



The Key Market Disadvantages for Public Private Partnership in Health Care Sector in Poland

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Abstract:

The Polish health care system is based on an insurance model. The main source of funding of the system is health insurance in the NFZ. Citizens are charged with compulsory insurance premiums representing 9% of personal income (7.75% is deducted from the income tax, and 1.25% is covered by the insured), which is paid to the health insurance institution (NFZ). But the health care system in Poland has been experiencing serious difficulties for many years now. Herewith this article I present the most important market difficulties. On the one hand, there are the weaknesses of the system of organizing and financing the provision of health care benefits and on the other, the lack of adequate financial resources to ensure an acceptable treatment standard. PPP might become the remedy for those problems. The key success factors of implementing PPP in transforming health care market in Poland are presented.

Keywords: Public Private Partnership; Public Medical Entities; Polish Health Care System; Market Disadvantages.

Introduction

The Polish health care system is based on an insurance model. In accordance with Article 68 of the Constitution of the Republic of Poland¹, everyone has the right to have his health protected. Public authorities ensure equal access to health care services, financed from public funds to citizens, irrespective of their material situation. The Acts on medical activity, on medical entities and on publicly funded health care benefits are the most important regulations concerning the market of medical entities². Patients are insured under the National Health Fund (NFZ). The main source of funding of the system is health insurance in the NFZ. Citizens are charged with compulsory insurance premiums representing 9% of personal income (7.75% is deducted from the income tax, and 1.25% is covered by the insured), which is paid to the health insurance institution (NFZ). Some highly specialized services are financed directly from the budget of the Ministry of Health, and not by the NFZ. Emergency care is also wholly financed from the state budget. Organizing regular competitive bids for the provision of health care benefits is a disadvantage of the National Health Fund's operation. As a result bids for the provision of health care benefits take place almost every year and in most cases the funding does not extend over the period of one year. It is virtually impossible to effectively plan the activities of hospitals over time and implement a stable investment policy in medical entities. The health care system in Poland has been experiencing serious difficulties for many years now. The Euro Health Consumer Index ranked Poland the 27th out of 33 countries³. These problems are manifested by:

- Impediments to access to specialist treatment (especially in hospitals) and long queues of patients, the waiting time in some specialties takes several years and is often extended,
- A poor quality of health services provided – including high mortality rates due to postoperative complications in some specialties exceeding 10% with the EU average of 4%,

¹ Konstytucja Rzeczypospolitej Polskiej, 2 kwietnia 1997r Dz.U. nr 78, poz. 483

² Ustawa o działalności leczniczej z 15 kwietnia 2011r, stan na 2012, Dz.U. 2013 poz. 217

³ Euro Health Consumer Index 2012. Health Consumer Powerhouse, 2012.

- Low salaries of medical personnel and mass emigration of specialized medical professionals to other EU countries,
- Public health care facilities going further into debt (at the end of 2008, the debt of hospitals amounted to PLN 3.5 billion), and Polish hospitals' debt trading⁴.

The causes generating the problems referred to above could be presented in two groups. On the one hand, there are the weaknesses of the system of organizing and financing the provision of health care benefits and on the other, the lack of adequate financial resources to ensure an acceptable treatment standard. Some of them are presented below:

- No carefully planned hospital network across the country with excessive fragmentation of county-level units, a haphazard medical structure in terms of actual social needs and of demographic and epidemiological fluctuations, central planning as per annual limits of providing services in selected specialties.
- NFZ policy which is not based on the willingness to provide for social needs as well as for epidemiological and demographic conditions of each region of the country.
- No competitive insurers other than the NFZ (a public fund).
- Lack of long-term NFZ financial policy, no long-term contracts for the provision of medical services makes it impossible to acquire external investment funding.
- Nepotism and favoritism in public health care facilities, resulting in excessive employment (particularly in administrative departments) reaching 20% while in some hospitals personnel salaries constitute 80-90% of the budget, for example, in the Children's Health Center there are only 300 physicians out of 2,200 people employed, while the majority of employees works in administrative and statistics departments (in 2012 the hospital had a debt of PLN 190 million),
- No well-defined system of financing health care benefits by the NFZ not based on the costs of the procedure itself, as it is calculated at present, but taking into account other factors affecting the cost of patient treatment, including costs associated with the necessary investments, such as equipment and obtaining external funding.
- A legal transformation of public entities into commercial companies is progressing very slowly; public entities are not willing to operate on a competitive market and to adopt the rules of commercial companies that may go bankrupt and cannot get into debt indefinitely.
- Lack of an adequate quality monitoring system of medical services provided and of medical personnel qualifications.
- Lack of human resources policy for medical personnel, manifesting itself in an outflow of the most educated people abroad and the lack of opportunities and prospects for their development in the country⁵.

The Basis Premises of the Transformation

All of these shortcomings in the Polish market of medical entities contribute to the key factor behind the crisis of the sector, which is the need for investment and a high financial outlay involved. An important aspect of the financial situation of medical entities is also a necessary transformation of the market itself, including changes in ownership interests in these entities and the statutory requirement to convert them into commercial companies. The basic premises of the transformation in the market of medical entities are as follows:

- i. Statutory mechanisms: provisions of the Act on medical activity involving the assistance to commercialized entities, cancellation of part of the debt, grants-in-aid to pay off assumed liabilities, solutions threatening the founding bodies with the obligation to cover a negative financial result of independent public health care centers with their own resources, if a health center is not restructured⁶,
- ii. Financial mechanisms: no possibility to fund development but also the current activities of independent public health care centers, due to excessive debt of the founding bodies and no possibility to incur further financial obligations to ensure the implementation of the statutory functions assigned to them of providing the public with an adequate number and quality of medical services,

⁴ *Europejski Konsumencki Indeks Zdrowia. Zdrowie Polaków*, 2012. (European Consumer Health Index) , Health of Poles, 2012.

⁵ *NIK o dostępności usług medycznych*, Warszawa 2010r. National Control Investigation Office :report about the Access to medical services in Poland, Warsaw, 2010.

⁶ Horosz P., *Komercjalizacja szpitali i jej skutki w świetle przepisów polskiego prawa gospodarczego*, ABC Wolter Kluwers Business, Warsaw 2011, p. 44

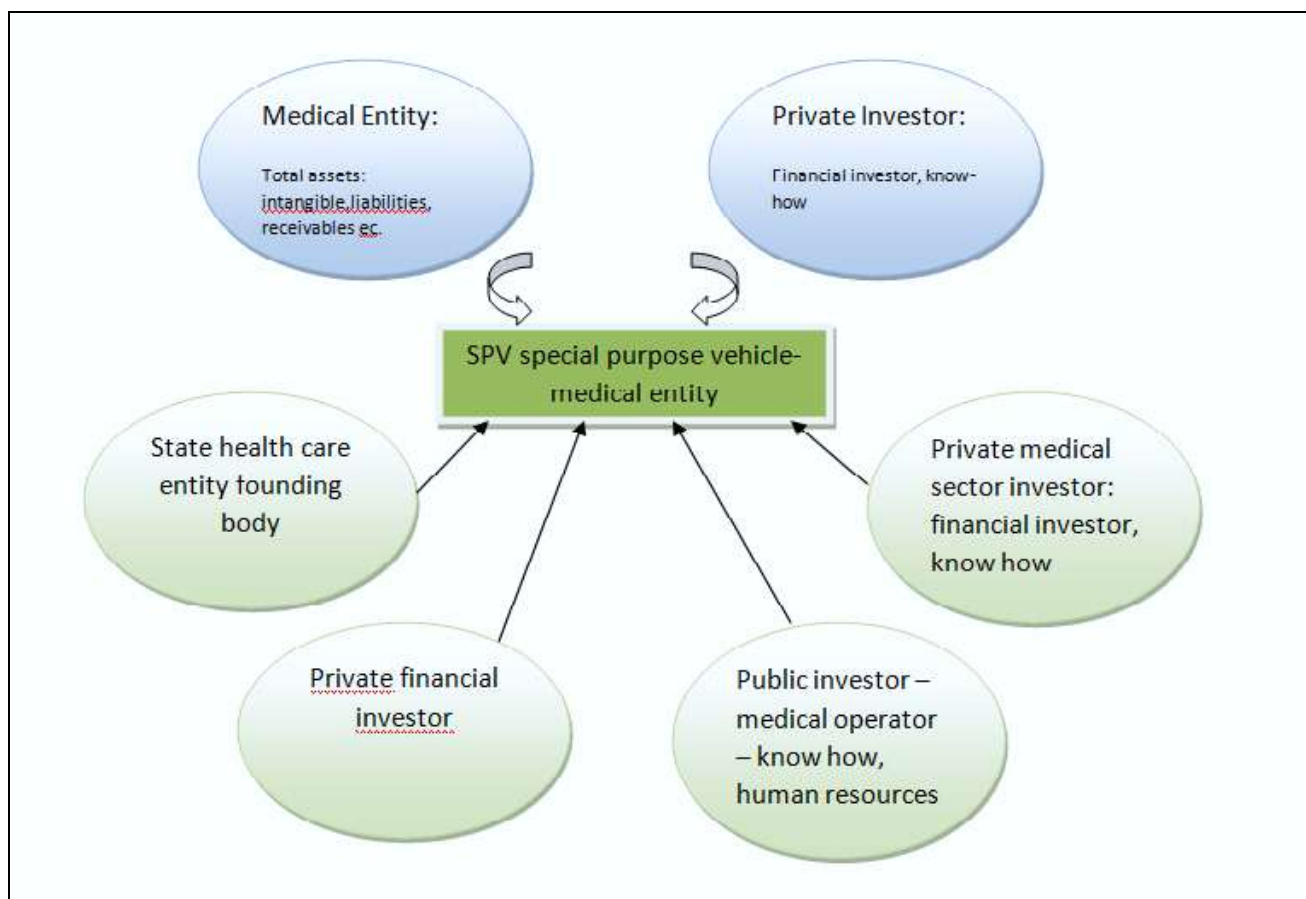
- iii. Management mechanisms: no possibility to improve the standards of independent public health care centers management with limited opportunities to exchange knowledge and experience and expanding it among independent public health care center managers, whose activity is also disturbed by the political factor of sustainability of management decisions extending over periods of political terms of office.

Opportunities to Implement PPP in Health Care Sector

In my opinion the needs of the sector and market characteristics of Poland’s medical entities so defined are an excellent basis for the implementation of PPP. This process would on the one hand contribute to carrying out the necessary investments and on the other, to improving the quality of both the service and the management of such medical entities. On the one hand, there is a great need for investments, including improvement of existing public infrastructure related to medical entities and on the other hand, there are no sufficient means to finance them from own resources. Owing to the act on public-private partnership and indications of a PPP risk analysis, this type of projects can prove to be a development measure most willingly used on the Polish medical services market.

The structure of a PPP project within the health care area should take into account the specificity of the entity to be transformed and the partner—future shareholder of the transformed limited liabilities or joint-stock companies (Figure 1). Thus, it cannot be specified only one model for the cooperation among the partners within a newly-created entity. However, a model can be created, which will evolve in accordance with arrangements agreed by the parties and individual values accepted by the future shareholders constituting capital of a newly-created company.

Figure 1. SPV⁷ Shareholders Diagram under the PPP—Medical Entity. Source: The Author’s Own Development.



The public (local government) entity takes up shares in the newly-created limited liability companies in accordance with the value of the enterprise or assets thereof it contributes. While the value of real property may be estimated in a simple and universally acceptable method of valuation of movable and immovable property⁸, many difficulties are encountered

⁷ SPV is the special purpose vehicle.

⁸ Methods of valuation of the companies include: (1) assets-based method consisting of estimating the value of property, i.e., the sum of labour, money, and resources in property for the establishment of a company. These methods include accounting method, method of adjusted net asset, method of the liquidation value, replacement cost method, and method of liquidation; (2) income-based method. In

in the valuation of other assets of the existing public medical entity. First of all, those include a human capital, without which the newly created company would not make sense of existence. Some other of my publications attempts to initiate a scientific discussion on the evaluation of medical entities and the factor of human capital within the health care area, which in most cases proves a high value of the entity and is also very difficult to be measured⁹. In the majority of financial analyses, in general, it is not taken into account at all. Therefore, if the existing public medical entity had any real estates, they were usually old and required high capital expenditures which did not contribute to the high valuation of the entity. If the existing public medical entity had equipments and medical technologies, then they usually also required replacement expenditures, and their market value was not high or was losing its value too quickly, along with technological advances in medicine. Then, what could be translated to obtaining a value of shares in the SPV under the PPP satisfactory for a founding body? I would like to hypothesized if the human capital and market potential due to the local epidemiology and demography of the existing public medical entity could prove to be the basic value features for the medical entities. However, not taking into account those hypothetical value factors of the public entity, the amount of shares shall be decided under the valuation of the public entity or its individual assets which the founding body shall decide to bring to a newly-created entity. The private partner, in accordance with idea of the PPP¹⁰, shall contribute the capital needed for further operations in the specified scale, necessary to conduct the investment needed to maintain liquidity, including management of the debt to be assumed from the founding bodies (if the agreement provides for such a solution). The private partner may also take up shares in the SPV through the valuation of its “know-how”, that is, experience and knowledge it has within the medical industry. Such a situation usually occurs when the industry shareholders are the insurers, i.e., enterprises financing the medical benefits and other health care entities that have already existed on the market. It is assumed that the total value of the shares resulted from the valuation of “know-how” of the shareholders should not exceed 20% of a company’s share capital value, and it usually does not exceed 10% of the capital.

At the stage of such a division of shares in a newly-created medical entity, it may, therefore, turn out that the assets of the existing public medical entity contributed by the founding bodies (land, building, and medical equipment) are worth far less than according to the subjective assessment of the current owners or the local community. Thus, the private partner includes a majority stake. In terms of the statutory collateral of the founding body interest (e.g., local government)¹¹ that partners should, first of all, provide for securing an intact and unlimited access to medical services for the designated community and an appropriate quality of these services¹². Thus, guaranteeing to the public representative, a real impact in a company within these two areas of its business activity should, despite the lack of its majority stake in the SPV, provide clear and relevant principles of cooperation between the public and private partners. Overcoming negotiating barriers among the partners, in which the public partner would have to be reconciled with the difficulties in the valuation of its assets, and thus despite the contribution of “large” assets, it could include only minority shares, which could be a first step for the understanding among the future partners. Protection of the public interest by completing tasks attributable to the local government entities, i.e., ensuring unrestricted access to adequate medical care and its appropriate quality, could be the next step to success in establishing cooperation and constituting an expression of an adequate division of powers and responsibilities in a company. It is worth noting that the unlimited availability of medical services for patients is not just decided by a healthcare entity. According to the applicable provisions, it is the National Health

this method, the value of income is estimated and defined as the sum of income that can be obtained from the operation of the company at the time. This group includes mainly the method of discounted cash (profits, cash flow, and dividends); (3) the method of comparison in the market. The market value is estimated, which is a hypothetical transaction price realizable by the owner in the sales process. For purposes of comparison, the following indicators are primarily used: price/earnings; price/sales; price/earnings before interest, taxes, depreciation, and amortization (EBITDA); dividend/per share; price/book value; and (4) mixed methods. See also Pantafil and Szablewski (2009).

⁹ Hass-Symotiuik M., System pomiaru i oceny dokonaa szpitala, ABC Wolter Kluwer Busines, Warszawa 2011, str.73.

¹⁰ According to one of the definitions, the PPP means a contractual solution where there is a strong demand for the services rendered on the one hand (here medical services), on the other hand, there is a lack of sufficient resources to carry out the necessary investments within the budgets of the founding bodies.

¹¹ Article 7 of the Local Government Act in *Journal of Laws* in 2001.

¹² Kachniarz M., Komercjalizacja samodzielnego publicznego zakładu opieki zdrowotnej. Kluczowe warunki osiągnięcia sukcesu, ABC Wolter Kluwer Business, Warszawa 2008, str. 137.

Fund that should be included into negotiations and discussions of the partners and would have the opportunity to provide the warranty of financing of services provided by the newly-created entity through the entire duration of the PPP agreement. It is well-known and widely acceptable in the world process that a newly-created public-private company possesses guarantees of financing of its services by the health insurance system payer's bodies. Clear rules on the financing of the SPV Company form another key factor for the success. The planned project under the PPP formula must be financially feasible. Long-term structure of the project, from the standpoint of a bank as a sponsoring organization, is increasingly perceived as a safe transaction (WestLB, 2004). The financial structure of this type of projects, in most cases, presupposes a significant share of external capital-financing. A SPV set up within the PPP project yielding tangible assets as a shareholding contribution to the public partners presents a good position of the credit worthiness assessments by financing institutions. It is also supported by both a private partner's capital contribution to the company as well as securities guaranteeing the repayment of debt to the financing institution. These guarantees are often not only the SPV's assets, but also guarantees and securities of the public partners. Also, contractual guarantees provided by the public payer (NFZ or Ministry of Health) are relevant, which are in form of a guarantee for a long-term financing of a social nature debt, which is provided by the SPV under the PPP. Some of the above mentioned guarantors of the project financial viability should be included in a detailed feasibility study of the project under the PPP formula (The World Bank Europe and Asia Region, 2004).

This study must show financial and economic viability of the project, taking into account different scenarios for the project¹³. Unfortunately, a significant drawback in the functioning of the health insurance system in Poland is the impossibility to obtain any guarantee of financing for the healthcare services rendered, regardless of whether the service provider is a private, public, or public-private entity. Lack of existence of such instruments severely hampers the functioning of medical entities and the possibility of involvement of private capital in the so long-term projects, as is the several years' cooperation of the partners under the PPP. It is difficult to imagine searching for private investors who are within, e.g., the 15-year PPP agreement would within a SPV finance the necessary investments in the newly-created entity, bear the costs of restructuring of the existing debt, and without significant changes in profile and scale of operations maintain liquidity without having any kind of financing services provided by NFZ and MZ (Młodzianowska, 2006). Therefore, this is a key barrier to the development of PPPs within the health care system in Poland, and hence, the difficulty in sharing responsibilities and risks of the partners in the SPV health care entities of the newly-created limited liability companies. It is worth to pay even more attention to the fact that for a positive effect on the local government budget obtaining guarantees for financing, the NFZ and Ministry of Health services would be significantly better, rather than obtaining a financial guarantee from the local government budget, which is synonymous with the deterioration of level of its debt, or in the case of many local governments, actually not at all possible due to the already high level of the existing debt.

Recommendations for overcoming the Market Disadvantages of PPP Development in Health Care Sector in Poland

Summarizing the above considerations on both the potential of transformation processes in the healthcare service system in Poland and selected factors on success of the PPP in the health service, the author has attempted to create a catalog of recommendations for overcoming the market disadvantages of the PPP within the healthcare transformation processes in Poland, under the current crisis of public finance. The following proposals will form the basis for further research, scientific analysis, and experts' discussions:

- i. Determination of value of the transformed public medical entity not only using the asset and income-based methods, but also designation of the value of public entity, which would take into account the human capital value of such a unit, quality of services, and market potential in terms of epidemiological and demographic level of the public medical entity functioning;
- ii. Obtaining an adequate and consistent allocation of powers and risks resulted from the value of the acquired shares and acceptance of the specific tasks of the public entity that within any kind of cooperation is required to maintain unrestricted access to and quality of public services for their local community, no matter whether those services are provided only by a public entity or by public-private entities. Although an often impossibility is to have a majority. Therefore minority shares in SPV, limited liability company, a public entity as a shareholder must be guaranteed a full opportunity to fulfill its statutory duties of control their performance by a public-

¹³ *BOT w projektach partnerstwa publiczno – prywatnego*, UNIDO BOT Guidelines Diffin, UNIDO, Bank Gospodarstwa Krajowego, Warszawa 2006r., str. 253.

private entity, including disposing of an appropriate catalog of sanctions as guaranteed in the PPP agreement, to be used if the task is performed improperly¹⁴;

- iii. Safety of a long-term financing of medical services, as a condition of entry of private investors in the area of public healthcare seems to be necessary¹⁵. By assumption, the PPP agreement and therefore the goal of an SPV of a healthcare entity within PPP represent the long-term cooperation. The long-term cooperation provides a private entity with a chance to obtain the desired rate of return on invested capital from the perspective of, e.g., 20 years, despite the fact that often it has to bear the costs of restructuring the existing public medical entity debt and significantly finance the newly-created company. Often, the replacement investments, especially within high-technology medicine area appear within periods of every five to six years, together with a change in trends and medical technology. It proves the further financing needs. Therefore, the only condition for long-term nature of the cooperation is provided by the security guarantees provided to the private partner. The long-term nature of the agreement should be interchangeable with the long-term financing guarantees of the payer, i.e., Ministry of Health or NFZ for the services provided according to the determined SPV company model, and in response to the market demand, consistent with the epidemiological and demographic trends.

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¹⁴ Kociemska H., *Public Private Partnership Project success circumstances*, Journal of Accounting and Auditing, str. 53, listopad 2010, vol. 6, no. 11, ISBN 1548- 6583, USA.

¹⁵ V. Kanakoudis, A. Papatitis, A.Sanopoulos, V. Gkoutzios, *Crucial parameters for PPP project successful planning and implementation*, Real Corp 007, Proceedings, maj 2007, s.174, ISBN 978-39502139-2-8.