The Economist

Hospital mergers

The war of the wards

Investors are eyeing up hospitals around the world

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AT FIRST glance, hospitals seem an unattractive business. They are heavily regulated and often run by governments or charities. Doctors wield immense power. Patients have high and rising expectations. Rapid advances in medical technology drive costs relentlessly upwards even as governments try harder to restrain spending on health.

And yet, consider the flurry of deals of late. On July 19th TPG and the Carlyle Group, two American private-equity firms, won a takeover battle for Healthscope, an Australian hospital chain, with a bid of $1.7 billion. In doing so, they edged out a bid by Kohlberg Kravis Roberts (KKR), another big American private-equity firm. Healthscope is Australia's second-biggest private hospital firm, but it also has operations in New Zealand and south-east Asia.

Another battle is brewing in Singapore. In March TPG sold its minority stake in Parkway Holdings, a chain operating 16 hospitals in half a dozen Asian countries, for $685m. The buyer was Fortis Healthcare, an ambitious Indian chain. This upset Khazanah, a Malaysian sovereign-wealth fund that already held a minority stake. In May it made an offer of roughly $835m for a majority stake. On July 1st Fortis put in a bid for all outstanding shares, worth perhaps $2.3 billion. A final verdict is expected by the end of this month.

All this comes on the heels of several big hospital deals in America. In June Vanguard Health Systems, which is owned by the Blackstone Group, a big private-equity outfit, completed its acquisition of the Detroit Medical Centre's hospitals for $417m. In March Cerberus Capital Management announced its $830m acquisition of Caritas Christi, a non-profit chain of hospitals based in Boston.

Two big trends, one global and one local, explain this frenzy—and suggest that more deals are to come. The global trend is that demand for high-quality health care is exploding, as rich countries age and developing countries grow more affluent. The rub, notes Gary Ahlquist of Booz & Company, a consultancy, is that the supply of top-notch hospitals is rising only slowly.

This mismatch has set off a scramble by investors for high-end hospitals both to cater to local demand and to meet the boom in medical tourism—an area in which Parkway was a global pioneer. Rana Mehta of Technopak, an Indian health consultancy, agrees. He believes that Fortis, which was started in 2001 by the billionaire brothers behind Ranbaxy, an Indian generics firm, requires a strong brand to help it expand internationally.

The local explanation for the American firms' investments in hospitals is Obamacare. America's new health laws will reduce payments to hospitals while forcing them to invest in expensive information-technology systems, thereby squeezing margins. John Nelson of Moody's, a ratings agency, argues that these reforms will favour large, efficient providers. He expects more takeovers of weak non-profit hospitals by for-profit chains.

Many firms will struggle to cope with the trend towards greater technical and regulatory complexity, reckons Mr Nelson. Poorly-managed ones will fail and be swallowed. Investors who make hospitals more efficient, by contrast, will be handsomely rewarded. HCA, a big American hospital chain that was taken private in 2006, paid a dividend in January of $1.75 billion to its investors (chief among them KKR and Bain Capital, another private-equity firm).

Still, as Obamacare's reforms bite into domestic margins, returns are likely to diminish and American investors may again head overseas in search of healthier markets. Mr Mehta thinks Africa will be the next frontier. But as the Parkway saga demonstrates, the Yankee raiders will increasingly have to compete with well-financed local rivals.

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