COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case No: 53/LM/Sep01

In the large merger between:

AFROX HEALTHCARE LIMITED

and

AMALGAMATED HOSPITALS LIMITED

Reasons

Approval

1. On 16 October 2001 the Competition Tribunal issued a Merger Clearance Certificate approving the large merger between Afrox Healthcare Limited (Afrox) and Amalgamated Hospitals Limited ("AmaHosp") without conditions. We set out the reasons for our approval of the merger below.

The Parties

2. Afrox is a South African-based company listed on the Johannesburg Securities Exchange whose main business is the provision of private healthcare services. It owns and manages a large number of private hospitals that provide a range of general and specialized medical care facilities and services. Most of these hospitals are operated by separate subsidiary companies controlled by Afrox. Afrox is ultimately controlled by British Oxygen Company PLC, an English company listed on the London Stock Exchange.

3. AmaHosp is a South African company also specialising in the provision of private healthcare services, it owns and manages four private hospitals in Kwazulu-Natal[1]. It also operates a small ambulance service. AmaHosp is controlled by Durclin Limited. Its ultimate shareholders are individuals comprising doctors and members of the communities in which its hospitals operate.

[1] Namely, Westville Hospital, Mount Edgecombe Hospital, Crompton Hospital and Chatsmed Garden Hospital.

The Merger Transaction

4. Afrox proposes to acquire 76% of the shares in AmaHosp for a consideration to be finalized subsequent to a due diligence exercise in relation to AmaHosp[2]. According to Afrox this transaction is part of its strategy to expand its presence in Kwazulu-Natal where it currently owns two hospitals. Afrox claims that unless it expands and creates critical mass it may be marginalized by the other players in that province. It submits that this merger will create the critical mass that will warrant future investment in that province resulting in Afrox becoming a more effective competitor. Furthermore, this transaction will give Afrox an opportunity to unlock certain synergies such as the consolidation of neurology, neurosurgery and cardio thoracic and cardiology units into more specialised centers.

5. As mentioned above the majority of the shareholders in Amahosp are doctors and members of the community where the hospitals operate. According to AmaHosp one of the motivations for the sale is to offer these shareholders the opportunity to release the value of their shareholding. More importantly, however, the parties referred us to a policy document released by the Health Professions' Council last year which seeks to outlaw the practice of doctors owning shares in hospitals. The aim of the policy is to remove the perverse incentive on the side of doctors to refer patients to hospitals where they own shares. The adoption of this policy by the Health Professions' Council has made doctors, who are the majority shareholders of AmaHosp, keen to realize their investment in the company.

Evaluating the merger

The relevant product/services market

6. Both parties operate in the market for the provision of private hospital services. Afrox owns and manages hospitals throughout South Africa while AmaHosp only owns hospitals in Kwazulu-Natal. These hospitals provide a variety of general and specialised medical services including medical, radiography, surgical, paediatrics, obstetrics, urology and ophthalmology.[3] Apart from the obvious requirement that the hospital has proper facilities and qualified staff there appears to be very little preventing a hospital providing any healthcare service. A license is required from the regional health authority to provide any healthcare service, but this will presumably be granted to a hospital meeting the requirements of the license. All the hospitals concerned in the merger provide a range of services. Although only

[2] Afrox currently has a shareholding of 19,2% in AmaHosp.
[3] The Commission in addition indicated the following services were provided by hospitals in the respective groups of the merging parties: Cardiology; Cardio-thoracic surgery; Dermatology; ENT; GP'S; Gynaecology; Obstetrics; Maxillo-Facial; Neurology; Neurosurgery; Ophthalmology; Orthopaedic Surgery; Paediatrics; Physicians; Plastic Surgery; Psychiatry; Radiology; Pathology; General Surgery and Urology.

Westville provides a comprehensive range of services there are significant overlaps.[4] It appears unnecessary therefore to limit the market to the provision of specific healthcare services.

7. In their definition of the market the merging parties argued that state hospitals belong in the same market as private hospitals. The parties claim that some state hospitals have set aside wards to accommodate private fee-paying patients in competition with the private hospitals. The parties allege a strategy on behalf of some health authorities not only to use spare capacity in some of their hospitals to cater for private patients, but to build, within the state hospitals, "private" hospitals that will accommodate private patients exclusively. They also state that some medical schemes, for example Transmed, have recently adopted an option that only offers hospitalisation at state hospitals as a benefit. They argue that all these factors put state hospitals in direct competition with the private hospitals.

8. The Commission disagrees with this assertion. It argues that state hospitals provide mainly primary healthcare compared to private hospitals, which, while also providing some primary healthcare, mainly provide secondary, and tertiary healthcare. Furthermore, the Commission argues, there is a huge difference between the prices charged by state and private hospital making it unlikely that they compete for the same clients. Firstly the rates of private hospital are much higher than those of state hospitals. Secondly, the scale of benefits prescribed by the Board of Healthcare Funders for private hospitals, which is the rate that healthcare funders pay for services provided by private hospitals, is above that for state hospitals. There is also a vast difference in the quality of the facilities and standard of service. Typically private hospitals attract patients who have some form of medical aid or medical insurance whilst state hospitals attract patients without.

[4] See Table 1 below:

TABLE 1: SERVICES PROVIDED BY AHL AND AMAHOSP

Hospital	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T
Westville	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Crompton				X	X	X	X	X			X	X	X	X	X	X	X	X	X	X
Chatsmed	X		X	X		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Mount Ed	X		X	X		X	X	X			X	X	X	X	X	X	X	X	X	X
Entabeni	X	X		X	X			X	X	X	X	X	X	X	X	X				X
Empangeni				X	X	X	X	X				X	X		X	X				X

A: Cardiology; **B:** Cardio-thoractic surgery; **C:** Dermatology; **D:** ENT; **E:** GP'S; **F:** Gynaecology; **G:** Obstetrics; **H:** Maxillo-Facial; **I:** Neurology; **J:** Neurosurgery; **K**: Ophthalmology; **L:** Orthopaedic Surgery; **M:** Paediatrics; **N:** Physicians; **O:** Plastic Surgery; **P**: Psychiatry; **Q:** Radiology; **R:** Pathology; **S:** General Surgery; **T:** Urology

9. On the evidence before us it appears that the type of service and the discrepancy in the tariffs charged for services provided that exists between the private and state hospitals militates against a single market for both. It may well be that the attempts by government to compete for private patients alluded to by the merging parties may change the face of this market in the future. However, we are not convinced that the services currently provided by state hospitals may be regarded as substitutes for the services offered by the private hospitals - at best they may act as a deterrent to any anti-competitive conduct on the part of the merged entity in the future.

10. In our opinion therefore the relevant product market is the market for the provision of a range of private hospital services.

The relevant geographic market

11. As mentioned above AmaHosp's businesses are all in Kwazulu-Natal, more specifically the Greater Durban/Pinetown Area. Afrox owns two hospitals in Kwazulu-Natal, namely, Entabeni Hospital and Empangeni Clinic. Only the former is situated within the Greater Durban/Pinetown Area.

12. The Commission suggests that the relevant geographic market is a local one, comprising private hospitals within a 20 to 40 kilometre radius around the Durban area. The Commission's view is that it becomes increasingly inconvenient for patients to use hospitals that are beyond the radius of 20 to 40 kilometres[5].

13. Predictably, the merging parties propose a wider market that includes the whole province of Kwazulu-Natal[6]. They claim that because the Greater Durban/Pinetown Area is the major metropolitan area in Kwazulu-Natal, it attracts patients from all over the province.

14. The Commission argues that it is very inconvenient for patients to travel long distances to get to a hospital and that patients would generally prefer to be admitted to hospitals close to their homes. They concede that hospitals in the Greater Durban/Pinetown metropolitan area sometimes attract patients from all over the province, but point out that this normally occurs where the hospitals around the patients' place of residence do not offer the type of specialist service required.

15. We suspect that the Commission's definition of the geographic market is the more probable one. However, given our finding below, that even on the very narrow conception of the relevant geographic market contended for by the Commission

[5] The obvious exception is that of patients who have no choice but to travel longer distances (usually to the city centre) in search of specialized services not offered by the local hospitals.
[6] There was some reference in the parties papers to the possibility of a national market but this submission was not pursued at the hearing.

the merger is unlikely to lessen competition, we do not consider it necessary to make a finding on this issue.

16. On the narrow market comprising only private hospitals in the Greater Durban/Pinetown area (where all AmaHosp's hospitals are situated and which is the major metropolitan with the largest concentration of private hospitals in Kwazulu-Natal) Afrox has one hospital, Entabeni Hospital, with 273 hospital beds. This translates to about 10% market share for Afrox. AmaHosp's share of this market is about 26% (702 beds). This would result in a post-merger market share of about 36% for the merged entity making it the biggest player in the market. Netcare will be the second biggest player with 31% (844 beds) and Joint Medical Holdings Limited third with 11% or 316 beds. The rest of the market shares will be divided between independent hospitals as follows: St Aidens Hospital will hold about 10%, McCord Hospital 9% and Nu Shifa Hospital the remaining 3% of the market.

17. The above market shares suggest a concentrated market. The HHI figures indicate a post merger HHI of 2568, representing an increase of 620 points from the pre-merger 1948 points. In terms of the 1992 US Horizontal Merger Guidelines this figure would lead to a presumption that the merger will result in the creation or enhancement of market power, or facilitate its existence but this presumption may be overcome by "a showing that non-structural factors reveal that such an exercise of market power is unlikely".

18. On the wider market comprising all private hospitals in Kwazulu-Natal as proposed by the parties, Netcare is by far the biggest player with over 28% of the market (1150 beds), AmaHosp has just over 17% (702 beds) and Afrox is third with a 9% share equaling 368 beds. Joint Medical Holdings and Medi-Clinic hold 8% (316 beds) and 5% (183 beds) respectively, with the rest of the market, comprising 1335 beds or 33% of the market, divided amongst many smaller independent hospitals. On this market the merged entity would become the second biggest competitor with 26% of the market.[7]

Impact on competition

19. Despite the significant concentration in the market, we find that the merger is unlikely to adversely affect competition in either of the markets referred to above. A number of factors peculiar to this market make it unlikely that the merging parties may acquire market power as a result of this transaction. We set out fully our reasons for this conclusion below.

[7] It is not possible for us to accurately work out the HHI figures in this wider market because we do not have adequate information on the breakdown of the 33% of the market shared by smaller independent hospitals. In any event, since our finding is that the merger raises no competition concerns at the narrower market proposed by the Commission, which in our opinion is the more probable one, the concentration levels in this wider market are of no consequence to our decision.

20. In addition to competition from other big players such as Netcare[8], Joint Medical Holdings and Medi-clinic the structure of this market makes it unlikely that the merging parties may acquire market power. Private healthcare funders, who foot the bill for the majority of the patients admitted to private hospitals, possess significant countervailing power in this market. Each year the Board of Healthcare Funders, in consultation with the private hospitals, sets a benchmark tariff to be paid for particular hospital services provided by private hospitals. This tariff is known as the scale of benefits and is generally adopted by all the funders as the amount of medical cover they are willing to provide for each specified service provided by the hospital[9]. According to the Commission and the merging parties, to survive in the market private hospitals have to charge prices within the scale of benefits set out by the Board of Healthcare Funders. A private hospital charging above this tariff would have to recover the premium from the patient, thereby running the risk of non-payment and/or default. Consequently, hospitals are disincentivised from charging prices above the tariff set by the Board of Healthcare Funders. Therefore the power of any private hospital or hospital group to control prices is severely limited.

21. With limited price competition, private hospitals compete most vigorously on the quality of service to attract patronage. Although patients are the clients of the private hospitals, they have very little influence over the choice of hospital to which they are admitted. It is the doctor's decision[10] whether a patient needs to be referred to a hospital, and if so, which hospital. Competition between the hospitals is therefore for the patient referrals from the doctor - it is marketing to the doctors that exercises the determinant influence. The hospitals compete by winning the favour of the referring doctor. Location, provision of quality care to patients, a multi-disciplinary pool of healthcare providers and possession of state-of-the-art-equipment are the most important competitive tools used to attract doctors.

22. Given this peculiar market structure, competition concerns are likely to arise primarily where a merger has the potential to adversely affect the ability of other hospitals to compete for the doctors' referrals or negate the countervailing power of the Board of Healthcare Funders. In our opinion this merger has no such potential.

23. With regards the potential for new entry into the market, the Commission found that there has been no new entry into this market in Kwazulu-Natal over the last three years; the trend has been to consolidate or extend existing businesses. As

[8] Netcare is the biggest supplier of private hospital services in Kwazulu-Natal and, according to the parties, announced a R73 million expansion and upgrading programme for its hospitals in Kwazulu-Natal shortly after the parties announced their plans to merge.

[9] For example, a specified maximum amount is paid for accommodation, use of specific equipment and pharmacy expenses. The parties claim that in recent years the annual tariff increases set by the Board of Healthcare Funders has been lower than the medical inflation rate resulting in a financial strain on the part of the private hospitals. They cite this as a manifestation of the countervailing power of the healthcare funders.

[10] Both GP's and specialist doctors refer patients to private hospitals.

mentioned above a license is required to operate a private hospital, and even to make extensions to an existing private hospital. The license regulates the specialties and facilities to be provided by the hospital and the number of beds and theatres allowed. According to the merging parties a major barrier to entry in this market is a moratorium by government on the establishment of private hospitals that has been in place for the last few years. The moratorium makes it virtually impossible to get a license to build a new private hospital at the moment. This may be the major reason for the absence of new entrants into the market recently. According to the Commission the attitude of the National Department of Health is that while they will currently grant no licenses for the building of new private hospital in the urban areas, they are willing to consider applications for licenses in the rural areas. The Commission consulted with both the national and provincial health authorities and neither expressed any opposition to the merger.

24. Afrox argues that the merger will in fact benefit both doctors and patients in Kwazulu-Natal. They claim that as one of the leading hospital management companies in South Africa, AmaHosp hospitals will benefit from the management expertise, significant skills and knowledge and technology that Afrox will bring into the merged entity. Afrox also claims to have in place a plan to co-operate with the University of Natal in the training of specialists in the field of cardiology and neuro-surgery once they have set up these specialists units.

Public interest issues

25. The merging parties anticipate no job losses. The Commission received no representations from the unions representing employees of the merging parties[11]. Accordingly no public interest concerns arise from the merger.

Conclusion

26. based on the above information we find that the merger between Afrox and AmaHosp is not likely to reduce or lessen competition in the market.

_____ **02 November 2001**

N.M Manoim **Date**

Concurring: D.H. Lewis, C. Qunta

[11] According to the Commission copies of the Merger Notice were served on NEHAWU, HOSPERSA, DENOSA and CEPPWAWU who represent the employees of the merging parties.