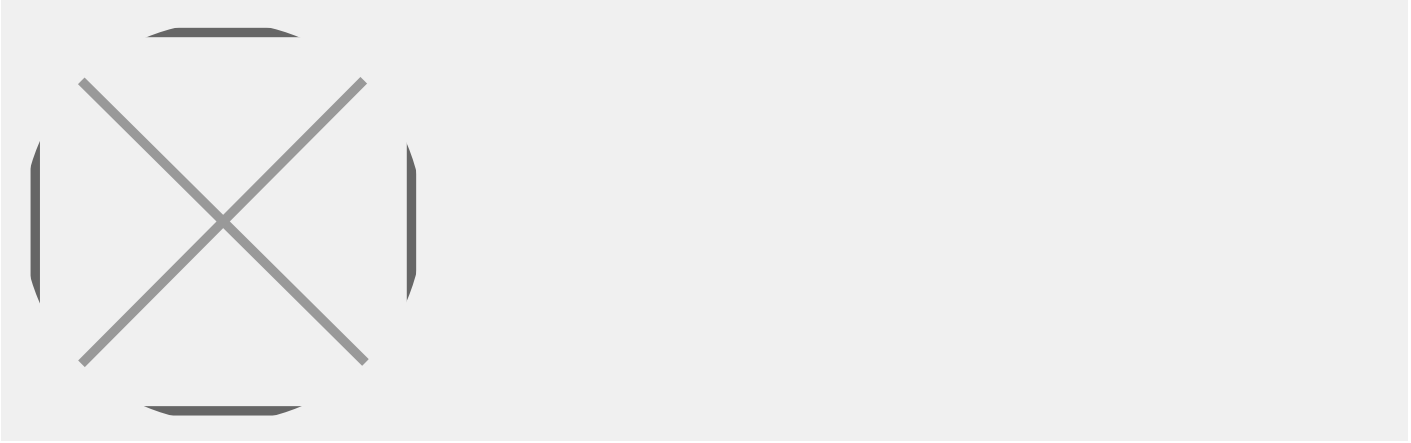
Interview with Jose Alarcon, Health Sector Partner, PwC Mexico



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PwC has been the advocate of convergence in the industry for a very long time, what does that mean and what are the implications for the Mexican healthcare system?

At PwC we have a common view for the health sector globally. We think that accessing cost-effective quality care is a worldwide challenge, and the way solutions should been implemented and addressed are similar in every country.

In order to be able to communicate these solutions, we have created what we call a “bending the cost curve “concept. We have discussions with the top minds around the world– and we think we can serve as a catalyst to bring best practices from one country to another, and applying them to current local circumstances.

Challenges are common around the world regarding cost, quality and access, as everybody is in a very challenging environment regarding political, economic, social and technological challenges. However we think that we are in a very good position in Mexico right now, as we have already started to transition for the four main drivers of transformation for the Mexican healthcare sector: regulatory changes, financial model changes through PPP on which we will develop later, the healthcare provision model, and personalized medicine.

Convergence is the way to approach the challenges of the sector with a broad view, making alliances with other players in order to provide the patient with the right affordable treatment at the right time with quality. We think that the industry players that embrace this vision of convergence

will succeed.

On the regulatory level, the Mexican regulators made several changes recently, either with the new COFEPRIS regulations, or with the new techno-surveillance norms that have recently been released, which helped the medical device sector, as well as the legislation around Public Private Partnerships (PPPs).

Today, President Enrique Pena Nieto is trying to continue the work that has been done to achieve universal coverage – and now that we have created demand, supply has to follow, and that implies an active participation and collaboration of all players to achieve cost effective healthcare solutions.

President Enrique Pena Nieto has been talking about implementing a fusion of all the different healthcare institutions in Mexico. The added value of that reform would be more simplicity and efficiency. But we need to recognize that we cannot make it happen from scratch in one day. First there is a need to create a mechanism to interchange patients in a fair and transparent transition. The other way should be the subrogation of different services to the private sector, that would allow decreasingthe infrastructure costs. What is certain is that we are going to witness a very significant change in the years to come.

When looking at Pena Nieto's plans for healthcare, the idea of having more decision-making enforcing leverage at the federal and empowerment at municipal level is a great thing because they are closer to the needs and they have the unique ability to see where the resources should be allocated. Pena Nieto also offers to double the number of physicians and nurses per citizens, which would be a great step but we would still be very far away from the OECD standards.

Another important player which should not be left out and should participate more actively in this transition phase are the private health insurance companies. Private health insurance in Mexico is only covering 5 to 6 % of the population so the value of that sector in terms of GDP is around less than 2%. Solutions should be found to make this sector grow more, for example by incentivizing the sector through regulation. One of the answers might be to work more on micro insurance and innovative products, and have regulations which allow insurance companies to act with more agility. The convergence challenge here is to make the insurance community work more as a team with the hospitals to provide products that are customer-designed for different groups of people in Mexico, and partner with universities to form academic medical centers.

Regarding the providers, there are around 3,000 private hospitals in Mexico most of them with less than 50 beds, and around 1000 public hospitals. We think a revolution is going to come in the middle sized hospitals. Sadly the medical tourism goals were not achieved partially because of the security problems that have not encouraged investors plus other factors such as the health reform in the USA.

One driver of reconfiguration in the hospital market should be a more active enforcement of the certification from the general health council of all hospitals.Since there are many little hospitals in the sector, we believe that there will be a consolidation, with mergers and acquisitions. If the foreign countries are smart enough, they should really look at Mexico as a very attractive country for investment in healthcare providers. We believe that there is big opportunity here, and we are surprised that very few foreign investors are not more present in that sector yet.

Another area of convergence in hospitals would be the telecommunications sector – and implementing telemedicine on a large scale – for remote areas for example. Carlos Slim's Health Foundation is making a lot of progress on that issue. It is a real area of opportunity to increase the potential number of patients treated and monitored by the same amount of physicians.

On the distribution level, the supply chain for medical devices is shifting from providing products to the hospital to delivering an integrated service covering everything from raw material to technicians which is great for hospitals who receive them as a complete package.

Regarding drugs, we have had three major wholesalers in place that have most of the market share, and we believe that the big retailers are drastically changing the rule of the game. Pharma companies are looking closer to the way these retailers work. Pharma companies need to find a different operating model. Both the pharmaceutical market, and the medical devices companies have to rethink their supply chain, and this is another area of convergence that is often ignored by companies.

On the government side, there is a need to bring innovative technology to the country – and educate the market. Agencies such as CENETEC have been doing a great job on that front. (Ed. Note: The National Center for Health Technology Excellence (CENETEC) is a body within the Mexican Ministry of Health established in 2004. Its mission is to contribute to the satisfaction of decisions and policy makers needs on management and assessment of health technology through, direct advise to users and administrators; coordination of efforts from institutions in the health sector; and the generation and dissemination of information.) It already developed more than 300 clinical guides but the process to implement them is going slower than the general expectation.

Last, Mexico needs more incentives to attract research in the country. One factor as to why we don't see more research being conducted in Mexico could be that the funds to conduct research have been awarded mostly to the public sector, with little incentive for commercial success. International agencies should put more attention on the private sector and incentivize a wider private participation as recipients for those funds.

We believe that the Mexican academic institutions, both public & private, should be playing a bigger role in transforming the way healthcare is being provided in the country – simply because they educate the health professionals and are a key player in research. The Universities can have

the entrepreneurial spirit to join forces and create APPP (Academic Public- Private Partnerships) such as bioclusters. That would be a key driver that would generate transformation of the sector in the short, medium and long term. The concept of bioclusters is still a challenge for the industry but is slowly emerging – and one example is the Campus BioMetropolis in the south of Mexico City.

A level beyond PPP's is smart cities – small communities where the patients are fully empowered. This is where we as a country would like to leadhowever ouraverage level of education is still limited and will not allow this in the short term. Having the right level of education is very urgent and would lead to a better repartition of wealth on the long-term.

In conclusion, the main focus of our activity at PwC is to help our clients to transform and create a paradigm shift in the health industry by linking academia, healthcare companies, infrastructure, government, and the energy and transportation sectors to create synergies that will revolutionize the health industry as a whole in serving communities better. This is what we call convergence.

A key component of convergence is the PPPs. What are the challenges and opportunities of having a PPP implemented today?

Where there are not enough resources, PPPs come in line as an innovation in financial models. Thanks to PPPs, the government has an enhanced cash flow management to provide the services they want, and the patients get better efficiency. It also brings better infrastructure that is built faster.

The financial model is a trust in which the government allocates ticketed resources. There is in most cases a 20 to 25 years contract in which the private sector commits to build and then operate the infrastructure for this period of time, providing the management while the government provides the supervision and the clinical services.

The challenge is to educate and raise awareness among the local governments on how the PPPs work.

How do you incentivize local governments to engage in PPPs ?

The advantages of a PPP are very clear.
First, they reduce risk for the government, as responsibilities and costs are shared with the private sector. Another very important factor is that cash flow pressure on the government side is reduced, allowing for bigger scale projects in the short term. In turn, this means that the population is provided with better services. PPPs also reduce administrative complexity for local governments, as the daily management of logistical services such as cleaning or laundry can be managed by the private partner. Finally, PPPs leave a lasting legacy for thegovernment administration that created them.

The main obstacle and challenge of PPPs is that they require strong and agile leadership from the government side.

Strong leadership is the key, sincethe political cycle is ill-adapted to PPPs. The local governments have to think through a long-term vision if they want to make the right choices, but on the other hand they are only in place for 6 years, which makes the task much more challenging. The issue is making sure that they leave the right projects in place for the future government without causing problems to the population, especially if there is a change of political party. Also, you need to sell the idea to the local congress and unions and convince them you are not giving away public property. That is a matter of education and awareness, and I am confident this will soon be an issue of the past.

Then, agile leadership, as PPPs are complex to implement politically. For example, the only players that have the financial leverage to build the infrastructure and get payments only after initiating operations are medium to large size companies. Often, the state governments tend to like more to provide investment opportunities to local or national companies which are often too small to support the financial challenges of integrating a PPP. A way around this challenge would be that the large companies often hire the smaller local companies to benefit from their market knowledge. Another political challenge that requires agility is being able to find a constructive agreement between federal & local levels for effective patient referral.

How do you get a PPP right for all parties in the healthcare industry?

In the planning stages, it is crucial that the government gets the best advice possible as it is a long term and highly complex project. The first step is to get a strong market study in order to forecast the size of the hospitals. It is absolutely critical to identify the minimum demand level to justify the project and guarantee to private investors the minimum return on investment they could receive – and this has been a major problem in Mexico so far. Then, the government should get a detailed business plan that would serve as a grid to evaluate the quality of proposals in the bid phase.

On the private side, companies should identify the right level of definition of the architectural design to ensure harmony while allowing reasonable flexibility of design and amenities.

The rest of the factors are linked to typical successful project management: adequate governance structure, a quality supervisor, monitoring key performance indicators (KPIs), independent assessors, appropriate penalties, and a strong Project Management Office (PMO) for aligning work streams and oversee risk management.

It is also very important to look at what has been done in Mexico PPPs project up to today, to extract best practices and capitalize on lessons learnt to better plan the next PPPs.

One of the lessons learnt in Mexico is that the market study period is critical. 2 of the PPPs conducted in Mexico – in Nuevo Leon and Ciudad Victoria –faced a big challenge there because there was an apparent mismatch between the infrastructure built and the actual demand.

Second, there is a need to gather the most precise details in the bidding process phase to increase transparency and avoid legal complications at a later stage.

Third, the medical devices companies can't bid for a 25 year contract when they don't know what tomorrow's technology will be. Therefore, the timeframe for medical device has to be divided into several layers, depending on expectations for the technology's future obsolescence. We could also think of different models such as opening to full service outsourcing for certain areas of the hospital, and leasing the equipment with a service level agreement.

Fourth lesson is how to deal the IT infrastructure in the hospital, and whether to keep it in the frame of the PPP or leave it outside. There is no rule here, but this is something that needs to be considered.

Another question that was raised is how to include the clinical personnel in the PPP – and correctly evaluating how much staff will be necessary to correctly run the hospital is crucial.

Last, Big Pharma still has to find their place in PPPs, possibly by offering clinical trials that could take place in those hospitals. If Pharma companies get smart enough, they can win with PPPs.

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