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No More Business As Usual for MedTech Firms in 2014

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Innovative technology alone will not ensure business success in the future for companies in the medical device field. To survive and thrive in the new healthcare landscape, device firms must reinvent their business.

Historically, the industry garnered billions of dollars in revenue through successful transactions with hospital customers (more specifically, physicians). But thanks to recent healthcare reform, the current environment rewards companies that can bring down healthcare costs by finding innovative ways to care for chronic care patients.

An improved stent, hospital bed, or other medical device can't really solve that problem, says Ed Yu, principal in PwC's health industries advisory practice. Instead, it will require companies to reimagine their business models and business operations.

Liam Walsh, partner and national healthcare and life sciences advisory leader at KPMG, echoes that thought.
"If my reimbursement model is based on outcomes, then clearly I need to think about how do I position my products in the context of better outcomes and better value," Walsh says. "That, therefore, is going to mean that you are going to have to think of more than just the product . . . unless you have a unique product that no one else has."

One example of this kind of business model innovation or disruption is exemplified by Fresenius, a German medical device company that makes equipment for dialysis patients. For the past

several years, the company has been running dialysis clinics through a subsidiary in the United States and other global locations.

It is hard to imagine U.S. device companies entering the point of care, but what else can they do in a world where value is highly prized, whether economic or clinical?

The answer, paradoxically, lies both in venturing out from the industry's comfort zone—the hospital setting—as well as taking on hospitals' cost and efficiency challenges. It also requires collaboration and partnership with entities that device firms may have previously kept at an arm's distance, such as payors, Walsh says.

Some firms are also looking at beefing up their service capabilities.

"I have seen companies actually saying, 'Hey, is there some way we can become a services provider to certain [healthcare providers] around drug delivery or the office pharmacy or the supply chain?'" Walsh says.
That's not a stretch if you are a large supplier, but OEMs are focusing on the services space, too. Case in point:
Medtronic.

Medical device giant Medtronic announced this past summer that it has launched a hospital solutions business with the goal of helping hospitals improve their operational efficiency. Currently, the company is working with University Hospital of South Manchester (UHSM) NHS Trust and Imperial College Healthcare NHS Trust in London to manage the hospitals' catheterization labs.

"We are acutely aware of the pressures facing hospitals and believe that we can play a very active role in helping them to manage these challenges," Frederic Noel, vice president of Medtronic Hospital Solutions, said in a news release announcing the formation of the hospital solutions unit. "This new business is about offering healthcare providers more than products. By applying high-quality, efficient, lean processes, we can provide long-term, all-inclusive solutions that can help hospitals treat patients more efficiently while maintaining the highest quality of care."

A PricewaterhouseCoopers (PwC) report described the arrangement as "risk-sharing for efficiency savings." In other words, as the hospital wins by cutting costs, Medtronic shares in the savings. If the hospital fails to achieve cost savings, Medtronic also bears the burden.

So far, taking this big operational and financial risk has paid off. The PwC report found that, "on average, efficiency savings range between 20% to 25% at partner hospitals. Patient throughput times and waiting lists have decreased. Physician and nurse satisfaction have improved, and patients are happier with their experience."

This kind of shared risk-taking is already happening on the payor-provider side. In 2012 Mayo Clinic announced that it was partnering with a Minnesota insurance plan to manage the health

of patients in southern Minnesota. In this example, Mayo Clinic is adopting a pay-for-performance model, whereby the insurance plan, Medica, rewards the clinic for keeping patients healthy. The arrangement is presumably a win for Medica, too, which reaps the benefit of reduced claims.

As hospitals seek to cut costs by using fewer medical products than in the past, how can medical device companies stay relevant?

They need to find ways to broaden their scope beyond the four walls of the hospital—by entering the diagnostics space and getting involved in patient health management and remote monitoring.
Under the Affordable Care Act, hospitals are being penalized for readmissions within 30 days of patient discharge for certain health conditions. So, keeping patients healthy and monitoring them from a distance is becoming increasingly important. That was the rationale for Medtronic's purchase of remote patient-monitoring firm Cardiocom, which helps keep tabs on congestive heart failure patients so physicians are aware of any red flags that may require immediate attention.

In a recent report from L.E.K. Consulting about the kind of business model innovation that is needed at medical technology companies, authors Stuart Jackson, global managing partner, and Jonas Funk, managing director, advocate "reorienting selling models."
They advise device firms to have a single account manager supported by a team that includes health economists for their hospital customers. In other words, firms should establish a leaner sales force and ramp up their in-house health economics expertise.

In an earlier e-mail to MD+DI, Funk wrote:

Large medtechs have traditionally had health economics departments that support marketing, but they tend to be few in number and not often used in sales calls. In addition, they have been more focused on evaluating and communicating macro health economics for reimbursement purposes, particularly with respect to payers considering broad patient populations. Historically, these health economists have not had as much focus on micro health economics at the individual hospital level. Moreover, smaller and medium-sized medtechs often are lacking in-depth health economic capabilities. As a testament to the lack of resources with appropriate health economic capabilities (and the growing needs for them), L.E.K. Consulting has increasingly been engaged by medtechs (large and small) over the last two years to help articulate the economic value proposition of their products/solutions to hospital customers.

Risk-taking and innovation are hard to come by at large companies with entrenched interests and too much at stake.
Previously, corporate development officers at device firms scouted new acquisition opportunities without much structure or financial resources in place, but medical device companies are becoming increasingly sophisticated in how they invest in startups and scope out innovative firms.

Pure-play medical device companies are becoming more active in investing in earlier-stage companies, and some have even set up formal corporate venture capital (CVC) arms. Covidien, for example, set up Covidien Ventures in 2008.

"[These medical technology companies] are trying to mimic a venture capital organization inside a corporation," says PwC's Yu. "If you just go up and down on Silicon Valley on Sand Hill Road, you will find corporates there now setting up their CVC [entities]. It is a very exciting trend."

In fact, traditional venture capitalists are finding that they are working alongside corporations doing syndicate deals.

"I think there has been a trend toward them being more active, so I think if you look back a number of years ago, [you had] JJDC, J&J's venture arm; Medtronic didn't have a venture arm, but they were pretty active and made small investments—50, 60, 70 investments in a year—and you didn't see as much from the other companies," Kirk Nielsen, managing director at Versant Ventures, said in an interview earlier this year. "Now you look and you have JJDC, Medtronic, you've got BSX that is starting to build out that capability, and you have Abbott, and you have Covidien."

These venture arms highlight how device firms are reorienting their business. But if there is one overarching culture and operational philosophy that needs to be jettisoned at both small and large device firms, it is the concept that they can remain within the confines of their comfort zone in the healthcare continuum and continue to be successful.

"You can't operate in a silo anymore," Walsh says. "I think there are lots of people exploring lots of ways that they can add value and reduce cost, and I think the life sciences are in a great position to do that if they are proactive and think strategically about how they can play differently in the ecosystem."

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