

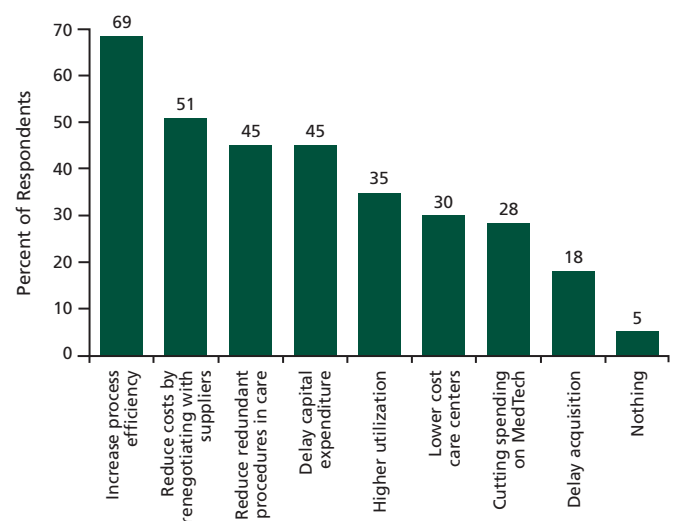
## L.E.K. Strategic Hospital Priorities Study: Hospitals Look to MedTech for New Services and Solutions

U.S. hospital systems are going through a challenging period and, just as species must adapt to environmental changes, hospitals are evolving to survive. Already tight margins are getting tighter as reimbursement levels fall and patient mix shifts towards more Medicare and Medicaid patients. To improve profitability while at least maintaining patient quality, hospital systems are taking on four broad measures with varying levels of intensity. Hospitals are continuing to consolidate (in order to improve leverage with payers and suppliers) and integrate with alternate care facilities (in order to secure sources of referral traffic and to be able to offer and take advantage of a full continuum of care). At the same time, more progressive hospital systems are increasingly taking on new levels of accountability (in order to take advantage of emerging reimbursement models that reward efficiency and improved outcomes).

These measures – consolidation, integration, accountability – individually and collectively are encouraging hospitals to take a fourth step that is having the greatest impact on suppliers: centralizing and coordinating their supply chains. While this may be frightening to some MedTech executives, it presents opportunities for companies that can reposition themselves to become broader solution partners to leading hospital systems.

The L.E.K. Strategic Hospital Priorities Study is a benchmark study that has been conducted annually since 2009. For the

**Figure 1**  
Planned Response to Address Impact of the Affordable Care Act\* (2014)



Note: \*What do you expect to do in order to respond to the shift as a result of the Affordable Care Act?

Source: L.E.K. interviews and the L.E.K. Study

2014 edition, nearly 150 hospital CEOs and other senior decision makers were asked what they believe are the major challenges to the industry and their institutions. They were also asked about their spending plans and the kinds of services they want from MedTechs. This paper summarizes some of the study's main findings.

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## Margin Pressure Mounts, Driving Continued Structural Changes

L.E.K. estimates that a typical suburban hospital's margins are currently approximately 4% but this is expected to decline to 0%, primarily due to payer-mix shifts. Similarly, respondents to our survey said they expect declining margins, with a majority expecting that the Affordable Care Act will have a net negative financial impact on their institutions despite an increase in insured patients.

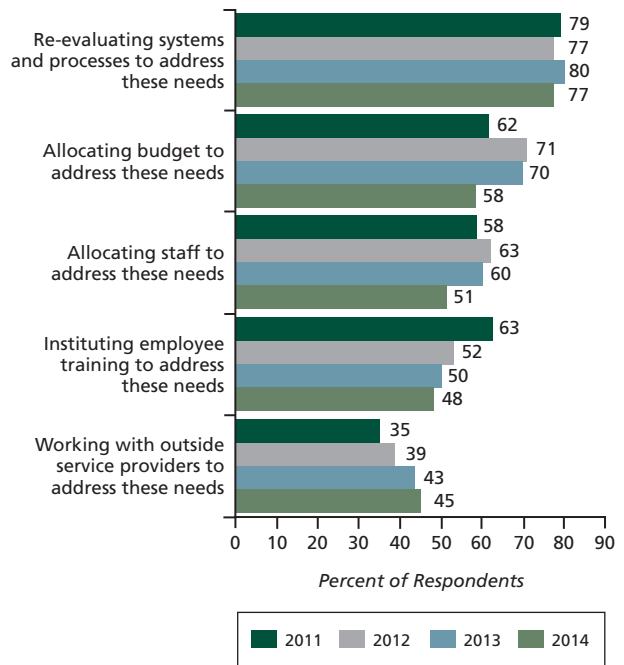
Hospitals are reacting to this by continuing to consolidate to improve leverage with payers and suppliers. While most hospitals still operate as standalone institutions, the majority will likely eventually move towards joining large, consolidated, and increasingly strategically integrated systems. By 2020, L.E.K. estimates, the top 100 hospital systems in the U.S. will account for more than 60% of hospital spending, up from 40% in 2008.

Hospitals, meanwhile, are continuing to invest in alternate site facilities. Acquiring medical practices has been a very popular way for hospitals to secure sources of referral traffic. A senior executive with a Minnesota healthcare system reports, "Most hospitals have been on a shopping spree for PCPs. There are very few standalone care practices left." In addition, some of the more progressive systems are vertically integrating with other alternate site facilities (e.g., ASCs, long-term care) to enable a full continuum of care, a pre-requisite to taking on broader accountability. Indeed, as the survey data suggests, there is a strong correlation between hospitals that expect to expand into alternate sites and those that expect to take on greater accountability.

## Spending Growth Will be Modest as Cost Cutting Remains a Priority

Survey respondents expect slightly positive spending growth over the next five years, but most of this growth will be represented by continued investment in IT. Spending is expected

**Figure 2**  
Key Activities Aimed at Addressing Hospital Needs\*

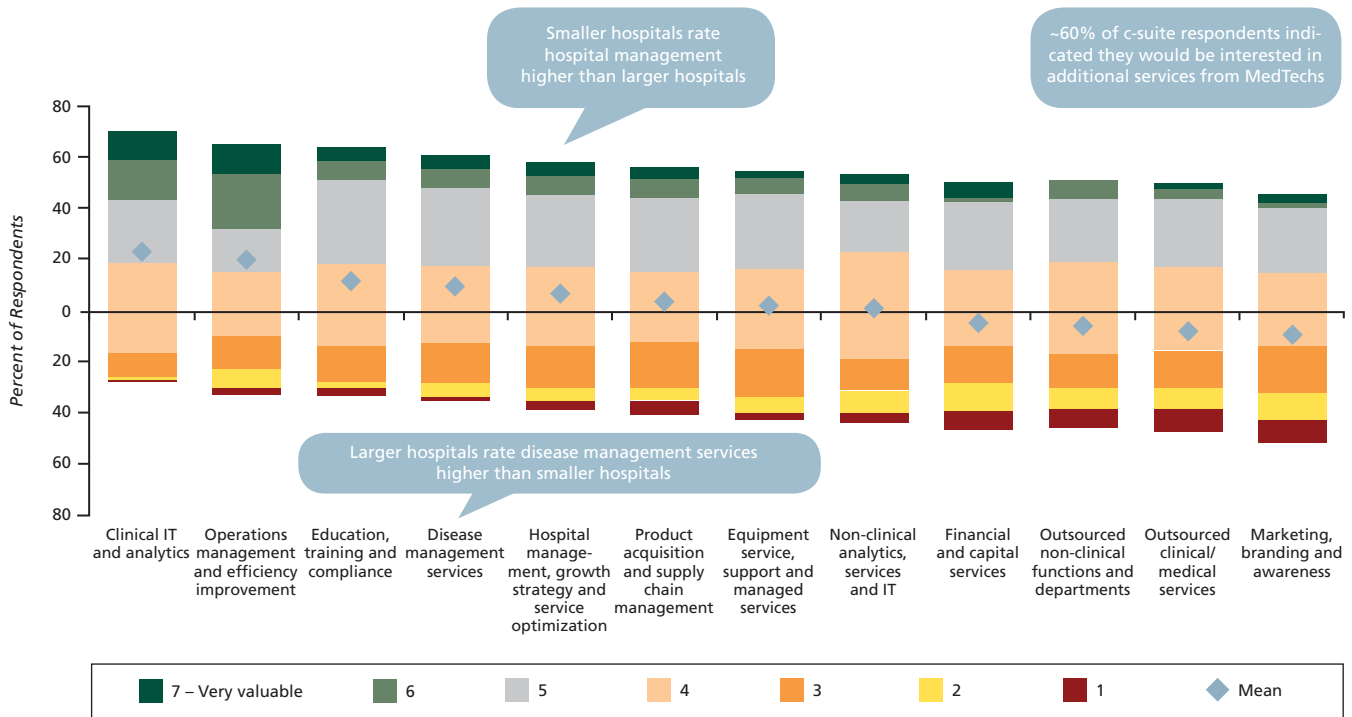


Note: \*How are you addressing the most pressing needs that you identified for your hospital?  
Source: L.E.K. interviews and the L.E.K. Study

to be generally flat for large devices, small devices, and disposables. In the short-term, hospitals will be concentrating on cost cutting and finding ways to improve efficiencies. Nearly 90% of survey respondents report that reducing costs is among their top five most pressing needs. Nearly 80% included improving hospital efficiency in their top five. Meanwhile, 74% of respondents indicate that they already have efforts in place in their hospitals to improve efficiency. Sixty nine percent indicate that their primary response to the ACA will be to try to improve process efficiency.

As hospitals consolidate and more physicians become hospital employees, hospital administrators are taking a greater role in MedTech device purchasing. Sixty eight percent of respondents to the survey told us that the purchasing process has grown more complex and time-consuming over the last year. The director of materials management for one Massachusetts hospital said, "The purchasing process has become much more complicated and restrictive. All supplies and new tech-nol-

**Figure 3**  
Hospital Interest in Specific Potential MedTech Services\* (2014)



Note: \*How valuable are each of the following services that MedTech companies could provide in addition to their products?  
Source: L.E.K. Study

ogy that are proposed for use have to go through a value/cost analysis committee. The days of the clinician getting to use a product because of sheer preference are behind us.” As part of their cost cutting efforts, hospital administrators plan to increase rationalization of suppliers going forward, particularly in invasive and large medical devices.

### Implications for MedTech: Opportunities for Those Who Can Offer – and Charge For – Proven Value

The drive for improved efficiency is creating an opportunity for MedTech companies: hospitals are increasingly turning to external partners for help. Over the last four years of the L.E.K. study, we have seen a significant and steady increase in the percentage of hospital executives who are looking to work with external partners to address their most pressing needs (i.e., 35% in 2011 to 45% in 2014) versus using or training internal resources to do so.

Despite the constraints on spending, about 60% of hospital c-suite executives are interested in purchasing additional services from MedTechs, particularly in clinical IT and analytics, operations management and efficiency, and education, training, and compliance.

Hospitals are primarily interested in demonstrated solutions from MedTechs that can improve the quality of patient care, lower their overall costs, or increase the efficiency of their clinical staffs. As the CEO of one California hospital told us, “If a MedTech can come in and show cost-benefit, that is highly, highly important for us. We want to see that the product is beneficial to patients and helps reduce utilization. This area is a fertile ground especially with the new concept of ACOs, where you have physicians working more closely with patient care in hospitals.”

The big unsolved challenge for MedTechs is to link value with pricing. Hospital executives told us they would like to see MedTechs offer outcome-based pricing for their products. Only 18% of respondents, however, say they are aware of good current examples of such arrangements. "What I would like to see, but is not yet in place," the director of materials management of a New Hampshire hospital told us, "is a

guarantee, particularly if a MedTech can claim that we will use less of a product or reduce length of stay. If a company tells me there is more savings if they work with us, that is going to capture some attention."

However, before MedTechs can offer performance guarantees or outcome-based pricing, most will first need to up their game in understanding the incremental economic value that their products and solutions deliver in the first place.

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