

Healthcare Reform Shifts Hospital Priorities, Creates New Opportunities for MedTech Companies

The winds of change from healthcare insurance reform are causing hospital executives to re-examine their operations, and L.E.K. Consulting's survey of senior hospital officials provides new insight into how purchasing decisions are evolving to address today's pressing requirements to comply with looming government mandates. The L.E.K. Strategic Hospital Priorities Study also identifies new opportunities for medical device companies that can fulfill these increasingly broad hospital requirements.

L.E.K.'s second annual survey¹ of nearly 200 senior hospital decision makers shows that the dramatic budget cuts during the past few years are primarily over and that hospital spending is expected to grow steadily during the next few years. Nearly 60% of hospital executives expect budget increases this year, which is a marked improvement from 2009 when only 38% believed that their spending levels would increase in 2010. And during the next five years, more than 70% of senior hospital executives foresee expanded budgets.

Hospitals expect their information technology (IT) investments to increase more than any other category this year, while the others will remain relatively flat. During the next half decade, however, more hospital executives also plan to increase their purchasing in multiple areas – including facilities (38%), large medical devices (37%), small medical devices (21%) and disposables (28%).

Recalibrating Purchasing Criteria

New federal healthcare changes are projected to increase Medicare and Medicaid admissions, which in turn will likely raise the number of hospital procedures. Cuts to select reimbursement rates will also require hospitals to focus on increasing efficiency and reducing expenses. Under new federal guidelines, however, Medicare and Medicaid reimbursement rates are expected to experience continued downward pressure.

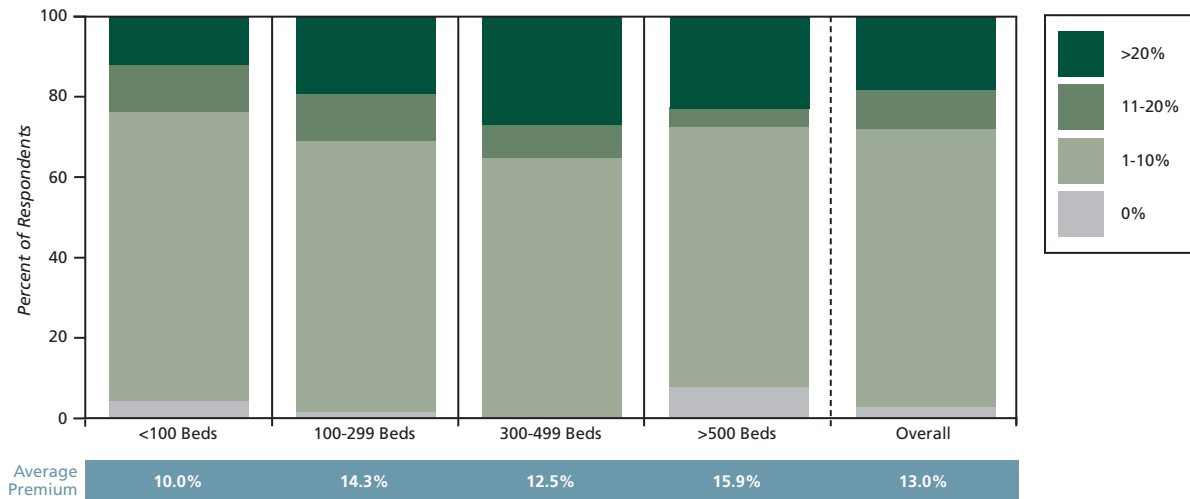
Hospitals plan to address the new federal value-based pricing reimbursement models by instituting new protocols to measure the quality of care and patient outcomes. An enhanced focus on tracking and recording outcomes will also be pivotal to achieving the highest reimbursement rates possible for procedures. Logically, hospitals are recalibrating their purchasing processes to focus on products that demonstrate the efficacy and support the monitoring required to track improvements in quality and patient safety, while also reducing medical errors.

As an example, hospitals of all sizes are generally willing to pay a 10-15% premium on average for disposables that demonstrate an ability to reduce errors and infection rates. Figure 1 highlights hospital responses based on bed size.

Healthcare Reform Shifts Hospital Priorities, Creates New Opportunities for MedTech Companies was written by **Stuart Jackson** and **Bob Lavoie**, Vice Presidents and co-heads of L.E.K. Consulting's global MedTech practice, and **Lucas Pain**, Vice President at L.E.K. Please contact us at medtech@lek.com for additional information.

Figure 1

Acceptable Premium on Disposables to Achieve a 20% Reduction in Medical Errors



Source: L.E.K. Consulting

Examining Hospital Needs from MedTech Providers

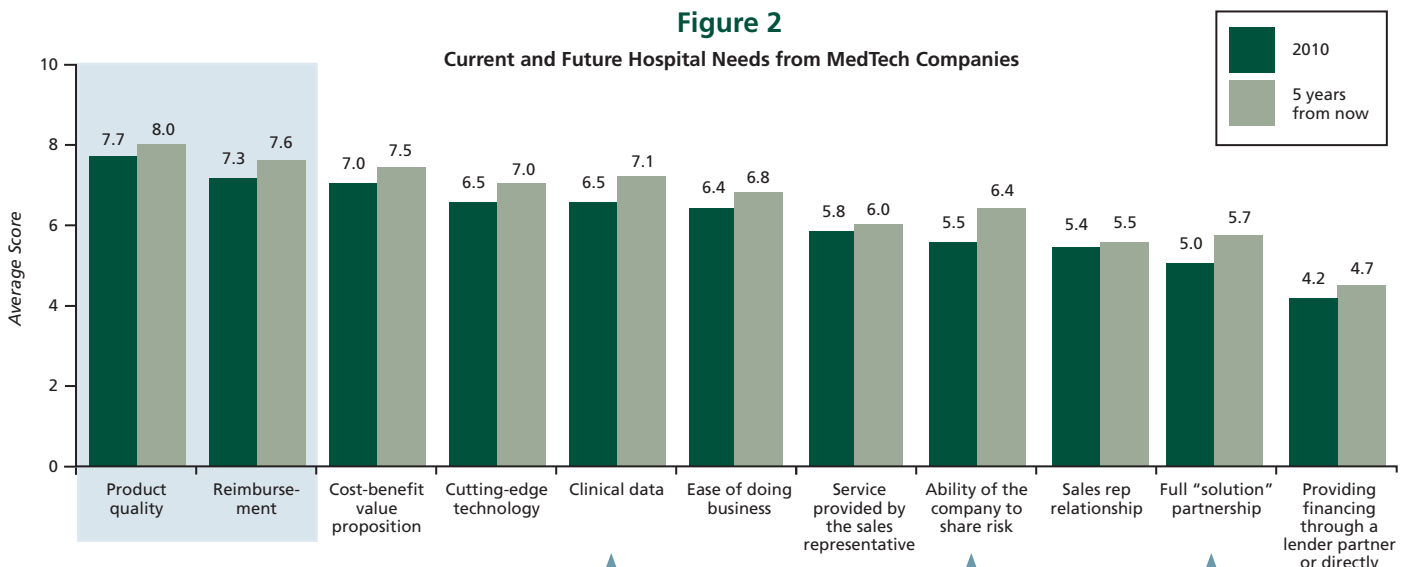
To understand how MedTech purchasing decisions are being made in light of healthcare insurance reform, L.E.K. asked senior hospital decision makers to rate the importance of selection criteria across 11 dimensions. Product quality and reimbursement are the most important purchasing criteria today (see Figure 2). But as hospitals continue to address new legislative reform mandates, other factors will have added weight in the product selection process during the next five years – including getting clinical data, sharing risk and providing a full solution.

Gauging Hospital Perceptions of MedTech Suppliers

L.E.K. then asked hospital executives to rank 15 of the top global MedTech manufacturers² using the MedTech purchasing criteria previously outlined. The overall average scores for leading MedTech providers (see Figure 3, left column) show that hospitals give the top MedTech vendors high marks for product quality and innovation, as well as providing clinical data. The results also show that MedTech companies fall short in critical areas that hospital executives believe will be even more important during the next five years, including reimbursement, full solution partnership and ability to share risk.

Figure 2

Current and Future Hospital Needs from MedTech Companies



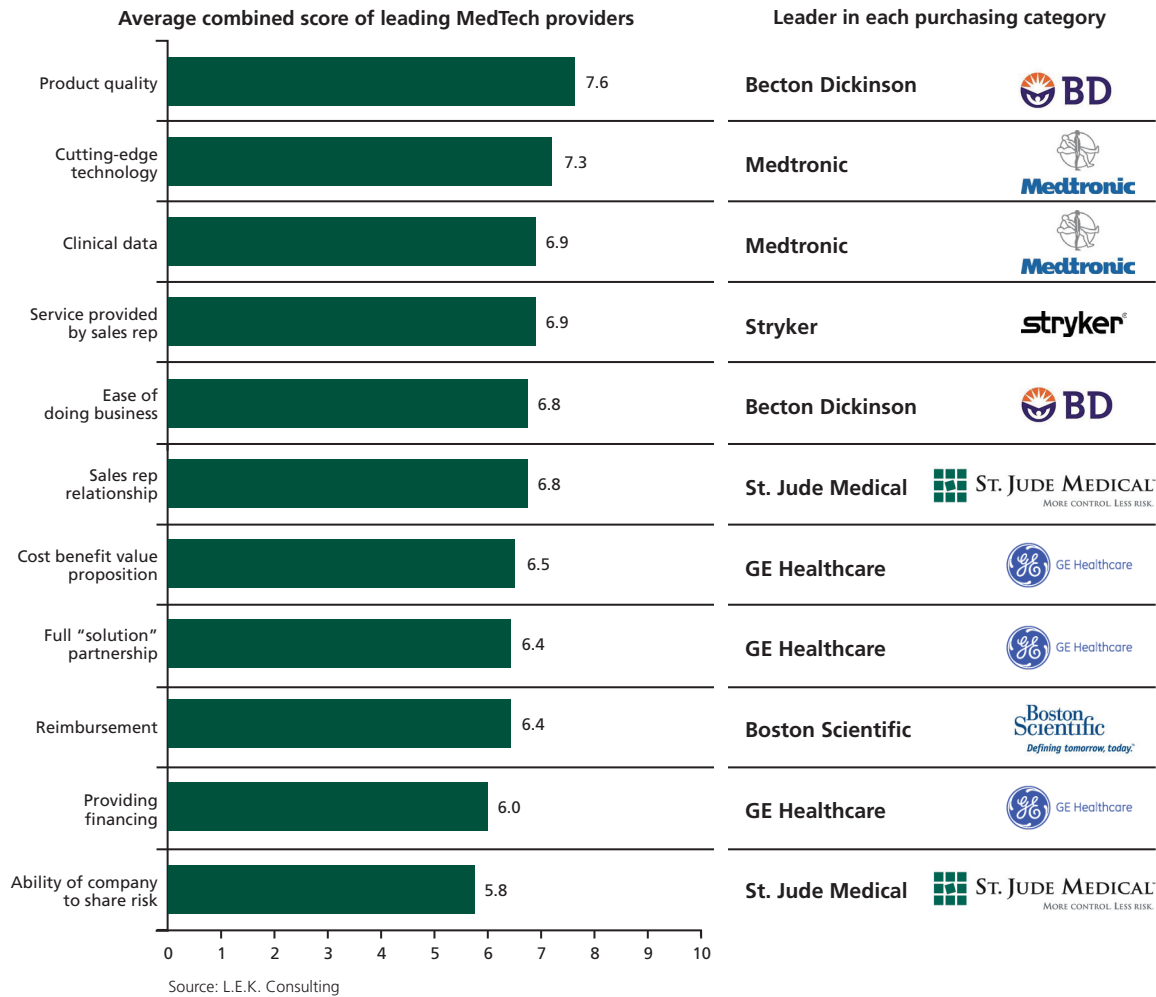
Source: L.E.K. Consulting

Getting clinical data, sharing risk and providing a full solution will grow in importance for hospitals over the next few years

Notably, hospital executives cited reimbursement as the second highest priority for selecting MedTech products, but gave MedTech vendors relatively low marks in this area (9th out of 11 purchasing categories). MedTech provider improvements in reim-

bursement support are directly tied to product quality, value and the ability to support the data collection that hospitals require to receive the highest reimbursement rates possible.

Figure 3
Grading Top MedTech Providers on Key Purchasing Criteria



Spotlighting Best-in-Class Vendors by Hospital Need

In addition to determining average vendor scores by purchasing criteria, L.E.K. also identified the brands that received the highest customer marks in each category. Six of the top-15 companies in L.E.K.'s research earned "best-in-class" designations from hospital executives (see Figure 3, right column). Becton Dickinson is cited as the category leader for product quality and ease of doing business, while customers selected Medtronic for cutting-edge technology and clinical data. Hospital executives also recognized GE Healthcare in three categories, including full solution

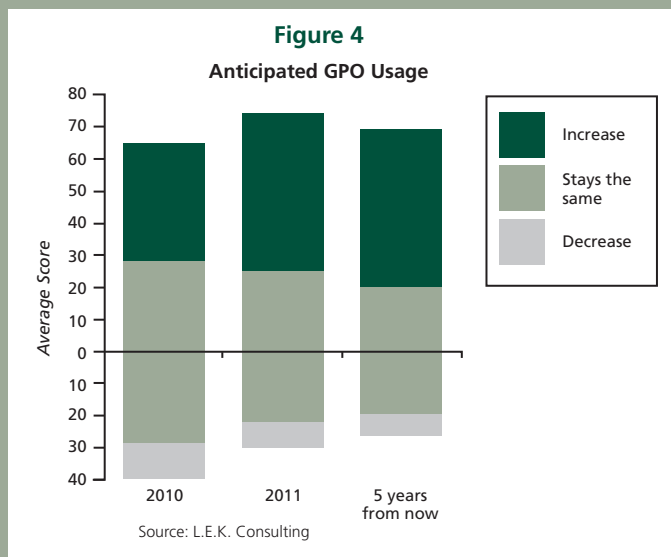
offerings. St. Jude received top marks in two categories (ability to share risk and sales team service), while Stryker and Boston Scientific also made the list of top MedTech providers.

Taking a closer look at the vendor preference results, no single company scores consistently high across the various purchasing categories. And hospital executives see little differentiation among companies in many of the important product evaluation categories or position themselves as top-tier providers across the spectrum of product selection factors.

GPOs Flex Their Purchasing Power

Hospitals are increasingly turning to group purchasing organizations (GPOs) to make the most of their budget dollars. After seeing the GPO model work effectively during the economic downturn, hospitals plan to increase GPO use moving forward. In fact, more than half of all hospital executives surveyed expect to use GPOs more by 2015 – a nearly 20% increase from 2010 (see Figure 4).

GPOs have traditionally worked on behalf of hospitals to negotiate beneficial terms for disposables and other low-price, high-volume items. That's beginning to change as some hospitals have also started to approach GPOs to procure high-priced capital equipment. Hospitals with fewer than 300 beds expect to expand their relationships with GPOs more than larger hospitals. Additionally, there has been a trend towards multi-source rather than single-source GPO contracts, which reduces GPO influence for any one supplier but makes it easier for hospitals to increase the proportion of purchases bought on contract.



To address these procurement changes, MedTech companies should continue to ensure that their sales teams are focused across entire hospital networks and have processes in place to identify and address challenges that either a specific practice or an entire operation is facing. And to help counterbalance the potential role of GPOs in capital equipment procurement, MedTech providers should also consider expanding their relationships with key GPOs to include sales representatives who sell larger products.

Key Takeaways and Opportunities for MedTech Companies

The evolving framework for healthcare creates new challenges as well as opportunities for MedTech providers. Previously frozen budgets are slowly thawing and hospital executives are prioritizing initiatives that have been on hold now that the economy is improving. Heightened cost pressures, however, are expected to be the “new normal” in hospital procurement negotiations.

Importantly, hospital officials are looking to the MedTech industry for more than just products, which creates new opportunities for companies to separate themselves from their competitors. This is especially important because hospitals don't perceive significant company differentiation in the key categories used to select MedTech products; there is a narrow gap between identified category leaders and laggards. L.E.K. research also shows that there are a number of unmet hospital needs from MedTech providers.

MedTech companies that consistently deliver good clinical data will help insurers set advantageous rates for hospitals, and will also help sway hospitals in their MedTech purchasing decisions.

Additionally, sharing risk and providing a full solution will play an increasing role in determining which MedTech suppliers hospitals use. Products with demonstrated support for improved treatment quality, patient safety and reduction of medical errors will also continue to stand out in the market. MedTech providers that can enhance their demonstrated value across hospitals' purchasing dimensions are well-positioned to succeed in the new healthcare landscape.

¹ L.E.K. Consulting surveyed nearly 200 U.S. hospital decision makers in December 2010 that included CEOs, COOs, CFOs, material managers and purchasing directors.

² L.E.K. asked senior hospital executives to rate the following 15 MedTech providers across a number of purchasing criteria: Abbott Labs, Baxter, Becton Dickinson, Boston Scientific, C.R. Bard, Carefusion, Covidien, Edwards Life Sciences, GE Healthcare, Johnson & Johnson, Medtronic, Philips, Smith & Nephew, St. Jude Medical and Stryker.

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