

Health inquiry's crossed wires will delay its progress on real problems

Report on Remgro and AfroCentric shows no understanding of competition or the way the sector works

Nicola Theron

The Competition Commission's health market inquiry has published research reports in its investigation of the private healthcare sector in SA. The aim of these reports is to stimulate debate and ultimately reach a finding on what could be done to fix a range of problems in the sector.

These reports have generally dealt with core issues, and stakeholders have had ample time to comment, contributing to the process. Last Friday, however, the inquiry changed course when it published its latest research note considering cross-ownership and cross-directorships in the private health sector.

This report is littered with allegations of implied misconduct against many of the larger private healthcare players, while not a shred of evidence is produced. In this form, it reads more like the next chapter of the white monopoly capital saga than a research report produced by a well-respected body such as the Competition Commission. This is a pity for many reasons.

The debate on the role of private healthcare in SA is already polarised. The latest disagreements on the role of medical schemes in National Health Insurance are a good example, with Cosatu insisting that medical schemes should play no role.

The health market inquiry research report lists cross-ownership and cross-directorships of mainly two holding companies: Remgro and AfroCentric. There is absolutely no in-depth discussion of how these cross-holdings are supposed to limit competition, yet the conclusion drawn is stark.

"The ownership structures in this note indicate complex and diffuse interrelationships between firms," it finds. "It stands to reason that these structures may provide disincentives to vigorous competition so as not to disadvantage the investment holding companies' financial interest."

This statement has to be unpacked to see what the inquiry means by it.

There is a large body of literature in competition law and economics that illustrates how cross-ownership could present competition problems. The research report refers to some of this research.

The first requirement for any such (traditional) theory of harm to hold is that the firms affected must be (horizontal) competitors. The director in the holding company of, for example, a hospital group can only have an incentive to act in a collusive or anticompetitive manner if there is some interest in a competing hospital group.

This is the type of problem the tribunal and the Competition Appeal Court grappled with in the Primedia/Capricorn merger – where the radio stations were direct competitors.

The health market inquiry's report, however, does not even put forward a theory of horizontal competitors colluding through cross-holdings. This traditional theory must therefore be dismissed.

The report seems to have another theory of harm in mind. The example it cites is a holding company that will not invest in managed care when it will hurt the profits of the hospital group in which it has an interest.

In practice, this means that the Remgro

director who sits on the Discovery board will now try to make the Discovery managed-care side of the business less efficient in order to ensure that Mediclinic has more patients who stay longer in their hospitals, yielding higher profits. Let us ignore for the moment the fact that this is clearly unethical behaviour and focus on the economic criteria to test whether this could happen.

The economic test asks whether this director has the ability and the incentive to act in such a manner. In terms of ability, one can assume that the Remgro director on the Discovery board is likely to be outnumbered by directors who presumably have the profitability of Discovery as their main goal.

It is unclear how this director will convince his fellow board members to hamstring the Discovery managed-care business in order to benefit Mediclinic (a group in which it has no direct interest).

In terms of incentives, the economics should again provide some guidance. One needs to weigh the benefits to Remgro of reduced profit at Discovery versus some increased profit at Mediclinic. Here, shareholding percentages of the holding company should give some

indication of these incentives and yet the health market inquiry makes no attempt to analyse these.

But most fundamentally, this theory shows no understanding of the functioning of healthcare markets. In fact, it would be much better for the Remgro director – assuming he has the ability and incentive and can live with his conscience – to grow the Discovery managed-care business.

Why would this be the rational thing to do?

Hospitals actually do not want healthy patients in their beds (they do not want patients to stay for longer than necessary). There is much more money to be made in treating sick patients, which implies that the incentives between the managed-care organisation and the hospital group are not misaligned in terms of profits.

All this illustrates the folly of the health market inquiry's flawed reasoning. One should as a first principle consider the fact that the behaviour suggested by the report is completely unethical.

These are serious allegations against some of the larger healthcare companies and their directors. A first step would have been to test

the facts with them. A factual mistake worth pointing out in this regard is that FirstRand does not have any interest in MMI (contrary to what is claimed in the report).

The inquiry acknowledges that it has produced not a shred of evidence in the report: "The health market inquiry is not in a position to draw any conclusions on the nature of the cross-directorships observed or the effects thereof without conducting further analysis of the relationships and operations of the companies."

And yet this does not stop it from concluding that there might be "disincentives to vigorous competition".

This report is a step in the wrong direction. Given the serious nature of the implied allegations, one would expect the relevant parties to object strongly to these types of unfounded claims – as they should.

This will simply cause unnecessary delays in a process that seems to have lost quite a lot of steam already.

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REPORT LITTERED WITH ALLEGATIONS

DISCOVERY HOLDINGS



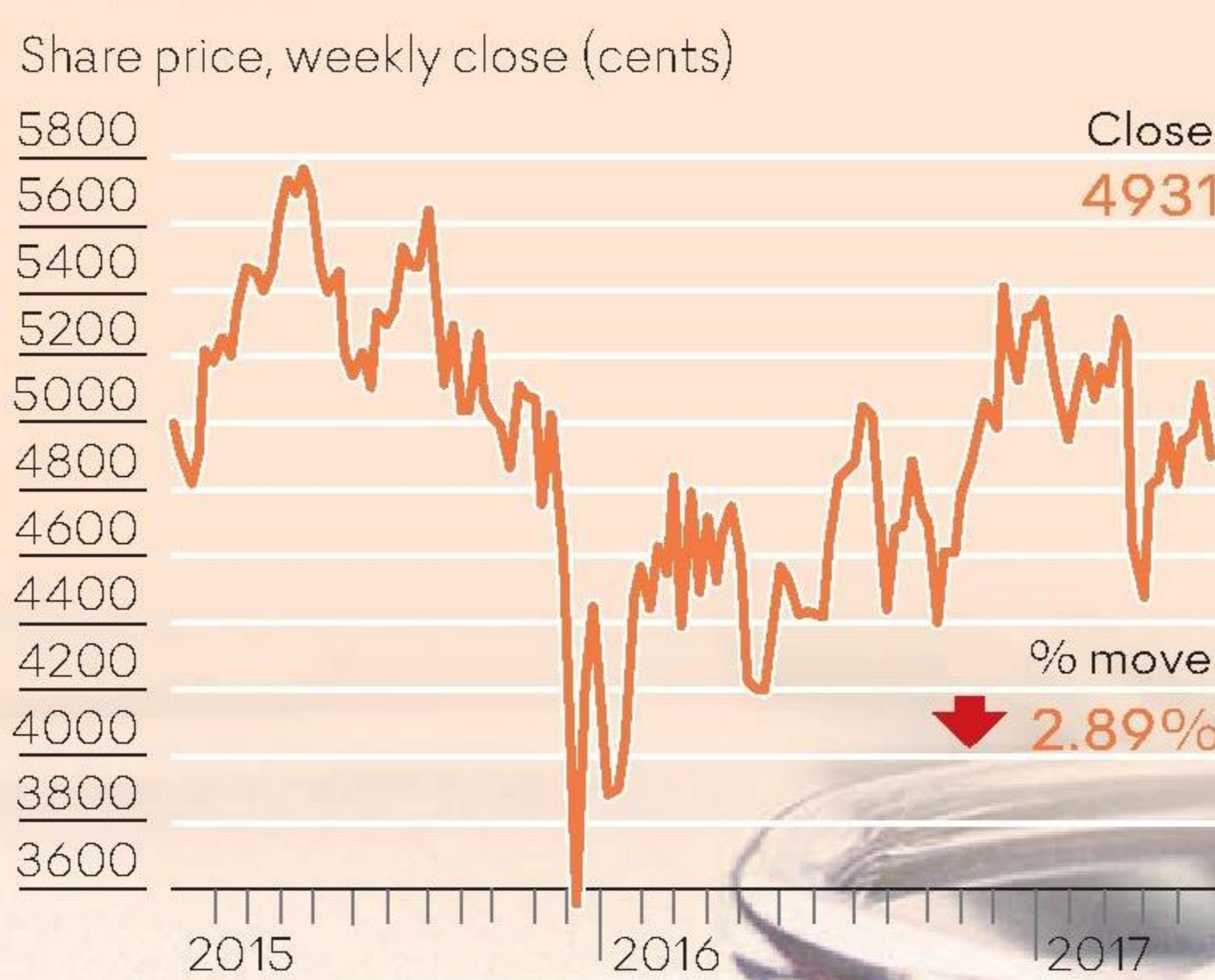
REMGRO



MEDICLINIC INTERNATIONAL



FIRSTRAND



MMI HOLDINGS



FTSE-JSE HEALTH CARE INDEX



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