

EDITORIAL

## Pricing Medical Technology - Hit or Miss!

It is rather surprising that in the world of sophisticated medical products, pricing is often an afterthought. A huge effort is put into R&D, regulatory approval, coding and reimbursement. When price is considered, however, the analysis is too often shallow or based on ill-advised principles.

The ultimate results of pricing products or services can be significant for a company. Excellent products frequently fail to achieve their optimal sales potential by being priced too high. Equally disturbing is when a product sells well, but “leaves money on the table” from being under-priced.

Pricing new medical technology is challenging. Looking outside of the company to determine how it creates value for customers, particularly as compared to competitive alternatives, is imperative. Do it well and you will reap a full return on value. Do it poorly and you may miss a golden opportunity.

### Market Overview: Challenges in Medtech Pricing

In most industries, a product’s optimal price represents the intersection of the value received by the customer and the seller—blending need and economic fulfillment. For medical technology products, four primary inter-related factors confound those who attempt to set a rational price.

**Type of Device:** The positioning of a product in the clinical value path can substantially influence the acceptable price. The presence of a required consumable provides the seller with the potential to reduce the price of equipment in exchange for recurring, higher profit supplies.

**Procedure Reimbursement:** Forecasting sales revenue requires understanding the likely level of reimbursement in each regional market. Such predictions are based on assessing competitive procedures, public policy, and the perceived clinical value. Globally, public organizations often resist adding new procedures to the list of those currently reimbursed.

**Financial Requirements:** Historically, corporate return-on-investment thresholds have driven pricing decisions. Cash flow requirements may also influence pricing levels as revenue helps subsidize operations.

**Market Dynamics:** Product demand and price are intrinsically linked. Demand and adoption rates frequently vary with each customer segment.

#### Selected Analytical Techniques that Guide Pricing:

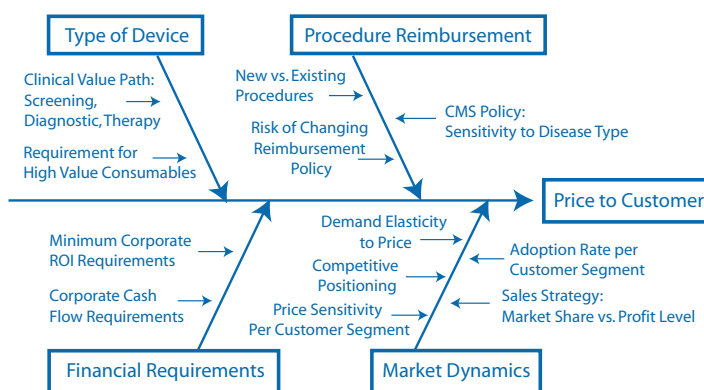
**Market Segmentation:** Defining each customer segment’s willingness to buy a device relies on data derived from in-depth interviews, focus groups, and/or surveys.

**Conjoint Analysis:** This family of research techniques assesses customer preferences for specific product attributes and also helps in the construction of price sensitivity functions. The results quantify the likely pricing levels favored by each customer segment for a mix of product features.

**Economic Value Analysis:** Long used in the pharmaceutical industry, EVA demonstrates the savings associated with different diagnostic and therapy choices using a decision-tree approach with outcome probabilities. Results may be useful when pricing equipment to buyers who are at risk to pay for random patient complications.

**Van Westendorp Analysis:** This well-tested survey technique can provide insights on the range of acceptable price points. The results often guide

initial pricing levels for new product concepts where few competitive benchmarks are available.



Considerations for Pricing Medical Devices to Customers

### CASE STUDY: Evaluating a New MRI Entrant

- The Client: A Fortune 500 company was interested in understanding customer perspectives of a competitor’s new MRI within two weeks of engagement.
- The Challenge: To understand the different MRI preferences from MRI buyers depending on whether they were historically loyal to one vendor or vendor agnostic. Results need to guide the creation of tactical and strategic responses.
- Our Solution: TMTG created an in-depth interview guide that explored why radiologists and hospital managers of diagnostic centers chose one vendor’s MRI over another. Recent buyers of the competitor’s MRI were identified and recruited. TMTG identified the MRI characteristics that triggered purchase of a competitor’s product.
- The Impact: Voice-of-the-Customer results helped the client develop an immediate promotional response and to consider effective longer term options.



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# HOT TREND

## of the Quarter: Pricing Medical Technology Products

*Tim Irish, Senior Vice President and Chief Marketing & Strategy Officer, Philips Medical Systems*

**Q:** Specifically, there are many methods for pricing: cost plus (engineering cost defined the price), competitive benchmarking (competitive prices define the price), value-based (price is based upon the perceived value of the product), EVA based (defined by the economic yield of the product), bundling or de-bundling with service or non-core offering like training. It seems that “cost plus” pricing is not adequate anymore and value-based pricing may prevail. Do you agree?

**A:** You are right. For imaging equipment at least, we are in a big transition. We used to be engineering driven relying on cost-plus pricing. Now our pricing approach is undergoing a transition: today, we don't distinguish the pricing question from the segmentation question.

**Q:** Compared to other industries, how would you assess the level of sophistication of equipment pricing?

**A:** At this stage, our customers are ahead of us: they know how to segment, to market and to price their services. We are not world class in healthcare market pricing. We are in the midst of a big and painful transition. We have to overcome organizational and capability challenges to be able to execute well.

**Q:** Which methods do you recommend for the pricing of a medical technology product?

**A:** We have to be pragmatic. It starts with the degree that your own data accurately depicts internal pricing practice. It is important that an OEM knows what it charges each type of client across the entire market. With that said, you then need to look at your market segmentation, your value proposition and the differentiators you created that would justify a premium price.

I believe in good qualitative and semi-quantitative research first to get a sense of price. Then, go more quantitative as needed. It should be noted that nothing replaces marketing's basic questions: what does each segment need? What is the relevant competitive value proposition and price? What is the demand likely to be at a specific price point? All of these questions help shape the right price for each segment. This is extremely complex in our business since we have to integrate external factors, like regulatory approval. In this marketplace, we still have two types of organizations: those that are geared towards marketing and those that are financially driven.

**Q:** To what degree will equipment pricing become based on price elasticity vs. reimbursement driven pricing?

**A:** This is a difficult question. I would probably say both. In some ways, I see more elasticity in price. Depending on the customer segment, if the packaging practice takes off, we will see different pricing levels depending on the mix of hardware – software – biology (contrast agents).

OEMs must provide true healthcare information (i.e. the diagnostic answer) to their clients by offering a complete package aligned to their needs. In that sense, I see more elasticity when this sort of packaging practice is established. However, I also see reimbursement having an impact on price. At this point, it is difficult to predict the effect on price. The reality is that healthcare is ripe for change, but it is slow. In my opinion, the long-term trend is more towards price elasticity.

*For more information on Philips Medical Systems, please visit: [www.medical.philips.com](http://www.medical.philips.com)*

*Long version of this interview: [www.themarketechgroup.com/minute/tmtg-min17-Irish.pdf](http://www.themarketechgroup.com/minute/tmtg-min17-Irish.pdf)*

## ON THE HORIZON: Technology Pricing Strategies

### HIGHLIGHTS

Medical vendors have become more sophisticated and are adapting their product pricing and distribution, as follows:

- “Account value potential” is now a decisive factor in determining how to sell to different customers and at what price;
- Expected value to the company and the cost to serve customers provide a definitive method for assigning customers and prospects to distinctive marketing channels.
- Robust CRM systems often provide the basis for a differentiated pricing structure.

### AT STAKE!

It is important to avoid the common pricing traps that historically have undermined medical vendors as they introduce new medical products:

- Pricing should be based on the actual economic value realized by customers, not abstract product benefits;
- Since new products often create a level of risk for customers, actual risk-management methods and not just price discounting should be utilized – performance guarantees, free trials, and usage-based pricing;
- Vendors must successfully manage the post-launch price trajectory, since the price generally begins eroding the moment sales begin.

### SO WHAT?

For some new products that are truly innovative, it might be both possible and preferable to establish a new price metric. For a new pricing metric to be effective, it must:

- Conform with how customers realize value
- Clearly delineate between customer segments
- Align with customer buying habits
- Take into account channel dynamics and the competitive environment
- Recognize indirect costs - training, new procedure codes, inventory management, etc.

## THE ASSOCIATE CORNER: The Price Is Not Always Right

**E**ffective pricing policies consider four “C’s”: the Company's costs and capabilities, the Customer, Competitors, and Contributors (resellers, suppliers, strategic partners, government regulation, etc.). At best, many decision-makers consider only one of the C's.

Common approaches include setting prices based on costs to achieve a target profit margin given an assumed sales volume and targeting a competitor's price. Each of those approaches consider only a single “C” (company costs and competition respectively) and run the risk of unprofitably choking off sales or leaving substantial money on the table and possibly triggering a price war.

The Customer “C” is often under-considered in pricing decisions because it can be difficult to quantify customer value. However, there are methodologies that can reliably estimate how a customer will value a product relative to competitors' offerings. Survey-based approaches, such as trade-off or conjoint analyses, estimate the relative importance of different features by evaluating how a survey respondent chooses amongst a set of hypothetical product alternatives.

While these approaches may seem expensive and time consuming, they often will pay for themselves when coupled with an analysis of the other three C's. The expected improvements include better strategic positioning, enhanced product design, and the ability to capture the differential value the product offers to target customers.

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