Medical device manufacturers must adopt stronger pricing strategy

Abstract

Medical device manufacturers have been faced with increasing price pressure.
In the medical device market where sales representatives are expected make price negotiation with wholesalers, frameworks / rules to efficiently provide the approver with proper information and to support appropriate pricing decision-making are required.

Pricing pressure

Medical device manufacturers have been faced with increasing price pressure as a result of changes in the market environment:

- Reduction in reimbursement price
  - Reimbursement prices of Special Treatment Materials have dropped by around 25% in the past decade, according to the Medical Device Strategy Institute
- Financial difficulties and strengthening of management control at healthcare providers
  - Providers are enhancing cost management in response to decreasing profitability
  - As an initial target of cost reduction, providers are reviewing purchasing price of medical materials
- Introduction of DPC is accelerating the trend, as it encourages use of the cheapest "ingredients" for any given set of procedures, including the lowest cost medial materials. Price information sharing among healthcare providers
  - Providers have strengthened their buying power through group purchasing, as well as information sharing within hospital groups
  - Lowest market prices have become more easily accessible due to emergence of group purchasing organizations (GPOs) and purchase price consultation services for providers

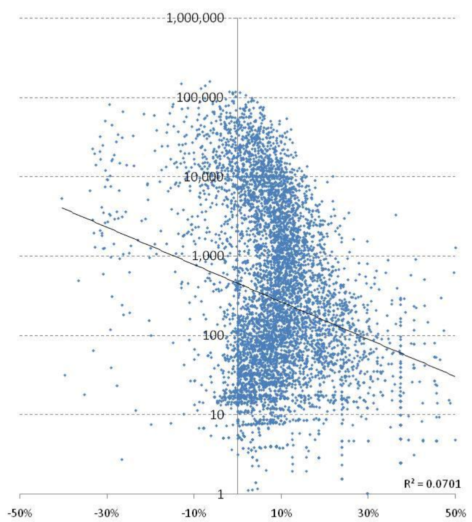
These environmental changes continue to push down the manufacturer price of medical devices, leading to financial losses amounting to a few percentage points of total sales to manufacturers (It should be noted that this loss will be continuously accumulated year-over-year since there are few examples of recovering the original price after a price reduction.)

Need for countermeasures

Are medical device companies currently fully dealing with this pricing pressure? -- Our   Based on our observations of current company practice, we think that much could be done to improve the situation.

Figure 1 is an example of a medical device manufacturer This scatter plot shows the correlation between total sales and unit price by hospital. Each dot indicates a hospital and total sales (Y-axis) and indices of unit price (X-axis; 0% indicates the average price) are shown. If the company successfully optimizes prices, the chart should have a downward trend to the right as hospitals that buy more would receive a better discount. However, in reality it looks like a "cloud" which has no trend; this suggests lack of effective price strategy by this company. Although this is only an example, how many companies' management can truthfully say that a similar cloud would not be observed if the exercise were repeated with their company's data?

Figure 1: Divergence from the average price



Field oriented pricing policy

In the medical device market, wholesalers are fragmented. Relationship building with local wholesalers is required and sales representatives are expected to help build this relationship, including price negotiation with wholesalers.

Thus, sales representatives with strong incentive to achieve target sales tend to easily provide discounts in order to ensure sales. Every company obviously has an internal approval process for making discounts, yet the following issues interfere with effective price strategy:

- Quite a few applications and inefficient, email-based operation of these procedures make it difficult for the approver to fully examine each application
- As items to be reviewed for approval are unclear, the approver tends to focus on what applicants emphasize, resulting in biased decision
- Decision is made case by case basis, without considering the entire picture of price distribution to optimize overall pricing

As described above, approvals are not granted based on company's pricing policy, but, perhaps, based on the persuasiveness of the sales representative and other idiosyncratic factors in each situation.

Infrastructure for price execution

In the medical device market, where price negotiation bodies are decentralized, frameworks / rules to efficiently provide the approver with proper information and to support appropriate pricing decision-making are required:

- Streamlined workflow system
- Optimization of information required for application for discount approval and responsibilities of approver
- Standardized / indexed evaluation items and criteria
- Rules to maintain consistency between sales and pricing strategies
- Information sharing on price distribution from various perspectives, such as nationwide, by region, etc.
- Sharing crucial information such as lowest prices in a given region / for a given hospital group

Successful price execution is achievable through establishing the frameworks and rules discussed above, which allow the approver to make decisions based on pricing policies.

Managing “potential” to take proactive price execution

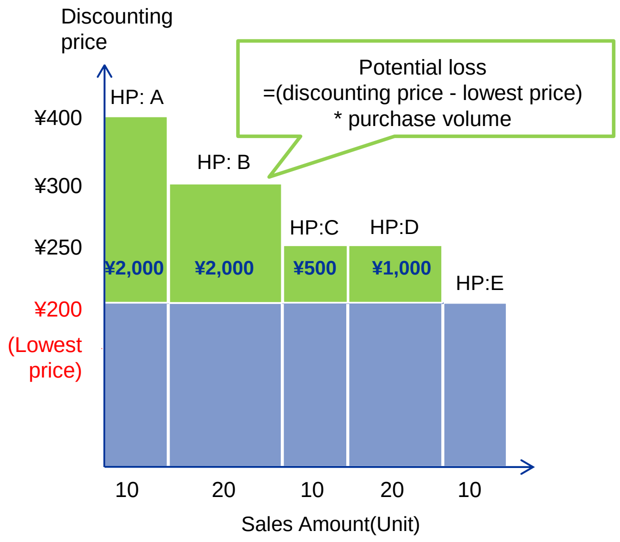
To break away from “passive reaction” in price negotiation, it is important to adopt streamlined frameworks / rules to improve price execution capability. For example, Deloitte recommends medical device manufacturers to manage “potential loss”, which is a product-level indicator calculated as follows:

(“Actual price for each hospital” - “Lowest price within the group”) * “Total volume purchased by each hospital” (Figure 2)

For medical device companies, this indicator represents potential of profit that they could lose, even tomorrow, if the hospital group internally shares this information. There was a company, for example, that had “potential loss” which accounted for more than one third of its operating profit.

Thus, quantifying potential risks is an effective way to foresee future events and prepare for them.

Figure 2: “Potential loss” of a product in hospital groups A-E



Conclusion

A company succeeded in reducing more than half of profit loss incurred annually by setting up a price execution function and implementing the measures described here. A “cloud” of price distribution represents insufficient price execution but it could also be a “gold mine” that provides the guide to optimize business in this maturing market.

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