L.E.K.

Special Report

Japan 2019-2020 Hospital Insights Survey

Contents

Summary

L.E.K. Consulting recently surveyed 70 decision-makers at hospitals in Japan to gain insight into how their strategic priorities and purchasing behaviors are shifting, as well as to identify any resulting opportunities — and imperatives — for medtech manufacturers going forward. The effort was part of a broader hospital survey conducted across the **Asia-Pacific region**; we carried out parallel surveys in the **U.S.** and **Europe** as well.

As the results of our survey make clear, hospitals in Japan are looking to decrease and/or redeploy acute bed capacity in the face of growing financial pressures and a widening range of new and unfamiliar operating conditions. In the meantime, the influence that hospital management and value chain intermediaries have over purchasing decisions is on the rise, and many hospitals are seeking closer, differentiated partnerships with device-makers, some of which may involve the device-makers themselves sharing economic risk or offering proprietary deals.

With that in mind, we recommend that medtech manufacturers serving the Japanese market revamp how they go to market and do the following:

- Take a refined approach to customer segmentation by basing it on a deep understanding of purchasing behaviors, especially around customer needs and engagement preferences, which differ significantly across hospitals
- Move away from a one-size-fits-all high-touch, rep-driven go-to-market model that treats all hospitals the same; rather, allocate investments and resources to accounts that will drive the greatest returns and develop go-to-market models that are most relevant to the needs and preferences of different customer segments
- Embark on the internal changes that are typically necessary to support transformative go-to-market change, whether they are organizational or cultural, including acquiring new skills and capabilities

Transformative go-to-market change of this nature can be both costly and challenging to execute. However, such initiatives should be seen as the price of market relevancy and leadership. Medtech companies that cling to the past and see only risk in go-to-market change leave themselves vulnerable to being disrupted by early movers.

For further information on this Special Report and its findings, please contact **lifesciences@lek.com**.

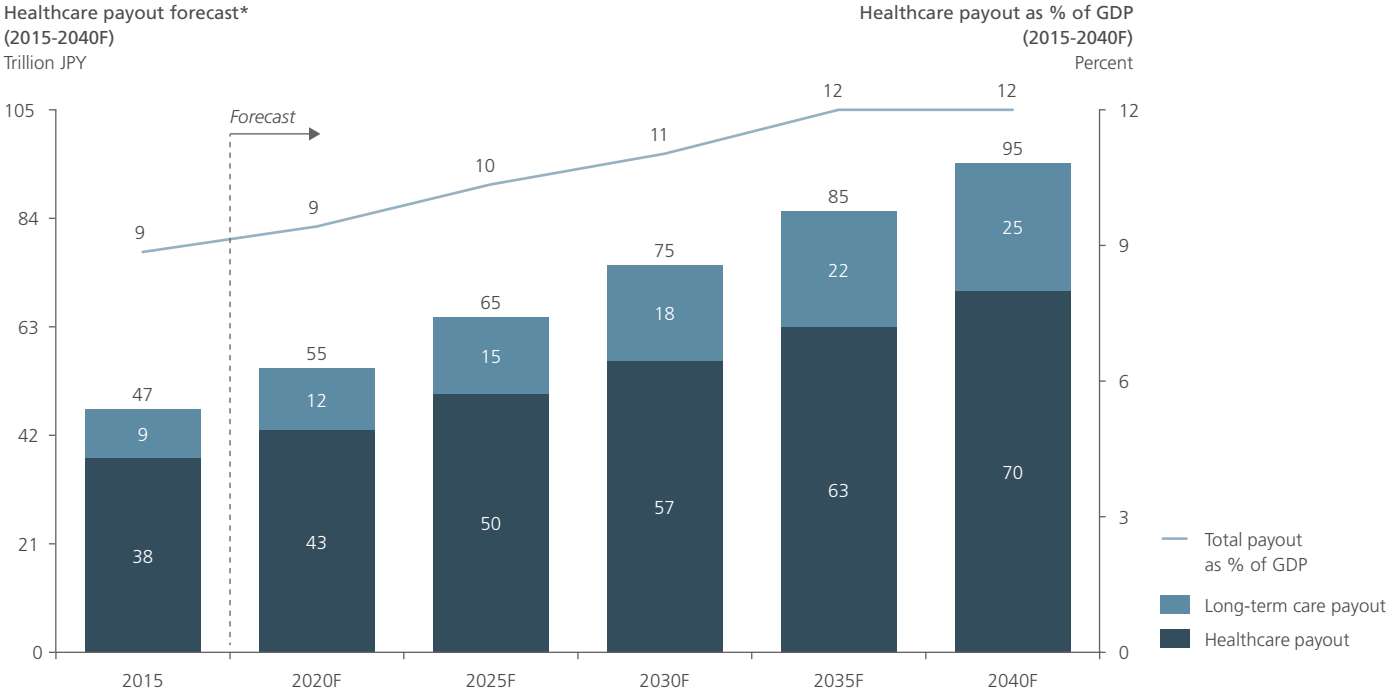
Pressures on Japan's healthcare delivery system

The sustainability of operations at Japanese hospitals (i.e., medtech manufacturers' customers) has come under pressure as a result of broader financial challenges to the country's healthcare system. The primary challenge is Japan's demographic situation. It is already the world's "oldest" nation, and the decline and aging of Japan's population are only going to accelerate over the coming decades. Japan's demographic challenges are being compounded by a rise in public indebtedness and slow economic growth. So while the country's healthcare expenditure is expected to grow rapidly in the coming years, its ability to pay for this growing expenditure is increasingly compromised. (See Figure 1.)

Japan's delivery system is plagued by overcapacity in the acute setting and as such is inefficient and ill suited to the demographic profile of the country. The delivery system is also notoriously fragmented — the country has more hospitals than the U.S. but just one-third of the population. For many hospitals, the resulting low, unpredictable patient volumes lead to operational inefficiencies and — given how difficult it is to achieve procedural mastery in light of such low patient volumes — make variable clinical outcomes likely. The country's delivery system is ripe for reform, and such change is all the more urgent given the financial challenges it is facing.

Meanwhile, Japan lacks sufficient capacity in nonacute settings, which often results in chronic and/or elderly patients being cared for in high-cost acute settings. The result is that, in the face of increasing cost pressure, the country is not well equipped to manage the needs of a rapidly aging population. Yet given the broader financial pressures facing the system, the ability and willingness of the government to prop up the delivery system as it

Figure 1
Forecasted healthcare expenditure in Japan (2015-2040F)

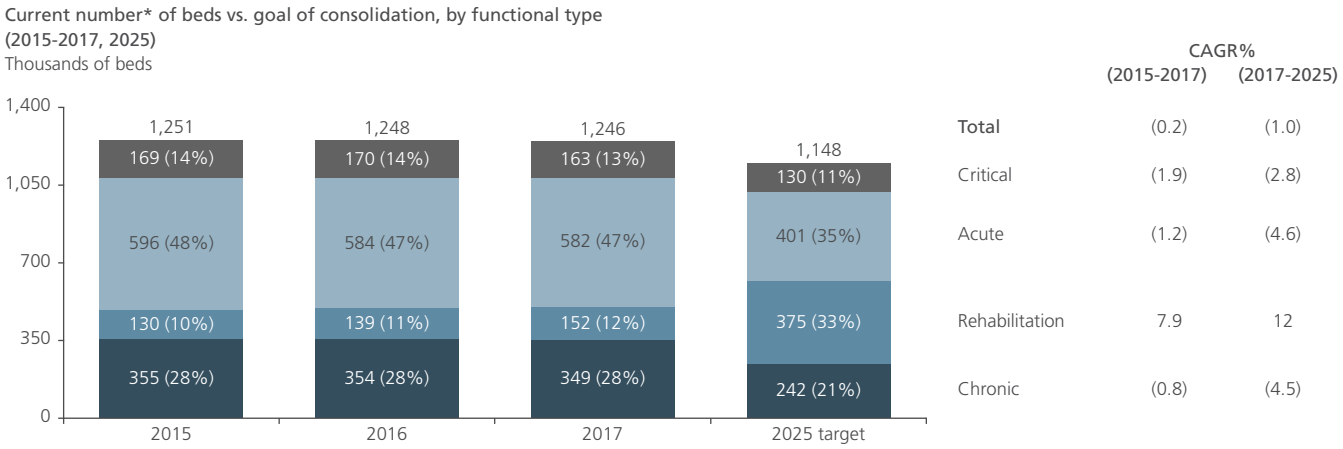


*Healthcare payout represents government spending on healthcare and is not equivalent to the total national healthcare expenditure
Source: Ministry of Health, Labour, and Welfare; Nippon Institute for Research Advancement; L.E.K. research and analysis

currently stands are flagging; instead, the government is trying to both reduce and redeploy capacity. (See Figure 2.)

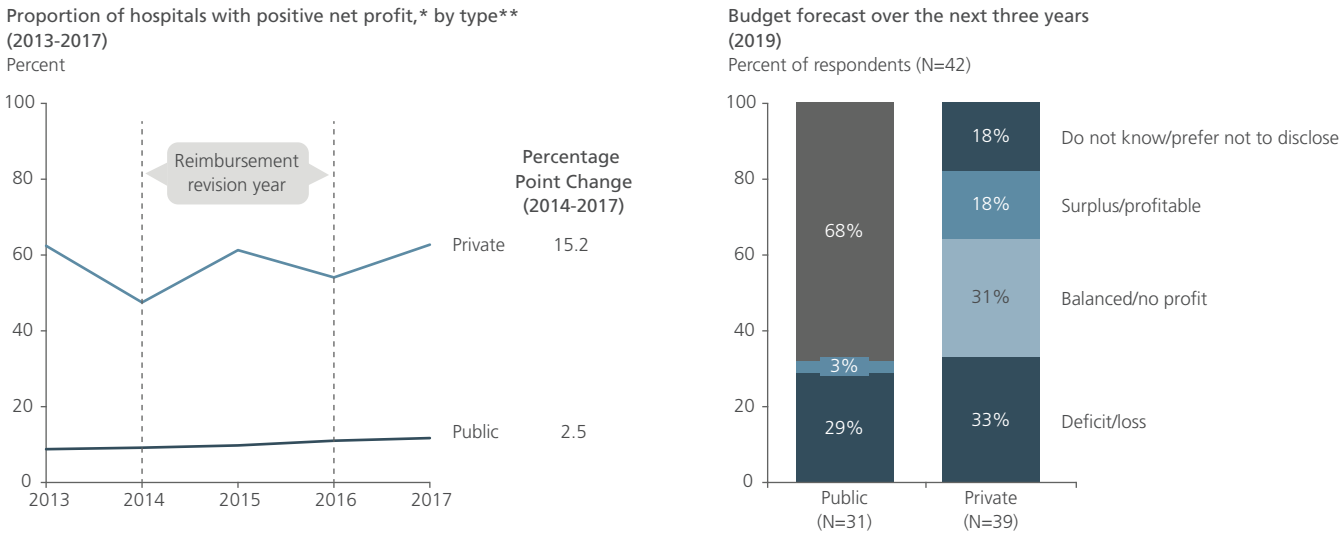
Hospitals are subsequently faced with a monumental task: improving the efficiency of their operations — including right-sizing their acute-care capacity — while pivoting away from acute care to other care facilities. Facilities that fail to streamline and redefine themselves face the prospect of bankruptcy and/or being forced to merge with more sustainable hospitals. (See Figure 3.)

Figure 2
Current number of hospital beds and government targets by 2025



*The number of beds is from MHLW survey results of over 7,000 hospitals and 6,700 clinics that are required to report the number of beds by functional category; the data therefore may not be a full representation of hospital beds in Japan
Source: The Ministry of Finance; MHLW; Nikkei; L.E.K. interviews, research and analysis

Figure 3
Profitability of hospitals in Japan (2013-2017) and outlook for the future (2019-2021)



*Results are derived from surveys and are not a reflection of all hospitals in Japan; subsidies received are removed from the calculation of net profit
**Public hospitals include national and municipal hospitals, privates include medical corporations, and Semipublics include hospitals such as Nisseki and Saiseikai
Source: Japan Hospital Association; MHLW; L.E.K. research and analysis

Evolving customer priorities and a shifting purchase process

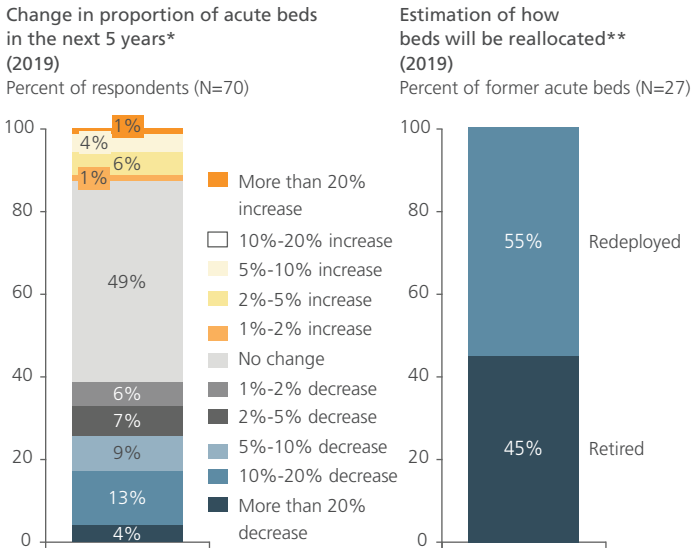
According to the results of our survey, hospitals in Japan are responding to these pressures in a number of ways, notably by:

- Rethinking their strategic priorities
- Shifting the relative influence of stakeholders involved in purchasing, most often away from clinical decision-makers and toward economic decision-makers
- Shifting their purchase criteria
- Using intermediaries for purchasing
- Opening up to new ways of working with device companies

In many hospitals, the prominence of economic decision-makers is increasing and a growing emphasis is being placed on economic imperatives vs. clinical considerations, in terms of overall strategic priorities as well as how purchases are being made. Hospitals in Japan are also putting a strategic focus on reducing and redeploying capacity; nearly half of the hospitals we surveyed expect to see declines in bed numbers. While many of these beds will be retired, a meaningful proportion will be deployed to subacute and longer-term settings. (See Figure 4.) Such efforts are being accelerated by government policies designed to enhance differentiated, community-based care.

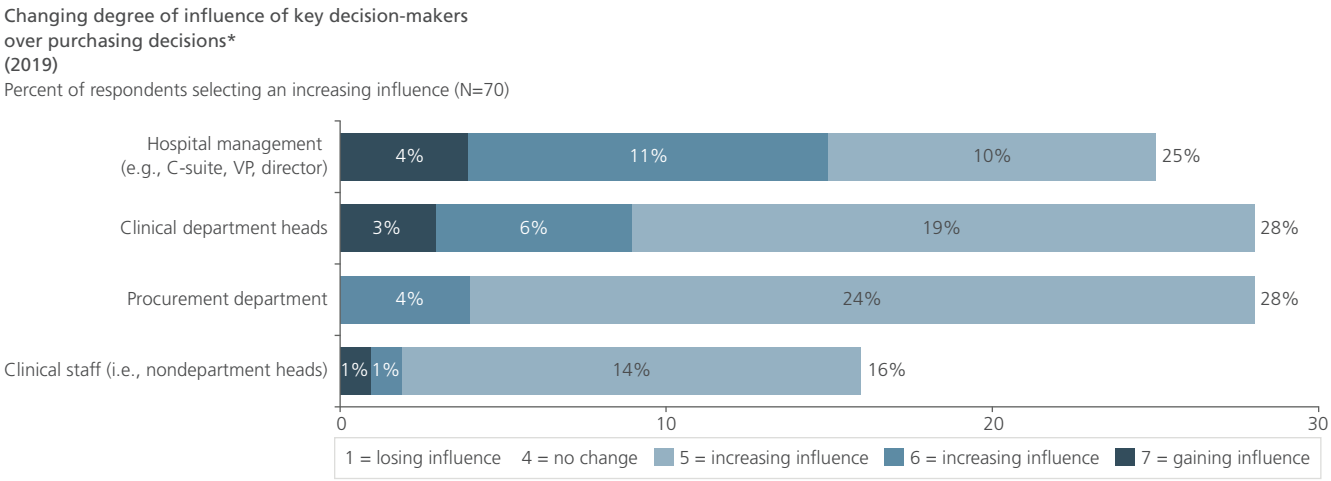
In the meantime, the influence of economic stakeholders is becoming more marked across device types. In the past, the input of administrators was given little credence when it came to decision-making for anything except commoditized devices. Now, in certain institutions, administrators are becoming highly influential across many device categories, save the most innovative ones (highly novel valve repair and replacement devices, cellular therapies, etc.), where clinician primacy still generally prevails. (See Figure 5.)

Figure 4
Planned reduction and redeployment of hospital beds in Japan



*Question: Please estimate the percentage point change in your estimated proportion of acute beds in your hospital in the next five years.
**Question: Please estimate the allocation of how these beds would be retired or redeployed (only for respondents who believe hospitals will decrease in bed count for acute patients).
Source: L.E.K. APAC Hospital Insights Survey 2019

Figure 5
Shifting importance of hospital decision-makers

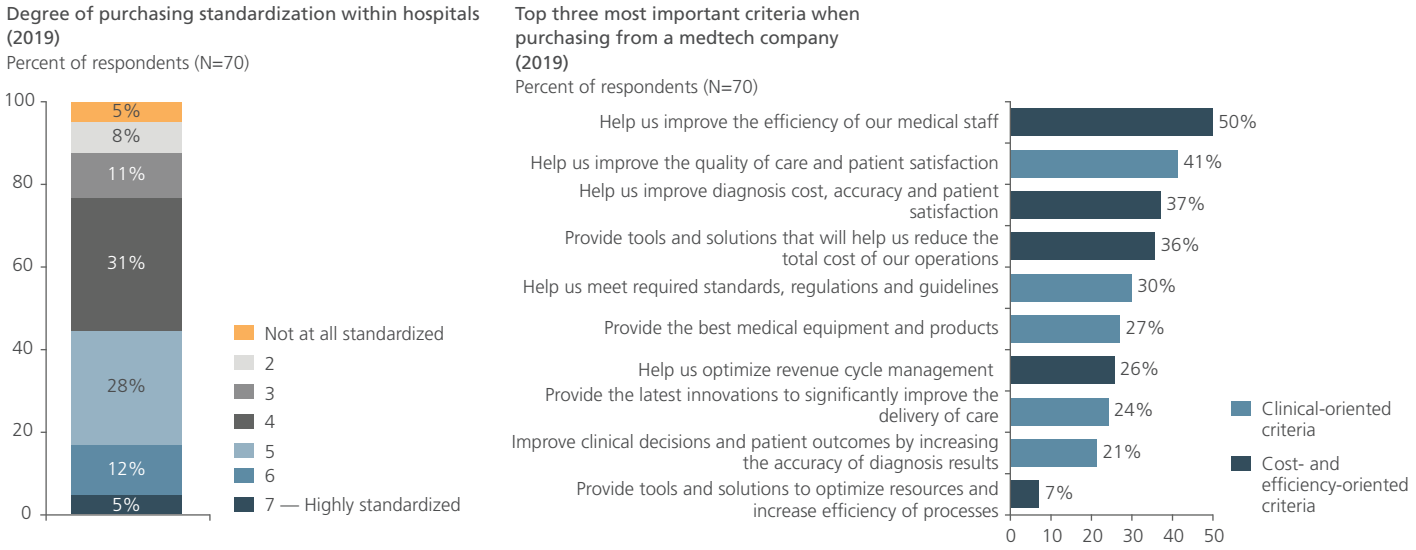


*To what degree is the influence of hospital administrators, clinical department heads and clinical staff (nondepartment heads) changing with regard to purchasing decisions for medical products and services in your hospital? (1 = losing influence, 4 = no change, 7 = gaining influence)
Source: L.E.K. APAC Hospital Insights Survey 2019

According to our survey, when evaluating device purchases, including high-value implantables, economic considerations and standardization are growing in importance. Again, this is not true in highly innovative, novel devices, where clinical considerations and clinician influence are likely to remain paramount. (See Figure 6.)

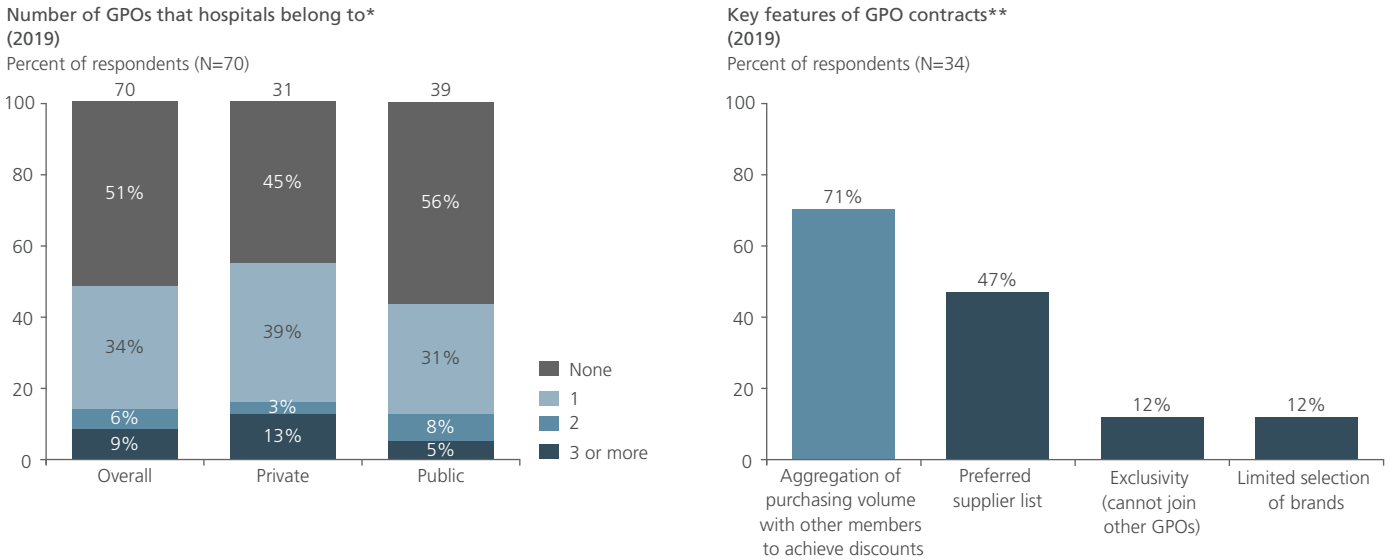
Our survey results also make it clear that hospitals in Japan are increasingly using intermediaries such as group purchasing organizations (GPOs) to build scale in purchasing, resulting in pricing pressures on manufacturers. Approximately half of the hospitals in Japan belong to at least one GPO. (See Figure 7.)

Figure 6
Hospital purchasing standardization and criteria in Japan



**Question: Please indicate the extent to which you agree or disagree with the following statements regarding your hospital's relationship with its medtech suppliers.
Source: L.E.K. APAC Hospital Insights Survey 2019

Figure 7
GPO affiliation rates and purpose of joining GPOs in Japan



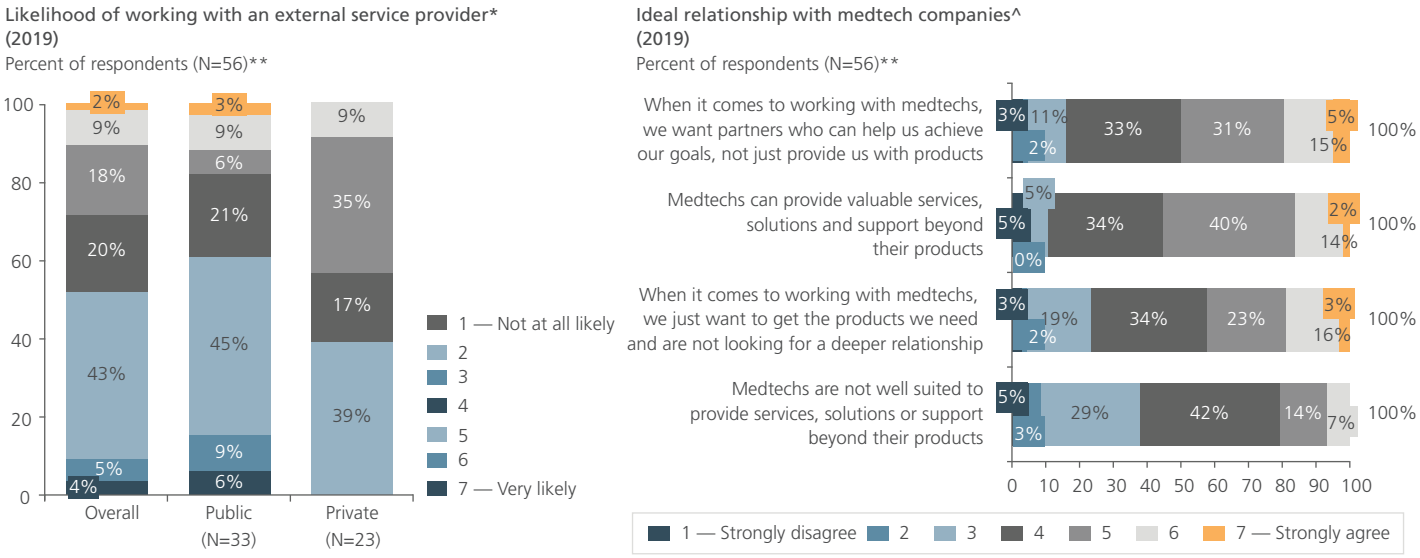
*Question: How many GPOs does your hospital belong to? (only for hospitals in Japan and Korea)
**Question: What are the key features of the GPO contract(s)?
Source: L.E.K. survey analysis

We are also seeing an increasing openness to novel, economically focused value propositions such as deals and risk-sharing agreements, which entail economic wins for both companies and their customers. (See Figure 8.)

Where the rate of change seems surprisingly muted from an outside-in perspective is around the introduction of digital solutions to enhance efficiency and extend nonspecialist capacity. Electronic health records (EHRs), for example, show low penetration, with only modest growth anticipated going forward. (See Figure 9.)

Figure 8

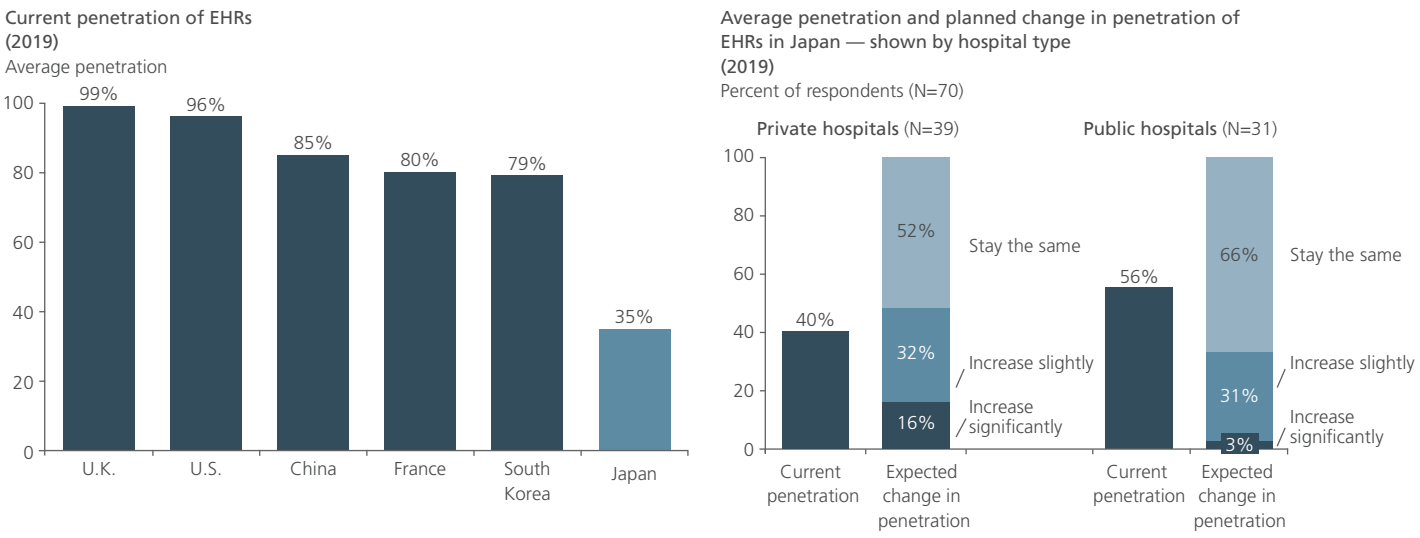
Hospitals' opinions on relationships with external service providers and medtech companies in Japan



*Question: How likely is your hospital to work with external product suppliers/service providers/partners to help address your key needs/priorities? Fourteen respondents responding "I do not know" have been excluded. **Question: Please indicate the extent to which you agree or disagree with the following statements regarding your hospital's relationship with its medtech suppliers (with 1 = strongly disagree and 7 = strongly agree).
Source: L.E.K. survey, interviews and analysis

Figure 9

Penetration of EHR systems and future outlook of adoption in Japan, China and South Korea

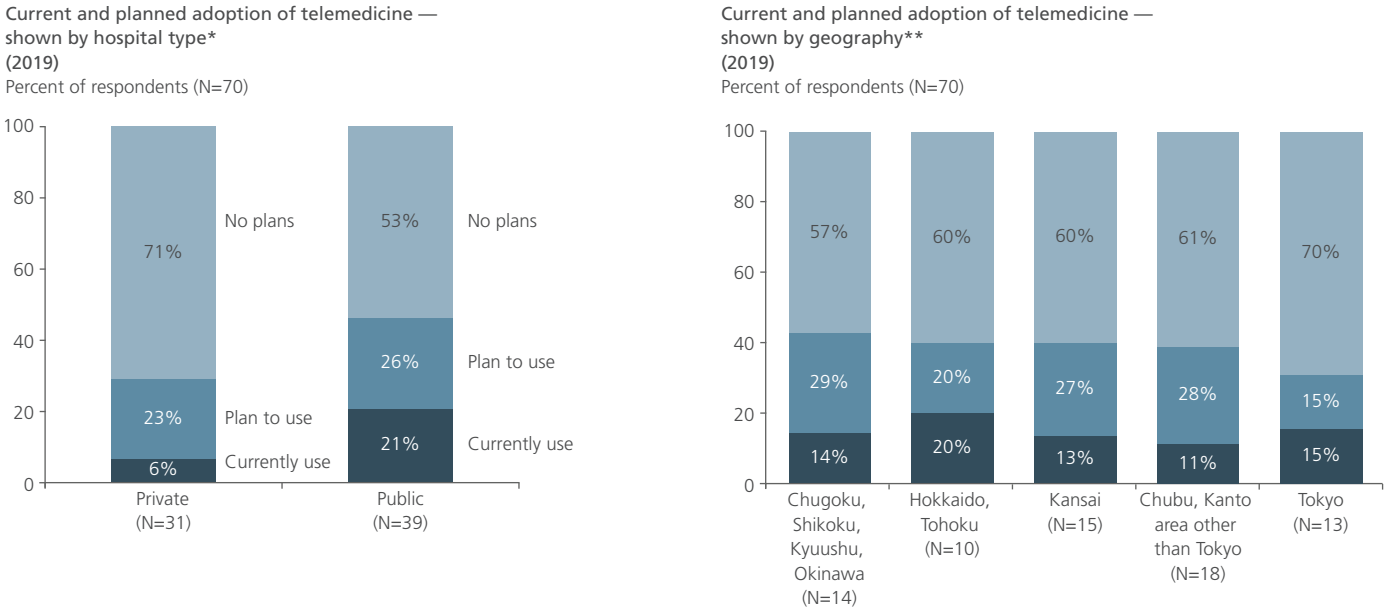


*Question: What is the penetration of EHRs in your hospital? **Question: How do you expect EHR penetration to change in the next three years?
Source: ASCII; HHS; OECD; L.E.K. 2019 APAC Hospital Priority Survey

Telemedicine is also proving slow to take off, partly due to challenges around reimbursability. (See Figure 10.)

As the data suggests, there are significant differences in purchase behaviors across hospitals in Japan. A large proportion of hospitals can now be classified as transactional or economic purchasers, in which administrative stakeholders are highly influential in purchase decisions — even for high-value implantables — and purchases are driven by economic considerations. In the past, we observed more homogenous purchasing behavior largely driven by clinical decision-makers and clinical purchase criteria.

Figure 10
Current and prospective adoption rates of telemedicine in Japan



*Question: Does your hospital/hospital group currently use telemedicine or telehealth (e.g., remote consultation, remote follow-up)? **Question: Do you intend on testing aspects of telemedicine (or telehealth) in your hospital's healthcare delivery system?
Source: L.E.K. 2019 APAC Hospital Priority Survey

How medtech companies should go to market now

As our survey findings reveal, for device manufacturers, the old way of doing things — an exclusively high-touch, clinician-focused sales model covering the full universe of customers — no longer makes sense. A new go-to-market approach that better aligns with the realities of the market is necessary.

Such an approach must start with a detailed understanding of customer purchase behaviors: who the relevant stakeholders are, how they make purchase decisions, and what their needs and engagement preferences are as they move through the process. This understanding should inform a behavior-driven segmentation, which should, in turn, inform how companies address each segment. That includes the channel(s) they use to engage, the content they communicate, how they transact, how they fulfill and their overall value proposition.

When it comes to serving the Japanese market, medtech companies should ask themselves the following questions:

- How are our accounts actually purchasing? How would they like to purchase?
- Which accounts are increasingly economic purchasers? Which ones remain clinically driven? How does this differ across our product portfolio?
- How valuable or potentially valuable is each of our accounts? Which accounts drive disproportionate value to our business? Which accounts are of marginal value?
- What segmentation can we discern by characterizing accounts along the two axes of purchase behavior and value?
- How should we configure our go-to-market model to better suit our customers' needs and preferences? How could we do so by using sales models that are more efficient than the traditional high-touch model? How should we reallocate commercial resources to more rationally reflect the distribution of value in the marketplace?

Medtech companies should also think about how to put in place an organization that is ready to deliver the envisioned go-to-market model. Questions they should consider include:

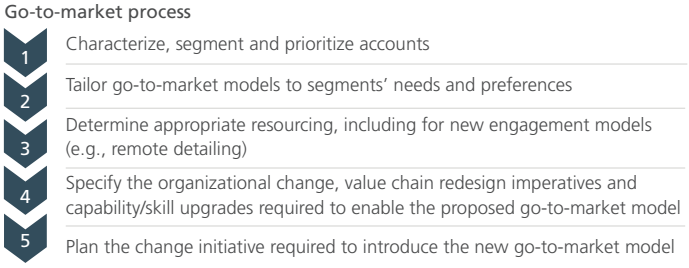
- How should we redesign the organization to enable the envisioned go-to-market model? What might we need to separate? What might we need to combine? How will we redesign incentives?
- How might we need to change the nature of our relationships with value chain partners such as dealers to enable the new model?
- What new skills may be required to engage with economic stakeholders, put together economic value propositions, etc.?
- What new capabilities will we need, especially around the aggregation and analysis of data, to drive the redesign of the go-to-market model and ongoing management of the revamped organization?
- What cultural change might we need to implement? What adversity do we envision necessitating greater collaboration across businesses, greater use of data in decision-making and resource allocation, and a general acceptance that the world is changing and the company needs to change accordingly?

Finally, medtech companies need to evaluate their go-to-market model by the types of accounts they currently have — and those they want to have. Notably:

- For very small accounts, device-makers should reconsider the economic rationale for a sales rep-led model and explore whether their sales resources would be better invested in higher-value accounts, as well as whether requisite servicing levels could be achieved by less resource-intensive sales models, such as remote detailing.
- For economically driven accounts, device manufacturers should assess which stakeholders within these accounts they should be targeting and what value propositions they should be delivering to them. That does not necessarily mean competing solely on price; manufacturers should offer win-win propositions that enable them to gain substantial share and embed themselves in accounts (e.g., through deals and risk-sharing models) while generating meaningful value for their customers.
- For very large economically driven accounts, they should look for opportunities to propose enterprisewide deals that enable substantial market share gains while at the same time locking out any competitors. (See Figure 11.)

Figure 11

Approaches and key considerations for go-to-market change for medtechs in Japan under current trends



The nature and degree of change required are significant, especially in large, complex and often highly siloed device companies. Nevertheless, companies that stand still risk becoming increasingly irrelevant in the eyes of the stakeholders who drive purchasing decisions. In the meantime, medtech companies that fail to embark on this change risk being disrupted by more forward-thinking competitors that are already thinking strategically about — and are bold enough to revamp — the way they go to market.

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