

VIEWPOINT

Value Capture in the Medical Device Industry

5 Pricing and Value Challenges from Our Medical Device Poll

The medical device industry is under greater pressure now than at any other time in its long and profitable history. The pressure comes from all quarters: politicians, regulators, pundits, payers, consumers, buyers, and of course competitors. Innovation has been a trademark for the industry, with many of the leading players investing well over 10 percent of revenues in research and development. Given the current environment, there are few medical device CEOs who are not scrutinizing their company's innovation investments. Naturally, this has increased the operational focus on product lifecycle management (PLM), particularly in those areas that create the products that drive future revenues.

But when it comes to innovation, there are two halves to the whole:

1. Value creation—the activities and investments related to the development of new products and services
2. Value capture—the extraction of cash and profit from products and services

While value creation is intuitive to sustaining profitability, medical device companies must *capture* value as effectively as they *create* it.

Kalypso polled over 500 medical device professionals from more than 100 companies using one question: "What is the biggest pricing and value management challenge facing the medical device industry?" The possible answers are framed in terms of the product lifecycle to gain a better understanding of how medical device professionals are thinking about value capture in that context.

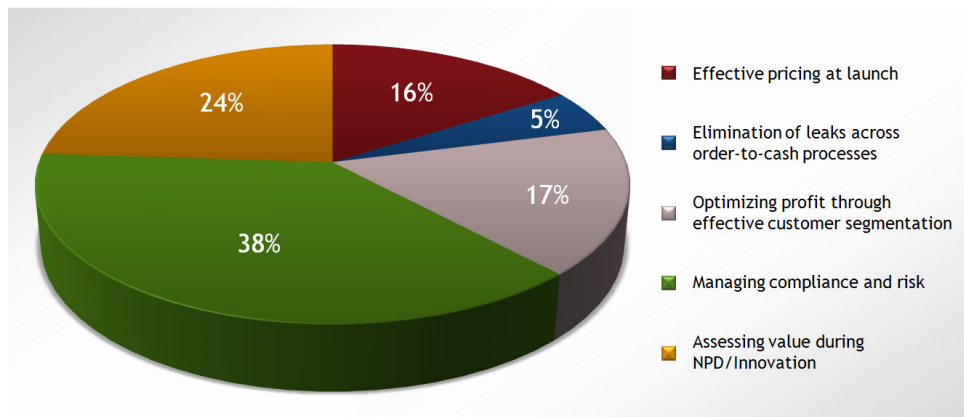


Figure 1: Medical Device Poll Responses: What is the biggest pricing and value management challenge facing the medical device industry?

While this poll doesn't account for the vast diversity of business models and segments that make up the medical device industry, the answers reveal a lot about the opportunities related to pricing and value management and the state of value capture in general. Interestingly, the responses also raised additional questions.

In order to deliver on the promise of innovation, medical device companies must *capture* value as effectively as they *create* it.

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Managing Compliance and Risk

Managing compliance and risk was the top-of-list challenge for 38 percent of respondents, and will remain top-of-mind as the reimbursement and payment landscape evolves. It's also clear that the current state of compliance and risk management processes is not settled at many companies. The intensifying scrutiny and complex maze of transactions will challenge the industry to address core issues that have existed for many years, including:

- Establishing effective controls and tracking mechanisms to support volume discounts and their potential impact on Medicare and Medicaid reimbursement
- Managing oversight on special deals, rebates and incentives
- Proper treatment of free goods and offers related to product trials
- Appropriate configuration of bundles and temporary price promotions

It's worth noting that this issue was ranked only fourth on the list for CEOs and CXOs who responded to the poll.

What we're asking: Is this challenge not getting the attention of the C-suite? What are the core issues which drove such high concern across the broader survey population?

Assessing Value during New Product Development & Effective Pricing at Launch

For pricing scientists and valuation experts, there are few challenges greater than accurately assessing the commercial value of new products. As a group, CEO and CXO respondents cited these two areas most frequently. This makes sense: because of the size of the industry's investment in innovation, companies that effectively quantify value early in the new product development process are better able to manage their innovation portfolios.

The increased scrutiny on pricing across the medical products sector means getting the "right" price at launch is more critical than ever. With the increased pressure on the operating environment, there has never been a greater need for medical device companies to be at the top of their game when it comes to value-based pricing. Early collaboration between engineering and product marketing is usually the biggest challenge; most medical device companies wait too long to establish a clear, quantitative price and positioning hypothesis for a new product.

What we're asking: How many medical device companies have pricing and commercial valuation experts actively engaged in the early stages of the new product development process? Are the tough commercial questions getting addressed during gate meetings? Are medical device manufacturers leaving money on the table with new product pricing?

Optimizing Profit through Effective Segmentation

Price segmentation has driven significant profit improvement across other B-to-B sectors such as chemicals and industrial goods. Medical device manufacturers share similar transaction models. For instance, they serve diverse customer bases with a broad range of demographic characteristics (e.g., size or purchase power) and buyer behaviors (e.g., price orientation), and the revenue mix includes a high number of unique deals and offers. This is an environment ripe for price segmentation.

Companies that quantify value effectively and early in the new product development process are better able to manage their innovation portfolios.

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Optimizing pricing through effective segmentation requires dynamic analysis of market insight and sophisticated scrutiny of current and past transactions. The reality is that the medical device industry has been slow to adopt tools and methods in use across other industries. That means that these data are out-of-reach for most medical device pricing departments. Notably, this was the second most frequently cited challenge by CXOs and was at the top of the list for product and business line managers who have accountability for pricing.

What we're asking: Will the medical device sector increase adoption of price segmentation and related tools?

Elimination of Leaks across Order-to-Cash Process

Surprisingly, this value management challenge was ranked low across all survey respondents with only 5 percent, which is notable since managing rebates, special discounts and charge backs is a critical driver for compliance and risk management. In other industries, this challenge is at the top of the list driving transformation initiatives that have improved the profitability of many companies.

What we're asking: Why is managing rebates, special discounts, and charge backs a critical driver for compliance and risk, but capturing the underlying profit improvements in the order-to-cash process is less important?

Where to Start? Where to Focus?

Value capture is the oxygen for innovation. To succeed in today's environment, medical device companies need to establish initiatives focused on one or several of the challenges described above. To decide on the right starting point, companies need to assess their current value capture capabilities holistically, giving consideration to the profit improvement potential in each area. Each company needs to establish its priorities and the corresponding roadmap to improvement (or transformation) according to its own level of value capture maturity.

Let's Hear Your Voice!

The responses to our poll raised several additional and compelling questions. Respond to this 5-minute follow-on survey on the drivers and strategies for pricing and value management and receive the complete responses with some practical recommendations as our thanks.

<http://www.surveymonkey.com/s/NTHHTFC>



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