

## Entry and expansion case study 3: Edinburgh and the Lothians

### Introduction

1. This paper, the third of our case studies on barriers to entry and expansion, examines the various attempts made by private hospital groups to begin providing private healthcare in Edinburgh from 2007. Whilst the other two case studies (London and Bath) focused on specific examples of entry and expansion in those areas, this paper takes a broader approach, examining the activity of a number of private hospital operators in Edinburgh over the last five years and seeks to understand the interplay between them.
  
2. Edinburgh has been selected for a case study due to the high level of interest shown in this area by a number of operators. In particular, we note the successful entry of the Edinburgh Clinic (TEC), which was subsequently acquired by Aspen, and the expansion of Spire, as well as the decisions of Circle and BMI not to enter despite their interest. We examine the extent to which these players encountered barriers to their entry and/or expansion and the nature of those barriers. In particular, we consider the role of market size, consultants, the PMIs and the Scottish NHS in facilitating or preventing entry/expansion. In addition, we consider the strategies deployed by Spire and Aspen to overcome any barriers to entry/expansion.
  
3. The structure of this paper is as follows:
  - (a) the first section describes the private hospital operators that have shown an interest in entering or expanding in Edinburgh;
  - (b) Section 2 provides a brief overview of the provision of healthcare in the Edinburgh area;
  - (c) the third section describes the entry/expansion plans of each private hospital operator and reviews their experiences; and

(d) the fourth section summarizes the main issues and sets out our current conclusions.

## **Section 1: The private hospital operators**

### ***Spire***

4. Spire is the second largest private hospital operator in the UK with 37 hospitals and 31 satellite clinics<sup>1</sup> located throughout England, Wales and Scotland. The Spire business was acquired by funds managed or advised by Cinven (a private equity firm), which acquired the business in two stages, reassembling the portfolio of hospitals that had been owned by BUPA. The first stage involved the buyout of BUPA Hospitals in August 2007 and the second involved the acquisition of the Classic Hospitals Group in February 2008.<sup>2</sup> Spire later acquired the Gerrards Cross private hospital (now known as Spire Thames Valley) from BMI Healthcare in March 2008. As at 3 October 2012, Spire's facilities comprised 116 theatres, 479 consulting rooms, 1,564 overnight beds and 210 day-beds. In Scotland, Spire has two hospitals (Murrayfield and Shawfair), both of which are located in Edinburgh.
  
5. In the year ended 31 December 2011, Spire generated turnover of £667 million and EBITDA (earnings before interest, taxation, depreciation and amortization) of £181 million. The business has grown its revenues by an average annual rate of 5.0 per cent between FY08 and FY11, and its EBITDA by 14.1 per cent a year. In FY11, around [X] per cent of Spire's revenue was generated by its Edinburgh hospitals.

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<sup>1</sup> These satellite clinics generally offer consulting rooms and a range of outpatient and diagnostic services. In some cases, they may also have facilities for minor surgical procedures.

<sup>2</sup> The Classic Hospitals portfolio had been part of BUPA Hospitals but was sold to Legal and General Ventures in 2005.

FIGURE 1

**Location of Spire's hospitals**



Source: Spire.

**Aspen**

6. Aspen Healthcare has eight facilities in the UK, five of which are based in and around London, with one each in Sheffield, Edinburgh and Solihull. These vary in size from a full-service hospital with a high dependency unit and dedicated cancer centre (Parkside), to consulting rooms that offer day-case and minimally invasive procedures (Chelmsford Medical Centre). In total Aspen's hospitals contain 15 theatres, 74 consulting rooms, 191 overnight beds and 24 day-beds. In the financial year ended 31 December 2011, the business generated £70 million of revenue and £18 million of EBITDA.

FIGURE 2

### Location of Aspen's hospitals and clinics



Source: Aspen.

Note: In addition to the locations shown, Aspen also has a facility in Chelmsford.

7. Aspen is owned by Welsh Carson Anderson and Stowe (a US-based private equity house) and was formed in 1998 via a management buyout of Paracelsus UK from Paracelsus Kliniken Deutschland GmbH. At the time of the transaction, Aspen owned the Parkside and Holly House hospitals. In 2003, the business acquired the Highgate hospital, followed in 2011 and 2012 by the acquisition of TEC, the Claremont (Sheffield), the Midland Eye Clinic and the Chelmsford Medical Centre.<sup>3</sup>
8. Aspen pursues a flexible expansion strategy, acquiring both full service hospitals and Ambulatory Surgical Centres (ASCs), depending on the characteristics of the local market and the opportunities that arise.<sup>4</sup>

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<sup>3</sup> Aspen website: [www.aspen-healthcare.co.uk/our-heritage/](http://www.aspen-healthcare.co.uk/our-heritage/).

<sup>4</sup> ASCs provide a range of diagnostic testing as well as day-case surgery and medical treatments but not in-patient services.

9. A market review, carried out for Aspen by Stanbridge Associates in 2009, identified ASCs as offering a significant growth opportunity, based on both the trend towards day-case and away from inpatient treatment and the movement by consultants towards grouping together and investing in setting up their own facilities. Stanbridge Associates suggested that the latter trend was a direct result of the squeeze on consultant incomes by the PMIs.
  
10. The criteria used by Aspen to identify potential locations for such facilities included: [X]. Aspen's model for investing in ASCs is to set up partnerships with consultants, aligning the interests of the consultants and the healthcare provider in driving highest quality of care for the patients. As discussed in paragraphs 55 to 58, Aspen's decision to invest in TEC was based on its assessment that the business and the Edinburgh area met these criteria and hence was an attractive investment opportunity.

### **BMI**

11. BMI is the largest hospital operator in the UK, with 61 hospitals and nine outpatient clinics located throughout England, Scotland and Wales. The business is majority-owned by Netcare, a South African hospital business, with Apax Partners and London and Regional Properties holding a minority stake.<sup>5</sup> Across its portfolio of hospitals, BMI has 181 operating theatres, 659 consulting rooms, 2,514 overnight beds and 225 day-beds. In FY11, BMI generated around £800 million of turnover and £218 million of EBITDA from its private hospital activities.

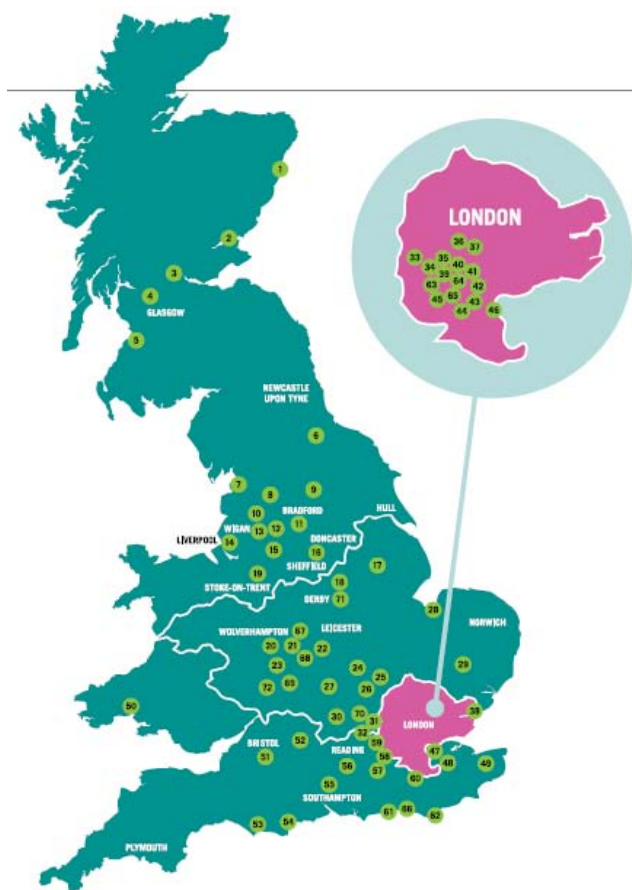
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<sup>5</sup> Apax website: [www.apax.com/news/apax-news/2006/april/network-healthcare-holdings-limited-acquires-leading-private-hospital-group-in-uk.aspx](http://www.apax.com/news/apax-news/2006/april/network-healthcare-holdings-limited-acquires-leading-private-hospital-group-in-uk.aspx).

12. BMI has grown both organically and via a number of acquisitions over the last five years, including the purchase of seven hospitals from Nuffield in February 2008<sup>6</sup> and the acquisition of the Abbey Hospital group in May 2010, comprising four hospitals in Scotland and northern England.
  
13. BMI has five hospitals in Scotland, located in Aberdeen, Dundee, Stirling, Glasgow and Ayr, which together generate turnover of around £[redacted] million, making it the largest private healthcare provider in Scotland.

FIGURE 3

**Location of BMI's private hospitals and clinics**



Source: BMI.

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<sup>6</sup> BMI originally purchased nine hospitals from Nuffield but pre-emptively sold two of these after having conducted an internal competition analysis and reaching the conclusion that a substantial lessening of competition may have arisen in these local areas. See OFT decision: [www.of.gov.uk/shared\\_of/mergers\\_ea02/2008/GHG.pdf](http://www.of.gov.uk/shared_of/mergers_ea02/2008/GHG.pdf).

## **Circle**

14. Circle was founded in 2004 and has pursued a 'mixed' model of independent healthcare provision, supplying both the NHS via Independent Sector Treatment Centres (ISTCs) and the management of NHS hospitals like Hinchingsbrooke Health Care Trust and the private sector via its hospitals in Bath and Reading and its outpatient/day-case clinics in Windsor and Stratford-upon-Avon.
15. The Circle model is based on a partnership with consultants who commit to bring a proportion of their revenue to the Circle facility in return for an equity stake in the business. Consultants are also encouraged to get involved in the management of Circle's hospitals in order to improve financial, operational and clinical performance. In FY11, Circle had turnover of £72 million and EBITDA of £(15) million.<sup>7</sup> (See the Bath Case Study for a detailed overview of the Circle group.)

## **Section 2: The provision of private healthcare services in Edinburgh**

16. As of mid-2010 the Edinburgh area had a population of around 486,000,<sup>8</sup> making it Scotland's second largest city. Edinburgh is relatively wealthy with a gross disposable income per head of £17,250 in 2010, which is approximately 10 per cent higher than the UK average of £15,730. The city exhibits low levels of unemployment, with a rate of 4.7 per cent as of June 2012 compared with a national average of 8.1 per cent.<sup>9</sup>
17. Estimates of the level of PMI penetration in the Edinburgh area vary, with BMI research putting the proportion at [X] per cent in 2010, significantly below the level for the UK as a whole, whilst Aspen used an estimate of between [X] per cent and [X] per cent prepared by Laing & Buisson in their analysis of the sector.

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<sup>7</sup> Numis, Analyst Report, 21 February 2012.

<sup>8</sup> ONS data, [Region and Country Profiles - Key Statistics Tables, October 2012](#). Glasgow is the largest city with a total population of around 590,000.

<sup>9</sup> ONS data: [www.ons.gov.uk/ons/dcp171778\\_286516.pdf](http://www.ons.gov.uk/ons/dcp171778_286516.pdf).

18. Scotland's population is more highly educated than the national average with around 35 per cent having a qualification at NQF level 4 or above, compared with a national average of around 30 per cent.<sup>10</sup> However, health outcomes are poorer in Scotland than in the rest of the UK, with male and female life expectancy at birth 2.3 and 1.8 years, respectively, below the UK average.<sup>11</sup>
19. There are a number of differences between healthcare policy and practice in England and Scotland which the CC has been told may have an impact on the private healthcare sector. In particular, we are aware of the following differences:
- (a) The Scottish Government is committed to a different model of healthcare provision from that in place in England. In particular, it is committed to delivering services via public facilities, rather than private hospitals and clinics:

The Scottish Government has been clear that it remains committed to the values ... of collaboration, co-operation and partnership working across NHS Scotland, with patients and with the voluntary sector; of continued investment in the public sector rather than the private sector.... The Scottish Government will not follow the route being considered by the NHS in England as their response to the global challenges.<sup>12</sup>

As a consequence of this policy, the Scottish Executive is seeking to minimise the use it makes of private hospitals to deliver its services. Moreover, although there are currently a number of contracts for such publicly-funded and privately-delivered services,<sup>13</sup> patients are unable to choose a private hospital as a matter of course as under the 'choose and book' scheme in place in England.

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<sup>10</sup> ONS data, 2010: [www.ons.gov.uk/ons/taxonomy/index.html?nscl=Higher+Education+Skills+and+Qualifications](http://www.ons.gov.uk/ons/taxonomy/index.html?nscl=Higher+Education+Skills+and+Qualifications).

<sup>11</sup> ONS data: Regional and Country Profiles—Key Statistics, October 2012.

[www.ons.gov.uk/ons/search/index.html?pageSize=50&sortBy=none&sortDirection=none&newquery=qualifications+scotland](http://www.ons.gov.uk/ons/search/index.html?pageSize=50&sortBy=none&sortDirection=none&newquery=qualifications+scotland).

<sup>12</sup> NHS Scotland Chief Executive's Annual Report 2011/12, p7, [www.scotland.gov.uk/Resource/0040/00408794.pdf](http://www.scotland.gov.uk/Resource/0040/00408794.pdf).

<sup>13</sup> See [www.scotsman.com/news/health/private-hospitals-needed-for-three-years-to-clear-nhs-waiting-list-1-2389187](http://www.scotsman.com/news/health/private-hospitals-needed-for-three-years-to-clear-nhs-waiting-list-1-2389187). These contracts are aimed at clearing a backlog of patients, waiting longer for treatment than permitted under current waiting list commitments.



(b) The Scottish Government has made certain commitments in terms of the quality of NHS services that are more ambitious than those in force in England. For example, the English NHS has a target that no patient should wait more than 18 weeks from the point of referral to commencing treatment.<sup>14</sup> By contrast, in Scotland: ‘From October 2012, patients requiring inpatient or day case treatment will be covered by a 12-week Treatment Time Guarantee enshrined in law which will apply every day of the year.’<sup>15</sup>

(c) Finally, the NHS in Scotland has developed an IT system called SCI Gateway which enables the electronic referral of patients by GPs to a hospital. This system avoids the need to send a referral letter to a hospital, with consultant appointments being confirmed during a patient’s GP visit, and their medical information transferred directly to the treating hospital at the same time. Some, but not all, of the private hospital facilities are also connected to this system, which requires NHS sponsorship.<sup>16</sup>

### ***Private healthcare provision***

20. Edinburgh and the Lothians are currently served by one full service hospital (Murrayfield), two day-case hospitals/clinics (TEC and Shawfair Park hospital) and a physiotherapy clinic (the Livingstone Clinic). Three of these facilities are owned by Spire, with TEC now owned by Aspen. There are three other hospitals within a one-hour drive of the city, two in Glasgow (Nuffield and BMI) and one in Stirling (BMI). In addition, BMI has a hospital in Dundee (Fernbrae).

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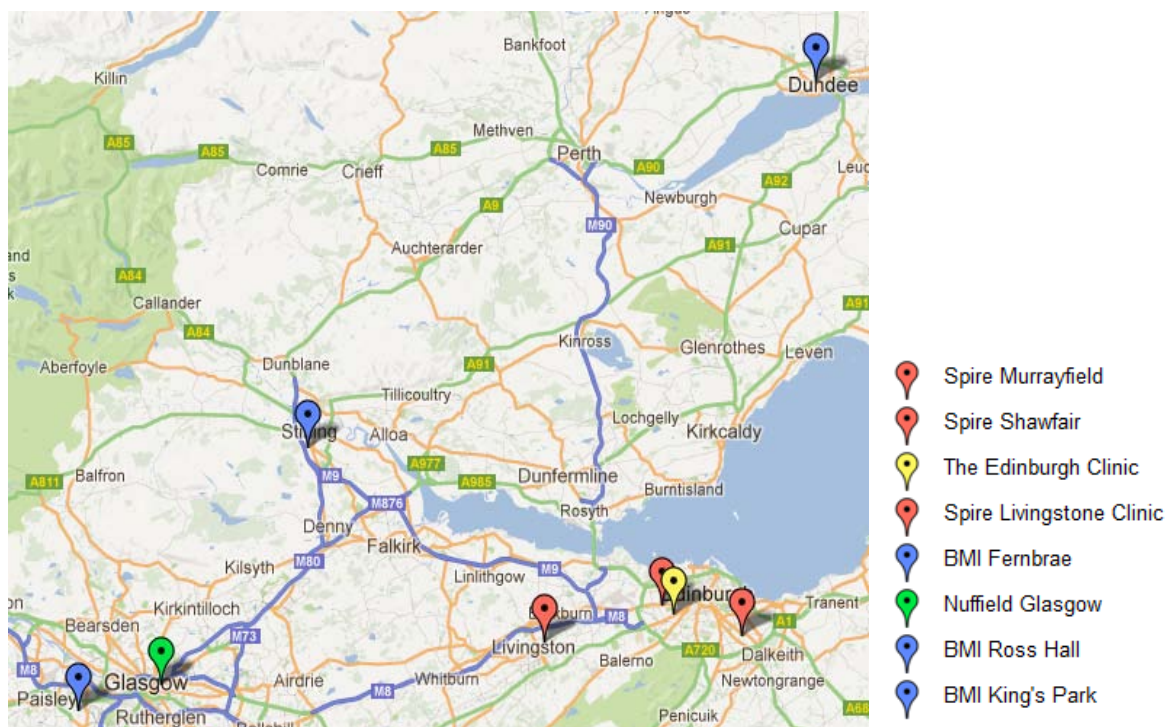
<sup>14</sup> [www.nhs.uk/choiceintheNHS/Rightsandpledges/Waitingtimes/Pages/Guide%20to%20waiting%20times.aspx](http://www.nhs.uk/choiceintheNHS/Rightsandpledges/Waitingtimes/Pages/Guide%20to%20waiting%20times.aspx).

<sup>15</sup> *Ibid*, p38.

<sup>16</sup> [www.sci.scot.nhs.uk/products/gateway/gate\\_desc.htm](http://www.sci.scot.nhs.uk/products/gateway/gate_desc.htm).

FIGURE 4

### Private healthcare facilities in and around Edinburgh



Source: CC analysis and Google maps.

21. Despite the relative proximity of Edinburgh and Glasgow, [X] told us that patients tend to be reluctant to travel between the two cities for private healthcare services.
22. In 2007, private healthcare provision in Edinburgh was significantly more limited—only the Murrayfield hospital and the Livingstone Clinic were in operation. The Murrayfield hospital was first opened in 1983 (by BUPA) and offers four theatres, 61 overnight beds and 14 consulting rooms. [X] The hospital is located in the north of the city, close to the former site of the Edinburgh Royal Infirmary (ERI).

FIGURE 5

**Spire Murrayfield hospital, Beechwood House building**



Source: Spire website.

23. The next section sets out the opportunities identified by the various operators and their plans for entering into or expanding within the Edinburgh area.

***Edinburgh Royal Infirmary***

24. The ERI is the main NHS hospital in the city. Up until around 2002/03, it was located in Lauriston Place, near the centre of the Edinburgh and close to the Murrayfield hospital. Between 2002 and 2005, the ERI moved its main site and several additional functions/specialisms to a new location in the Little France area in the south-east of Edinburgh. Several of the parties told the CC that this move had an impact on the dynamics of private healthcare provision in the city.

**Section 3: Entry and expansion plans**

***Introduction***

25. This section provides an overview of the attempted entry by Circle into Edinburgh, the successful entry of TEC and the successful expansion by Spire, the incumbent operator. In addition, it sets out the issues considered by BMI in deciding not to enter the area.

## **Circle**

26. Circle's strategy for expansion in the UK was based around identifying the 15 to 20 largest markets for private healthcare (outside London), raising the required levels of committed revenue from local consultants in each area and building hospitals in those markets. The funding for each hospital building was to be raised on the basis of the consultant commitments. One such target area identified by the group was Edinburgh. Circle's assessment of the market opportunity was as follows:
- In 2007 Circle saw Edinburgh as a market with PMI and cash pay revenues in excess of £20m. This market was dominated by Spire Murrayfield, which at the time was capacity constrained and enjoying a monopoly market position. The new Edinburgh Royal Infirmary was located to the East of the city with Spire Murrayfield located in the Western suburbs. Circle saw that an opportunity existed to provide more capacity closer to the Edinburgh Royal Infirmary.
27. In February 2007, Circle was approached by an agent with details of a site in Edmonstone, near the new Royal Infirmary site. The business decided to pursue the opportunity and began the process of seeking revenue commitments from consultants in March 2007. Circle's management set a target for revenue commitments of £[redacted] million, which the business reached in less than a year. In August 2007, Circle secured an option over the site and then submitted an application for outline planning permission, which was granted in February 2008. The hospital was to offer four operating theatres, 30 in-patient beds and 25 day-case beds, with diagnostic imaging and outpatient facilities.
28. In early 2008 [redacted]. Circle was able to secure [redacted] funding of approximately £9 million from AIB, which allowed it to complete the acquisition of the Edmonstone site in March 2008. Circle subsequently appointed architects to draw up more detailed plans

for a new hospital on the site. However, the business was unsuccessful in raising the financing required to build the hospital. [✂]

29. In early 2012, Circle made the decision not to proceed with its entry into Edinburgh.

### **Spire**

30. Prior to 2008, when TEC opened, Spire was the only private hospital operator active in Edinburgh and the Lothians with its Murrayfield hospital and Livingstone Clinic, which had been acquired from BUPA as part of a larger portfolio in 2007.
31. Spire presented its initial business case for a new hospital to its Board in November 2007. According to the 2007 Board Paper, Spire's decision to invest in a second hospital in Edinburgh (at Shawfair Park) was motivated by three considerations, namely: (a) the relocation of the ERI and the stated preference of the Edinburgh consultants for a private hospital location nearer to their NHS base and the consequent threat to the Murrayfield hospital; (b) the threat of competitive entry, and (c) the growth of the Edinburgh market. In this Board Paper,<sup>17</sup> Spire identified the threat of competitive entry, stating that its 'ambition would be to deter Circle or other competitors from entering the market'. In particular, Spire was concerned that the movement of the NHS's main facility—the ERI—from Lauriston Place to a new site in Little France, made its Murrayfield location less attractive to its consultants. The new ERI location was in the south-east of the city, whilst Murrayfield was located to the west of the centre of Edinburgh, a 25-minute drive away: Spire indicated that, as a result of the ERI move, the location of the main NHS practice of many of Spire's consultants shifted from the city centre to the south-east of the city. 'The location issue has opened up a chink in Murrayfield's armour that competitors are seeking to exploit. Developers have sought to identify sites which are capable of being

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<sup>17</sup> Spire discussed similar concerns in an 'Executive Briefing' document, dated 4 October 2007.

developed into a new private hospital close to the ERI. This search has been encouraged by strong interest from potential competitors, most recently Circle.’

32. Spire indicated that its main concern was that consultants based at the ERI would move their private work to a new facility built close to the ERI in order to avoid the inconvenience of travelling between Murrayfield and the ERI. The business case presented to the Board set out a number of scenarios showing the potential impact on Murrayfield in the case of entry by Circle.
33. The business identified a growing private healthcare market in Edinburgh, which was under-served by its existing facility. [REDACTED] A new facility would allow Spire to treat more patients, carry out more complex procedures and to provide several new service lines, including paediatrics, oncology, cardiology and IVF.<sup>18</sup> [REDACTED]
34. The November 2007 business case recommended the building of a new day-case hospital on the Shawfair site, whilst maintaining its existing facility in Murrayfield, with services being split across the two sites. [REDACTED]<sup>19</sup>
35. Spire acquired the Shawfair site in November 2007 and began a process of more detailed financial planning and evaluation prior to making a final decision regarding the site.
36. The November 2007 Board Paper highlighted the following ‘critical success factors’ that would minimize the probability and potential impact of competitor entry:
  - (a) ‘Securing a site which is close to ERI and affords easy access for both patients and consultants.

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<sup>18</sup> IVF was added to the planned new service offering in the April 2008 business case that was submitted to the Board for final approval. Spire told the CC that, at the time, there was a six-month wait to obtain privately-funded IVF treatment in NHS Lothian, and the next closest private IVF provider was located in Glasgow.

<sup>19</sup> [REDACTED]

(b) Acting quickly to ensure potential competitor investors know they would not be in a position to exploit the location weakness of Murrayfield unchallenged.

(c) Demonstrating our commitment to supporting the growth of consultants' private practice.

(d) Demonstrating the capability to improve the range and complexity of clinical services and to market aggressively in the region.'

37. In April 2008, an updated business case was presented to Spire's Board. It set out a number of areas in which Spire's plans for a new hospital at Shawfair had been developed.

38. The board paper reported that Circle had lost some credibility among the consultants due to its failure to keep to its original timetable for acquiring the site and building the Edmonstone hospital (see paragraphs 26 to 29). However, it also noted that Circle had completed the purchase and appointed architects in March 2008:

Whilst Circle has not abandoned proposals to establish a hospital in Edinburgh, if the Board accepts the recommendation to proceed with developing a new Spire hospital at Shawfair Park, the Spire facility will be operational for several months prior to a new Circle hospital. [X]

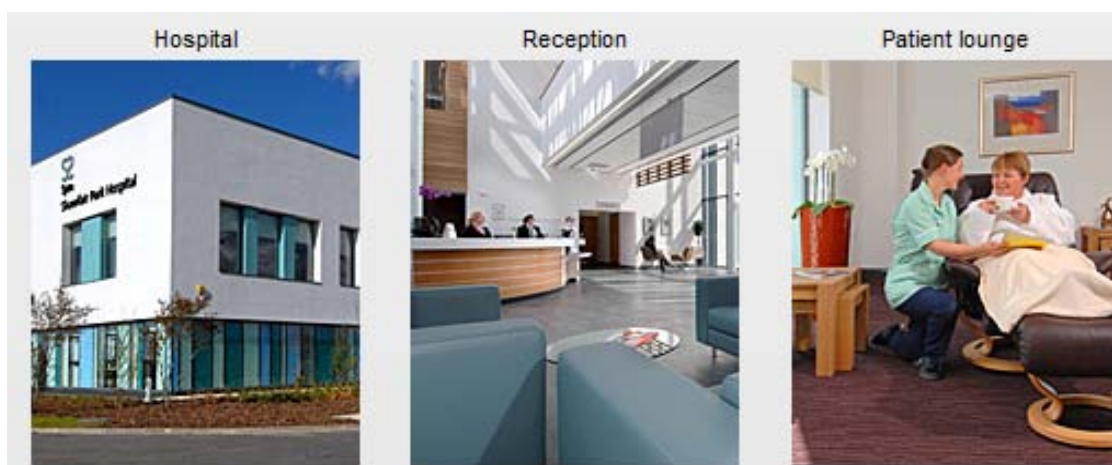
39. During this period, Spire Edinburgh considered the introduction of a cash-based, deferred payment incentive scheme for consultants to secure their loyalty for a period of five years from 2008. [X]

40. [X] Spire did not proceed with the consultant incentive scheme. Spire told the CC that the reason it had not proceeded with the scheme was because it considered such a strategy to be inappropriate.

41. Spire decided to proceed with construction of Shawfair Park in April 2008 with work starting in January 2009 and the hospital opening in March 2010. In total, the new facility cost £[redacted] million to develop, comprising £[redacted] million of land costs, £[redacted] million of build costs and £[redacted] million of equipment. Facilities include two operating theatres, 18 day-beds, an IVF treatment centre, a cardiac catheterization laboratory and imaging facilities, including X-ray and ultrasound equipment.

FIGURE 6

### Spire Shawfair Park Hospital



Source: Spire website.

42. The business plan targeted new revenue of £[redacted] million and EBITDA of £[redacted] million by FY11, based on a [redacted] per cent increase in the volume of patients treated in Edinburgh. This growth was expected across the two Edinburgh sites, which are operated and managed as a single unit.<sup>20</sup>
43. Spire indicated that it did not experience any difficulties either in obtaining planning permission for the hospital, or obtaining recognition from the PMIs, although the PMIs did not provide any advanced commitment to recognize the new facility. Spire explained that it 'was able to secure recognition, subject to quality certification, from Bupa, AXA PPP and Aviva UK Health during contract negotiations in Q1/Q2 2009'.

<sup>20</sup> [redacted]



Hence, the Shawfair hospital was recognized by the three largest insurers from opening with most PMIs accepting Shawfair as an extension of Murrayfield. In addition, Spire's Board Minutes indicate that the expansion was supported by local consultants, who demonstrated significant interest in the new facility.<sup>21</sup>

### ***Investment in Murrayfield***

44. In addition to developing the new Shawfair Park hospital, the financial information provided by Spire to the CC indicates that over this same period there was a significant programme of investment in the Murrayfield site. This included:
- (a) installation of a new modular theatre in April 2008 to increase capacity on the site, at a cost of around £1.5 million;
  - (b) acquisition of a new CT scanner in October 2008, at a cost of just under £1 million;
  - (c) refurbishment of patient bedrooms, reception and other communal areas, theatres, consulting rooms, the wellness suite, and the physiotherapy gym at a total cost of around £600,000 over FY10, FY11 and FY12; and<sup>22</sup>
  - (d) investment in new medical equipment, including a phaco machine, MRI coil, new camera stacks, specialised theatre, CSD and anaesthetic equipment at a total cost of around £200,000 over FY10, FY11 and FY12.

### ***Performance of Shawfair (and Murrayfield)***

45. A review of the first year of operations at Shawfair Park indicated that the hospital [X].
46. [X] Spire has increased total revenues in Edinburgh from £[X] million in 2009 to £[X] million in 2012, growth of [X] per cent. Over the same period, EBITDA

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<sup>21</sup> Edinburgh has a concentration of financial services firms, such as RBS, which have been particularly badly affected by the financial crisis.

<sup>22</sup> The bedroom refurbishment programme appears to have started in 2008/09 at Murrayfield. Only the costs for 2010 and 2011 are shown here.

increased by £[redacted] million, with the EBITDA margin increasing from [redacted] per cent to [redacted] per cent, compared with an average of [redacted] per cent for the Spire group as a whole. Volume growth has come from [redacted].

47. [redacted]<sup>23</sup>

FIGURE 7

**Financial performance of Spire in Edinburgh**

[redacted]

*Source: Spire.*

48. Spire noted in internal documents that it believed that its construction of Shawfair Park caused Circle to withdraw from Edinburgh, maintaining Spire's solus status in the city. Furthermore, Spire's assessment was that, following this withdrawal, new entrants in Edinburgh are unlikely.

***The Edinburgh Clinic***

49. TEC was founded in 2008 by Dr Martin Errington, an Edinburgh-based consultant radiologist. Facilities include an imaging suite with MRI, CT, Dexa scanner and 4D ultrasound scanners, as well as an X-ray machine, six consulting rooms, a laminar flow operating theatre for day-case patients and a physiotherapy suite. The clinic is located in the Morningside area of Edinburgh.

50. Dr Errington told the CC that he had been motivated to open the clinic as the result of a lack of available diagnostic facilities in the Edinburgh area. In particular, he stated that he had been unable to obtain practising privileges at the Murrayfield hospital during the early 2000s and, having spent a number of years renting diagnostic facilities from both the NHS and Alliance Medical in Edinburgh and from other private

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<sup>23</sup> [redacted]

and NHS facilities elsewhere in Scotland, he decided to establish a diagnostic and consulting facility from which to develop his practice.

51. Dr Errington's strategy for TEC was to attract consultants in specialist fields that had a particular requirement for diagnostic and scanning equipment, including orthopaedics, urology, cardiology and physiotherapy, among others, in order to generate demand for the facility's imaging equipment. In addition, the clinic sought to develop its offering over time with a day-case theatre (opened early 2012) in order to capture a greater proportion of the patient journey.
  
52. In early 2007, Dr Errington located a suitable site for the clinic in the affluent Morningside area of Edinburgh, which was conveniently located in terms of the clinic's likely catchment area for patients and with respect to the consultants' residential addresses. The clinic did not encounter any significant planning issues as the building had previously been owned and used by NHS Lothian for healthcare purposes. However, the building did require modernization, which took around 18 months.
  
53. Since opening in 2008, the clinic has attracted around 90 clinicians to practise at its facilities, from both Edinburgh and the surrounding areas, including some Glasgow-based consultants. In 2009, it entered into an agreement with the Glasgow Centre for Reproductive Medicine (GCRM), a specialist fertility (IVF) centre. GCRM already provided IVF services to patients in the Edinburgh area and was looking for a local facility to provide a range of pre- and post-treatment services, including consultations, blood tests, counselling and scanning. The strategy was to develop the

business and enhance customer service by reducing travelling for Edinburgh patients.<sup>24</sup>

54. Dr Errington told the CC that his initial venture (Errington Associates) had already been recognized by all the main PMIs as a 'virtual hospital' for scanning and diagnostic tests prior to opening TEC. He stated that all the PMIs wanted the clinic to succeed and that his existing (virtual) recognition was relatively easily transferred to the new facility. The one exception to this situation was gaining recognition from AXA PPP. Dr Errington had understood from AXA PPP that it was keen to recognize the clinic but in his view a pre-existing agreement with Spire meant that it was unable to do so.

### ***Aspen's decision to invest in TEC***

55. Aspen told us that its interest in the Edinburgh market was triggered by an approach from Dr Errington, who was looking for a private healthcare group to manage and grow the business.
56. Aspen carried out an evaluation of the market as part of its due diligence process and identified a number of possible challenges and risk, including:
- (a) recognition had not been obtained from all PMIs for theatre procedures (nor prices agreed), although most had provided verbal support,<sup>25</sup>
  - (b) the prevalence of 'Dear Doctor'<sup>26</sup> referrals which are distributed to consultants by hospital facilities not only 'makes it very difficult for aspiring consultants to build a strong and commercially rewarding practice' but that it also meant 'very little

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<sup>24</sup> Patients would continue to travel to Glasgow for the IVF treatment itself but would no longer need to travel for the associated consultations, tests and scans.

<sup>25</sup> Aspen indicated that AXA PPP, in particular, was reluctant to commit to recognition or agree prices. However, AXA PPP's low penetration in the Edinburgh market was considered to counteract this risk.

<sup>26</sup> 'Dear Doctor' referrals are sent directly to a hospital, which then passes the referral to an appropriate consultant, rather than being addressed to a specific consultant.

practice can be brought instantly to the Clinic due to the majority of referrals going straight to Spire Murrayfield'; and

(c) it was 'essential' to gain access to the SCI Gateway system in order to attract referrals from GPs. Dr Errington also highlighted the importance of gaining access to this system.

57. In spite of these risks, Aspen decided that Edinburgh met its criteria for investment in an ASC [redacted]. It noted that TEC was 'a new phenomenon' in Scotland but that the investment 'allows Aspen early entry into an attractive emerging market at a relatively low investment exposure'. In addition, although not part of Aspen's business case for the investment, it identified a further potential opportunity arising from a number of initiatives by the Scottish NHS to work with external providers with an objective of increasing capacity. Aspen's view was that capacity constraints in the local NHS would mean private provision would be required to meet their commitments.
58. Aspen's plan was to develop a broader range of services than those currently offered, including urology, cosmetic surgery, cardiology and diagnostics.
59. Aspen entered into discussions regarding a joint venture with TEC in October 2009, and completed the deal in January 2011, acquiring a 50 per cent stake for £[redacted].

FIGURE 8

### The Edinburgh Clinic



Source: The Edinburgh Clinic website.

#### **Performance of TEC**

60. Aspen initially forecasted revenues of £[redacted] million in 2011, rising to £[redacted] million by 2013. [redacted] Aspen estimated that the clinic needed to undertake [redacted] scans and [redacted] minor procedures per month in order to become cash positive.
61. During 2011, TEC performed [redacted]. In addition, it has taken up to four years for TEC to gain access to the SCI Gateway system (effective from January 2013), although it is unclear what impact this may have had on performance.<sup>27</sup>
62. Aspen told the CC that it had taken a number of steps to improve the performance of the clinic, including:
- (a) In October 2011, Aspen increased its equity stake in the clinic to 90 per cent.
  - (b) Aspen had invested £300,000 in developing the operating theatre, with day-case procedures in ophthalmology, cosmetics, urology, orthopaedics, ENT and general surgery commencing from January 2012.
  - (c) TEC had signed a 'treat' contract with a local health trust under which it was carrying out around [redacted] MRI scans and [redacted] procedures per month. Aspen

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<sup>27</sup> Aspen stated that it had taken two years to gain access to the SCI Gateway system, whilst Dr Errington told the CC that the process had taken four years.

indicated that this contract had been effective in raising the profile of the clinic among local GPs and consultants.

63. Aspen told the CC that these changes were starting to show results, with the clinic now generating a profit [✂] and a number of new consultants bringing work to the clinic. [✂]
64. Figure 9 shows the performance of TEC compared with Aspen's initial forecasts for the facility.

FIGURE 9

### **Financial performance of TEC**

[✂]

Source: Aspen.

65. TEC is recognized by all the PMIs with Aspen indicating that obtaining this recognition had not been 'as challenging as it might have been if TEC had overnight facilities'. Dr Errington told the CC that an advantage of Aspen's involvement with the clinic was its ability to bring 'firepower' to the negotiations with the PMIs.

### ***Competitive response***

66. Dr Errington stated that he believed the entry of TEC had provoked a limited competitive reaction from Spire, in part due to its relatively small scale and focus on diagnostics and minor procedures, with consultants continuing to refer their patients to the Murrayfield hospital for in-patient treatment.<sup>28</sup> For example, he stated that Spire did not appear to have changed its self-pay prices for certain scanning procedures, such as MRI, despite the lower prices charged by TEC.

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<sup>28</sup> Dr Errington told the CC that Spire's decision to start offering IVF services at its Shawfair Park hospital may have been a direct response to its agreement with GCRM in 2009. However, we note that the business case prepared by Spire in April 2008 includes revenue forecasts for IVF treatments at the Shawfair hospital.

67. Spire told the CC that it had recently invested in new optometry equipment in order to better compete with TEC for patients.

### **BMI**

68. BMI first identified Edinburgh as a target market during a network strategy review undertaken in 2005. The city was identified as a gap in BMI's portfolio of hospitals and a key target [✂]. The market was viewed as being 'worthwhile' on the basis of having a local population of more than 40,000 people with private medical insurance. BMI noted that the transfer of the activities of the Royal Infirmary to the Little France area of the city reduced the attractiveness of Murrayfield's location and that there were at least two potential sites for a new hospital which were now better located. However, this strategy review also noted that the Edinburgh area might not be sufficiently large to accommodate two hospitals.
69. In early 2007, both the Edmonstone and the Shawfair sites were reviewed by BMI as potential means of entry. The Shawfair site was initially considered attractive for a number of reasons, including its proximity to affluent populations in south-central Edinburgh and the border region, good transport links, a positive planning environment, and its location next to the ERI, which was considered to provide access to consultants.
70. However, in July 2007, BMI's board came to the conclusion that the Edinburgh area was not sufficiently attractive since 'either significant growth of the market in the area or significant cannibalization of BUPA Murrayfield's work was required to make the project viable'. [✂]
71. In addition, BMI noted several features which reduced the perceived opportunity for BMI in Edinburgh at the relevant time, including:



- (a) Circle's intention to build a hospital in Edinburgh;
- (b) the low level of PMI penetration in Scotland; and
- (c) the recent change of Government in Edinburgh, with the SNP winning a majority.

72. On the other hand, BMI noted that the Murrayfield hospital did not have an ICU and so more complex, higher acuity work was being done by the NHS in Edinburgh rather than the private sector. This was considered an opportunity for a new entrant.

73. [REDACTED]

74. In early 2010, BMI identified a joint venture with TEC as a potential means of entry. [REDACTED] It went on to highlight the opportunity to attract consultants and their business to TEC and other BMI facilities and away from Spire's hospitals:

[REDACTED]

75. BMI did not proceed with the acquisition of TEC because it was unable to agree commercial returns with the owners.

#### **Section 4: Conclusions**

76. The experience of the private hospital operators in Edinburgh provides a number of interesting insights into the dynamics of competition in the private healthcare market, both in Edinburgh itself and more generally.

77. Several operators identified Edinburgh as a desirable area in which to have a hospital due to the size of the insured population—more than 40,000 people—and the existence of a single provider [REDACTED]. Furthermore, there were at least two sites near to the ERI that were both available and able to achieve planning permission for a hospital.

78. BMI, Circle and TEC all sought to enter Edinburgh but only the latter has done so and via a diagnostic and day-case facility rather than a full service hospital. Their experiences highlight a number of pertinent factors:
- (a) the importance of economies of scale in hospital provision (particularly inpatient services) and the limited level of demand for private healthcare in certain areas, which may make entry, at least in the format of a full-service hospital, unprofitable;
  - (b) the incumbent operator in an area may face a different calculation than a new entrant when deciding whether or not to expand, with the potential costs of losing its existing solus position being taken into account alongside the potential growth opportunity from expansion. A new entrant will only consider the potential returns from operating a hospital in competition with the incumbent;
  - (c) TEC's approach to entry—opening a diagnostic and day-case facility—appears to have circumvented the issue of economies of scale and the risks of large-scale entry by focusing on a specific part of the market. The focus on outpatient and diagnostic services may also have minimized the issues associated with obtaining PMI recognition; and
  - (d) the existence of NHS-funded work has the effect of increasing the level of demand for privately-provided healthcare services but this facilitates entry to a lesser extent where there are risks that the work will not continue in the longer run.