

Hospitals Apply Surgical Precision to Budgets, Brace to Support Healthcare Reform

The fiscal health of America's hospitals has a far-reaching impact on the quality of care that individuals receive and the well-being of the communities that they serve. Although it's well-documented that the healthcare industry has been cutting costs, new L.E.K. Consulting research reveals sophisticated hospital strategies to reduce expenses in targeted areas and simultaneously increase investments in others. The L.E.K. survey also reveals how hospital executives have been preparing to address the impact of new healthcare insurance reform.

The L.E.K. Hospital Purchasing Survey¹ provides insight into budgeting trends that span all hospital operations and impact specific departments. The evolution of hospital purchasing decisions reveals important opportunities and ramifications for the companies that serve the hospital community – medical device and life sciences companies, hospital equipment manufacturers, healthcare service providers, and information technology (IT) vendors.

Examining Financial Challenges

L.E.K.'s survey of more than 200 senior hospital officials indicates that medical care organizations across America have been struggling with constrained budgets. Hospitals have faced decreased spending during the last year, and facilities with more than 500 beds have been hit the hardest. While the financial challenges facing hospitals vary, commonalities in cost abatement include workforce reductions and delays in capital equipment purchases.

Department budgets are being pared according to their strategic value to hospitals, as administrators see select departments as pivotal to distinguishing themselves in an increasingly crowded healthcare market. In fact, 76% of respondents believe that hospital differentiation is important, and a key strategy to increasing revenues. This broad notion of differentiation typically incorporates activities including outsourcing, separation of specialized services, mergers and acquisitions (M&A), and a focus on complete personal health.

But not all hospital functions are being scaled back. Looking ahead, the executives that L.E.K. reached are cautiously optimistic that their budgets will increase to support targeted growth opportunities during the next five years. A significant portion of additional revenue is expected to stem from the federal government to support new healthcare reform and ongoing initiatives such as electronic health records (EHR) implementations.

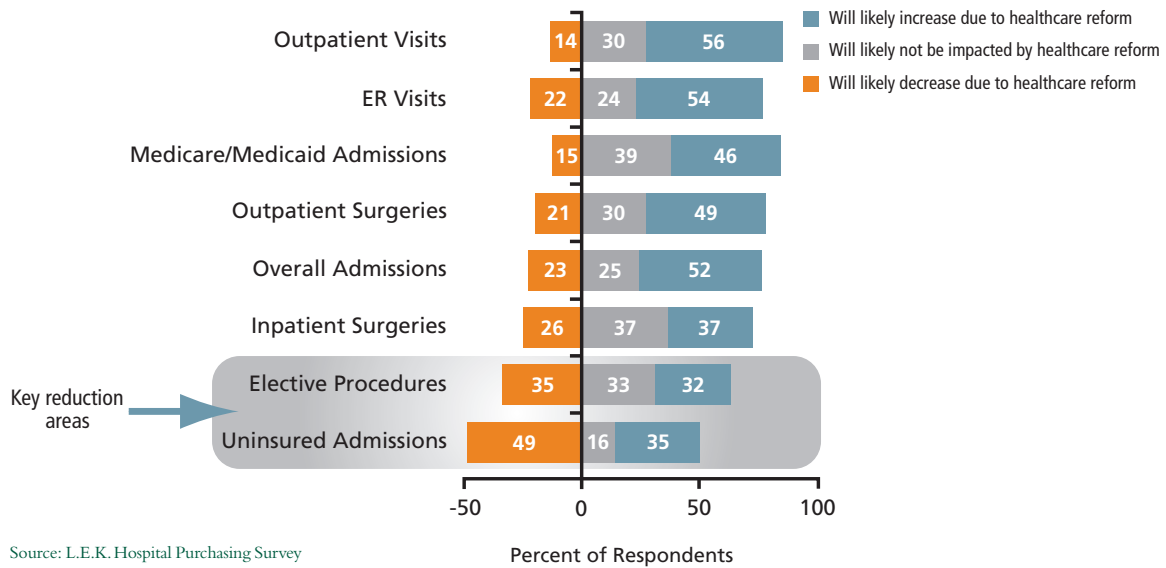
Similarly, new federal mandates – and a focus on hospital differentiation – are key drivers for administrators to protect their patient safety programs.

¹ L.E.K. Consulting surveyed 203 senior hospital executives in January 2010 across the United States. The executive decision-makers that L.E.K. surveyed include CEOs, COOs, CFOs, material managers and purchasing directors.

Hospitals Apply Surgical Precision to Budgets, Brace to Support Healthcare Reform was written by **Bob Lavoie**, Vice President and Co-Head of L.E.K. Consulting's global MedTech practice; and **Lucas Pain**, Vice President at L.E.K. Consulting. Please contact L.E.K. at medtech@lek.com for additional information or to schedule a meeting to review the full report.

Figure 1

Healthcare Reform Implications – Projected Shifts in Types of Hospital Care



Bracing for Healthcare Reform

While Congress and Americans were actively debating changes to the U.S. health system, hospital executives were establishing broad contingency plans to address new government mandates, and forecasting how legislative changes may impact hospitals.

Key insights include:

- Hospitals see healthcare reform leading to an increase in overall admissions, but predict a decline in many elective procedures
- More than 90% of respondents believe that healthcare reform will drive increased IT spending
- Senior executives believe that the replacement of existing capital equipment and/or medical instruments is a catalyst for increases in current and future spending

Strategic Spending Priorities

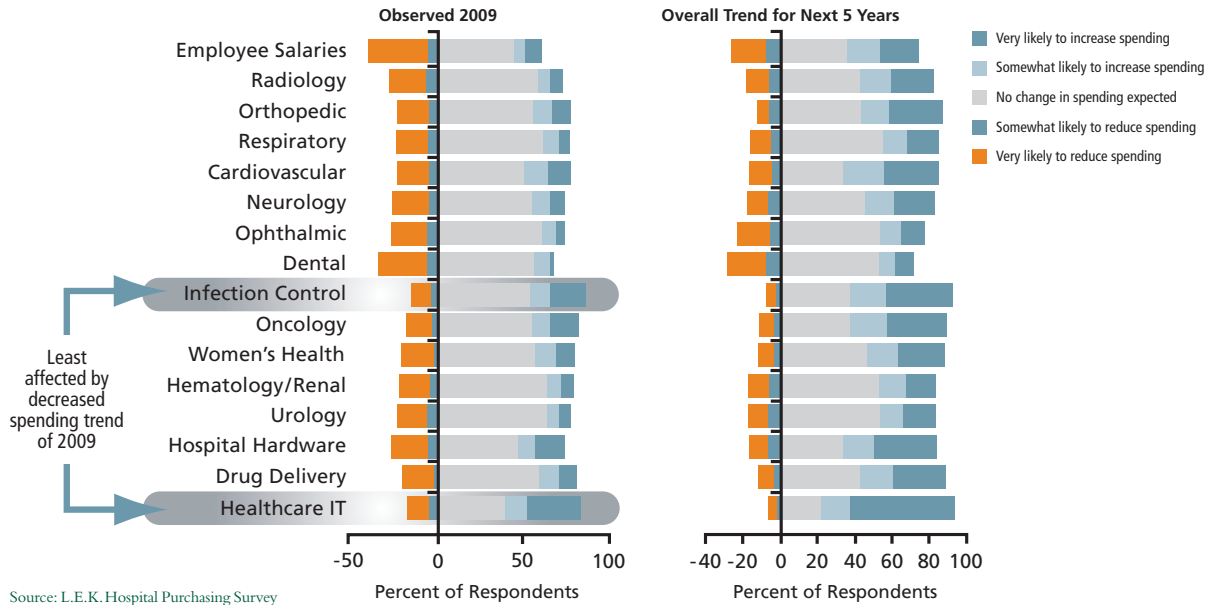
It is important for companies serving the healthcare industry to understand hospitals' collective operational priorities and budget strategies. Vendors and partners that provide the greatest value toward key hospital pain points have the strongest opportunity to expand their relationships with healthcare facilities.

L.E.K.'s research shows that hospitals are protecting patient care-related budgets while also reducing expenses in less essential areas. Key findings include:

- Almost all respondents indicate that patient safety, infection control and patient error initiatives will not be cut
- Supplies, large purchases and investments that are unlikely to generate significant short-term returns are more likely to be reduced or delayed
- In the past year, hospital executives have utilized multiple strategies to address budgetary pressures, including:
 - More than 80% are pursuing more aggressive supplier negotiations
 - 70% are delaying facility upgrades
 - 65% report freezing their capital equipment budgets or conducting more aggressive payer negotiations
 - 58% are delaying instrument replacement, laying off staff or instituting hiring freezes
- 61% are making focused budget cuts in specific departments

Figure 2

Hospital Spending Changes During the Next Five Years



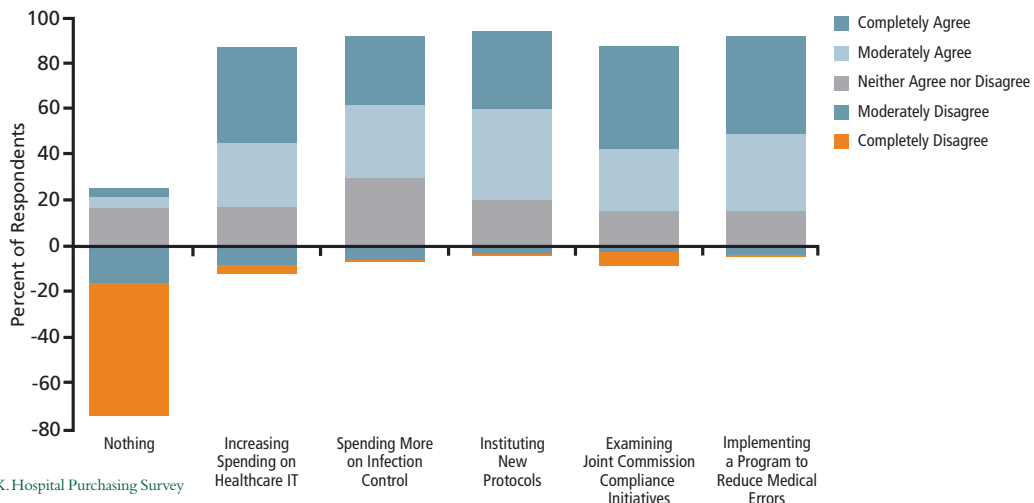
The L.E.K. Hospital Purchasing Survey also identified hospital spending changes in 2009, as well as projected budget adjustments during the next five years. As Figure 2 shows, the following hospital categories have the highest budget growth potential: cardiovascular, health IT, hospital hardware, infection control and oncology.

Safety First

A focus on patient safety is integral to a hospital's strategy to expand its reputations in select specialties – despite the current financial constraints. Hospitals of all sizes are committed to reducing errors and infection rates, and more than one-third of respondents are willing to increase spending by 10% or more to do so. Figure 3 below outlines hospital investment areas in patient safety.

Figure 3

Examining Patient Safety Spending Priorities



Vendor Ramifications

The trends identified in the L.E.K. Hospital Purchasing Survey have a sweeping impact on all sectors of the economy. Specifically, L.E.K.'s analysis found several implications for the healthcare market segments, including:

MedTech Companies

- Devices that address unmet needs such as infection control or patient safety may be able to command premium pricing if they can demonstrate clear value
- Devices for outpatients are more likely to have growth potential than other applications
- Medical devices that address elective procedures are more likely to be negatively impacted by healthcare reform

Life Sciences Companies

- Diagnostic products suppliers may see opportunities with departments and functions targeted for growth – including cardiovascular, infection control and oncology
- Cost is a pervasive issue across all budgetary line items, and hospital suppliers must be able to offset premiums with quantifiable advantages
- Drug companies must be keenly aware of the potential threats and opportunities associated with MedTech substitutes and complements

Hospital Equipment and Supply Manufacturers

- Due to budgetary pressures, hospitals continue to delay large capital expenditures
- Hospital purchasers across departments have been engaging in more aggressive supplier negotiations, which could reduce manufacturer prices for hospital equipment and supplies
- Because budgetary pressures are expected to ease during the next five years, hospital equipment/supply manufacturers could grow through increases in procedures

Healthcare Service Providers

- Service providers that support positive patient outcomes have an opportunity to expand their existing hospital engagements
- As hospitals focus on differentiation, senior administrators will turn to third-party providers that can bring unique capabilities and scale seamlessly to address changing hospital requirements
- Service providers that address specialized needs – including pharmacy compounding and related services – are well positioned for future growth, as these areas are considered important by hospital purchasers

Healthcare IT

- Healthcare IT is one of the key areas where hospitals have been increasing spending, and most decision-makers expect to increase their investments through 2014
- More than 90% of hospital purchasers believe that healthcare reform will lead to increased IT spending, as the need for physician order entry and EHR increases
- Healthcare IT can also enhance patient monitoring and safety initiatives, which further supports the expectation of increased spending in this area

Key Takeaways

- Although most hospitals expect further budget cuts in 2010, executives are cautiously optimistic that budgets will increase and afford targeted growth opportunities during the next five years
- Federal programs are expected to support and extend current initiatives (such as EHR), through additional hospital funding
- Hospitals see federal healthcare reform leading to increased overall admissions, but many believe that elective procedures will decline
- Budget pressures have led to more aggressive negotiations with suppliers and payers, delays in facility upgrades, capital expenditure freezes, longer equipment replacement cycles, and staff reductions

- Budget reductions are generally not even across departments, and departments that hospitals deem strategic will maintain their budgets, and potentially grow during the next five years
- Virtually no respondents have cut their infection control budgets in 2009, and spending maintenance or growth is projected in the future
- Most respondents have maintained or grown their IT spending and expect to increase spending during the next five years
- Going forward, future spending is expected to be driven by adding or replacing equipment and procedural volume
- Top unmet hospital needs include achieving competitive differentiation, increasing patient safety and improving patient outcomes
- Priority strategic initiatives include outsourcing, separation of specialized services, M&A activity and a focus on complete personal health

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 more than 25 years ago, L.E.K. employs more than 900 professionals in 20 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. For more information, go to www.lek.com.

For further information contact:

Boston

28 State Street
16th Floor
Boston, MA 02109
Telephone: 617.951.9500
Facsimile: 617.951.9392

Chicago

One North Wacker Drive
39th Floor
Chicago, IL 60606
Telephone: 312.913.6400
Facsimile: 312.782.4583

Los Angeles

1100 Glendon Avenue
21st Floor
Los Angeles, CA 90024
Telephone: 310.209.9800
Facsimile: 310.209.9125

New York

650 Fifth Avenue
25th Floor
New York, NY 10019
Telephone: 212.582.2499
Facsimile: 212.582.8505

San Francisco

100 Pine Street
Suite 2000
San Francisco, CA 94111
Telephone: 415.676.5500
Facsimile: 415.627.9071

International Offices:

Auckland
Bangkok
Beijing
London
Melbourne
Milan
Mumbai
Munich
New Delhi
Paris
Shanghai
Singapore
Sydney
Tokyo
Wroclaw