

Hospitals Rethink MedTech Purchasing Strategies as Budgets Grow

Many hospitals have weathered the economic downturn that forced dramatic spending cuts and are now refocusing on strategic initiatives. Although many hospital budgets are growing, health executives are still scrutinizing purchases and are using multiple channels to procure MedTech products at highly competitive prices.

At the same time, federal healthcare insurance mandates and private payer emphasis on cost controls are placing added fiscal pressures on hospitals. Addressing quality care requirements and reporting capabilities will be pivotal to ensure that hospitals receive high reimbursement rates from insurers. Adding complexity to this issue, hospitals are also being asked to transform their approach to patient care. Specifically, the federal government is providing incentives beginning this year for hospitals to partner with outside caregivers via Accountable Care Organizations (ACOs) to support patient health and wellness beyond physical care facilities.

The L.E.K. Strategic Hospital Priorities Study shows that these healthcare changes present opportunities for MedTech companies that can address the evolving requirements facing hospital executives.

Healthy Outlook for Hospital Budgets

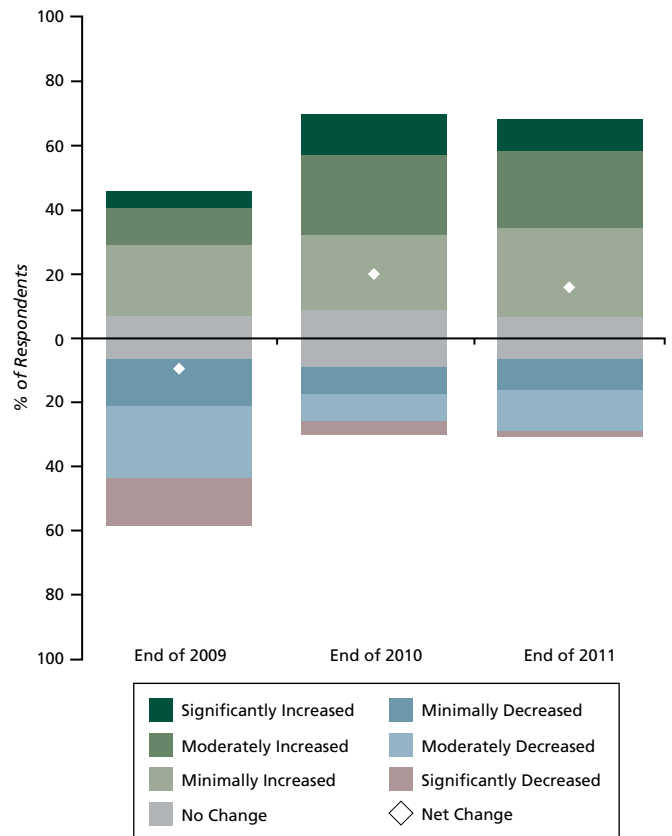
L.E.K.'s third annual survey of nearly 200 senior hospital decision makers shows a projected increase in overall spending

Hospitals Rethink MedTech Purchasing Strategies as Budgets Grow was written by **Bob Lavoie**, Vice President and Head 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.

this year, and continued budget growth forecast during the next five years. More than 60% of hospital executives expect to see budget increases this year – a growth forecast that is nearly double our findings just two years ago (see Figure 1). At the other end of the budget spectrum, only 2% of respondents expect that their funding will decrease significantly in 2012, which is dramatically lower than in 2009 when nearly 14% of respondents were bracing for steep cuts.

Figure 1

Expected Change in Total Spending in Next Year vs. Current



Source: L.E.K. Strategic Hospital Priorities Study

Spending Priorities

The types of patient admissions and medical procedures that hospitals conduct ultimately shape their MedTech needs. In 2011, hospitals continued to see an increase in uninsured admissions, emergency room visits, outpatient surgeries and outpatient visits. And many hospital executives attribute the decline in elective procedures to the weak economy and patient decisions to delay select care due to costs.

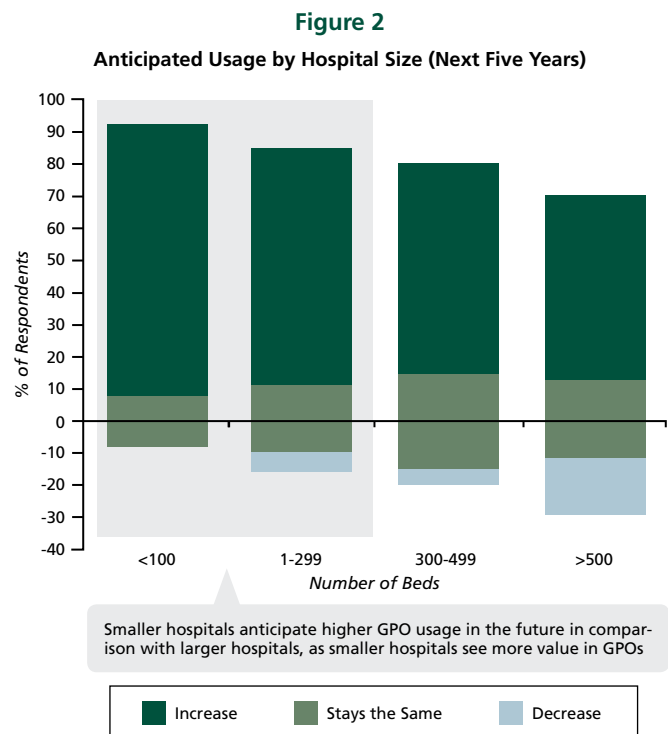
Looking ahead, IT spending is projected to continue its high-growth trajectory through 2016 as care providers continue their implementations for electronic health records (EHR) capabilities. And although many hospitals have extended the life cycle of capital equipment in recent years due to financial constraints, one-third of executives plan to increase their budgets for large medical devices during the next five years.

Infection prevention and reduced medical errors continue to be top-of-mind for care providers, and hospital executives are willing to pay premiums for disposable products that demonstrate an ability to address these issues. L.E.K.'s survey results also reveal moderate purchasing increases in small medical devices, disposables and facilities supplies during the next five years. More broadly, there is an overarching concern that MedTech equipment manufacturers will raise their prices and that health providers will also face increased costs due to regulatory and reimbursement changes (such as the medical device tax).

GPOs Gain Breadth and Depth

Despite the recovery of hospital budgets, 80% of administrators are continuing their aggressive supplier negotiations in an effort to manage costs. To help with continued fiscal discipline, Group Purchasing Organizations (GPOs) are playing an ever-expanding role in MedTech procurement. As one Midwest hospital CFO noted, "Because of the poor economy we're pushing more to buying on GPO contracts....because right now every purchase is heavily scrutinized."

To that point, more than 60% of survey respondents are increasing their current GPO use in 2012, which is up from more



Source: L.E.K. Strategic Hospital Priorities Study

than 50% last year. L.E.K. research also shows that smaller hospitals anticipate greater GPO adoption compared to larger hospitals (see Figure 2). The variety of products that hospitals are purchasing from GPOs is also expanding from low-cost, high-volume product categories with minimal perceived product differentiation to high-cost, low-volume equipment. MedTech companies should foster strong relationships with GPOs and develop strategies to work with this growing market channel.

Hospitals are also trying to increase efficiency by beginning to centralize purchasing of disposables and other categories with commodity-like properties – and away from physicians who have traditionally been the sales targets for MedTech companies. That said, physicians will continue to play an influential role in product selection. One reason driving this change is that a growing number of doctors are trading private practice for salaried hospital staff positions. Hospitals are embracing this strategy to control costs, build out the continuum of care and establish the operational structure required to remain profitable as insurers begin to transition from performance-based reimbursements to a bundled payment structure.

In light of these changes, MedTech companies need to ensure that their commercial sales models reach beyond physician audiences and communicate their value effectively to multiple constituents. This requires dedicated sales teams with tailored programs that resonate with specific audiences (e.g., hospital CFOs, etc.).

Prescription for Addressing Unmet Hospital Needs

Hospital operational priorities include controlling costs, increasing efficiency and improving the profitability of their patient mix. Similarly, patient focus is centered around enhancing care and outcomes (including reduced medical errors and improved infection control). To achieve these goals, an overwhelming majority of hospital executives are reevaluating their systems and processes, and 71% are allocating budgets to address these needs.

Hospital leaders continue to look toward the medical device industry for help. They believe that MedTech companies can support their goals by clearly articulating product cost-benefit value propositions, providing clinical data, sharing risk and offering full solutions. These criteria will continue to grow in

importance for hospitals, along with the continued adoption of innovative products (see Figure 3).

MedTech companies that can package additional services to help hospitals address central pain points and demonstrate added value with patient care, reporting needs for reimbursement and other requirements will be well positioned to succeed in this evolving healthcare landscape.

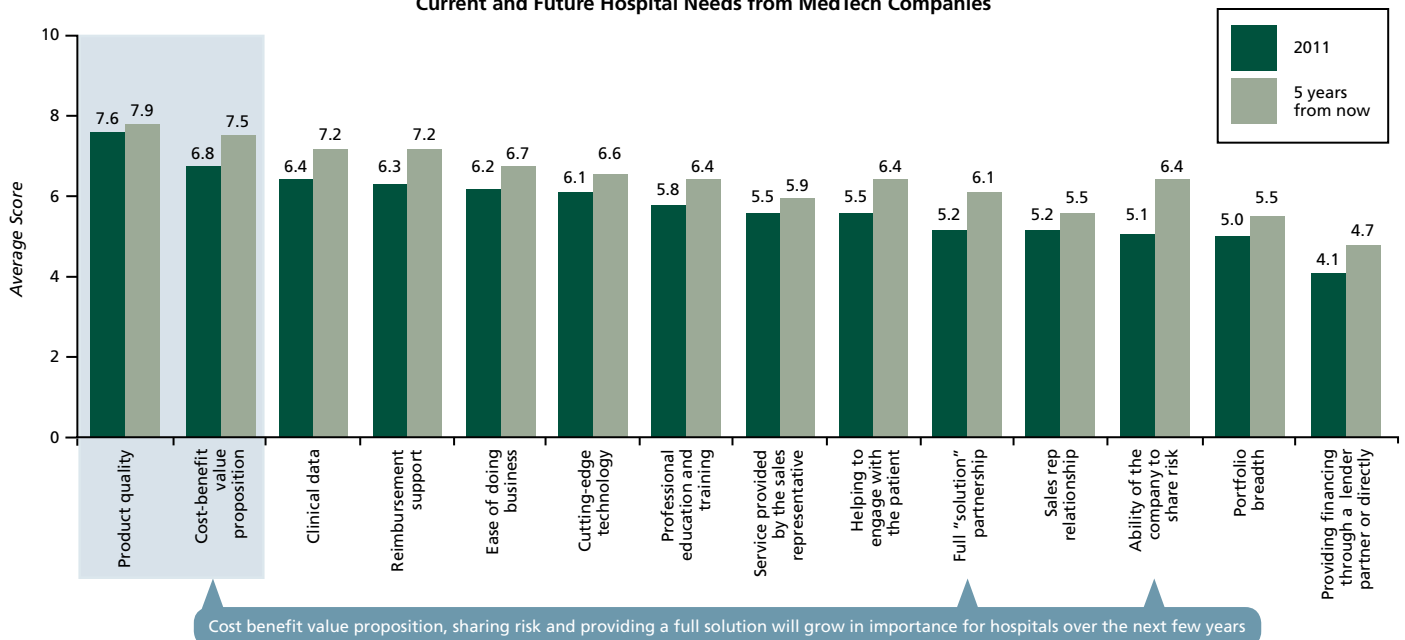
Embrace Customer Excellence

Hospitals are emerging from a fiscal lock-down to revisit many initiatives that were previously tabled or curtailed due to budgetary constraints. Although many strategic initiatives remain consistent with past surveys – such as measuring patient outcomes – fiscal realities and federal mandates are changing how they deliver care. Hospitals are also increasingly centralizing operations to address new reimbursement guidelines and ACO-like models.

MedTech providers need to respond to new market dynamics by evolving from a product-centric mindset to a customer excellence focus that provides solutions-based services that address hospital pain points more holistically.

Figure 3

Current and Future Hospital Needs from MedTech Companies



L.E.K. Strategic Hospital Priorities Study

Elements of this new approach can range from adding services to existing product offerings to developing more cohesive and targeted sales programs that are attuned to C-level hospital requirements, individual physicians and other stakeholders.

As part of this effort, medical device companies that can clearly differentiate how they enhance care quality, measure patient outcomes and play an active role in controlling costs have a clear opportunity to grow share.

Hospitals Use ACOs as a Vehicle to Expand Care

Figure 4
Concerns Regarding ACO Formation



Source: L.E.K. Strategic Hospital Priorities Study

ACOs are designed to provide patients with a greater continuity of care throughout the healthcare ecosystem while controlling costs. In this approach, ACOs would be forged by partnerships among hospitals, other providers and payers to deliver holistic patient care. Because hospitals and integrated delivery networks (IDNs) have the financial resources and operational infrastructure to establish and control ACOs, they will have the greatest opportunity to shape their success. However, running an ACO effectively will require hospitals to shift to a more outpatient-focused, coordinated health framework and take on population risk.

Despite the current ambiguity in ACO guidelines from the Centers for Medicare & Medicaid Services (CMS), hospital executives are preparing to adopt some form of an ACO-like structure in the coming years. Currently, less than 20% of hospitals surveyed are pursuing some form of this new model, while 61% believe that there is a likelihood of ACO participation within the next three years.

Still, many of the fundamental tenets of this healthcare model need to be addressed. More than half of hospital executives surveyed are concerned about how participating hospitals would reduce costs, engage physicians and manage risk (see Figure 4).

MedTech companies should continue to monitor ACO developments, as they could create additional spheres of centralized purchasing as they align hospitals and other care providers more closely. Additional opportunities may emerge for MedTech providers that can provide products and solutions that can quantify improvements in care and superior economic value through the patient care cycle across hospitals, other care providers and home settings.

(Note: for an additional perspective on ACOs, please read L.E.K.'s Executive Insights report titled, Will ACOs Keep Hospitals and Insurers out of Critical Care?)

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