Vistas: A View from the High Ground

The Changing Face of Distribution in Orthopaedics – Part II (following up on the predictions)

An Editorial from High Ground Medical, Inc.

Predicting what is going to happen in the orthopaedic market can be very difficult. Major change comes from disruption not typically from changes in preferences. Changes from single lead to double lead threads, for instance, did not impact the spine market all that much; while changes in reimbursement (disruptive, remember disc replacement approval vs. reimbursement) can impact the use or lack of use of a product segment. Examples can be seen in most areas of orthopaedics. We did anticipate some changes back in early January 2013 and I'd like to take a look at those now and where we think things are going.

The main points we predicted 3 years ago:

"Current distribution models will be largely a thing of the past so prepare now for the future."
"The profitability of the procedures [total joint and spine] has caught the eye of another group – insurance companies."
"…surgeons are being employed by the hospital and they are, in some cases, being told what implant they can use."
"Hospitals will have to become more efficient and waste less."
"They will have to drive down the cost of their implants further."
"…major orthopaedic companies have models of what a "rep-less" sales force will look like."
"We may see reps become consultants to the hospital and the hospital will pay for case coverage."
"Sales of new technology will be sold by company sales people….product specialists or regional managers to be the salesman…"

OK, I'm feeling pretty good about our accuracy on where we thought things were going but not so much that we got there, and this quickly. I was also wrong on the estimates of surgeons becoming hospital employees; unfortunately I underestimated that point significantly.

Sales Roles and Strategies

There is no doubt that there is a role for sales representatives of yesterday's models but the larger companies are changing their reps roles and so too will the traditional independent rep, they will have to change. We now are having several tiers of reps, the titles vary for those who have titles but the roles are becoming more defined. Case cover rep: brings the instruments in before the case, brings the inventory in the day of (if separate), does the hospital paperwork and gets it to the office, and retrieves what is needed back from the hospital. Sales rep: Calls on all players in the buying center (Initiator, Influencer, Buyer, Decider, User, and Influencer). In today's environment, it would be very difficult to reach all the players in the buying center without some reason to be in contact with them; therefore those who are sales reps must really be sales focused and may not be coming from the pool of what we traditionally have termed as our reps. The large players in the market are going top down in sales. They have some business in a hospital or system, through their multiple divisions, and are seeking to organize their offerings in a way to benefit the hospital. Their approach will be to maximize their footprint in as many hospitals as possible, driving the smaller players out. In this role, the "sales rep" might be the VP of Sales or

VP of National Accounts. With the changes in surgeon employment, this approach will be significant and if targeted appropriately, very effective. Smaller players however may be more willing to help the hospitals on pricing or other terms which would be of benefit. The smaller players will need to have reps that can play on multiple levels or have strong sales support mechanisms. We're seeing "deal makers" picking up business and showing hospitals the value they, the rep, can bring to the table. The layers of sales management will be stripped away; that is a sales cost that can be automated in many cases. Technical support, reimbursement specialists, and those coming from national account backgrounds will be the keys in the new sales process. Or we could see the role of the rep move from the sales side of the equation to the purchase side. AT Kearny published a report confirming they were aware of hospitals that had hired or contracted with sales reps to manage their implants and instruments.

Just as the hospitals have to strip out costs from the purchase and use of the products, so to do the companies have to strip out costs in the sales process. Companies have been active in cutting costs on the manufacturing and internal process segments of their business for a long time and where necessary the sales process. With significant restructuring by DePuy Synthes, Medtronic, Smith & Nephew, etc. announced, you can be sure that within the Zimmer/Biomet merger there is more, the orthopaedic market is going to be impacted and much of the impact will be on the sales side, now and in the near future. We may not be heading toward a Walmart of Orthopaedics but costs are going to be stripped out to provide the hospitals material cost savings. We have seen some interesting new models which I will discuss later.

The advent of CRMs, and the now actual use in orthopaedics, is opening up opportunities. While the reps were reluctant to use CRMs for a long time, the companies that pushed hard on the implementation are going to reap the benefits. For some reason the reps appeared the most reluctant, I believe out of fear that the companies were going "Big Brother" on them. In reality the ones who are going to be impacted the greatest will be the managers in multitier structures who will either be replaced by the technology or be elevated by its use.

Payers and hospitals have gained power. CMS has already stated 90% of payments would shift from fee-for-service to value-based payments by 2018. That is going to impact companies selling implants. The private insurance companies did not reap the benefit of adding all the uninsured lives that had been promised them at the Affordable Care Act table, but they have gained greater power in what will or will not be covered, and, when in the treatment process it will be covered. That is costing surgeons' time and effort to call to check coverage and payment and that impedes the growth of a product or segment, especially one that is new or emerging. Hospitals have gained the surgeons and cleaved the long talked about surgeon rep relationship. We had estimated that about 35% of surgeons would shift to hospital employee; I was wrong. That number now stands around 50% according to published reports. This is giving rise to opportunity for the hospitals. In the past a hospital may have asked for greater discounts or set capitated pricing for procedures. Now they are going out and seeking companies, in some cases manufacturers, to find ways to get the implants for significant discounts. In several cases, we're seeing hospitals contract with companies for extremely low pricing, eliminate the sales representative and buy bulk products. That is not the Syncera or White Box model (older

generation products packaged under a different name); this is the hospital approaching manufacturers, in some cases, private labeling their own lines.

Where to Now?

The question is very apropos, where indeed? The location of the procedures is going to be the next big change. August 2015 Managers Guide to Orthopedic Surgery cover "Total Joints Totally Outpatient" and January 2016 Managers Guide to Joint Replacement "It's Time to Add Outpatient Total Joints". Likewise, March 24, 2016 Becker's Spine Review: 'Which 4 emerging trends will drive the global spine surgery market?" Megan Wood points out in number 3: Physician-owned ASCs. More surgeons are performing minimally invasive surgery in the outpatient setting. Some are already offering lumbar fusion, TLIF and anterior cervical discectomy procedures in ASCs. The CPT codes for spine came out in August of 2014 and were effective January 2015.

We have seen an interesting phenomenon with the ASC market. The same surgeon who wants the rep to be in the case at the hospital, is comfortable with his staff and their abilities at the ASC and the rep doesn't need to be there as often, if at all. Will that structure change in order to facilitate greater price reductions? The influx of direct to hospital or direct to ASC companies in the spine market coupled the similar influx of foreign competitors seeking to enter the market based on price and distributor relationships increases the supply and therefore should either see a decrease in price or a shift in the demand curve. We actually read a recent search for distributors that was seeking distributors who had an existing book of business and could switch over sales immediately. Simply switch your hospitals over to the new system, no need to worry about the committee approvals for that company, nor convincing your customers there is an advantage to the new system. That could be why the Senate has released their report on PODs. Go to that article in this newsletter to read more on that topic.