OCTOBER 17, 2018
Vol. 5, No. 14

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Three Strategies to Avoid Medical Device Commoditization

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Value-based care demands medtech companies transform the pathways, not just the products.

Healthcare isn't just changing. It's changing in more disruptive ways than ever before. Value-based reimbursement is inverting service lines from profit centers to cost centers. Health systems — bigger than ever after a decade-long buying binge of hospitals and practices— are now aggressively standardizing products, processes and partners to achieve economies of scale and clinical integration.

This is a wake-up call for medtech companies that innovate incrementally. They're now realizing that their business models can no longer sustain historical price margins. As we conduct win/loss market research interviews with selection teams that recently have made technology purchases, more than 60% chose the lowest-priced proposal. Many simply are not seeing differentiation or added value beyond "low price."

That's the definition of commoditization. And it's a seismic force that's driving medtech companies to completely rethink how they innovate, engage with customers, and articulate their value. The urgency for premium brands is greatest of all. Brands must decide whether to sacrifice margins to grow or maintain share, or sacrifice share to grow or maintain margins.

Here are our top three strategies for medtech companies to create greater value and ward off commoditization.

STRATEGY #1:

Vertical Integration by Leveraging a Deeper Portfolio

Forward-thinking companies are vertically integrating their portfolios within a service line (e.g., the clinical lab, imaging, orthopedics, operating room and the cath lab) and/or within a product category (e.g., knee/hip implants). Many of these products could be considered by customers to be commodity items. Yet by leveraging a deeper portfolio, the greater the hospital spend that can be captured becomes. And the greater the captured spend, the bigger the credit or rebate back to the hospital at the end of the year—a win-win for all.

For example, **Medtronic plc** sports the deepest vascular portfolio. With cardiovascular, peripheral vascular and neurovascular products, they can support the large majority of a cath lab's product needs. If the cath lab standardizes with Medtronic's portfolio, it could expect a sizable rebate at the end of the year as a percentage of overall spend.

Similarly, in orthopedics, companies like **Stryker Corp.** and **Smith & Nephew PLC** have deep portfolios of knee and hip implants, arthroscopy and sports medicine/trauma fixation. If a hospital or health system standardizes 80%-90% or more of their hips and knees with one of these companies, they could receive a credit at the end of the year to be used toward purchases of arthroscopy and or fixation systems. One health system administrator we interviewed was very proud of their orthopedic contract. They realized "free" arthroscopy systems at each of their hospitals by standardizing their hip and knee spend with one company.

Benefits of vertically integrating within a service line:

- Enables significant service line cost savings to the bottom line
- Requires minimal changes to the company sales and marketing model
- Requires minimal changes to existing customer processes
- Empowers the company to build strong relationships in the service line
- Locks out the competition for the duration of the contract

Challenges of vertically integrating within a service line:

- Requires very strong marketing of the company brand, since a strategy like this is creating a long-term corporate partnership
- Doesn't help reduce overutilization of products whose added cost may offset the annual rebate
- Doesn't necessarily incentivize better clinical outcomes
- If discounting is sizable enough, even the winners can lose, as profits can be so slim that there is much less available to fund R&D

STRATEGY #2:

Vertical Integration with Value-added Services

As healthcare systems move to centralized purchasing departments, the nature of the supplier partnership has become increasingly important. Companies that seek new ways to differentiate at the product or portfolio level are finding success with value-added services after the sale.

Royal Philips has packaged clinical workflow consultation with its traditional imaging and monitoring systems into a managed services model that optimizes the usage of its technology in verticals such as radiology, cardiology, oncology and neurology (e.g., the "ologies"). Expert consultants drive change management initiatives to realize unprecedented improvements in efficiency that health systems could not realize on their own.

By expanding from a "Big Iron" company to a clinical transformation company, Philips is beating larger competitors by creating added value *(see Figure 1).* In 2015, Philips signed a multi-year, $500 million contract with Westchester Medical Center Health Network. Since then, other health systems have followed.

Benefits of value-added services:

- Addresses critical business needs beyond the technological
- Incentivizes companies to redefine the value of partnership
- Redesigns or eliminates inefficient workflows
- Fuels proper utilization of products and resources
- Increases patient throughput without corresponding increases in resourcing
- Supports long-term contracts; locks out the competition for the duration

Challenges of value-added services:

- Requires that new consultation skill sets be added to the portfolio
- Requires a change from marketing and selling *products* to marketing and selling *problems*—and how the partnership can *solve* them
- Requires very strong marketing of the company brand, since a strategy like this necessitates creating a long-term corporate partnership
- Usually sparks internal company debates as to whether the product or the consulting is the valued differentiator

STRATEGY #3:

Horizontal Integration

Reimbursement is changing how health systems look to partner with medtech companies. Two of the biggest challenges are bundled payments and readmission penalties. A primary strategy to manage these challenges is to integrate care horizontally.

There are two types of horizontal integration: across an episode of care (e.g., knee replacement) and across an entire disease state (e.g., heart failure, diabetes, etc.).

Episode of care integration: Capitated episodes of care, like the Comprehensive Care for Joint Replacement (CJR) model for knee arthroplasty, require a broader focus. It goes beyond the implant cost or a physician's surgical technique to *all* aspects that contribute to a successful outcome, up to 90 days post op. For a medtech company to compete, it will require the integration of products, services, data analytics, education and expertise throughout the entire episode of care. Medtechs will have to help surgeons engage their patients and keep those patients engaged throughout their entire rehabilitation and recovery. They will have to expose themselves to financial risk—a true pay-for-performance model.

Companies like **Johnson & Johnson**'s **DePuy Synthes** and Stryker are well-positioned to support the 90-day horizontal care journey with formal programs that integrate various portfolio items that may include data analytics, implants, robotics, navigation, sutures, dressings, patient education, coaching, and monitoring. Company representatives will be present for every

Figure 1

Service Line Optimization

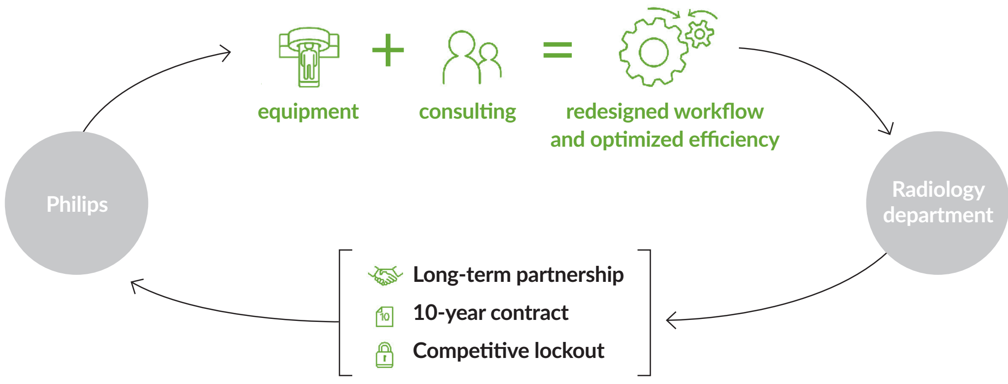


Figure 2

Bundled Episodes of Care

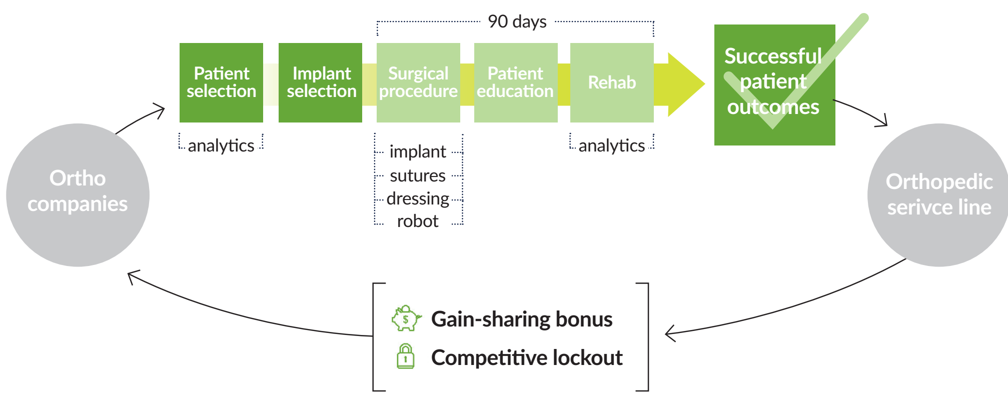
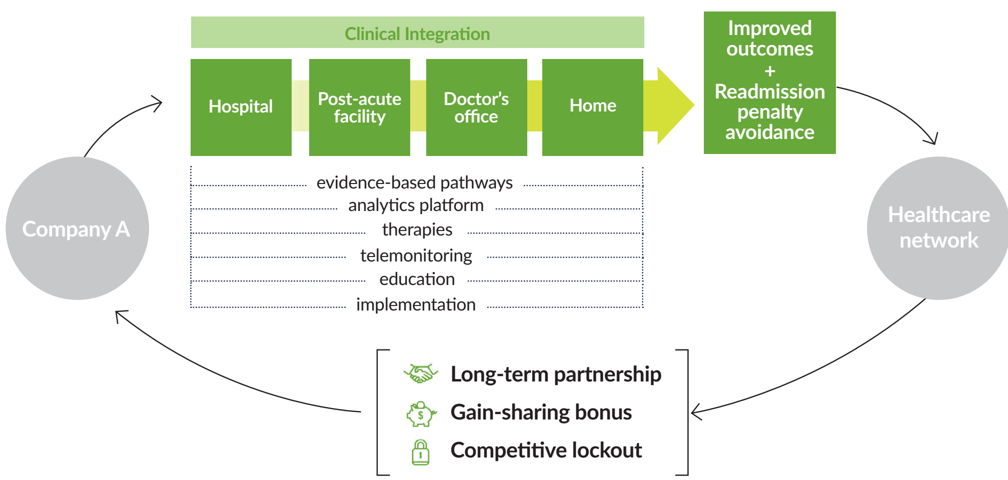


Figure 3

Care Model Redesign



Source: VIVO

case to ensure the proper use of their bundled solutions and are included in tracking the patient during recovery. The solution will be sold at reduced cost, with the ability to earn back margin for a successful outcome (*see Figure 2*). It may also cover the supply cost of a revision, if needed, within the 90-day window.

Disease-state integration: Thirty-day readmission penalties are expected to extend to 60 and 90 days. Health systems are largely shouldering these penalties rather than preventing them. However, this is beginning to change, as penalties and uncompensated care increase and clinical outcomes remain stagnant. Health systems are widening their focus beyond the hospital to the horizontal management of disease across *all* disease stages and *all* settings, including the home.

As patients transition across care settings, they often fall into care gaps where their disease worsens and they reappear in the emergency department with a costly exacerbation. Unless health systems integrate care to close the gaps, the cycle will continue. As health systems have limited ability to clinically integrate on their own, they need to partner with Industry to fully achieve it.

Medtech companies that can help drive more clinically integrated care by integrating IT systems, best practice care pathways, therapies, telemonitoring and patient engagement will be in position for a health system to standardize with them *for an entire disease state.* This reward is not just through the purchase of their solutions but in the sharing of financial gains. Furthermore, they can secure competitive lockouts and marketing opportunities.

For example, in cardiology, Company A is working to further affect patient outcomes and reduce the overall cost of care, with an end-to-end heart failure management solution. It provides an analytics platform, evidence-based pathways, and therapies that are connected to a telemonitoring system that can strategically deploy resources to intervene prior to an exacerbation. Since this is essentially a new care model, Company A would help implement the solution and train care providers and staff (*see Figure 3*).

Benefits of horizontal integration:

- Implementation and standardization of clinical best practices
- Closes gaps in care with clinical integration
- Improves diagnosis
- Reduces the number of readmissions/penalties
- Enhances overall patient health
- Documents cost savings and better clinical outcomes

Challenges of horizontal integration:

- Requires expertise outside of many companies' comfort zones—like consulting, IT, care redesign, and new service lines
- Requires wholesale cultural change—from innovating widgets to innovating across an episode of care or disease state; this can require entirely new employee skill sets
- Requires very strong marketing of the company brand, since a strategy like this demands a long-term corporate partnership
- To horizontally integrate the portfolio requires separate business units to work together; this can require the merging of organizational business units, which is difficult if they have spent years working toward vertical integration
- A new marketing and sales playbook is needed to map and market solutions to the patient journey for a disease

Which Strategy is Right for Your Company?

In many cases there are three determining factors:

- **Factor #1: Your portfolio.** Medtech company portfolios reflect their strategy. Are you a best-of-breed innovator, a "one-of-everything" shop, or something else? Does your description of your portfolio and services mirror how a customer would describe it? Do your products integrate in meaningful ways?

- **Factor #2: Your customer.** Do their needs require horizontal disease-state integration, or vertical integration with a primary company for a rebate? Are they comfortable with long-term, deeply integral relationships with Industry? Do they need help changing, and are they willing to partner with someone to help them?

- **Factor #3: Capacity for change.** Companies that have been successfully refining their strategy for the last 30 years may find it very difficult to move away from it and adopt a new formula. This most often requires cultural change, a staffing profile change, a shift in innovation methodology, and even decisions on whether to acquire complementary companies or be acquired. Others may agree they must change but lack the ability to execute it.

What Does This Mean for You?

To create ongoing value, medtech innovation must transcend products and features and embrace cutting-edge business, marketing, and sales models.

Companies that break the cycle of commoditization and orient themselves to the needs of a rapidly evolving customer base will be rewarded with market share gains, higher margins, and deeper and longer relationships. Those who fail to innovate and continue to orient themselves inwardly to their technology will see an erosion in margins, market share, relationships, and relevance.

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