Medical device-makers face challenge of falling prices

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At a time when U.S. health care costs have been rising faster than inflation, the prices for many medical devices have been dropping.

Included in the price declines are devices that helped build companies that employ tens of thousands of Minnesota workers.

Key changes are driving the trend. The hospitals that buy most of the implantable medical devices in America have grown wary of incremental improvements long used by device-makers to prop up prices on pacemakers, defibrillators and the like.

And in a reverse of another long-standing practice, medical device-makers are finding it much harder to rely on physician brand loyalty to drive purchasing decisions.

Major med-tech corporations have responded by buying emerging companies with hot products that can still command premium prices, like heart valves implanted via small tubes that can cost four times as much as traditional valves.

Device giants are also looking to dominate the market for fast-growing diseases like heart failure with a broad array of treatments.

But such strategies have not stopped the overall slide.

"Historically, a lot of (med-tech) suppliers, once they were in a hospital,

they just felt no risk of loss of business," said Ginny Borncamp, purchasing director for Allina Health, which had $3.6 billion in net operating revenue in 2014. "So they were able to hold the line wherever they wanted it. And I think that is what has changed."

At Boston Scientific Corp., which employs about 5,000 people in the Twin Cities, price declines are likely to shave a percentage point from the gross profit margin of the company this year.

Some company divisions "deliver positive price because they are delivering new products that help patients and save hospitals money," Chief Executive Mike Mahoney said in an interview. "And there are some commodified products that are more prone to price pressure, and we lose more price. So when you mix it all together for the overall corporation, we have a net effect that is a negative pricing impact."

Other major companies declined to talk about device prices, which are typically considered trade secrets subject to confidentiality clauses.

Data from market analysis firm GlobalData show worldwide average sale prices for 71 common cardiac and orthopedic devices have dropped by an average of 4 percent since 2010. The prices in North America dropped 5 percent in that time.

Another source, the not-for-profit health care analysis firm ECRI Institute, said U.S. hospitals reported 5 percent price declines for basic pacemakers in the past three years. Bioprosthetic valve prices dropped 2 percent, while drug-eluting coronary stents dropped 10 percent.

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The med-tech industry's Washington trade group, AdvaMed, argued that the declining prices are the result of strong competition.

AdvaMed senior executive vice president David H. Nexon said that while a highly competitive market is a good thing, growing pressure on hospitals to cut costs could end up depriving med-tech companies of the funding they need to pursue new lifesaving treatments. "That would be a concern, not just to the industry but to the American people," Nexon said.

Research sponsored by the association showed that the overall share of national health care spending devoted to medical technology has not budged in decades, hovering around 6 percent of all expenses since 1992. All told, spending on medical devices and in-vitro diagnostics appeared to have totaled $160 billion in 2011, according to estimates based on the most recent data available.

The price-decline trend contrasts with recent moves by pharmaceutical companies, which are raising prices even for some products that have been on the market for years.

Nearly $300 billion was spent on retail prescription drugs last year, federal data show.

Similar figures for implantable medical devices aren't available, because their costs are largely borne by hospitals and lumped into the overall category of hospital spending (which jumped 4 percent to $972 billion in 2014).

Unlike with pharmaceuticals, which are primarily bought by insurers or pharmaceutical benefit managers, medical devices are purchased by hospitals and clinics. That has forced med-tech firms to reckon with the hospitals' financial struggles in ways that drugmakers generally don't.

In the past, med-tech companies relied on their relationships with independent physicians to drive interest in the latest, greatest pacemaker,

stent or artificial heart valve. Hospitals struggled to get price deals because doctors dictated what devices to buy, and price was not the factor that swayed them.

Today, doctors are more likely to work directly for hospitals and are expected to back up personal preferences with data good enough to sway other physicians on the purchasing committee. At the same time, financial ties between doctors and manufacturers are under increased scrutiny.

"The doctors like new. Just like everyone else, they think newer is better and they don't question it too much. And that all works pretty well until someone says, we're not going to buy the newer version unless you can prove to us that the new version is really worth it," said James C. Robinson, health economics professor at the University of California, Berkeley. "If a hospital can do that, this whole business model of the device company, the incremental annual model changes and price increases, wobbles. And that's what's happening."

Here's how it works.

Longtime device analyst Thomas Gunderson at Piper Jaffray recalled the story of a California hospital (he didn't have permission to identify it) that decided during the Great Recession to reduce its suppliers of artificial hips from four to two to save money.

"They went back to the four vendors and said, 'All right, one of you is going to get 60 percent and one is going to get 40 percent. Give us your best price,'" Gunderson said. "The winner gave an over 35 percent discount to what the hospital had been paying."

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With their traditional business model losing effectiveness, device companies around Minnesota and the nation are scrambling for new sources of growth and stability.

The iteration model can still work for some devices. Boston Scientific predicts that half of the drug-releasing stents it will sell in the United States this year will have a new, higher-priced feature called bioabsorbable polymer. The polymer coating dissolves as it releases the drug, eliminating the risk of inflammation seen with older polymer coatings that linger on the stent's surface.

The company said it's the only stent of its kind on the U.S. market, which will enable it to charge a premium price.

Meanwhile, device-makers are chasing deals intended to give them more depth in their product mix.

Medtronic last year completed its biggest corporate deal ever, buying the diverse surgical-device-maker Covidien for $49.9 billion. St. Jude Medical completed its largest-ever deal, paying $3.3 billion to buy California-based heart-pump -maker Thoratec. Boston Scientific last year paid $1.6 billion to buy the men's health division of Minnesota-based American Medical Systems.

Other strategies involve adding "value" to existing devices, such as educational sessions with patients or special just-in-time shipping of products, Gunderson said.

Ultimately, though, it's the hot new products that will contribute to price growth, just as they did when stents and implantable cardioverter defibrillators were first introduced.

Last year, Medtronic paid $458 million to buy a California startup called

Twelve Inc., a company doesn't have a website or a trade name for its sole device. But the device is a transcatether mitral valve replacement, which is seen as one of the biggest opportunities for growth in med-tech today.

St. Jude and Medtronic are also racing into the new category of leadless pacemakers, which are smaller than AAA batteries and fit entirely inside the heart.

St. Jude paid at least $123 million to buy leadless pacemaker company Nanostim in 2013, while Medtronic pulled off the rare feat of innovating a new-category device internally. Both devices are being tested on U.S. patients.

"If you are the device company, what you need to do is create a whole new device, a breakthrough innovation," Robinson said. "Not just an incremental version of your old device - that's OK, but the gains from that are modest over time. You need to do something really different. And everyone wants to do that."