

The European public-procurement opportunity: Delivering value in medtech

Value-based procurement is a reality today. To capture the opportunity in today's European medtech-public-procurement market fully, winners need to adapt to new realities quickly.

Olivia Cavlan, Lewis Grey, Adam Krych, Chris Llewellyn, and Christian Zerbi



Across Europe, there is unprecedented financial pressure on healthcare payers and providers, which, in turn, makes the European medtech landscape increasingly challenging. As public procurement becomes more sophisticated, price transparency is growing, and demand for integrated solutions is driving changes in product offers, requiring new sales channels and tactics.

Value-based procurement is a reality today, and it is proving to be a key driver to unlocking outcome-based value for health systems and patients. It is facilitated by the new EU directive on public procurement (2014/24), with decisions assessed through two lenses: total cost of ownership (TCO) and price-quality ratio. However, our research across six core categories of medical products suggests that they are moving toward value-based procurement at different speeds; equally, countries will also evolve at different speeds of adoption.

Medtech winners will need to develop a demand-shaping mind-set; engage early on, at the right level, and quickly; and offer a value proposition “beyond the device.” They must move quickly to tailor their go-to-market model by geography and segment, enhance service offers to include solutions based on relevant outcome key performance indicators (KPIs), and develop capabilities that enable them to link outcome measures with tender award criteria.

Our estimates suggest that for a medium-size medtech company, proactively investing in line with this trend over the next three years will lead to a 2.5 to 5.0 percent growth in the top line.

The medtech landscape in Europe is increasingly challenging

Across Europe, medical-device prices for all major categories—cardiovascular, in vitro diagnostic (IVD), medical imaging, general surgery, orthopedics, and wound care—decreased on average by 1.5 percent a year from 2012 to 2016

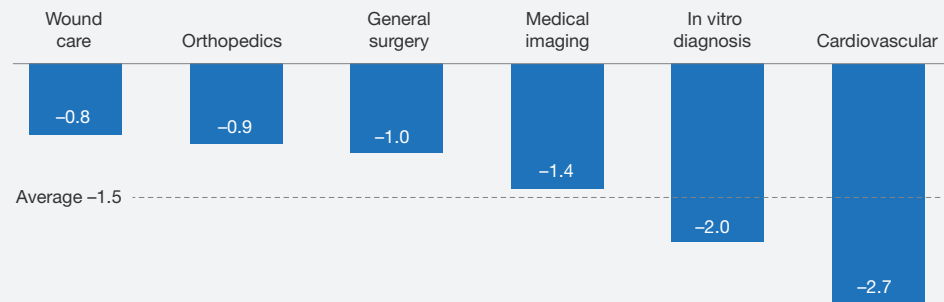
(Exhibit 1). Despite efforts to improve margins through globalized business services, reduced cost of goods sold, commercial transformation, and so on, there continues to be significant pressure on shareholder returns. Exhibit 2 illustrates the consistently lower total return to shareholders compared with other industries.

Today, three major trends are challenging traditional medtech commercial models:

- **Consolidation and sophistication of public procurement is increasing.** The past ten years have seen successive rounds of public-hospital consolidation, with new, highly sophisticated procurement teams becoming the norm. For example, France established the *groupements hospitaliers de territoire* (GHTs), or regional hospital groups, in July 2016, reducing the number of bargaining units from more than 890 hospitals to 135 GHTs. Meanwhile, centralized procurement teams have been strengthened by acquisition of new talent specialized in tender management supported by investments in tools and analytic capabilities. Across the National Health Service (NHS) in the United Kingdom and in Spain (in the Balearic Islands and Madrid), we see a similar trend.¹ Moreover, with the increased focus of national bodies, such as the National Institute for Health and Care Excellence (NICE) in the United Kingdom, on medtech versus pharma, procurement teams are becoming increasingly sophisticated, progressively deploying tactics such as market consultation and competitive dialogue to negotiate on price and to shape tenders to meet their needs better.
- **Price transparency is putting traditional models under pressure.** Following similar moves across the pharmaceutical industry, in January 2017, MedTech Europe implemented the MedTech Europe Code of Ethical Business Practice, which

Exhibit 1 Prices for medical devices have been declining on average for the past five years.

Average selling price decrease by segment, 2012–16,¹ % compound annual growth rate



¹Average selling price by segment as buckets of 8–10 products within each category for EU-5, Switzerland, and Netherlands (cardiovascular: pacemakers, bare-metal stent, drug-eluting stent, access devices, transcatheter aortic-valve implant; medical imaging: magnetic resonance imaging, computed tomography, mammography, X-ray, ultrasound, C-arm; orthopedics: hip replacement, knee replacement, spinal, trauma; wound care: advanced dressings, compression, negative-pressure wound therapy, wound closure; general surgery: sutures, gastric balloons, ablation devices, hernia repair, laparoscopes, energy generators; in vitro diagnosis: based on industry experts and comments from the European Diagnostic Manufacturers Association).

McKinsey&Company | Source: GlobalData Medical; Thomson Reuters Datastream

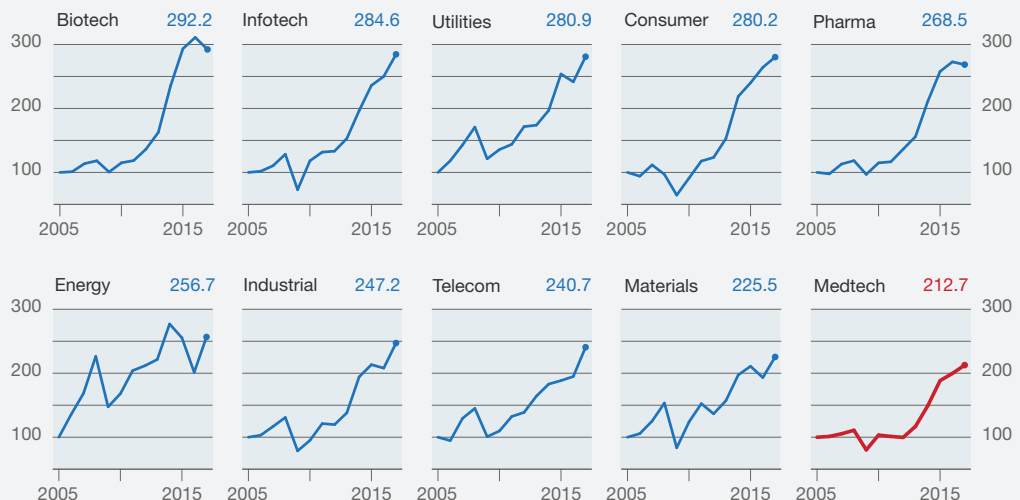
lays out guidelines on cost transparency. At the same time, low-cost players are challenging traditional pricing approaches; together with an increasing uptake of online tools and social media,² this has led to procurers becoming more price conscious.

- ***Demand for integrated solutions is driving product-offer changes.*** As payer and provider approaches shift toward care pathways, closer adherence to guidelines and protocols, increasing utilization of equipment, and treatment in ambulatory and home-care settings, medtech players are increasingly being asked to support the shift through outcome- and value-based contracts. For example, in 2012, the Stockholm County Council (SCC) offered an innovative tender for wound-care products. The SCC asked for three hypothetical patient cases and required bidders to calculate the total cost of treatment

for each, along with evaluated outcomes for such treatment. Another program linking payments to outcomes in hip- and knee-replacement surgery achieved a decrease in complications by 18 percent, reoperations by 23 percent, and revisions by 19 percent; costs per patient declined by 20 percent.³ The United Kingdom's NHS looks at comparative cost-effectiveness studies to determine optimal clinical treatment guidelines and therapy choices—for example, NICE clinical guidelines and health-technology assessment. Recently, the focus on standardizing operational pathways, such as with the Getting It Right First Time program, has further driven best-practice operational delivery, including improved procurement. Consequently, medtech players will increasingly need to deliver “beyond the product” solutions that integrate education, service, consultation, and finance with the products themselves to deliver greater value for payers.

Exhibit 2 Shareholder returns for medtech are consistently lower than for other industries.

Total return to shareholders, S&P by industry, 2005–17 (Jan 2005 = 100)



McKinsey&Company | Source: Thomson Reuters Datastream

While these trends may seem challenging, a recent Europe-wide legislative change—the new directive on public procurement—is making it easier for medtech players to deliver successfully the goals defined in these demands. Indeed, the shifting procurement landscape presents real opportunities for medtech players to think through optimized value-based offers and business models that better match health systems’ evolving needs.

Value-based procurement opens new opportunities for the industry

Value-based procurement is a reality today, facilitated by the new EU directive on public procurement, which was approved by the European Union in 2014, with an option to procure based on criteria that favor the most economically advantageous tender. This introduces two new lenses through which decisions are assessed:

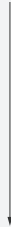
- TCO criteria, which allow public procurers to go beyond the acquisition cost and consider all expenses during the device’s life cycle (for instance, acquisition costs, maintenance costs, and consumables)
- Price-quality ratio criteria, which encourage procurers to consider qualitative and economic benefits for the full set of stakeholders along a care pathway (for example, care providers, care staff, the wider care system, and environment)

Both methods are fundamental in the move away from price as the only criterion for procurement toward value-based procurement (Exhibit 3).

Currently, all analyzed regions (the EU-5, the Netherlands, and Sweden) have incorporated this directive into their own national legislation. While

Exhibit 3 The EU directive lays out two core elements to win contracts: Contract-award criteria and life-cycle costing.

EU directive: Article 67



Subsection 3, award of the contract

Article 67, contract-award criteria

The most economically advantageous tender from the point of view of the contracting authority shall be identified on the basis of the price or cost, using a cost-effectiveness approach, such as life-cycle costing in accordance with Article 68, and may include the best price-quality ratio, which shall be assessed on the basis of criteria, including qualitative, environmental, and/or social aspects, linked to the subject matter of the public contract in question

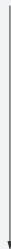
Implication for contract-award criteria

Article 67 introduces the option of considering a wider breadth of qualitative and economic benefits to a broader set of stakeholders:

- to care providers
- to care staff
- to the wider care system
- to the environment

Implication: public bodies can now procure based on value, not just pure price; this is an opportunity to stop or reduce price pressure

EU directive: Article 68



Article 68, life-cycle costing

Life-cycle costing shall to the extent relevant cover parts or all of the following costs over the life cycle of a product, service, or works:

- costs related to acquisition
- costs of use, such as consumption of energy and other resources
- maintenance costs
- end-of-life costs
- costs imputed to environmental externalities

Implication for contract-award criteria

Article 68 introduces to contracting authorities the option to request life-cycle-costing-calculation approach and data required to make an objective assessment (eg, acquisition, maintenance, consumables, disposal costs)

Implication: procurers are encouraged to think in the long term and encourage medtech players to be creative regarding their end-to-end service offer

McKinsey&Company | Source: EUR-Lex; McKinsey analysis

countries are at different stages of implementation, there are a growing number of examples of successful value-based-procurement efforts.

For example, in Sweden, Karolinska University Hospital has recently launched multiple strategic partnerships and made value-based procurement

a core vision of its newly built hospital. The same is true in Catalonia, where several value-based tenders have been awarded (see sidebar, “Case example: Hospital Sant Pau, Catalonia”), with further expansion into other medtech categories. And there are other leading examples from the Netherlands, Sweden, and the United Kingdom.

As part of this transition to value-based procurement, we have seen economic incentives in select countries shifting from payment-by-episode to payment-for-population outcomes. This represents a fundamental shift for public procurers: in the new scenario, they have incentives to improve for the whole system (and not just the hospital) and to acquire products and services that optimize outcomes and cost along an entire patient pathway—from primary care to hospital-based care to community care. One key example is in the United

Kingdom, where nine regions have recently been selected to form part of a fast-paced accountable care system—ACS Accelerator⁴—and will effectively control the budget on a cross-regional (as opposed to hospital) level.

Procurement decision makers today have a number of needs that leading medtech players are starting to fulfill. These range from the need for medtech players to deepen their knowledge of the implications of the EU procurement directive to the need for evidence from use cases in which the price-quality ratio model was applied and delivered more value for the care system (Exhibit 4).

Our research across six core categories of medical products⁵ suggests that categories are moving toward value-based procurement at different speeds. On one hand, cardiology, medical imaging, and

Case example: Hospital Sant Pau, Catalonia

Background

In 2016, the Agència de Qualitat i Avaluació Sanitàries de Catalunya (AQuAS)—the Catalan Agency for Health Information, Assessment, and Quality—and Hospital Sant Pau in Barcelona procured a service related to an implantable cardioverter defibrillator (ICD), with a four-year contract worth €10 million.

Approach and criteria

AQuAS followed an innovative procurement format called competitive dialogue, which stated the needs of the service and expected companies to suggest solutions to them. Both total cost of ownership and delivering outcomes beyond the device were core criteria for this tender.

Outcomes and value

A new service contract, which included devices, technical assistance, and a new remote monitoring center for patients with ICDs, with two providers was put in place.

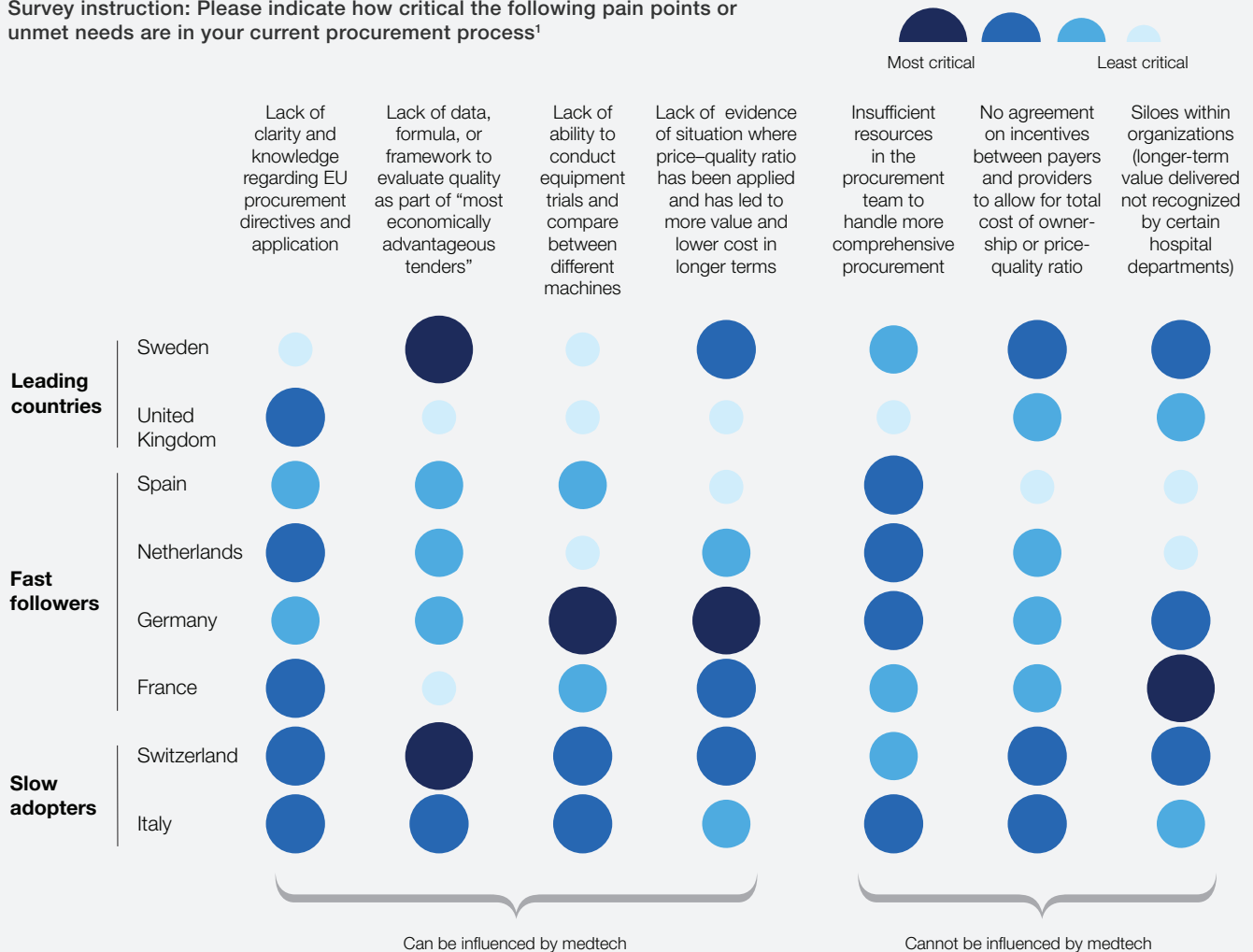
This led to a 10 percent drop in outpatient visits, a 10 percent reduction in complications, and increased collaboration along the care pathway.

This successful case is now being replicated both with other hospitals in Catalonia and for other services related to cardiology.

Exhibit 4

Procurers have a number of unmet needs that can be positively addressed by medtech players.

Survey instruction: Please indicate how critical the following pain points or unmet needs are in your current procurement process¹



¹Results from survey of public hospital procurement professionals and physicians across listed European countries (n = 300), July 2017.

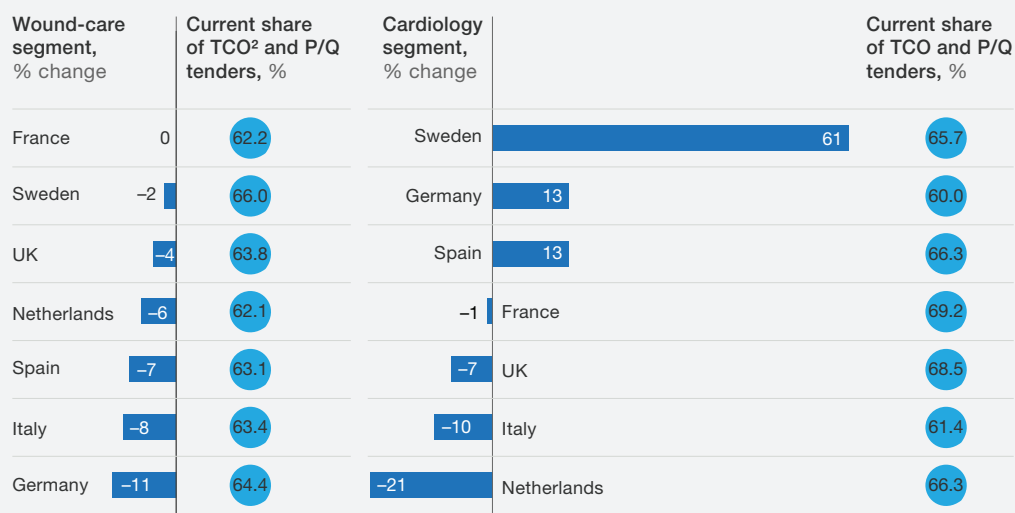
McKinsey&Company | Source: McKinsey analysis

orthopedics are expected to be the most advanced over the next three years, with a 15 to 20 percent average increase in the number of tenders prioritizing price or quality across most advanced countries. On the other hand, wound care and

IVD are expected to see a 5 to 10 percent decrease in the number of price-quality tenders over the next three years—these are high-volume, commodity products for which price is still the most important criterion (Exhibit 5).

Exhibit 5 Implementing the ‘most economically advantageous tender’ approach varies by category and country.

Expected change in price-quality (P/Q) tenders by segment in the next 3 years¹



¹Results from survey of public hospital procurement professionals and physicians across listed European countries (n = 300), July 2017.

²Total cost of ownership.

McKinsey&Company | Source: McKinsey analysis

Meanwhile, countries and regions are also at different stages today and will evolve at different speeds to form three main archetypes:

- **Leading countries** (Sweden and the United Kingdom) currently use a range of innovative procurement approaches across therapeutic areas and are experienced in constructing and evaluating innovative tenders—including outcomes—and linking them to part of the financing.
- **Fast followers** (France, Germany, the Netherlands, and Spain) currently have some examples of innovative procurement approaches and the ingredients to continue to pursue this path over the next three to five years.

- **Slow adopters** (Italy) place a lower priority on innovative procurement approaches, and while they may have some examples of the approach, it is not clear that expansion will accelerate over the next few years.

What is needed to capture fully the value-based procurement opportunity

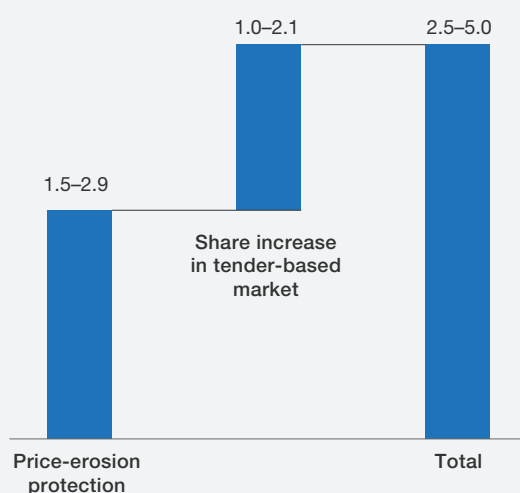
Our estimates suggest that for a medium-size medtech company, proactively investing in line with the value-based-procurement trend over the next three years would lead to 2.5 to 5.0 percent growth in the top line (Exhibit 6 shows the detailed impact by lever).

Medtech players must move quickly in three distinct areas:

Exhibit 6

Proactively investing in line with value-based procurement over the next three years could lead to a 2.5 to 5.0 percent growth in the top line.

Expected market-share gain in the next 3 years,¹ %



¹Results from survey of public hospital procurement professionals and physicians across listed European countries (n = 300), July 2017.

McKinsey&Company | Source: McKinsey analysis

- Tailor the go-to-market model to each archetype and segment. Players should redefine their country and territorial coverage and create a detailed segmentation that will allow for better targeting of sophisticated public tenders across geographies. This should help improve commercial-resource allocation and sales-force capabilities in targeting nonclinical senior stakeholders.
- Enhance the service offer to include a set of solutions based on the outcome KPIs at which customers are looking. These KPIs will range from education and training to IT and digital.

For example, for procured services related to an implantable cardioverter defibrillator in Catalonia, medtech players had to reach beyond the core to start offering remote monitoring as well as the IT infrastructure to support an integrated solution. This approach should cover both short-term service-line offers and a medium- to long-term playbook for innovation partnerships with an associated rollout plan.

- Develop players' capabilities that enable them to link outcome measures with tender-award criteria. Specifically, players need capabilities across three main areas: first, a deep understanding of care pathways to tailor the service offering to where providers/payers have more need; second, the measurement of health and service outcomes to enable innovative financing; and third, more sophisticated approaches to fee arrangements, including risk sharing and outcome-based financing. To achieve this, players will need to invest in the capabilities of frontline team members to interact effectively with procurement teams. In particular, team members will need to be comfortable using data to develop and discuss a more quantified value proposition.

Our research suggests three enablers to separate medtech winners from losers in this changing landscape:

- Have a demand-shaping mind-set (or do not assume that demand will find you). For example, Catalonia updated its approach to public procurement long before the requested date for full adoption of the EU directive into national law. The region has entered into more than 15 risk-sharing agreements with pharmaceutical companies and €10 million worth of tenders for value-based procurement since 2013—all of which now constitutes real-world evidence of successful outcomes and is providing lessons that

are now being applied to the wider €20 million value-based procurement initiative launched in the third quarter of 2017. Only those pharma and medtech companies that were willing to innovate managed to convert this opportunity successfully.

- Engage early on, at the right level, and quickly. For example, the new Karolinska University Hospital and Koninklijke Philips have agreed on a partnership for a 14-year contract to deliver end-to-end equipment and service solutions while coinvesting in R&D to develop next-generation imaging. This approach required extensive preparation from Koninklijke Philips as well as the readiness to offer a broad R&D-collaboration option to win a highly competitive tender.
- Offer a value proposition beyond the device. For example, IMS Medical won a tender from the Erasmus Centre for Entrepreneurship in the Netherlands by offering a fit-for-purpose bed-cleaning facility that went beyond the core service. Deep understanding of the client's strategic needs, active participation in competitive dialogue, and collaboration with industry and academic experts allowed IMS Medical to build a highly innovative facility. Along with its main purpose of cleaning beds, this approach reduced carbon footprint by 65 percent and brought a 35 percent reduction in TCO.



The global medical-products industry is facing many challenges, and nowhere more so than in Europe. Companies that are willing to make bold choices with regard to their strategies and business models will emerge as future leaders; those that continue to make marginal changes will not. The time to act is now. ■

¹ "Madrid decreta la compra centralizada de los fármacos para el Sermas," Acobur, March 23, 2017, acobur.es.

² Based on "The doctor will see you now: How hospital administrators make purchase decisions," Think Insights by Google, May 2013, thinkwithgoogle.com, more than 50 percent of medtech customers are influenced by what they find online.

³ "Most economically advantageous tendering and value-based procurement of medical technology: Changing practices, increasing value for money of health care," meeting in Vienna, March 22–23, 2016.

⁴ "NHS moves to end 'fractured' care system," NHS England, June 15, 2017, england.nhs.uk.

⁵ Cardiology, orthopedics, wound care, imaging, general surgery, and in vitro diagnostics.

Olivia Cavlan is an alumna of McKinsey's London office, where **Lewis Grey** is a consultant, **Chris Llewellyn** is a senior partner, and **Christian Zerbi** is a partner; **Adam Krych** is a specialist in the Poland Knowledge Center.

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