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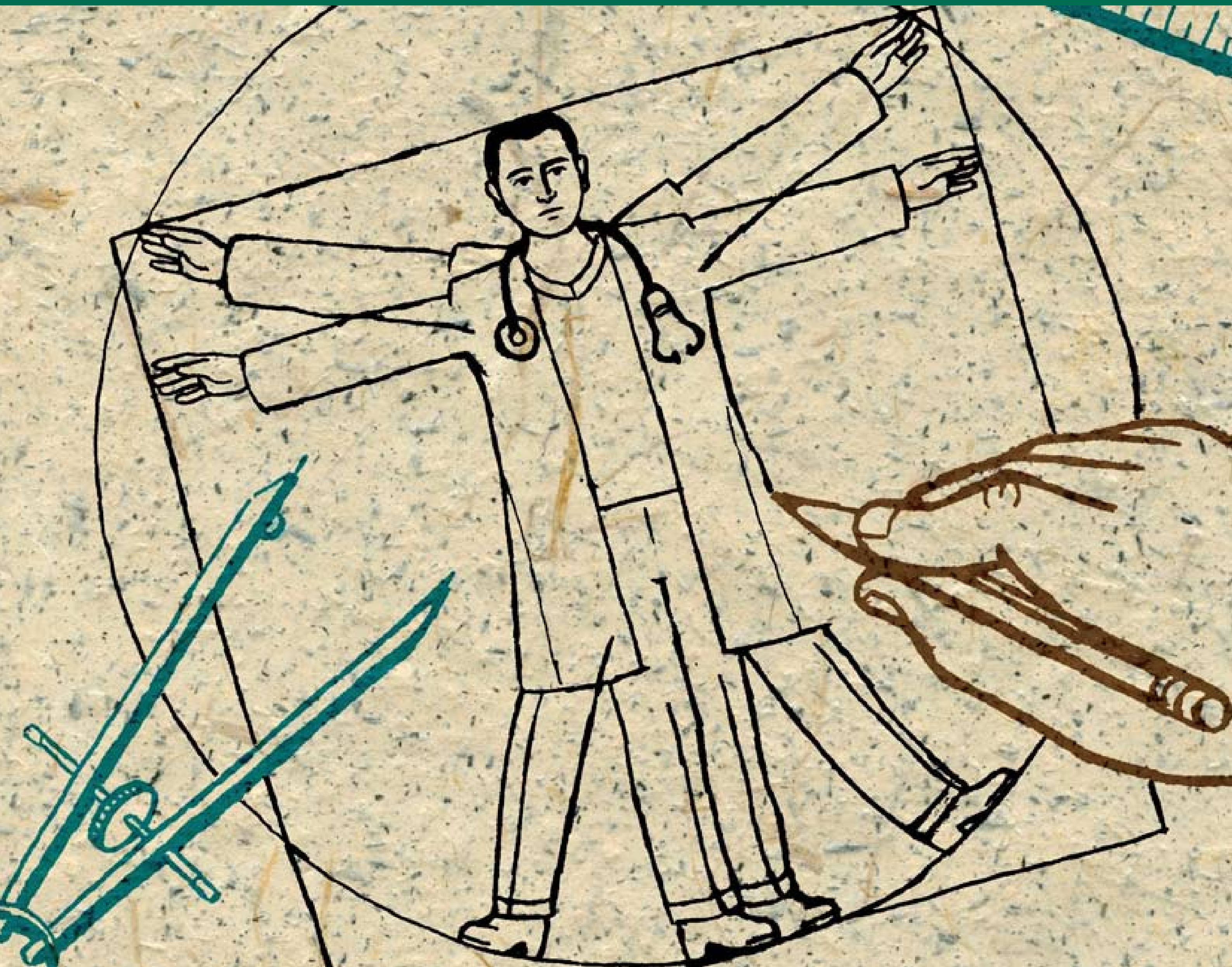
Slow Burn

The Need to Transform the Medtech Model in Europe



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MedTech Europe is an alliance of European medical-technology-industry associations. The alliance was founded by EDMA, representing the European in vitro diagnostic industry; and Eucomed, representing the European medical-devices industry. Other European medtech associations are welcome to join the alliance, which was established to represent the common policy interests of its members more effectively and efficiently. Our mission is to make value-based, innovative medical technology available to more people while supporting the transformation of health care systems onto a sustainable path. We promote a balanced policy environment that enables the medtech industry to meet the growing health-care needs and expectations of its stakeholders. In addition, we demonstrate the value of medical technology by encouraging our members to execute the industry's five-year strategy. For more information, visit www.medtecheurope.org.

Slow Burn

The Need to Transform the Medtech Model in Europe

Nicolas Kachaner and Vinciane Beauchene

October 2013

It is not the strongest of the species that survives, nor the most intelligent. It is the one that is most adaptable to change.

CHARLES DARWIN'S WORK LAID bare the need for all organisms to transform in the face of change. Medical-technology companies in Europe will understand the power of that insight in the years ahead. While the industry enjoyed robust top-line growth and healthy margins in the first decade of the twenty-first century, that performance is now threatened. Pricing pressure; the emergence of new, more sophisticated buyers; intensifying competition; new market-access schemes; and regulatory changes are all driving this shift. The critical question is whether medtech companies will respond quickly and effectively enough to the altered landscape.

The Boston Consulting Group and MedTech Europe have teamed up to determine how companies must respond to the new market realities and to assess where the industry stands in terms of making the necessary changes. This work is a follow-up to MedTech Europe's industry-strategy report Contract for a Healthy Future *and is based on extensive research and interviews with more than 50 senior leaders, a group that includes both industry players and external stakeholders.*[1]

Our research indicates that companies need to move to maximize the value of their existing business while embracing new markets and approaches, including reinventing their innovation efforts and positioning themselves as catalysts of health care system efficiency. But our interviews highlight that most companies are only just beginning this journey. And perhaps the greatest danger ahead is complacency. Think of the boiling-frog metaphor. Put a frog in hot water, and it jumps out. If you put it in cool water and gradually turn up the heat, it remains in the water, eventually succumbing to the boiling temperatures. Medtech companies that fail to respond effectively to the pressures around them risk facing a similar fate.

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Pricing pressure is mounting in Europe as governments grapple with burgeoning health-care bills, and more and more payers demand evidence that products are worth the cost. And while these trends have been at work for years, the recent economic crisis has accelerated the pace and intensified the impact.

- Demographic changes—most notably aging populations—are driving major shifts in health care, including an increase in the incidence of chronic diseases, rising demand for medical technology and services, and a move toward e-health solutions as well as community and home care.

- European governments are looking for ways to dampen health care inflation, including exerting downward pressure on prices for medical technology, which accounts for 5 to 10 percent of total health-care expenditures. In Europe, this pressure would come on top of already low prices. For example, the cost of a hip replacement in the U.S. runs $40,634, compared with an average of $10,182 in France, the U.K., and Spain. And the average cost of a magnetic resonance imaging scan in those three nations is $309, as opposed to $1,121 in the U.S.[2]

- Payers are increasingly focused on the overall value delivered by products, requesting not only clinical information but also evidence of the health-economic impact over the full cycle of care.

- Cost-conscious buyers, such as purchasing groups, play an increasingly active role in purchasing decisions.

- Through the Internet and social media, patients can share information about their experiences with medical devices, procedures, and outcomes—increasing transparency and empowering patients to make better-informed decisions.

The combination of intensifying competition and regulatory pressure will further strain the existing medtech model.

- Many mid-sized European companies are fighting to reach critical size in a slower-growth market. According to some interviewees, this trend is made clear by, for example, the recent increase in the number of bidders for hospital contracts.

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- A potential growing threat may come from emerging-market companies, some of which are opening branches and subsidiaries in European countries. The degree to which they will gain ground in Europe is unclear, according to the senior leaders we interviewed. We believe, however, that it is a trend that bears watching.

- Ongoing regulatory revisions, notably those of the European Medical Devices Directives (the rules governing the industry in the EU), are likely to trigger an increase in the cost of bringing new products to market and to delay market access. This threatens a key competitive advantage in Europe, where, between 2000 and 2011, products received market access approval 43 months earlier, on average, than they did in the U.S.[3]

- The EU is creating a new framework for cooperation across EU countries through efforts such as the Cross-Border Healthcare directive—with a particular focus on areas such as health technology assessments and understanding the value delivered by medtech. This will put additional pressure on companies to adapt their business models.

Innovation, a key driver of industry growth and performance over the past decade, is likely to be less robust in the years ahead.

- After medtech patent applications in the European Patent Office increased at an 8 percent annual rate between 2003 and 2010, they declined by 8 percent annually in the following two years, reflecting a slowdown in the innovation engine.

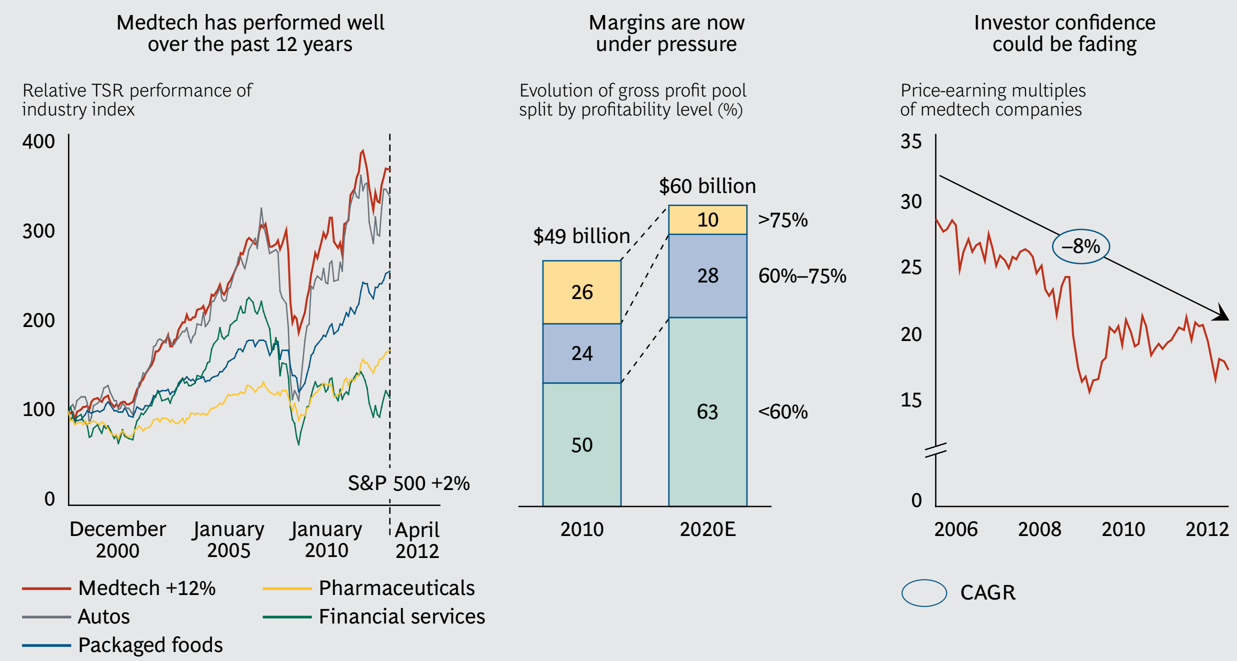
- Medtech companies run a risk of overshooting—delivering new products or enhancements on existing ones that do not add tangible value for payers, users, and patients and are already addressed well enough in some segments.

Our analyses show that the convergence of pricing, regulatory, and other market forces could lead to the deteriorating performance of the European medtech industry in the years ahead—compelling companies to do more with less. (**See Exhibit 1.**)

- Sales are projected to grow 3 percent annually between 2010 and 2020, down from a 10 percent annual-growth rate between 2000 and 2010; average gross profit per product segment is forecast to slide from 56 percent in 2010 to 52 percent in 2020.

- As investors have recognized the challenges that the industry faces, the price-to-earnings multiple of medtech firms has slid 8 percent per year between 2006 and 2012.

EXHIBIT 1 | Medtech Companies in Europe Are Feeling the Heat



Source: Capital IQ; Compustat/GlobalVantage; BCG ValueScience; BCG analysis; BCG Future of Medtech.
Note: CAGR = compound annual growth rate. The medtech total shareholder return (TSR) index is the monthly median index comprising representative devices, supplies, equipment, and diagnostics companies. All calculations are based on U.S. dollars and month-end figures. Price-earnings figures are based on the median P/E multiples; earnings per share include earnings before extraordinary items.

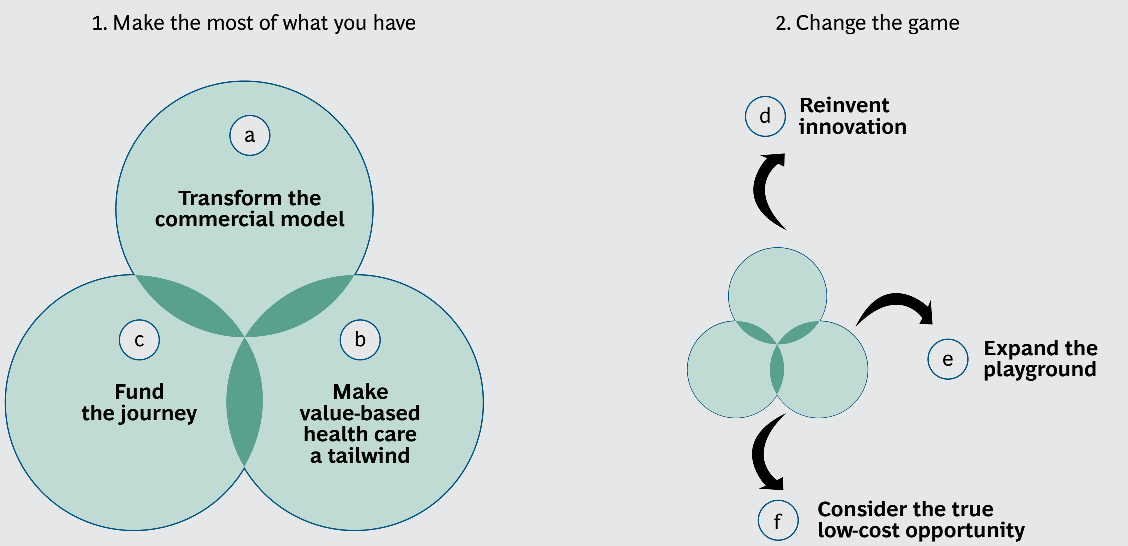
- Price increases and "mix benefits" (the launch of new products that replace less expensive, older products) were a key growth driver in the 2000 to 2010 time period, but companies will find that they will no longer be able to rely as heavily on those levers.

- Volume growth will be moderate at best. Trends such as aging populations will drive demand, but actions by payers in Europe—for example, the restrictions that have been placed on reimbursement for certain products—will constrain that expansion.

- Companies will be required to manage internal organizational change, bring new skills on board, and develop talents and capabilities in a cost-constrained environment.

To succeed in this challenging environment, our research makes clear that companies must shift from a technology and product focus to concentrating on delivering solutions that truly address customer and patient needs and have proven clinical and health-economic value. This concept is what lies at the core of MedTech Europe's industry-strategy Contract for a Healthy Future. *Putting it into practice requires action on two fronts. (See Exhibit 2.) First, it is critical to maximize the performance of the existing business—to do the most with what you have. This encompasses transforming the commercial model, understanding and capitalizing on the shift toward value-based health care, and funding the journey by optimizing the cost structure of the business. The second effort involves moving beyond the existing core business—that is, changing the game. Here, companies have the opportunity to revamp their methods of innovation, to expand the definition of their business by moving into adjacent markets or by vertically*

EXHIBIT 2 | Medtech Companies in Europe Should Embrace a Twofold Agenda for Change



Source: BCG analysis.

integrating, for example, and to grab the lead in creating truly low-cost offerings where relevant.

In order to maximize the opportunity within the existing business, medtech companies must transform their commercial model and build best-in-class commercial capabilities. (See *Fixing the Medtech Commercial Model: Still Deploying Milkmen in a Megastore World?* BCG Focus, July 2013.) Six key moves can help companies make progress along this path.

- It is critical to customize the go-to-market strategy. This includes a systematic review that prioritizes the most valuable market segments, determines what is required to win in each segment, and tailors the commercial model for each segment accordingly.

- Companies should reinvent clinical selling to reflect the changes in how purchasing decisions are made in the market. This includes a move to do less—but more focused—clinical selling.

- The medtech industry lags behind other sectors when it comes to key account management. Companies must put a greater emphasis on this effort—based on a solid analysis of the business potential and profitability of specific customers.

- While the sales rep has historically been the driver of the commercial operation in medtech, marketing must now take on the primary role. This is imperative if companies are to successfully build and communicate the case for the value of their products.

- Securing reimbursement and adequate pricing is more difficult than ever. As a result, developing reimbursement and pricing capabilities is essential, an effort that is just beginning within many medtech companies.

- A tremendous opportunity exists to offer services that not only bolster revenues but also differentiate a company's product offering.

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- Value-based health care is a paradigm shift from an initial focus on efficacy and safety to one on achieving better outcomes at a reasonable price.

- Medtech companies are in a position to offer providers support in making decisions. This can include developing applications that help users select the right diagnostic test and interpret the results. And there is also demand for offerings that help reduce the variability of clinical outcomes, an effort that medtech players can support with products such as computer-assisted surgery, real-time imaging, and virtual-training systems for health care professionals.

- A key element in this effort is reprioritizing budgets toward cost-efficient products with solid evidence of value based on outcomes data. This can include forming partnerships in order to run clinical trials that evaluate the cost effectiveness of treatments in a real-world setting. Pricing and contracting efforts should also be centered on delivering value, which may involve the development of new models of funding and pricing based upon the value offered by the product, as well as a better awareness of the populations that will benefit the most.

- Understanding and meeting the needs of payers, providers, and policymakers is paramount. A key aspect of this is integrating evidence of clinical outcomes with information on the overall social impact and lifetime cost of various medical interventions.

To fund the journey, a significant opportunity exists for medtech players to improve their cost structure.

There are tremendous potential rewards for companies that look for ways to "expand their playground" and move beyond their existing business definition.

- The ratio of operating expenditures to sales for the industry increased 510 basis points between 2003 and 2012—while pharma players managed to cut that ratio by 350 basis points over the same period.

- Companies must trim their base in sales, general, and administrative costs, as well as in the cost of goods sold. For example, organizations can rethink their manufacturing footprint and sourcing strategy, selectively outsource some processes, or bundle some administrative tasks in shared service centers in order to benefit from scale.

In addition to maximizing the opportunity that is found in the existing model, medtech companies in Europe must also change their game. A key element of this is to reinvent the innovation process, building on best practices observed among high-performing companies.

- High-performing companies in medtech have a track record of making bigger, less-incremental bets on new-product development.

- It is also critical to be more open to external innovation through licensing, partnerships, and acquisitions.

- The innovation process should be driven by the needs of key stakeholders. So customers—patients, payers, and physicians—should play a role in new-product development.

There are tremendous potential rewards for companies that look for ways to "expand their playground" and move beyond their existing business definition.

- To move beyond their core business, companies should identify opportunities to expand into adjacent markets. This can include products and services that are upstream or downstream from their current offerings, as well as products and services that are in different but related markets. These moves can be defensive (protecting the core), offensive (building new profit streams), or both. Some medtech companies have begun this process—vertically integrating into medical services that are commonly required by the patients who use their devices. Such companies may offer disease management programs or patient support services, or they may even take on the operation of hospitals or clinics.

- There are also likely to be opportunities to develop services for purchasers of medtech products such as software and data management.

- Companies can also play a critical role in the improvement of the overall health-care system by finding ways to reduce costs or improve the efficiency of operations beyond the scope of their particular device.

Changing the game also calls for exploring true low-cost opportunities.

- Companies should dispense with some common myths. Low cost is not low quality. Low cost is not low margin. Low cost is not necessarily unbranded.

- In fact, not only are low-cost companies often highly profitable but there are examples in which the profitability of these low-cost operators exceeds that of most competitors.

- To remain competitive, companies should consider when they can develop high-quality, efficiently priced offerings for newly cost-conscious customers and how they can do so without compromising margin levels. This can require shifts in manufacturing and supply chain operations, as well as designing products to ensure that those with low prices have commensurately low manufacturing costs.

- Low cost is not just about achieving a lower cost of goods sold. High-performing, low-cost companies have managed to reduce their total system cost, sometimes transferring part of their costs to customers.

- Companies will often find that it makes sense to create distinct brands in different pricing categories in order to minimize cannibalization.

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Our interviews, along with a recent BCG benchmarking study, show that the medtech industry has initiated the first phase of transformation—maximizing the performance of the existing business—but has barely begun the second phase of changing the game.

- Efforts are under way to revamp the commercial model in order to respond to the new value-based environment and to reduce the cost base, but companies acknowledge there is still a long way to go. In the BCG benchmarking study, for instance, EU respondents self-assessed their companies' readiness as intermediate, well below the target level they believe is required to compete. To continue the momentum in this area, it is critical to move beyond quick wins.

- Most leaders understand the need to move beyond the existing core business. So far, however, few have managed to progress beyond exploratory pilots.

The need for change is irrefutable—but transformation will not come easily. According to interviewees, there are four major challenges for companies looking to adapt. First, *leaders must abandon the old mindset and embrace change. Medtech companies must also find a way to bring people with the necessary skills and capabilities on board without alienating or causing disengagement within the existing workforce. At the same time, there is tremendous complexity to manage in this new environment, particularly given Europe's heterogeneity. And companies committed to changing their business must very clearly choose between a big-bang overhaul and a phased, stepwise approach.*

The industry has much to gain by acting in unison. National and regional trade associations such as MedTech Europe can play a critical role. This role includes not only promoting the industry's image but also ensuring that the need for change is well understood. In addition, those groups can promote policies that foster an ecosystem in which change can thrive. And they can build bridges with other industries and stakeholders to promote progress toward improved efficiency in the health care system.

In the end, however, success will depend on whether companies understand the fundamental shifts occurring and respond with the requisite force and responsiveness. Those that do can move ahead with a clear vision, a strong commitment to change, and a well-designed roadmap to move the company toward its goal. Those that do not will find the heat only growing more intense.

NOTES

1. *Contract for a Healthy Future* can be found at www.reforminghealthcare.eu. Stakeholder interviewees included selected senior representatives from purchasing groups, patient organizations, government agencies, medtech regulatory authorities, and academic research groups.
2. Price comparisons come from the International Federation of Health Plans' *2012 Comparative Price Report.* The cost of a hip prosthesis is $12,222 in the U.S. and $2,682 in Spain.
3. See *Regulation and Access to Innovative Medical Technologies,* BCG White Paper, June 2012. Data relate to products receiving premarket approval.

About the Authors

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