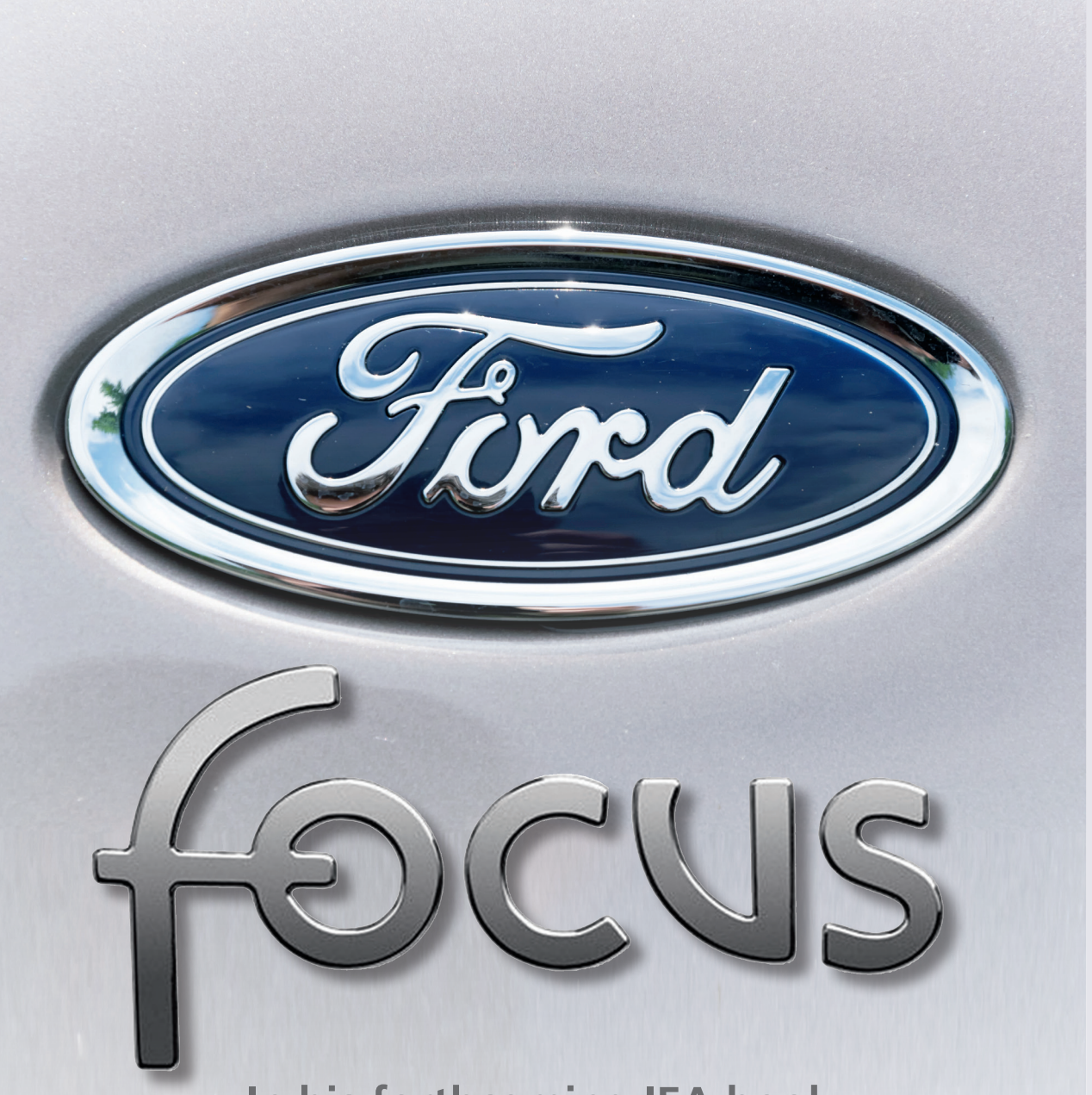


In his forthcoming IEA book, ***The Henry Fords of Healthcare***, **NIMA SANANDAJI** shows how healthcare experts in the East **drew inspiration from car manufacturers** to **boost quality** and **drive down health costs.**

Can the West learn the same lessons?

The debate on how to improve health services and reduce costs in the UK and other European welfare states has been going on for many decades.

Ideas such as increasing spending on preventive health care, better use of digitalisation to reduce bureaucracy, streamlining of work routines and 'pay for performance' schemes have been suggested.

Such reforms can marginally improve health delivery, but fail to solve the true problems of European health care systems.

In the forthcoming IEA publication, *The Henry Fords of Healthcare* I show that a new approach is needed: disruptive innovations brought in by entrepreneurs acting in an environment where they are able to try new health delivery models.

While the idea of allowing true entrepreneurial capitalism in healthcare might be seen as extreme in a Western setting, it is currently enjoying a wave of success in places such as India, Thailand, China and the Middle East.

When it comes to healthcare, the new market economies of the East are many steps ahead of the West.

European health care is under strain

WHEN IT COMES TO HEALTH CARE, THE NEW MARKET ECONOMIES OF THE EAST ARE MANY STEPS AHEAD OF THE WEST

In the UK most of health care is organised, financed and provided directly by the National Health Service (NHS).

This centrally planned system has major problems with long waiting times, inefficiencies, care quality and patient safety incidents.

Similar problems also exist in other European welfare states. Ageing populations and patient knowledge of the availability of higher quality treatments are driving up demand.

Since healthcare in Europe, particularly in Western Europe, is mainly financed through taxes, the rising costs are putting the social contract of European welfare states under strain.

If current trends continue, while many Europeans can expect to live longer, they might also experience many years of illness.

Trapped in Baumol's cost disease

The healthcare models in European welfare states differ from one another. Some, as with the one in the UK, are heavily centrally planned. Others, such as that in Sweden, do have a larger role for private companies operating with public funding.

Still others have a combination of private providers and private funding with protection for those who are less well off.

Although systems with greater private provision are more open to improvements, they too are weighed down by heavy public regulation. These regulations hinder cost-saving innovations.

Because of this, healthcare is often said to suffer from Baumol's cost disease. This phenomenon was described by the famous economist William J. Baumol together with William G. Bowen in the mid-1960s.

It leads to the situation whereby salaries in areas of the economy that experience no labour productivity growth tend to increase to reflect the general rise in salaries in the economy that is driven by increases in productivity in other sectors. This means that the relative cost of those services where there is little productivity growth increases.

A cause for alarm is that Baumol's cost disease might lead to a need for a continual increase in the tax burden to finance the same quality of health services over time because, it is often argued, healthcare is one of those sectors where productivity growth is very difficult.

However, is it necessarily the case that healthcare suffers intrinsically from stagnant productivity growth?

If healthcare were funded and provided differently, perhaps innovation and productivity growth would be much more likely. This is especially so given that technology and globalisation both open up entirely new ways of providing care. In The *Henry Fords of Healthcare* I explore the possibilities.

True entrepreneurship in healthcare

Devi Shetty is one of the entrepreneurs who is changing the scope of healthcare delivery.

After learning in school about the South African doctor who had just performed the world's first heart transplant, young Devi decided that he would pursue a career as a heart surgeon.

He followed up his dream by completing his graduate degree in medicine in India, training to become a cardiac surgeon in the UK

and consequently returning to his home country in 1989.

Shetty soon became a famous cardiac surgeon, having performed the first neo-natal heart surgery in India on a nine-day-old baby, and also having operated on Mother Teresa after she suffered from a heart attack and subsequently serving as her personal physician.

However, Shetty realised that heart surgery was simply too expensive for private citizens or for the government health system in India.

In an interview with the *Wall Street Journal*, he explained that almost none of the patients that came to see him could pay the cost of open-heart surgery: "When I told patients the cost, they would disappear. They literally didn't even ask about lowering the price", he remarked.

To solve this dilemma, the entrepreneurial surgeon employed economies of scale.

Shetty turned to his father-in-law, the owner of a large construction company, and explained that he needed to create a heart hospital that was big enough so that high volumes could push down the price of treatments.

The father-in-law agreed, and in 2001 the new hospital – Narayana Hrudayalaya – opened on 25 acres that previously had been marshland around a cement factory.

"Japanese companies reinvented the process of making cars. That's what we're doing in health care", Shetty explained. "What health care needs is process innovation, not product innovation."

The interview was recorded eight years after the flagship hospital opened. Already by then, the hospital, which had 42 cardiac surgeons, was performing thousands of heart operations each year.

Shetty and his team had streamlined procedures, creating an environment where each employee became specialised in performing the same part of the job over and over again. By employing streamlined procedures and economies of scale they had reduced the cost of cardiac surgery dramatically.

While surgeons in the US typically perform one or two surgeries a week, the surgeons in Shetty's hospital performed two or three operations a day, six days a week.

The operations at the hospital were continually scrutinised, in order to find opportunities to cut costs and increase quality. The average price charged for coronary artery bypass graft surgery was merely $2,000 in Narayana Hrudayalaya, compared to $5,000 in other private hospitals in India and between $20,000-42,000 in the US.

Yet, the mortality rate 30 days after coronary artery bypass graft surgery, one of the most common procedures, was not only on a par with but even somewhat lower than the average in the US.

The Henry Fords of Healthcare

Devi Shetty is not alone. A number of entrepreneurs in developing economies have taken advantage of economies of scale and streamlined procedures in health care, paving the way for a revolutionary change in health delivery.

BY EMPLOYING STREAMLINED PROCEDURES AND ECONOMIES OF SCALE THEY REDUCED THE COST OF CARDIAC SURGERY DRAMATICALLY

Govindappa Venkataswamy, an Indian eye doctor who passed away in 2006, founded Aravind Eye Hospitals – one of the largest networks of eye hospitals in the world.

A Harvard Business School Case Study has found that the hospital, which was founded in 1976, already by 1992 had screened 3.65 million persons and performed 335,000 cataract surgeries. Impressively, nearly 70 per cent of the operations had been performed at very low cost or free for the poor.

While Shetty cites Japanese car manufacturing as a role model, Venkataswamy was reportedly impressed by the service efficiency of McDonalds.

He sought to transplant it to the Aravind system in order to cope with the high demand for eye surgery and limited funds to finance it.

Chen Bang has similarly spread affordable eye treatment in China. Bang was an investor when he met a retired ophthalmologist who explained the economies of scale in the eye care business. The result was Aier Eye Hospital – the largest private eye hospital group in China.

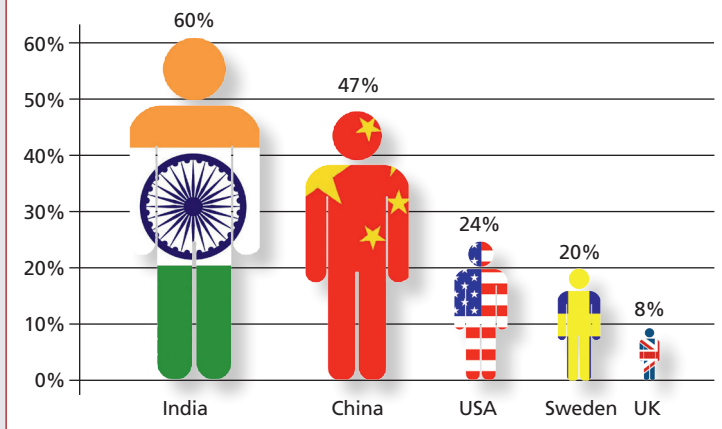
The firm has gained a significant share of the entire Chinese eye treatment market by implementing a similar vision for economies of scale as Aravind Eye Care. Forbes reported in 2016 that the group had 80 eye hospitals in operation, and planned to build 200 more by 2020.

A case study by the International Financial Corporation explains how the efficient service delivery of the Chinese hospital network is benefiting the poor:

"Aier adapted a multi-tier network of hospitals to ophthalmology and introduced it to China. The network model lowers costs through efficiencies as lower tier hospitals in smaller cities refer patients to larger, more sophisticated hospitals. […] A strong reputation for quality enables Aier to subsidize prices for lower-income patients with higher prices for discretionary procedures like LASIK surgery. […] As a result, Aier accepts patients, regardless of income level."

This illustrates the ability of entrepreneurial health firms to adapt to the need of patients with different income levels. Other similar health entrepreneurs can be found in Thailand and the Middle East.

Figure 1: Number of people who believe that the healthcare system in their country is improving...



based on figures from a Global Attitude survey at the end of 2016

Time to learn from the East

Why is it that these entrepreneurs thrive in the new market economies of the East rather than in the West?

One answer is that necessity breeds innovation. Another is that countries such as India and China have had failing state health systems. This disadvantage has been turned into an advantage, as entrepreneurs have designed new health systems from the ground rather than adapted to existing models. The result is a model with which many people are happy.

A Global Attitude survey at the end of 2016, for example, showed that 60 per cent of people in India and 47 per cent in China believed that over the coming years the quality of the healthcare that they and their families would receive would improve. This can be compared with 24 per cent in the US, 20 per cent in Sweden and just 8 per cent in the UK. (see Figure 1)

The UK and other Western countries have good reason to be inspired by the developments happening in the East.

For similar change to happen in the UK, the existing NHS system doesn't have to be completely overhauled. Public funding can for example continue to play an important role aslong as the right incentives are created within the system.

The important lesson from the East is that it is not enough to have a market in health. We also need a market that functions properly.

To a significant degree private firms operating in Western healthcare are bound by regulations and primary care (GP) services that hinder basic organisational innovations. They can thus not improve health delivery outcomes more than marginally.

The UK and other European countries should open up their healthcare systems to truly disruptive innovation. Economies of scale and streamlined procedures combined with new technologies can cure Baumol's cost disease•

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FOR MORE

The Henry Fords of Healthcare will soon be available for free download from the IEA at:

www.iea.org.uk/research