



Primary Care - It is a Tough Business



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HERE IS A NEWS FLASH that will come as no surprise to the *SSV Med* readership. Primary care is a tough business.

From the investor perspective less than a year ago, the idea of putting walk-in clinics into pharmacies, supermarkets and big-box retailers seemed like a slam-dunk profit opportunity.

Hailed as an inexpensive option for treating minor health ailments like sore throats and rashes, the retail clinics had grown in number to 963 as of May 1 - from just 125 three years ago. These clinics typically feature nurse practitioners who can prescribe basic drugs, and the price for a visit ranges from \$50 to \$75.

But reality has dawned on investor groups as they observe the financial performance of their investment. Health clinic operators are closing their doors, shuttering 69 clinics in 15 states. Now, according to the *Wall Street Journal*,¹ the biggest retail-clinic operator, CVS Caremark Corp., says it is scaling back expansion plans for its MinuteClinic brand.

It is becoming evident that the venture capitalists and private-equity firms that backed many of the retail clinic operators failed to appreciate how complicated and expensive these clinics are to establish and operate. Each new clinics costs about \$500,000 to open. Furthermore, these operations need to spend a lot of money on marketing to build public awareness during their start-up and ongoing operational periods. Thus, these clinics become very expensive very quickly.

The largest clinic operators*

Operator	Retail partners	Clinics
MinuteClinic	CVS, QVC, Cub Foods	513
TakeCare	Walgreen	162
The Little Clinic	Kroger, Publix, Fry's	57
RediClinic	Wal-Mart, HEB	34
Target Clinic	Target	24

* as of 05-01-08

* Source: Merchant Medicine LLC

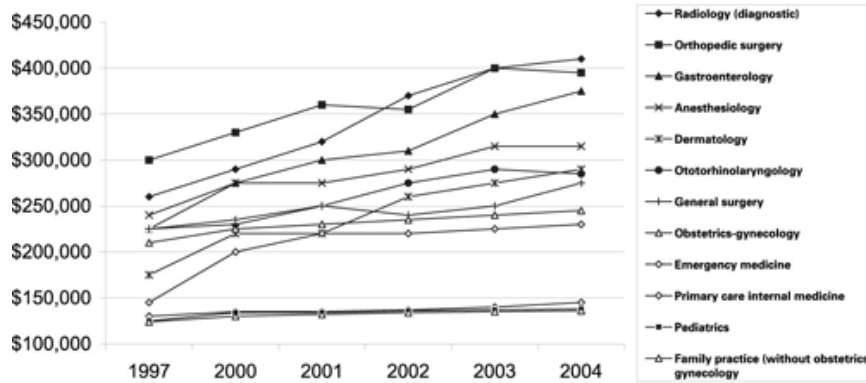
Not everyone is trimming sails. Walgreen Co has announced that it still plans to more than double the number of the company's Take Care health clinics this year by adding about 240 locations between now and the end of the year. This development activity will bring Walgreen clinics closer to the number operated by rival CVS (see accompanying graph). The expansion will cause a drag on earnings in fiscal 2008 of five cents a share, the company says.

Wal-Mart plans to partner with established community hospital systems to open as many as 400 co-branded store clinics by the end of 2010, up from about 50 sites in operation now. These hospital partnerships leverage the established hospital brand, thus decreasing the marketing costs. This approach is a departure from an earlier strategy under which Wal-Mart leased space to operators like CheckUps that weren't associated with hospital

systems.

The problems confronting investor backed primary care has been recognized for some time. The cost structure for diagnosing and managing clinical conditions is becoming progressively untenable. The primary culprit is the current reimbursement system that favors invasive procedures over cognitive skills (see following graph²).

Median Compensation for Selected Medical Specialties*



*Data are from the Medical Group Management Association Physician Compensation and Production Survey, 1998 and 2005.

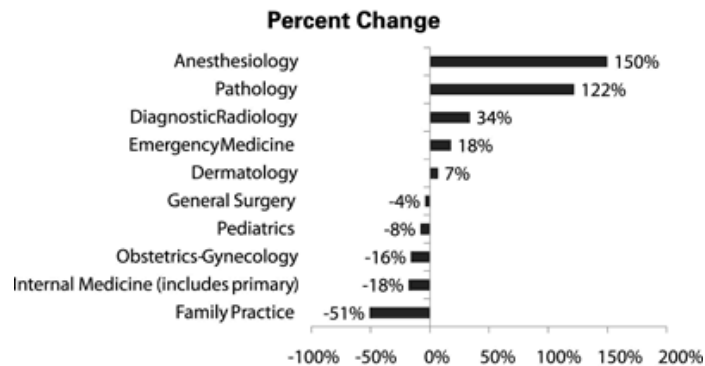
This disparity in reimbursement is skewing the choice medical students are making when they select a residency (see following graph). Thus, the de facto public policy effect of the current reimbursement system will influence health care over the next generation and will continue to do so unless it is changed.

The warning signals that have been evident within health care are now coming from the investment sector. The current reimbursement system is not only a barrier to innovation in health care delivery; it is also a major obstacle to reforming the health care system itself.

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Percent Change Between 1998 and 2006 in the Percentage of U.S. Medical School Graduates Filling Residency Positions in Various Specialties*



* Data are from the National Resident Matching Program

1. http://online.wsj.com/article/SB121011939298572319.html?mod=2_1566_leftbox
 2. <http://content.nejm.org/cgi/reprint/355/9/864.pdf>

