

## Hospitals Adopt New Strategies to Boost Profitability, but Still Face Deep Challenges: A New Imperative for MedTech

Demand for healthcare services continues to rise due to an aging population, rising obesity, higher rates of chronic disease, and expansion of healthcare coverage. Yet for most hospitals, top-line growth is not keeping pace with strong industry headwinds. In the coming years already-low margins will be further squeezed by rising enrollments in Medicare and Medicaid, as well as significant investments in IT and facilities.

To remain viable hospitals are exploring new sources of added value, from integration of care and partnerships with payers, to outsourcing and competitive differentiation. MedTech companies will need to evolve too, working harder to understand their customers' complex business challenges and adopting new models to serve them.

The fourth annual L.E.K. Hospital Priorities Study asked nearly 200 hospital CEOs and senior administrators about major trends in their industry, and how MedTech companies can partner with hospitals to overcome the significant hurdles they face (see Figure 1).

### Hospital Budgets Continue to Expand; Driving Down Costs as Critical as Ever

Our survey shows hospitals expect relatively consistent spending growth over the next five years. More than 60% of hospital administrators expect their budgets to increase in 2013, and fewer than five percent expect a significant decrease.

Investment in IT continues to be the most significant category of spending growth. "Due to the mandate of EMR, 50% of our capital budget is being eaten up by the need for IT," explains a director of materials management from a Massachusetts hospital. Yet EMR adoption is just one driver of IT spending. Hospitals are also relying more heavily on IT-intensive quality metrics for both reimbursement and competitive differentiation.

As in previous years, hospitals continue to show interest in becoming accountable care organizations (ACOs) due to legislation that encourages bundling of payments, even in the face of uncertainty about implementation. In a sign of growing traction behind the integrated model, the number of ACOs jumped 35% from September 2011 to May 2012, and over 80% of surveyed hospitals plan to join or are already in an ACO.

Hospitals indicate the line between hospitals and payers will continue to blur as many hospitals will adopt payer capabilities—12% report they will likely do so over the next five years.<sup>1</sup> Hospitals offering insurance plans hope to gain critical expertise in risk management, and payers are looking for ways to expand profits beyond the reform-mandated caps on administrative fees. This type of vertical integration will take place through partnerships, acquisitions (e.g. a hospital group acquires an insurer, or vice versa), or by hospitals launching their own payer plans.

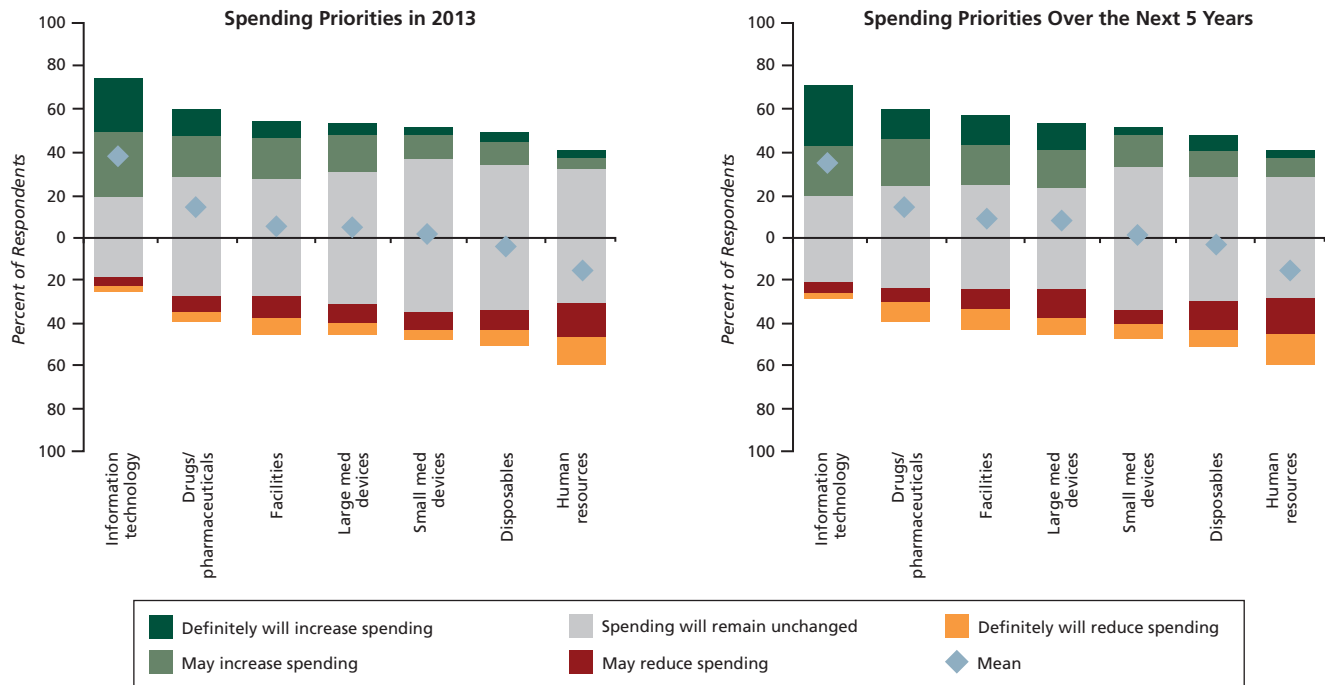
<sup>1</sup> Defined by as a '6' or '7' response on a 7-point scale assessing "likelihood of hospital gaining payer capabilities in the next five years."

*Hospitals Adopt New Strategies to Boost Profitability, but Still Face Deep Challenges: A New Imperative for MedTech* was written by Vice Presidents **Lucas Pain** and **Jonas Funk**. Please contact L.E.K. at [medtech@lek.com](mailto:medtech@lek.com) for additional information.

Figure 1

## Spending Priorities in 2013 and Beyond

Spending on IT, drugs and pharmaceuticals, and facilities at top of spending priorities, and will continue to be an area of focus in the next five years.



Source: L.E.K. Hospital Priorities Study

Hospitals also continue to acquire specialty and primary care physician practices; the move expands hospitals' networks, grows the referral base and shifts care to lower-cost settings. As hospitals grow through acquisitions, they also consolidate purchasing power, which can counter-balance physicians' influence in the purchasing decision. This development is having a significant impact on MedTech companies; hospital administrators and their purchasing departments use more complex cost/benefit analyses to inform buy decisions, rely less upon referrals and physician preferences, and are more likely to ask for clinical and economic data supporting a product's value and price point.

In fact, as hospital administrators take on greater control of purchasing decisions, MedTech representatives are losing influence to group purchasing organizations (GPOs) and distributors. Asked which external parties influence their purchasing decisions, nearly 80% of administrators cited GPOs, 50% cited distributors, and less than 45% named manufacturer's sales reps. Of those three groups, administrators report that MedTech reps have lost the most influence since 2012. As proof of this

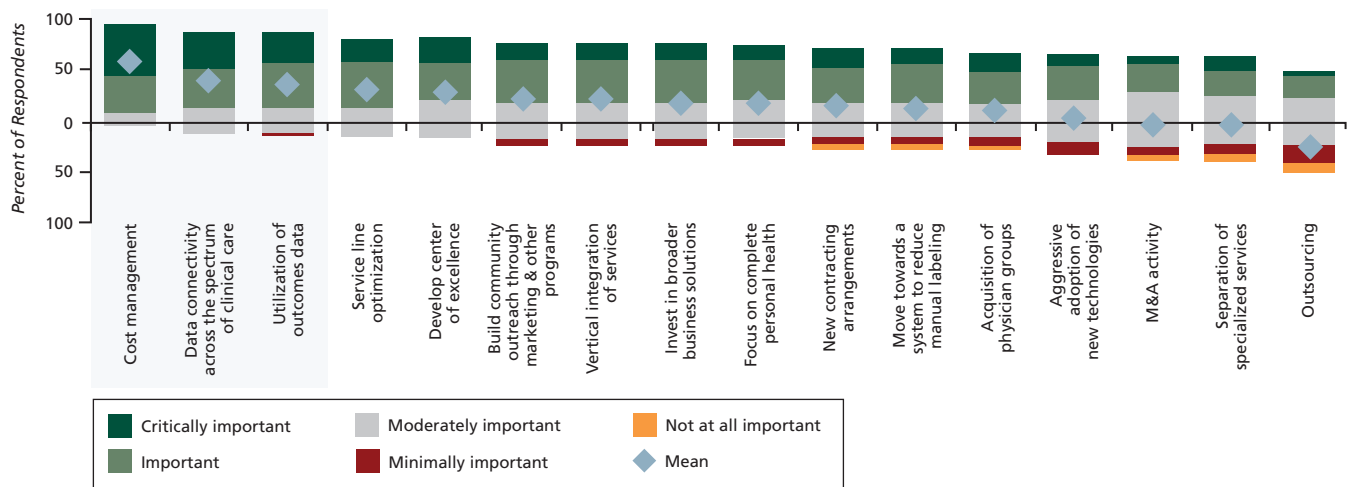
trend, hospitals are actively limiting the access of MedTech sales reps to their physicians and administrators. (See sidebar, "Hospitals Continue to Restrict Access to Decision-Makers."). MedTech companies must take pains to overcome these barriers, moving away from a purely transactional relationship based on negotiating on price with procurement, and instead seek out a broader, strategic relationship with the hospital system, C-level administrators and physicians.

### Beyond Cost Controls, Hospitals also Focus on Top-Line Growth and Differentiation

Hospitals increasingly realize that competitiveness—whether through a differentiated offering, efficiency gains or by growing higher-margin specialties—will be a key source of value going forward. One Illinois hospital CEO explains, "Imaging equipment and anything related to the operating room are a spending priority; we're paid fee for service there. Until we get in a situation where we are reimbursed to control value, the imaging department and the operating room are very profitable places."

Figure 2

## Importance of Initiatives to Hospital Strategic Plan



Source: L.E.K. Hospital Priorities Study

With rising capabilities in technology and electronic records, hospitals have become more adept at leveraging meaningful use metrics, particularly those related to new reimbursement rules (e.g., hospital-acquired infection rates, readmission rates and patient satisfaction scores). Even so, hospitals must now build more robust management metrics (i.e. insights about how their hospitals operate), as well as outcomes and quality metrics that can help them differentiate from their competitors.

Another key strategic imperative: integration of care. The move to an integrated care model is based in part on boosting outcomes and related reimbursements, but hospitals also realize that integrated care drives positive customer experience and hospital differentiation. Even so, an integrated care model is exceedingly complex to develop and deploy, requiring data connectivity across the spectrum of clinical care (e.g. smart devices that support IT integration), better utilization of outcomes data to support reimbursements and payment bundling, and greater collaboration across internal stakeholders on standards of care.

## For MedTech, an Opportunity to Partner with Hospitals

As their business model undergoes profound disruption, hospitals expect MedTech companies to evolve with them. MedTech companies should move away from the mindset of delivering incremental product and cost improvements—those won't satisfy the new regime of hospital decision-makers—and instead

offer broader, more holistic solutions. Product innovation is still critical, but alone will be insufficient for competitive differentiation in the years ahead.

First and foremost, hospital administrators are in the midst of massive data-driven changes and they expect the same from MedTech companies. Hospitals want MedTech companies to provide stronger data and analyses to support purchasing decisions. (For example, approximately 10% of hospitals say MedTech companies are "completely addressing" the need for clinical data that demonstrates better patient outcomes, and only nine percent are "completely addressing" the need for ROI analysis supporting a purchase decision.) As one director of purchasing described, "We want to know if a knee replacement that costs two times as much as a competitor's [...] is actually going to last double the time as the competitor's model." More robust data can also be the basis of value-add offerings, such as a profit-sharing agreement to split the risks and rewards of specific purchases.

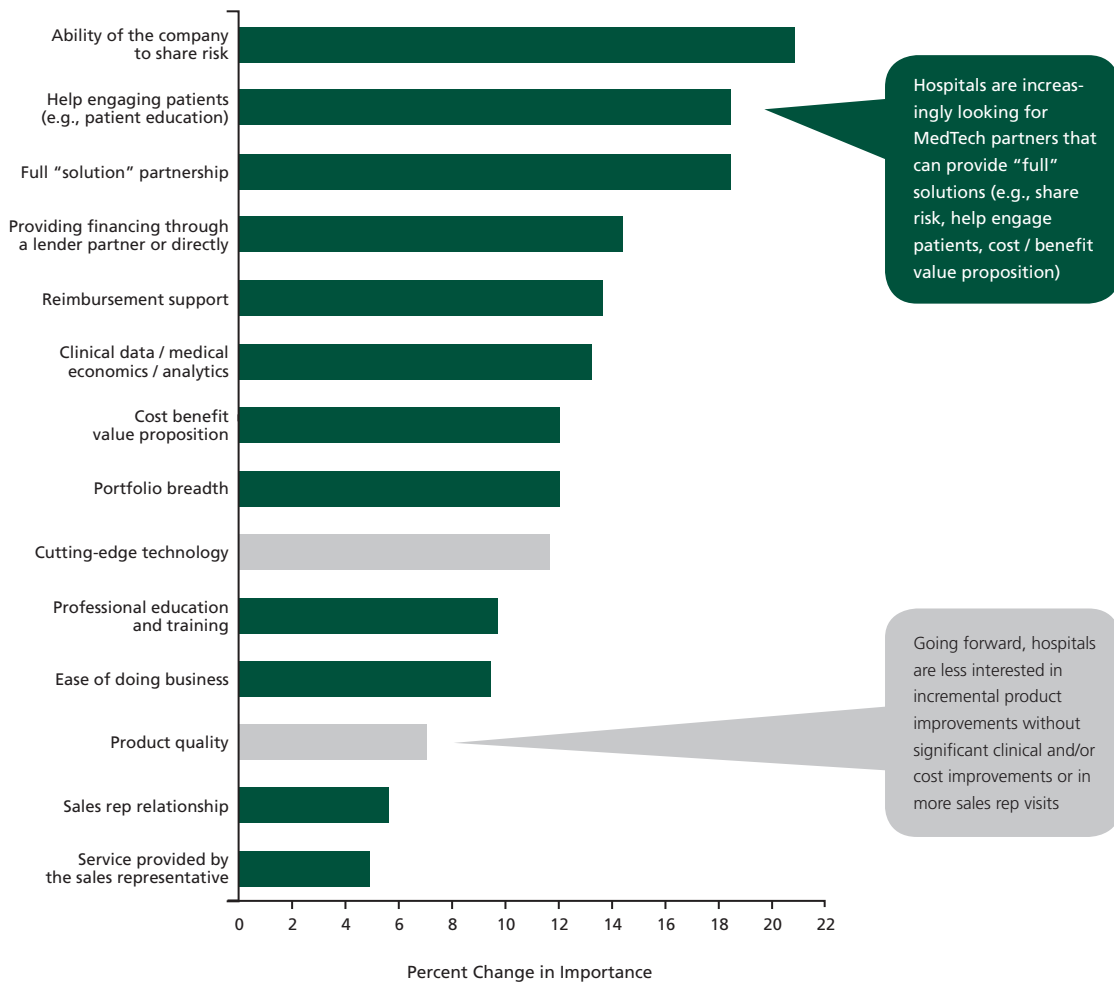
Hospitals will also look to MedTech to provide other add-on solutions, such as helping to engage patients, providing professional education and training, and offering best-practice consulting. Satisfying these needs is no small task. MedTech companies must rethink their sales force size and structure, adding specialized roles in disease management, management metrics, and health statistics and economics.

Hospitals also indicate they prefer a single point of contact to simplify vendor relationships, and it must be a high-quality, beneficial relationship. The MedTech rep must be well informed about clinical and economic data, the full range of products in the portfolio, and the hospital's unique needs. As one hospital CEO described, "It would be great if MedTech companies would take a more coordinated approach and assess our needs before providing their offering. So far, no one is doing this."

Based on our research, MedTech companies have a unique opportunity to help solve hospitals' most pressing problems—and

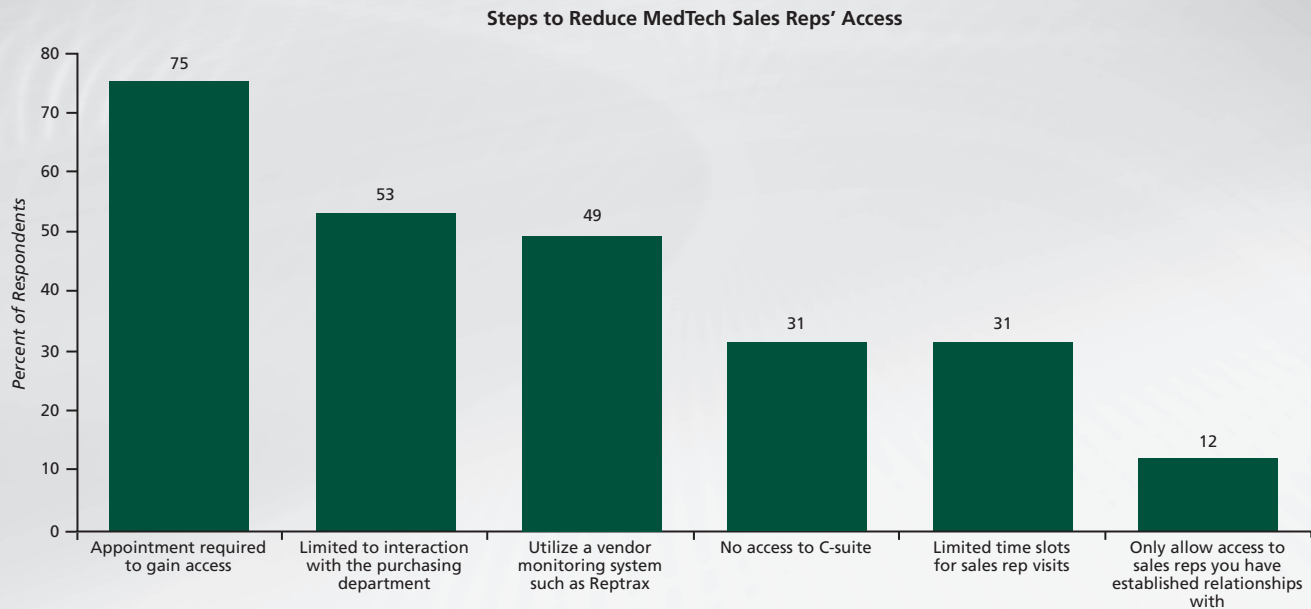
few are doing so effectively. Some have begun to make the required changes to their commercial model, but according to hospitals, MedTech companies still have work to do. Just as technology companies did 20 years ago when they began bundling technology with services, so too must MedTech think more carefully about how to create new 'product + service' solutions that address critical hospital needs. These changes will require investment in and reorganization of the sales force, yet those MedTech companies willing to adapt and innovate will be in a position to offer a highly differentiated approach.

**Figure 3**  
**Expected Change Over the Next 5 Years in Hospital Needs from MedTech Companies**



Source: L.E.K. Hospital Priorities Study

## Hospitals Continue to Restrict Access to Decision Makers. Thoughtful Commercial Response Now Critical.



As most in the industry know, the traditional model of MedTech sales—in which a rep drops in on a physician, unannounced—is on the way out.

- Fully 75% of hospitals now require representatives to make an appointment instead of dropping in. As one CFO described reps' visits, "It is [...] a distraction – to our teams, physicians, and staff."
- 53% of hospitals require reps to interact with purchasing departments only, which effectively takes the purchase decision away from physicians. "We want to see what [MedTech reps are] selling before they get a hold of a doctor who brings it in without our knowledge," said the CEO of Illinois Hospital.
- Just under half of respondents use a vendor monitoring system (VMS) like Reptrax to vet vendors for reputation and credentials.

These measures, plus added security and shortened windows for visits, create an environment in which it's exceedingly difficult for reps to operate and succeed.

On the plus side, MedTech companies and sales representatives have strong opportunities to increase their influence, first through improved account management and client services, and second, through a more coordinated approach to selling. As one director of supply chain management at an Arizona hospital described, reps should be "educated in regards to where healthcare is going and how they can support and enhance it" rather than resist it and create barriers.

The most effective MedTechs will be those who offer broader solutions to hospitals' challenges, such as quantifying the clinical and economic benefits of a product. Going forward, MedTechs must cater to hospitals' imperative to increase efficiency, reduce costs and improve quality of care.

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded 30 years ago, L.E.K. employs more than 1,000 professionals in 22 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns.

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