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COVID-19: AN ACCELERATOR OF EXISTING TRENDS

What are the strategic implications for medtech companies as they contemplate the "post-COVID-19" world?

L.E.K. Consulting looks at the near-term and longer-term impacts.

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There is no doubt that COVID-19 has had a severe impact on the US healthcare ecosystem (as well as the rest of the economy) as providers have focused on managing and caring for COVID-19 patients. The near-term impact, particularly the reduction in elective procedures and physician office visits, has been the focus of major stakeholders in the healthcare ecosystem. Now, as the resumption of physician visits and elective procedures gains traction, the longer-term impacts of COVID-19 are becoming a growing area of focus, given the major changes that will persist even after COVID-19 completes its destructive path.

At the highest level, COVID-19 is a disruptor to the delivery of care that is accelerating several trends (e.g., provider consolidation, shifts to lower acuity, increased digitization, evolution in supplier go-to-market [GTM] models) that are not new, but are becoming amplified *(see Figure 1)*. The following trends have clear underlying themes:

1 A Darwinian drive toward efficiency

Many organizations across the ecosystem will not endure the ripple effect of COVID-19, and those that do will likely emerge quite different (perhaps stronger) than before. Prior to COVID-19, approximately one in six US hospitals was "at risk" financially, based on L.E.K.'s proprietary Provider Pulse hospital segmentation framework/tool. This proportion has increased over the past several months and some hospitals may not survive. Similarly, other market participants ranging from physician practices to smaller medtechs with weaker balance sheets may also struggle to remain independent going forward. COVID-19 is a catalyst of efficiency in a historically inefficient US healthcare system.

2 Strong focus on risk management

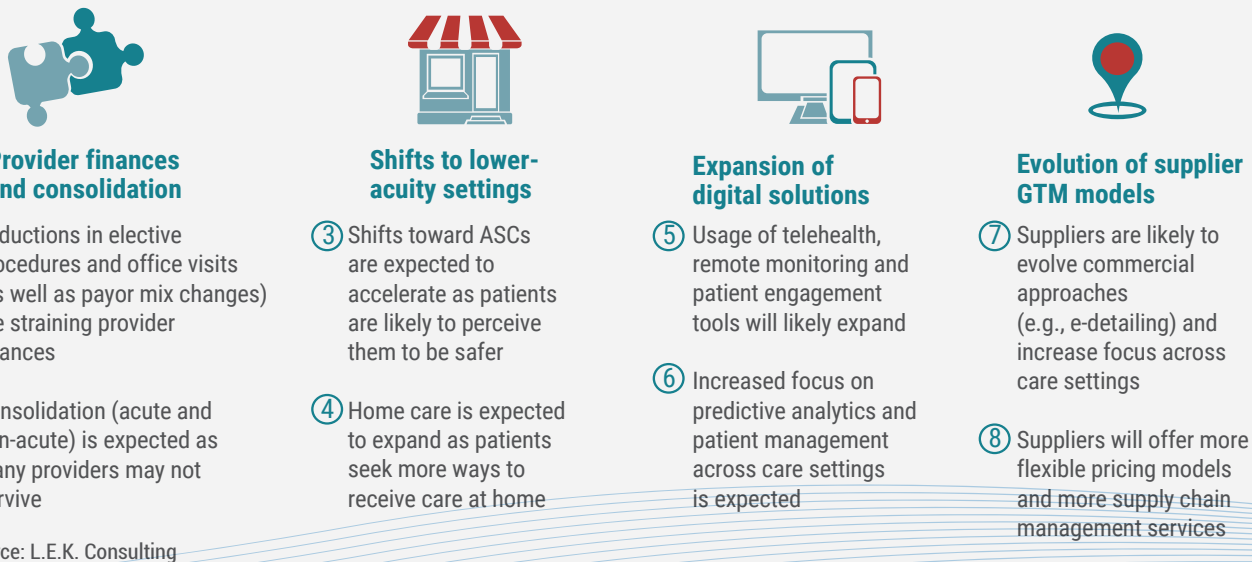
The healthcare ecosystem—like the broader economy—has found itself surprised and disrupted by the pandemic, in a manner and extent unlike any event in recent memory. Decisions that were once seen as "good business"—from off-shore supply chains to just-in-time delivery to lean operations—are now seen as a reason for unpreparedness and crisis. Changes that were once seen as too difficult to implement—like shared risk pricing models—are now being considered more than ever. And investments once considered overkill—such as in extensive personal protective equipment (PPE) and infection prevention—are rapidly becoming status quo. COVID-19 has changed, or at least expanded, the lens through which operational decisions are viewed.

3 The emergence of "service at a distance" as a necessity and a choice

While the emergence of "telehealth" as a "stop-gap" replacement for in person visits to healthcare facilities (which will persist a lot longer) has garnered significant attention, technology-enabled service at a distance goes significantly further. Society is transforming to expect products and services

Figure 1

COVID-19 is Expected to Accelerate Key Healthcare Trends and Force Improved Efficiencies Across the Delivery of Care



Source: L.E.K. Consulting

to appear on the doorstep, and this is true for medical and diagnostic products and services as much as it is for daily living needs. While many office workers may find themselves staying away from the office as we change how we work, similar impacts are now being expected for sales and support representatives in (some) medical settings/situations. Major healthcare conferences are committing to or at least considering virtualization. Aspects of this theme intersect the efficiency evolution and the risk management lens, but notably, service at a distance is becoming an expectation versus just an offering.

Take Notice and Plan Ahead

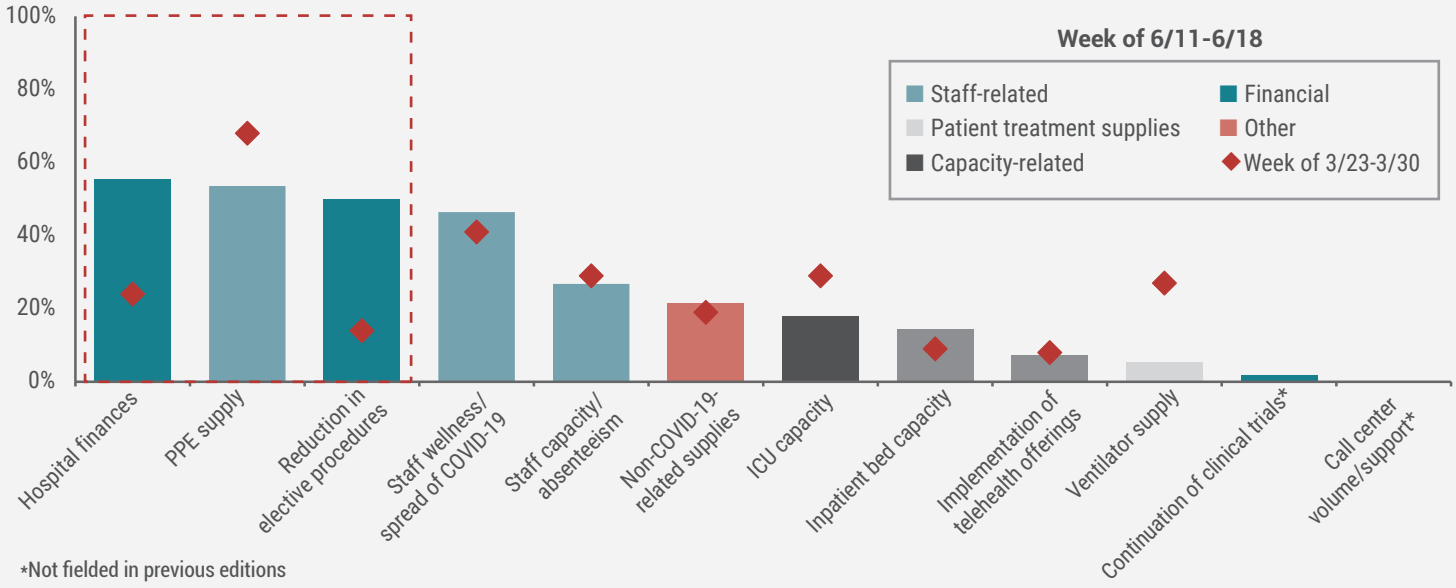
As healthcare organizations emerge from crisis management and dealing with the immediate impacts of the first COVID-19 wave, they must take stock of the key impacts of COVID-19 and begin to strategically align with them in order to survive, if not thrive, in the "new normal" that will come. Providers will be the stakeholder group most impacted by COVID-19, but other segments are impacted by COVID-19 in numerous ways. For example, medtechs, providers, and healthcare information technology (HCIT) companies are among the most impacted market participants facing new headwinds, but also new opportunities (e.g., how to participate in high-growth areas like telehealth). In order to better understand and navigate these challenges and opportunities, it is instructive to review the initial impact of COVID-19 on providers, the drastic reduction in elective procedures, and the associated financial distress that providers, and particularly, hospitals face.

Recent and Near-term Impacts: "Shift from Health Crisis to Hospital Finances Crisis"

Hospitals across the country responded to the surge of COVID-19 patients in March and April and shifted their full attention to preparing for and/or managing the health crisis. As evidenced by an L.E.K. survey in late March and early April, hospitals' primary concerns were with supplies of PPE, ventilator and ICU bed capacity, and preventing the spread of infection to their staff. However, given the major drop in elective procedures during that time frame and as the number of new COVID-19 patients started declining in late April (or never materialized in some geographies), hospitals shifted their focus from the health crisis to their own finances. Normally razor-thin hospital margins dropped into the red in March and deeper into the red in April, with large hospital systems losing millions of dollars per month as their primary source of revenues (i.e., elective procedures) was severely reduced (if not eliminated altogether).

Figure 2

Hospital Finances and Elective Procedures Have Risen as Top Concerns for Hospitals Over the Past Few Weeks Versus the COVID-19 Health Crisis Itself



*Not fielded in previous editions

Source: L.E.K. Consulting

June 11-18, 2020

Some hospital systems have already announced bankruptcy and some industry experts talk of widespread bankruptcies for others. Not surprisingly, the most recent L.E.K. hospital survey shows hospital executives' top two concerns are now hospital finances and the reduction in elective procedures (with the former a consequence of the latter). Although PPE concerns still remain high (at least partially, if not largely, due to the need for PPE to conduct elective procedures), concerns regarding treating COVID-19 patients (e.g., ventilators, ICU capacity) have dropped significantly since March. That said, recent surges in COVID-19 cases in early July in states like Florida, Arizona, Texas, and California may shift the focus back to hospital capacity issues.

Given the criticality of resuming elective procedures to help counter falling hospital finances, the key questions for many hospitals (and the suppliers that serve them), have been about the timing, magnitude and mix of the elective procedures as they return. L.E.K.'s hospital survey shows that elective procedures have been gradually resuming since mid-April 2020, and that surveyed respondents (i.e., a combination of hospital executives and clinicians) expect hospital volumes to gradually resume, but still only achieving 75%-85% of pre-COVID-19 levels by the end of Q4 2020. Moreover, most respondents expect that over the next couple of years, volumes will "max out" at around 85%-95% of pre-COVID-19 levels.

Forecasts on Resumption of Elective Procedures; Qualified and Nuanced

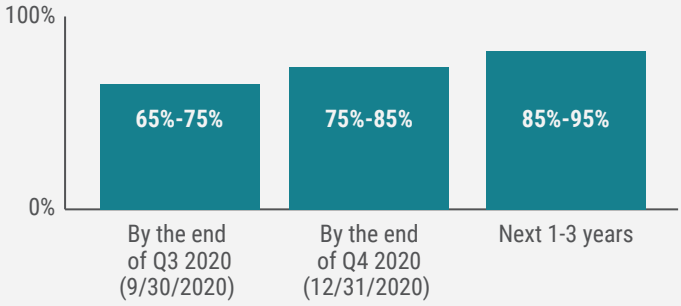
Important context, questions and issues surrounding the resumption of procedures include:

- **Patient leakage:** Some patients are avoiding their healthcare providers, particularly hospitals as the obvious hot spots of COVID-19 activity, and will continue to delay or outright avoid a procedure for some time. As estimated in several surveys (e.g., ReviveHealth, Needham, MA), ~20% or more of patients say that they would delay any procedure beyond the end of the year. Other patients are likely to select ambulatory surgery centers (ASCs) whenever possible (for most outpatient procedures) to avoid going to a hospital. Some patients have lost their insurance coverage with loss of employment and may indefinitely delay certain procedures (COBRA not expected to meaningfully address this issue), while other patients have been moved to alternative therapies in the near term and may not come back for a procedure. This expected "patient leakage" implies that procedural volumes will be lower than pre-COVID-19 levels, for, at least, the rest of the year for hospitals that desperately need them.
- **Key requirements to restart:** The gradual nature of the resumption is a function of several gating factors

Figure 3

The Average Ramp-up Expectations Indicate that Elective Procedure Volume Will Reach 75%-85% by the End of 2020

Expected elective procedure volume
Average percentage of pre-COVID-19 volumes*



	By the end of Q3 2020 (9/30/2020)	By the end of Q4 2020 (12/31/2020)	Next 1-3 years
Minimum Response**	0%-10%	0%-10%	0%-10%
Maximum Response**	90%-110%	90%-110%	110%-130%

Although some hospitals anticipate reaching volumes of >100% pre-COVID-19 levels in Q3 and Q4 2020, average ramp-up expectations indicate that elective procedure volume will reach 75%-85% by the end of 2020

In the long term, elective procedure volumes are expected to return to slightly below pre-COVID-19 levels (85%-95%)

*Average of three weeks (5/22-5/29, 5/30-6/10, and 6/11-6/18) for Q3 and Q4
**Minimum and maximum responses from 6/11-6/18
Source: L.E.K. Consulting

June 11-18, 2020

including hospitals' adequate levels of PPE, COVID-19 testing supplies (to screen for COVID-19-positive patients) and available clinical staff as well as, most importantly, hospitals' ability to convince potential patients that they are safe from COVID-19 infection.

- **Impact of location and organizational scale:** The slope of the recovery curve is impacted by location (given variable COVID-19 impact) and provider scale (given that larger systems have more ability to access the PPE, testing supplies, staff, and vetted protocols needed to successfully navigate recovery under the constant threat of ongoing infections and future "waves").

- **Mix and prioritization of procedures:** Hospitals expect that general surgery, gastrointestional, orthopedic, urologic and gynelogic, vascular, and cardiac/structural heart elective procedures will be the highest priority for their facilities to restart. Severity/urgency of procedures is the most important factor in deciding which procedures to prioritize, but hospitals are secondarily considering factors such as degree of backlog, patients' willingness to undergo procedures and the economic benefits/reimbursement.

- **Mix between hospitals and ASCs:** Many procedures, including a growing set of cardiovascular (e.g., percutaneous cardiac intervention) and orthopedic (e.g., spine, knee) were already shifting to ASCs and are expected to shift faster. ASCs are perceived by patients to be "safer" on COVID-19 risk, and they will be more flexible to adapt to capture patient demand (e.g., weekend, late-night procedures)—reflecting strong economic incentives for physician owners. Among hospitals, the mix shift will further concentrate as a result of COVID-19, with large, scaled health systems most likely to have the resources (e.g., PPE access, "brand" names) to attract a disproportionate share of patients who are willing to go back to hospitals. In fact, some brand name hospitals (e.g., Mayo, Duke) are nearly back to pre-COVID-19 levels and others may even achieve demand surges as the COVID-19 ripple effect will disproportionately hurt the more vulnerable hospitals in their catchment areas.

- **Expectations of a second wave:** Interestingly, 95% of the hospital survey respondents (and predictors of the procedure forecasts above) also believe that a second wave (if not also a third, etc.) of COVID-19 infection is coming. Moreover, 65% of respondents who expect a second wave indicate that although they will continue to do elective procedures, they will need to do so at reduced volumes. The high likelihood of a second wave also extends the time frame for "direct" COVID-19 impacts (e.g., hospital financial distress) as well as the wave of ripple effects (e.g., consolidations, shifts to home care, changes in supplier engagement approaches) to occur.

- **Other factors:** The "forward" slope of the curve can have a range of scenarios pending hospital staffing and morale issues, shifting sentiment of key stakeholders, and the impact of "referral cascades" as lost visits translate into lost screenings, specialist consults, and prescriptions, creating complex and interconnecting delay effects.

Implications for Medtechs

Given the impacts of COVID-19 on hospitals described above, medtechs will need to redefine themselves and how they support their hospital customers. L.E.K. has defined several key implications for medtechs, which will need to evolve to thrive (if not simply survive) in the new normal. These can be categorized into the following:

Commercial models

Account targeting and coverage

- Numerous hospitals and non-acute providers are facing major financial challenges due to COVID-19 and government subsidies may not be sufficient to keep them afloat. Some high-profile systems have already declared bankruptcy and others may follow suit.

- Medtechs should identify the providers that will be most likely to stay active in the near-term and survive in the post-COVID era and prioritize them where possible and implement required updates to their commercial models to support them (e.g., appropriate mix of strategic accounts vs. field rep resourcing). Leveraging tools like L.E.K.'s Provider Pulse or analyzing internal sales and market data can help with prioritization.

Customer engagement models

- Increasing challenges to sales rep access, particularly as hospitals continue to deal with COVID-19 patients (including heightened sensitivity regarding safety protocols and limited PPE) are likely to drive both near-term and long-term changes in medtech commercial resourcing models. Furthermore, physician expectations for in-person engagement are changing due to the COVID-19 experience—more of them feel comfortable leveraging virtual engagement, and some may even prefer it.

- Some types of sales reps (e.g., those who provide support the operating room) will likely remain needed much as before, but medtechs should seek alternative ways to engage with hospital stakeholders (e.g., e-detailing, webinars) to find other ways to effectively communicate with and support them. Even in the operating room, virtual approaches are being experimented with and may play a broader role going forward. Overall, medtechs should expect some rebalancing of commercial models away from field reps and toward inside sales and/or virtual tools.
- As shown in *Figure 4*, most hospital respondents show high receptivity to new ways for medtech reps to engage with them without a physical presence. Medtechs should proactively seek and leverage emerging tools that enable effective virtual engagement.

Portfolio changes

R&D and portfolio optimization

- Medtechs should evaluate and reprioritize their R&D efforts, ensuring funding of the pipeline priorities that best align with the needs of the new normal.
- Moreover, rationalization of SKUs and ensuring "good/better/best" options exist in portfolios are also likely necessary steps to streamline and optimize portfolio options, as providers will be increasingly cost conscious and willing to accept "good enough" products.

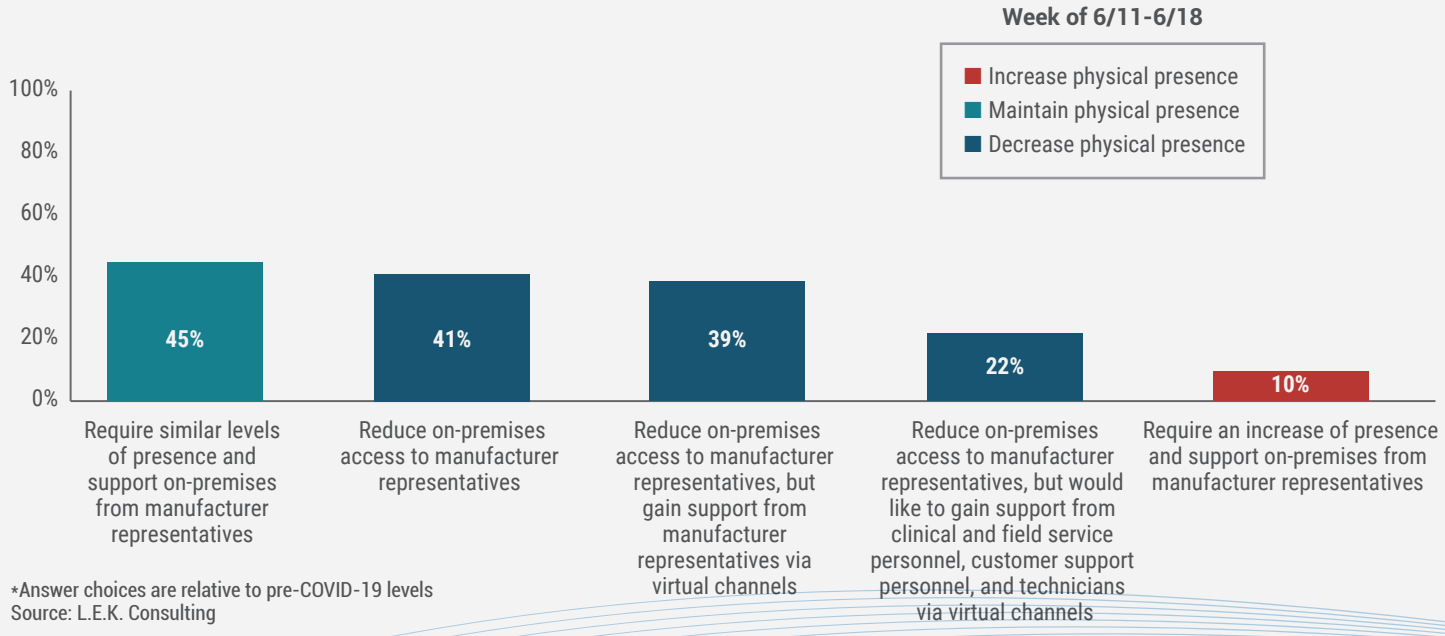
Investments into "continuum of care" strategies

- Given accelerated emphasis on home care and lower acuity settings, medtechs should expand efforts to manage patients across non-acute sites where relevant.
- As a result, some key areas attractive for increased medtech innovation include integrating technologies across care sites, remote monitoring, patient engagement, and data analytics for improved disease management outside hospitals.
- In addition, medtechs should consider additional direct-to-patient investments (e.g., call centers, disease awareness programs) as they orient themselves and support patients more directly with respect to disease management, reflecting increased patient involvement and interest in managing and paying for their healthcare.

Figure 4

Hospitals are Actively Seeking New Ways for Medtechs to Engage with Them

Anticipated changes hospitals are planning with manufacturers*
Percentage of respondents



*Answer choices are relative to pre-COVID-19 levels
Source: L.E.K. Consulting

Digital strategies

- Telehealth usage has soared due to COVID-19 and is widely expected to remain core to care delivery moving forward, as providers have experienced the benefits, patients prefer the convenience and payors will be pressured to retain coverage longer term. In fact, ~90% expect future utilization of telehealth to remain higher relative to pre-COVID-19 levels.
- Medtechs should be actively looking for ways to have their products and solutions support (and possibly integrate with) telehealth solutions.

Supply chain management

- Medtechs need to insulate their supply chains from any future shocks, both upstream (e.g., increased redundancy, greater emphasis on near-shoring/on-shoring) and downstream (e.g., more direct distribution, larger safety stocks).
- Medtechs should proactively engage provider customers to help solve and plan for any future supply chain challenges. This area of service and collaboration has long been overlooked by most medtechs and can help them secure a seat at the table with senior administrators as a strategic partner that can help manage enterprise risk. Receptivity to these types of collaborations is arguably higher than ever before.

Pricing and contracting models

- As shown in *Figure 5*, hospitals are beginning to actively seek price discounts from suppliers. In response, medtechs should look to offer more flexible contracting and pricing models (e.g., extended terms, variable-use pricing models for capital, shared savings, good/better/best pricing tiers). This is particularly true for capital equipment that hospitals indicate will be most negatively impacted as a result of COVID-19. This presents an opportunity for medtechs to reevaluate historical models and potentially experiment with and/or expedite shifts to recurring revenue models (e.g., SaaS/XaaS). MTS

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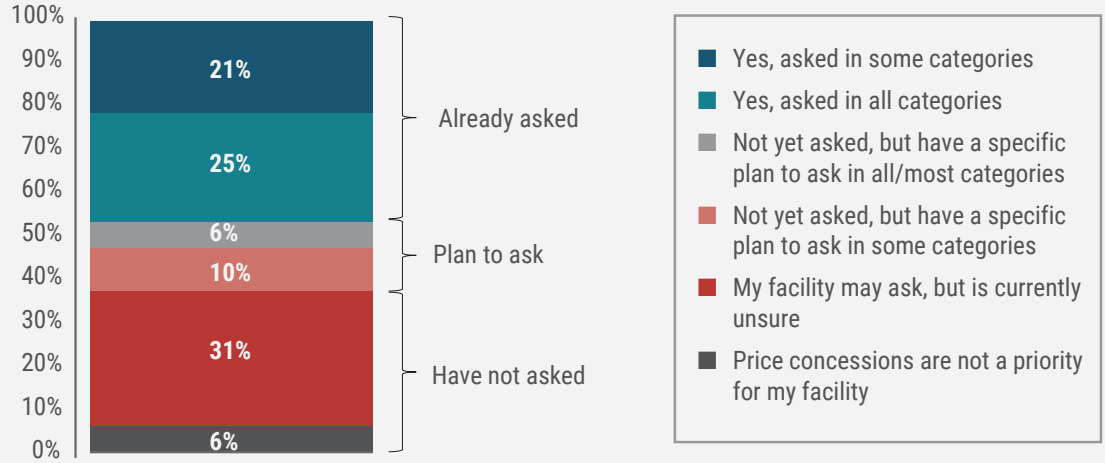
Figure 5

Approximately 60% of Facilities Have Already Asked or are Planning to Ask Their Manufacturers for Price Concessions on At Least Some Categories of Medical Supplies to Improve Their Financial Situation

Status of price concession inquiries among hospitals
Percentage of respondents*



*Data included for two weeks (5/22-5/29 and 5/30-6/10)
Source: L.E.K. Consulting

May 30-June 10, 2020