

# Designing the optimal go-to-market strategy for MedTechs in Latam

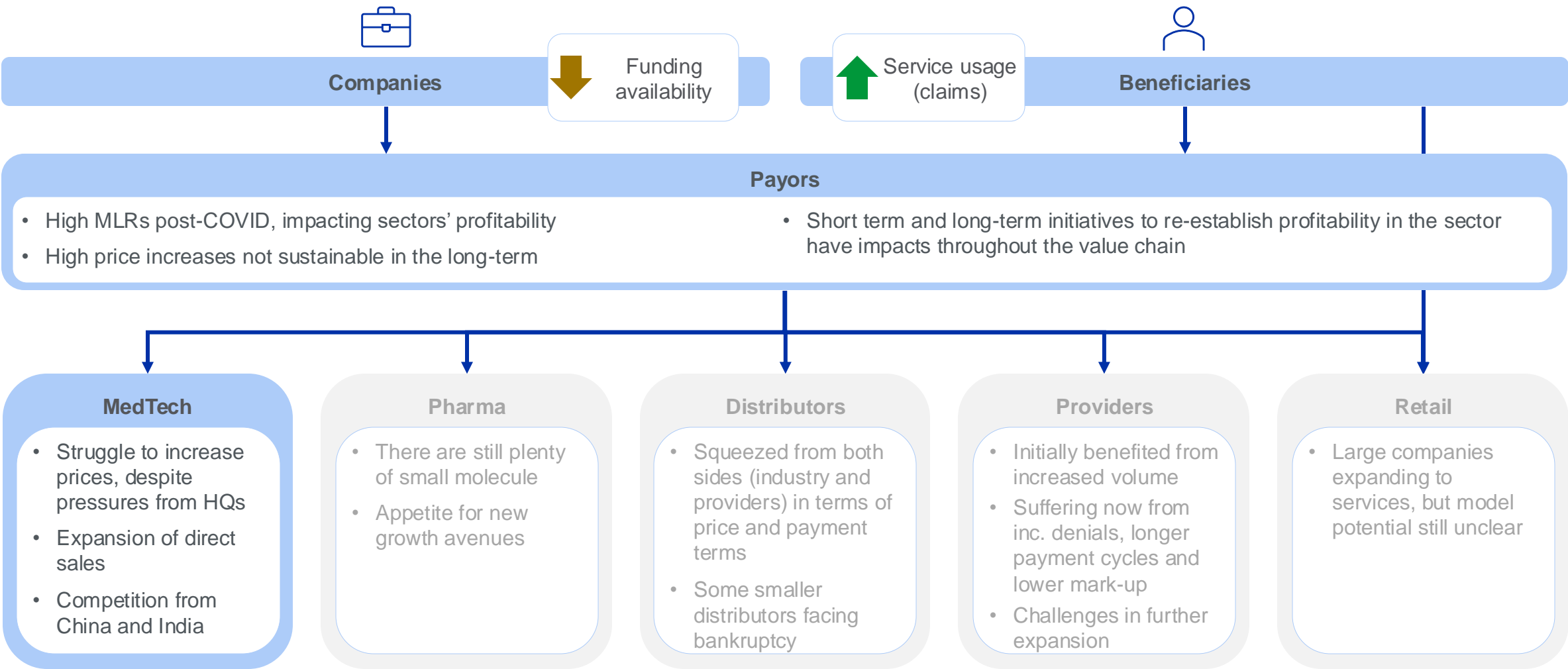
## Historical movements and key considerations

April, 2024

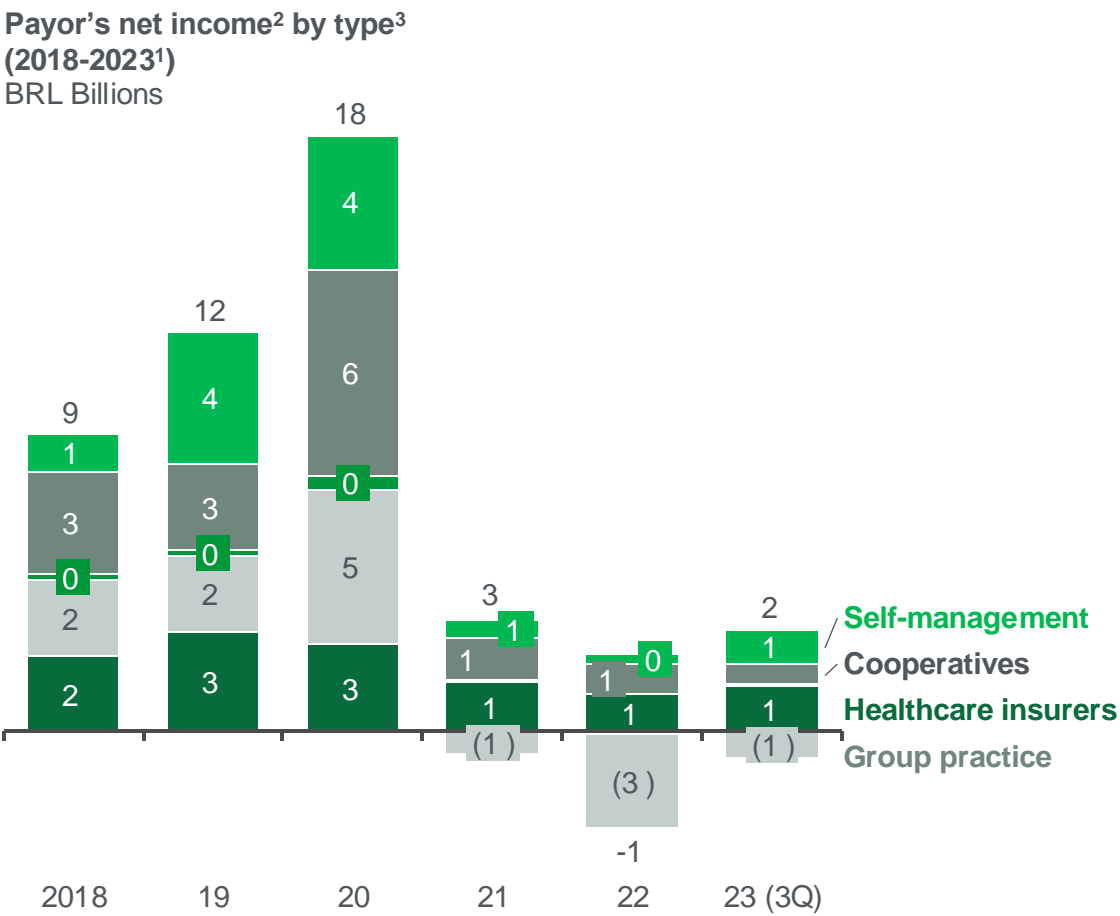
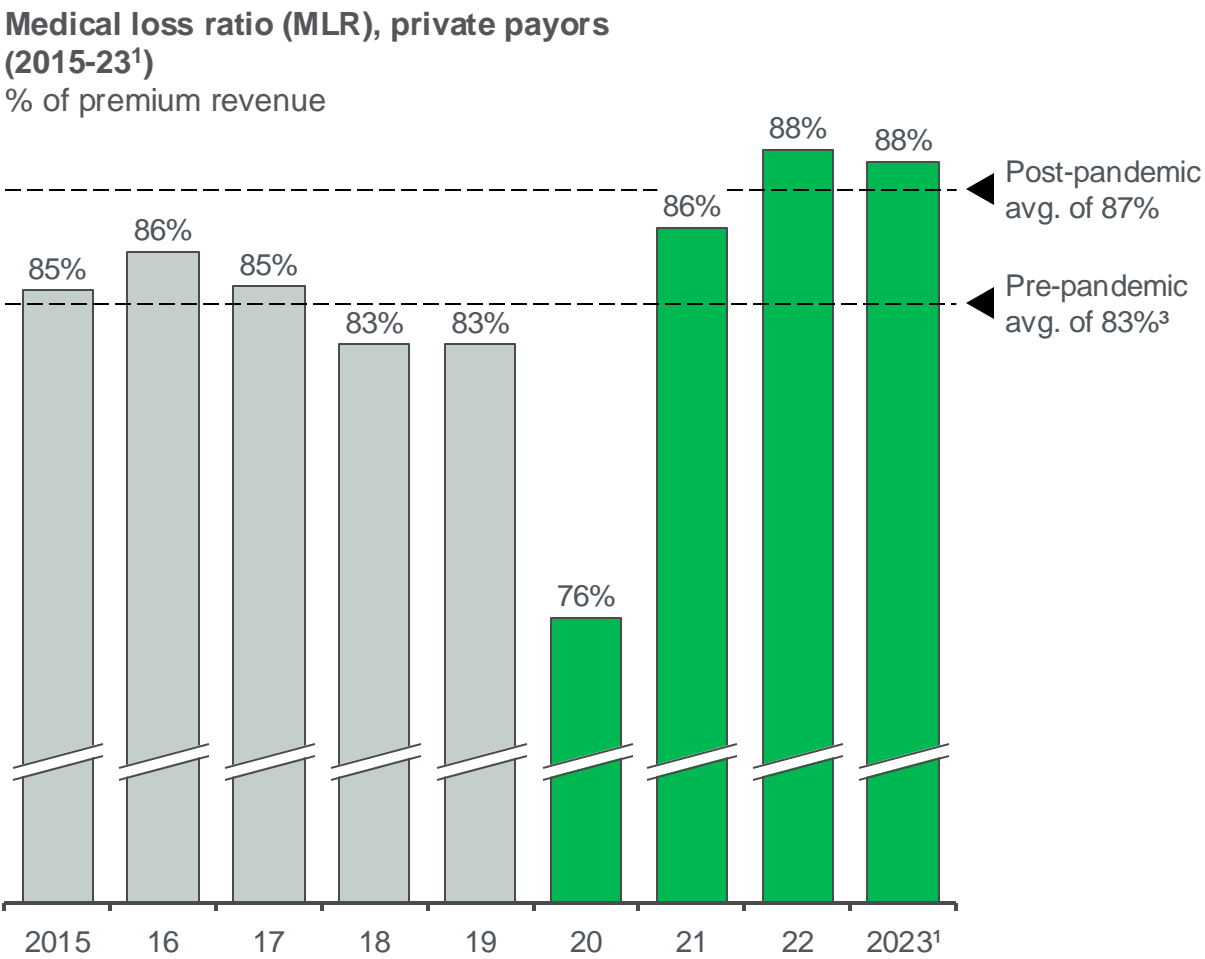
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The health sector has felt the increase in MLR in the aftermath of the pandemic, impacting the flow of capital throughout the system and MedTech companies



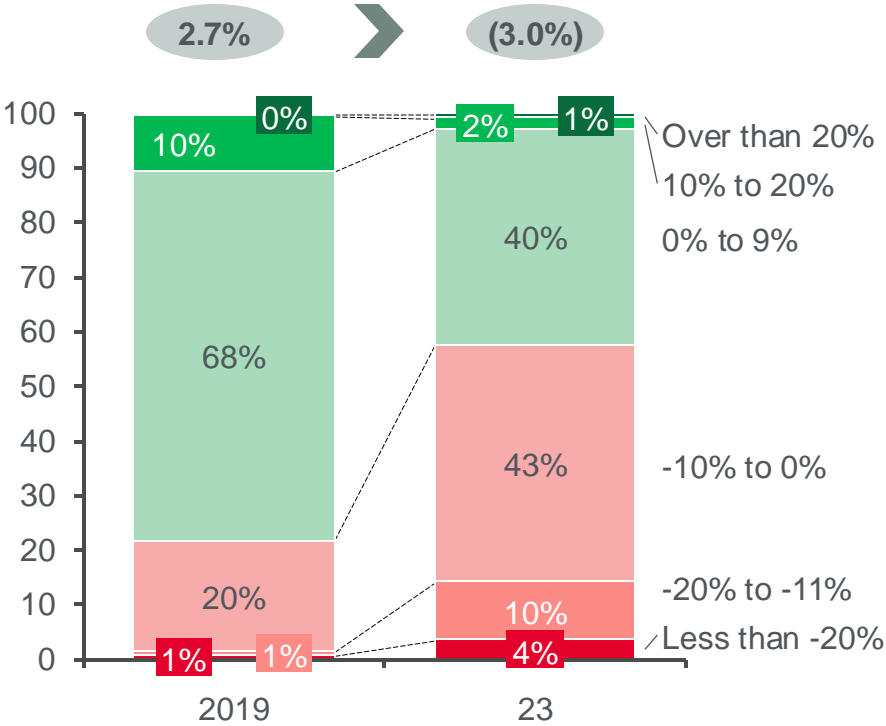
# Post Covid, MLRs reached an all time high and have not yet recovered, impacting payors' profit across the board



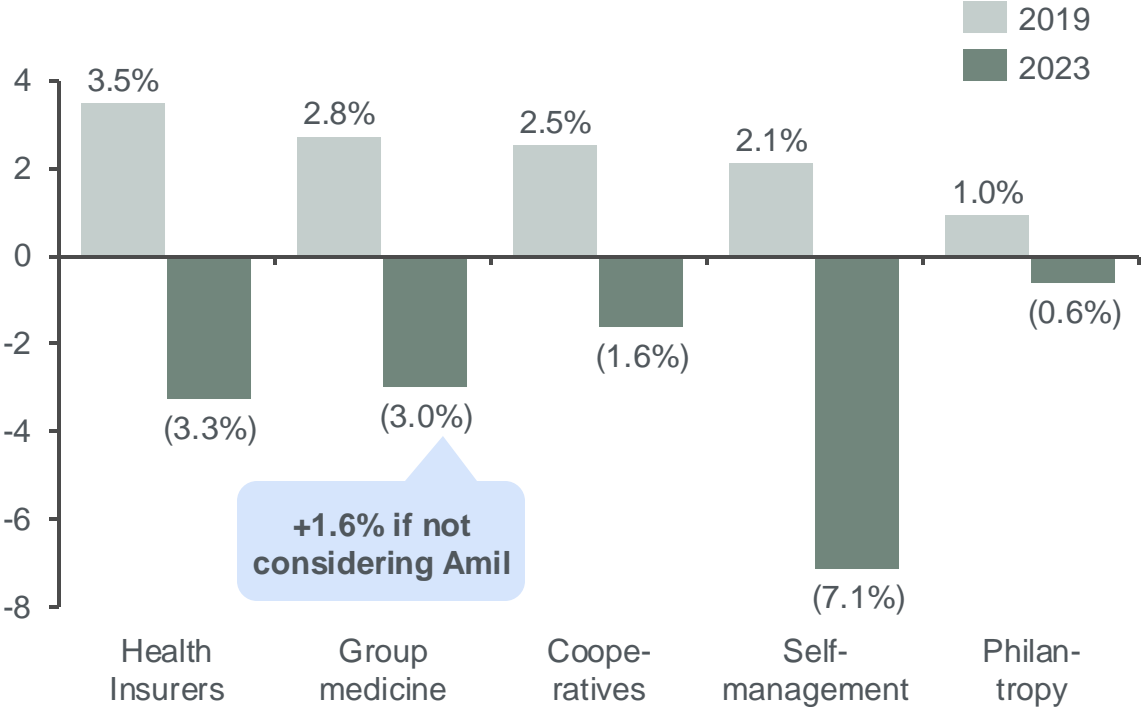
Notes: 1) Considers 2023 until 3<sup>rd</sup> quarter (last available data) 2) Operational and financial results 3) Includes only medical and hospital insurance  
Source: ANS; DataSUS; companies' websites; L.E.K. analysis and research

# Profitability has declined between 2019-23, from 2.7% to (3.0%), with 36% more payors operating in the negative spectrum - a trend experienced by all archetypes

Total revenue of payors by operational result range  
(2019-23<sup>1</sup>)  
BRL Billions, % of revenue

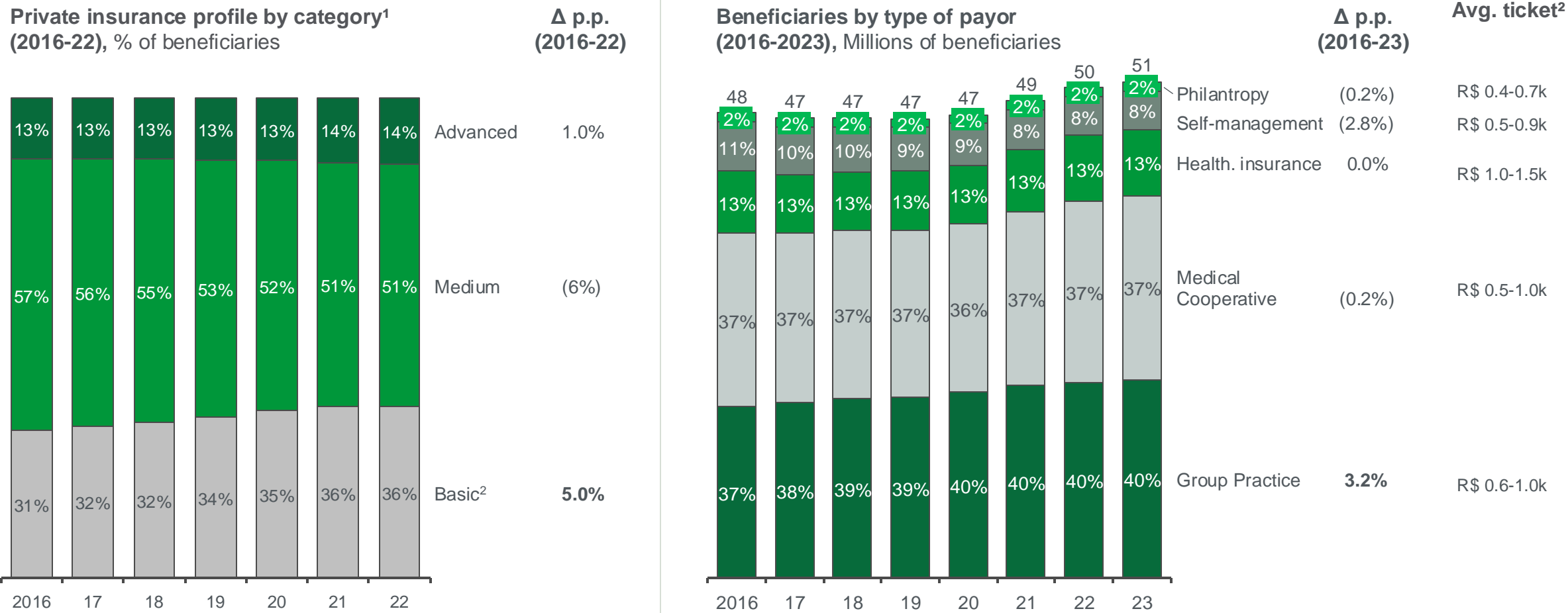


Operational result by payor type evolution  
(2019-23<sup>1</sup>)  
% of revenue



Notes: 1) Considers 2023 until 3<sup>rd</sup> quarter (last available data)  
Source: ANS; L.E.K. analysis and research

# Beneficiaries and companies have been struggling to afford the high premium increases and are downgrading to basic plans and lower-cost verticalized players

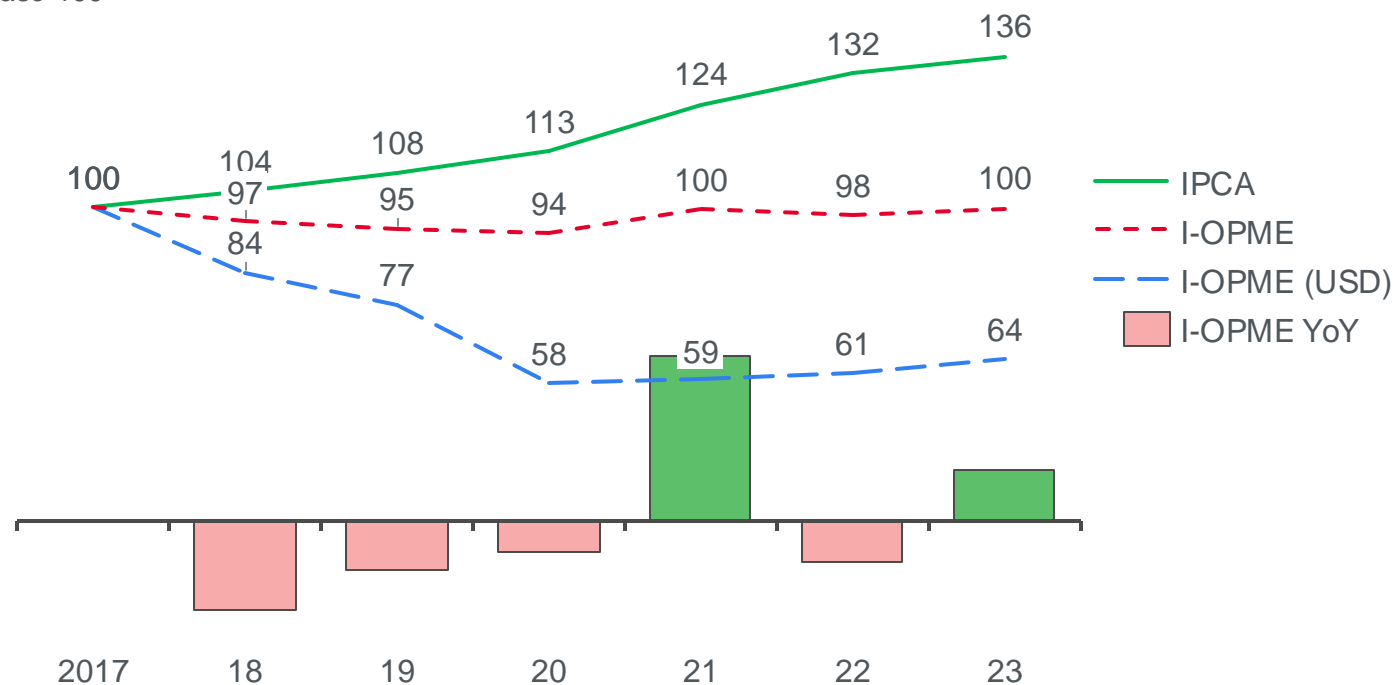


## Medtechs have not been able to pass on inflation in Brazil; In dollars, the price in 2023 is ~36% lower than in 2017 - generating pressure from the headquarters to recover profitability

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Evolution of the I-OPME index vs inflation  
(Brazil, 2017-23)

Base 100

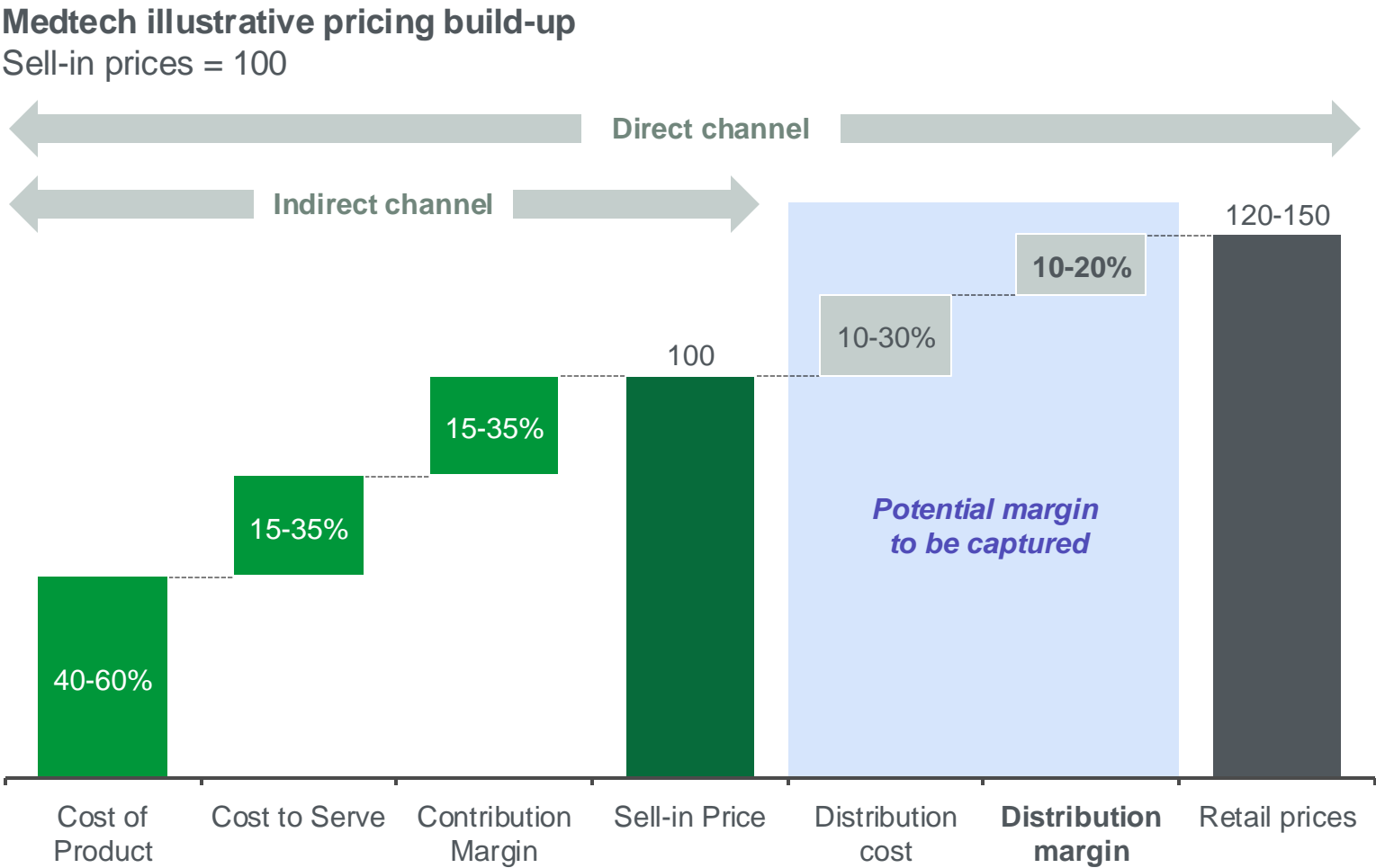


- Medtech companies have **not been able to pass on prices in line with inflation in Brazil**, and this is even more the case for multinationals, which **seek a return in dollars**
  - As a result, there is **pressure from the headquarters to transfer and increase prices**
- OPME indices faced several pressures during the period, including:
  - Consolidation movement** among major accounts, increasing their bargaining power to negotiate lower prices
  - Intensified competition** with the entry of low-end players, coupled with high-end players reacting by lowering prices
  - Trend of some multinational companies expanding the relevance of the **direct sales channel** to mitigate compliance risks, resulting in cost reduction and market share gains

Capture of distributor margin is a way to boost margin recovery,  
as pressure from the healthcare system limits potential price increases

# To increase competitiveness and revenues, companies are attempting a series of initiatives, with special highlight to direct-sales

DIRECTIONAL

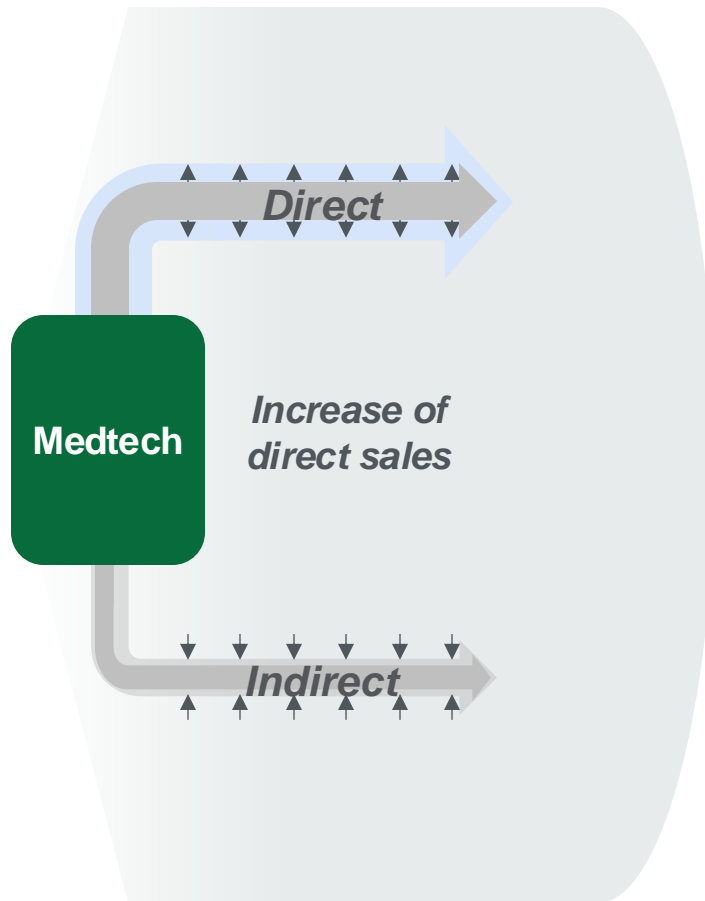


## Market dynamics

- **Medtechs are increasingly focus on direct sales to strategic customers**
  - Primary goal is to capture distributor margins
  - But this engagement also supports cross-selling and enhances relationships with key providers
- **The approach is most effective for large providers and/or those in regions with simpler logistics**
  - In areas with complex logistics, Medtechs are seeking partnerships with logistic operators
- **On the other hand, payers and providers explore vertical integration to increase efficiency and gain a strategic edge in the chain**
  - Examples include Rede D’Or + Mederi, and Bradesco Saúde establishing its own hospitals

Source: L.E.K. analysis and research

## In addition to revenue and profitability potential, compliance concerns, demand from clients, and service level alignment are also factors bringing direct sales to the top of C-level strategic agenda



- ① • **Compliance:** cases of corruption ("CPI das próteses") and dubious incentives, raising the risk and latent concern in the case of multinationals
- ② • **Providers and payors looking for direct purchase:** objective of purchasing at a lower cost, with gains in scale and centralized purchasing
- **Level of service:** Direct sales can have a better effect when selling sophisticated and complex products, with a more technical presence in the field - although the distributor usually has more time available to the providers
- **Access to and knowledge of the customer:** Indirect selling creates challenges in terms of market intelligence, lack of pricing data, customer context and feedback from the front end
- **Strategic alignment and cross-selling:** A challenge in encouraging the distributor to pursue the same objectives as the company, such as promoting product categories that are strategic for the company.



# Compliance concerns are a constant in MNCs’ agenda as many distributors have been involved in corruption by overpricing products and paying commission to physicians

1

## “CPI das próteses”

Irregularities and crimes in medical procedures involving orthoses and prostheses, uncovering allegations of bribery, overpricing, and unnecessary surgeries for financial gain, implicating manufacturers, distributors, and physicians

### Scheme *modus operandi*

- **Physicians were billing up to 30% of the cost of OPME**, with the potential to override the technical decision-making process of the operation
  - **Instances of unnecessary procedures to boost revenues** – a study conducted by Hospital Albert Einstein indicates that in ~55% of cases, spinal surgeries were unnecessary
  - **Unnecessary replacements and intentional damage to parts to boost the volume of procedures** and the revenue generated
  - **Inflated pricing involving the sale of prostheses at rates up to 20x their market value**, facilitated through forged signatures and falsified documents
- **Processes were conducted through a consulting contracts between the physicians and the distributors**, resulting in an additional income of up to R\$ 100,000 / month to the physicians
  - **Research from the regional medical council indicated that**
    - 37% of the respondents received some commission (>R\$500) in the last year
    - In medical colleges, 74% received or heard from colleagues who received benefits throughout the course
- **In the public system, distributors would advise those drafting tenders**, providing specific details to favor particular brands – thus securing a reward for the tender's author.

### Examples of brands that are involved in schemes



“... We were able to negotiate a 20% cash commission for endorsing our brand...”  
- Seller, Oscar Iskin

“... We offer even more; we pay 30% if doctors recommend our brands...”  
- Partner, Total Medic

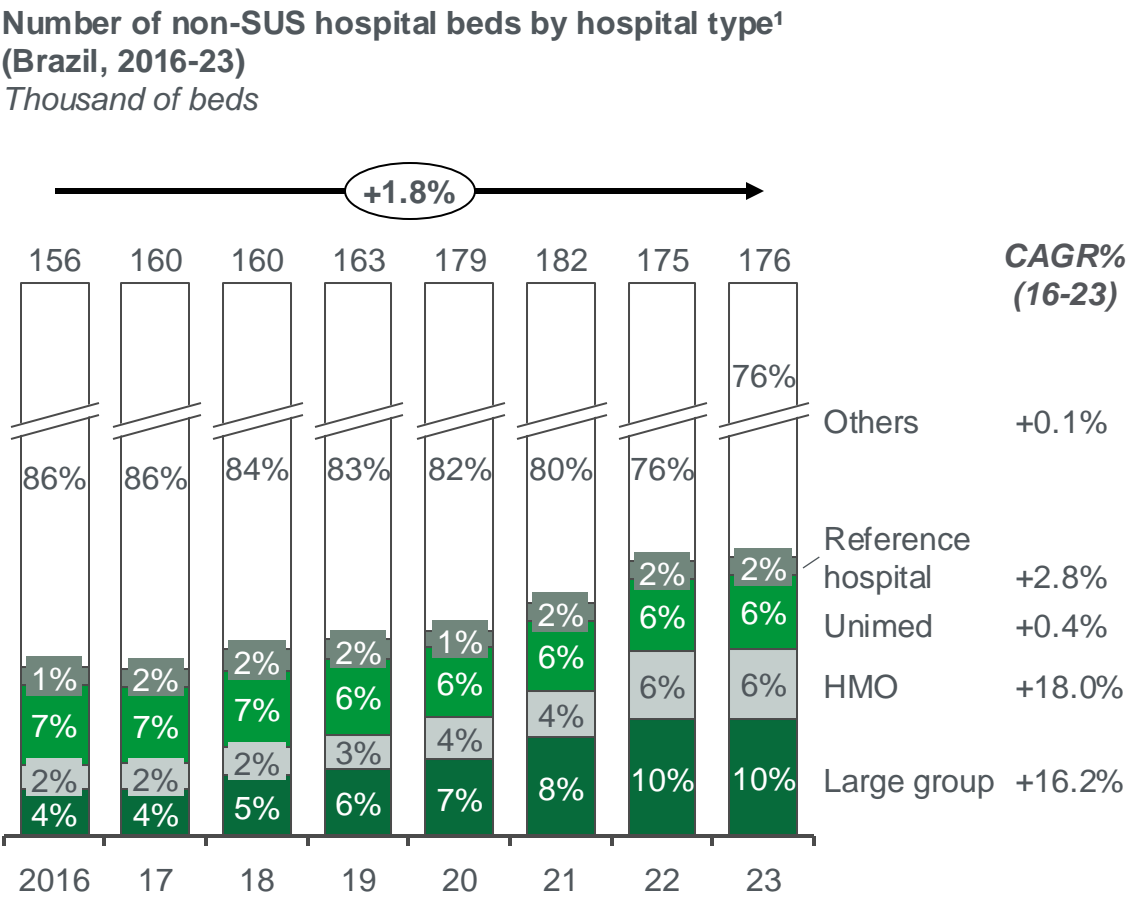


Laws approving penalties for corruption schemes in healthcare have been enacted to target frauds committed by manufacturers, distributors, and physicians, to enhance compliance in the sale of medical products

Source: G1; L.E.K. research, and analysis

Moreover, large groups and hospitals are also demanding direct negotiations, to leverage bargain power from market consolidation

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- Rising costs and operational challenges **force providers and payors to buy directly from the manufacturer**, reducing one end of the value chain
- Large players are **consolidating the market**, thus bringing more weight to direct sales and purchasing on a larger scale

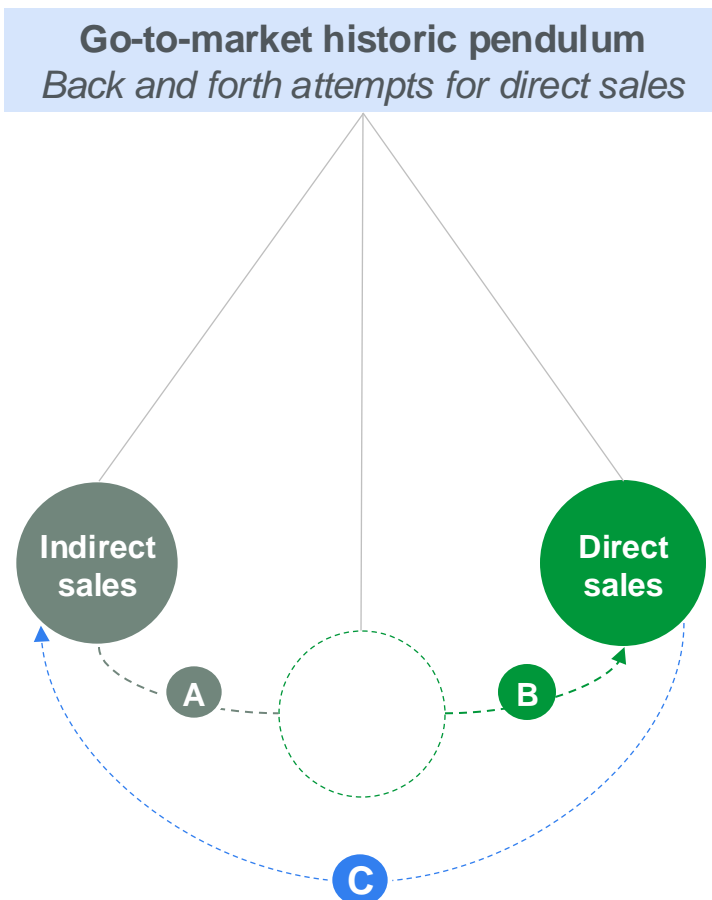
Examples:

REDE D'OR



- Rede D'or acquires distributor (Mederi) consolidating its hospitals' purchases and going directly with the industry
- Hapvida, with a well-known procurement area, with difficult negotiations and very focused on price, seeking to incorporate a similar strategy for GNDI

## Direct-sales attempts, however, are not new in the market, but companies have struggled to find the right balance of channels, as tend to disregard operational complexity and distributors' reaction



### A Direct sales motivations and rationale

- ✓ Potential to increase revenue by absorbing distributors' markup
- ✓ Interest to better control accounts' relationship and compliance
- ✓ Topline focus, with limited consideration on operational complexity and cost-to-serve, both direct and indirect (e.g., back-office), given lack of visibility of accounts' P&L

### B Operational difficulties and impacts

- ! Profitability difficulties, given higher cost-to-serve than initially forecasted, need to absorb smaller (less-profitable) accounts, and extended cash flows
- ! Market share loss due to:
  - Inability to sustain service level required by hospitals
  - Difficulties to increase the number of headcounts required on sales and back-office structures
  - Time to establish relationship with hospitals and physicians
  - Distributors' reaction / retaliation to direct sales movements, many times leveraging relationships to position competitors in the same lines

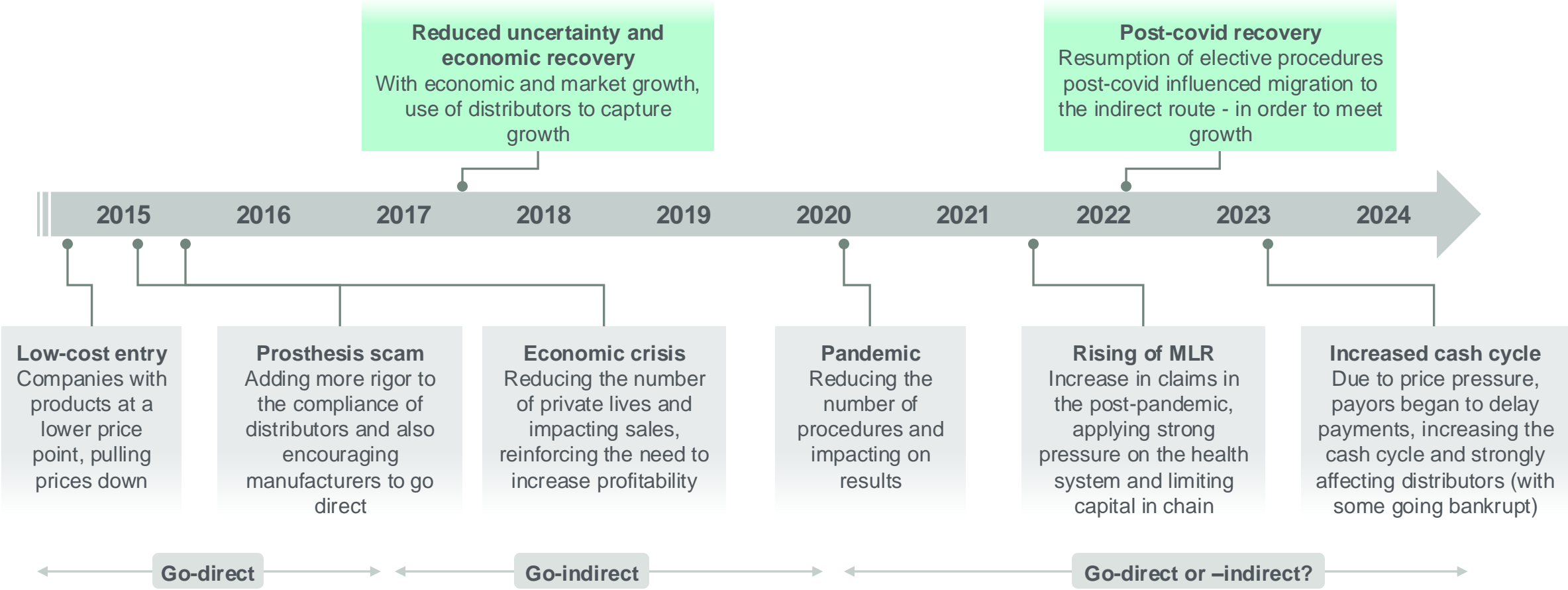
### C Return to legacy structure

- ✓ Return to indirect channel structure, but with need to give higher margins to partners and to rebuild distribution network, and difficulties to manage attritions with and concerns of partners

**Difficulties to create sustainable go-to-market structures deriving from failure to recognize all nuances of direct sales approach**

# Such difficulties are further exacerbated by external factors impacting the market

## Trends impacting the GTM strategy (2015-24)



Source: L.E.K. research, and analysis

## Therefore, direct-sales approach need to be planned at account-level, supported by robust business cases, and comprehensive considerations of operational complexities and risks

### *Need for robust and comprehensive business case for the direct sales approach by account / segment...*

- **Topline potential**

- Account size for the lines of interest (vs. hospital size)
- Insurers profile of each hospital and reimbursement rates
- Market share potential by account

- **Commercial and fulfillment costs**

- Commercial structure, including sales and technical / surgery support teams
- Logistics and warehousing structure, including reverse logistics requirements
- Inventory, obsolescence and scrap costs

- **Backoffice costs and expenses**

- Backoffice enhancement costs (treasury, legal, tax, ...)
- G&A growth to control operation and dilution potential

- **Cash flow detractors**

- Payment terms and cash cycle
- “Glosa” rates by hospital segment and product line

- **Investments**

- Team hiring and training
- Logistics infrastructure (e.g., distribution centers)
- Equipment leasing for specific lines that rely on “comodato”
- Inventory purchase from distributor

### *...that considers operational complexities and requirements, and distributors’ movements*

- **Service level required**

- Inventory, supply chain, and logistics
- Surgery support resources
- Services provided to hospitals

- **Back-office complexity and requirements**

- Accounting and finance, especially for OPMEs given “Fiscal Notes” dynamics
- Logistics and supply chain
- Market access

- **Timing and investments required to build relationship and re-list products in hospitals and insurers**

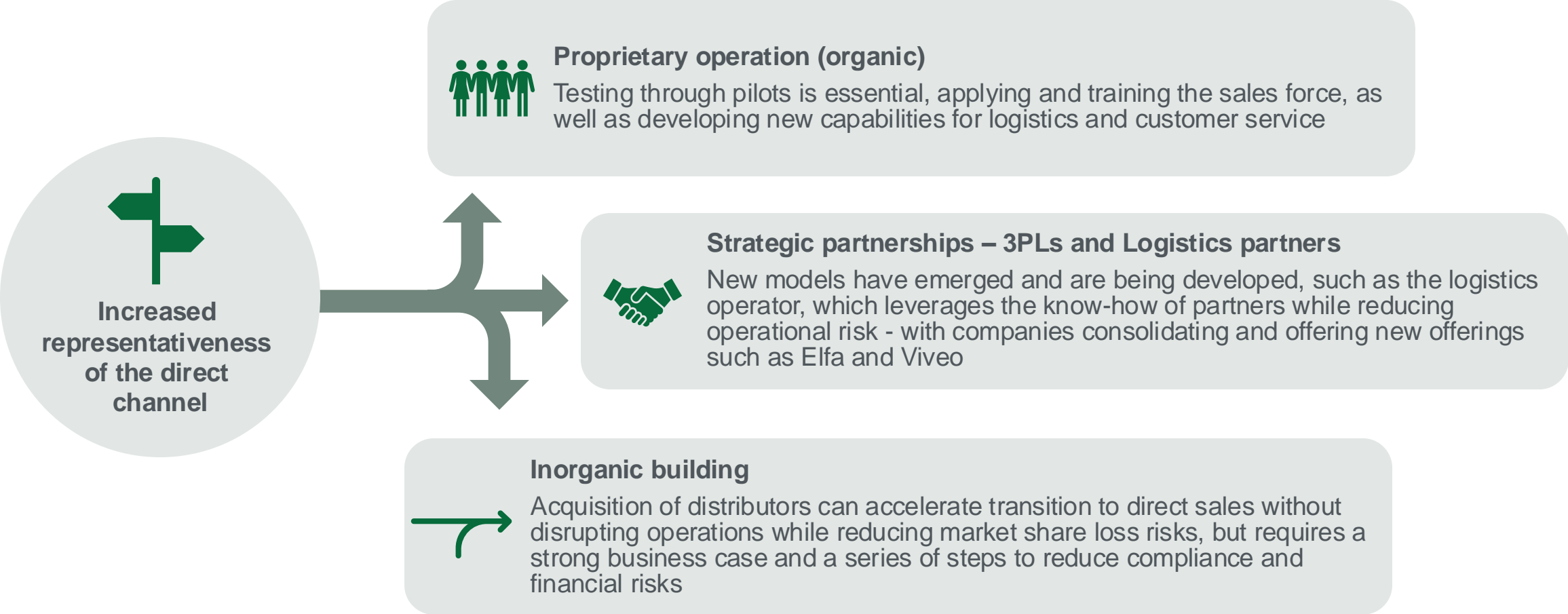
- Potential market share loss during transition period, given limited relationship

- **Distributors’ potential retaliation movements, impacts and mitigation factors**

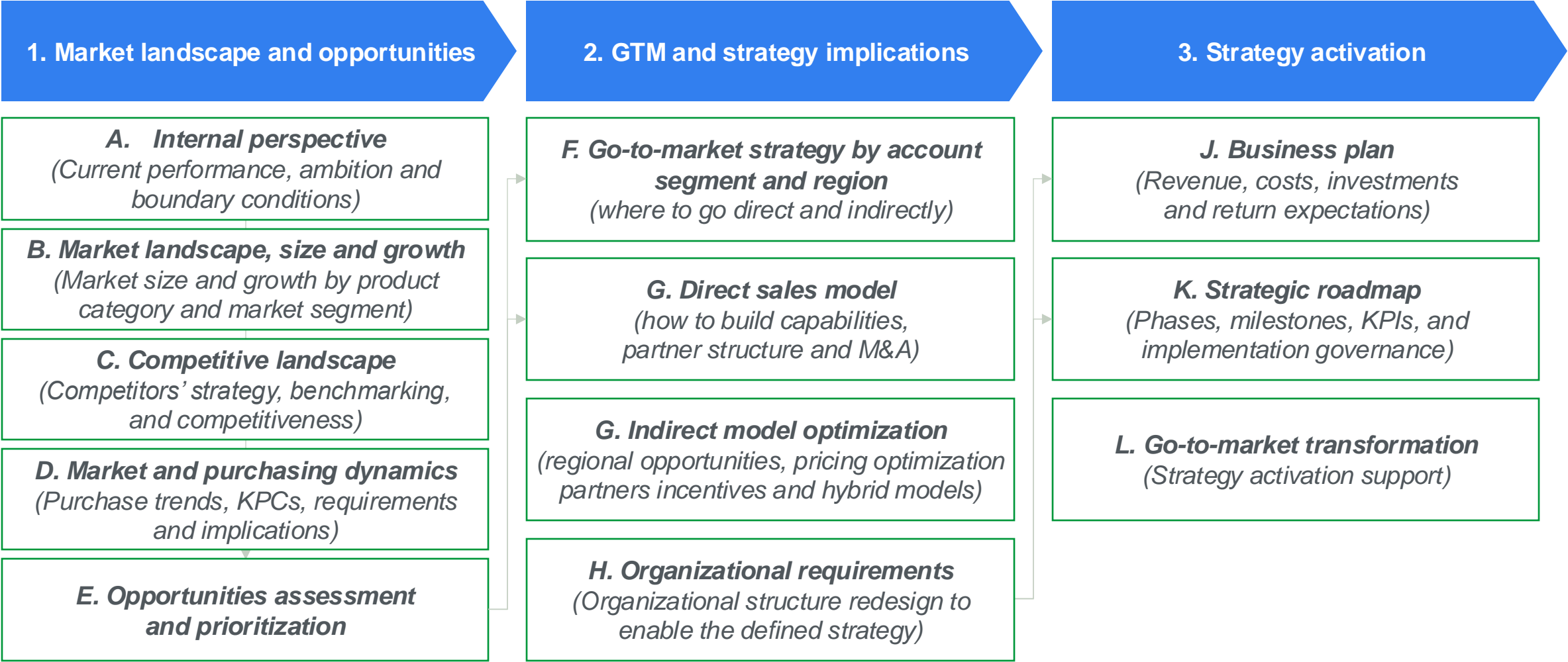
- Transition to current and new competitors, accelerating market share loss movements
- Potential loss in perpetuity

- **Need to absorb smaller accounts, with smaller margins and similar operational complexity**

Moreover, companies should consider the optimal operational / partner structure and ways to build the required capabilities



L.E.K. has supported dozen of companies in redefining their commercial strategies in Brazil and Latam, through a robust and tested methodology



Source: L.E.K. research, and analysis



We have extensive experience in the healthcare sector in Latin America, with strategy projects, looking at growth, M&As, portfolio, GTM strategy and pricing

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Selected L.E.K. Brazil experience in the healthcare sector<sup>1-2</sup> (MEDTECH FOCUS)



Notes: 1) Includes (a few) companies evaluated in the strategic due diligence process for private equity funds; 2) L.E.K. Brazil also has experience in other markets such as Peru, Costa Rica, Panama, Ecuador, Venezuela, and Uruguay





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~2,200 Staff



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