

# Healthcare Market Conditions Today

Applied Medical  
September 26, 2003

# The Issue at Hand

- Drafted with good intentions, Statement 7 today is out of touch with market realities.
- Today, the U.S. medical device market is closed.

# Applied Medical

- Fully integrated U.S. company
- Most competitive cost structure
- 20% R&D commitment
- Top 50 most innovative under \$100M in 2002
- Most Innovative Products Awards

In a Free Market....

...Such commitments and  
accomplishments would have  
favored Applied!

## Despite All the Accomplishments....

- U.S. markets are closed as fortified castles.
- And, similar to how castles have concentric lines of defense . . . .

# In Contrast....

- Cardiac Atraumatic Occlusion
- Europe

# GPO Markets

- Shut out from 80% of the market by just a handful of GPOs.

# GPO Markets

- May 2002 campaign
  - Nearly \$300 million trocar market would have been halved. Not one taker!
  - Why? For one, 3% on the halved market is much less than 3% on the nearly \$300 million.



# GPO Markets

- Teaching centers and university hospitals are especially closed to us.

# So, What's Going On?

- Monopoly Multiple Model
- Union Model
- Franchiser Model

# The Monopoly Multiple Model

- Handful of GPOs can control 80% of the demand.
- One supplier can require 90% compliance.
- 90% of 80% is 72% market share, i.e., monopoly.
- The results tend to last.

# The Monopoly Multiple Model ...Add Bundling

- How can a supplier mandate 90% compliance from 80% of the demand channel?

## Example of The Monopoly Multiple Model

# The Elements

1. J&J started with near-monopoly in sutures.
2. Bundled sutures then trocars, clip applicators and stapling.
3. Bundled of rebates.
4. Required high market share compliance.
5. Prohibited evaluations of competitive products.
6. Bundled multiple suppliers and rebates.
7. Misused compliance requirements.
8. Blurred non-contracted with contracted products.
9. Reduced customer ability to evaluate an offering.

## Example of The Monopoly Multiple Model

# The Outcome

- Examine the suture market
- Examine the trocar market
- Examine the clip applier market
- Examine ASPs
- Examine so-called savings



# Add It Up: \$2.1 Billion Market

## COMMITMENT DOCUMENT

Ethicon Suture, Endoscopic & Mechanical Products (MS00070)

**ETHICON, INC.**

a Johnson & Johnson company

P.O. BOX 151  
SOMERVILLE, NEW JERSEY 08876-0151



**ETHICON ENDO-SURGERY, INC.**

a Johnson & Johnson company

4545 CREEK ROAD  
CINCINNATI, OH 45242-2839

### Novation / Johnson & Johnson Health Care Systems Inc. Tiers 2,3 & 4 Member Commitment Document

#### Section 1: Member Data

Hospital Name: \_\_\_\_\_ JJHCS Customer #: \_\_\_\_\_  
 Address: \_\_\_\_\_ Ethicon, Inc. Customer #: \_\_\_\_\_  
 City: \_\_\_\_\_ State: \_\_\_\_\_ ZIP Code: \_\_\_\_\_

#### Section 2: Member Purchase Analysis

Ethicon Inc. (EI) Purchase Analysis  
 Member purchases during last 12 months:

| PRODUCT CATEGORY | ETHICON, INC. PURCHASES | OTHER PURCHASES | TOTAL PURCHASES |
|------------------|-------------------------|-----------------|-----------------|
| Sutures          | \$                      | \$              | \$              |
| SUBTOTALS        | \$                      | \$              | \$              |
|                  |                         | % Compliance    | %               |

#### DERMABOND™ Topical Skin Adhesive

VHA or UHC member commits to the following annual purchase volume for DERMABOND Topical Skin Adhesive:

< \$75,000       > \$75,000

Note: Purchases of DERMABOND Topical Skin Adhesive Products will not be included in the compliance calculation for suture products.

AND/OR

#### Ethicon Endo-Surgery (EES) Purchase Analysis

Member purchases during last 12 months:

| PRODUCT CATEGORY                                 | ETHICON ENDO-SURGERY PURCHASES | OTHER PURCHASES | TOTAL PURCHASES |
|--|--------------------------------|-----------------|-----------------|
| Procedure Trays <sup>1,2</sup>                   | \$                             | \$              | \$              |
| Endoscopy  |                                |                 |                 |
| External Skin Stapling <sup>2</sup>              |                                |                 |                 |
| Internal Stapling Devices and Reloads            |                                |                 |                 |
| Ligation (Multiple Clip and Single Clip)         |                                |                 |                 |
| Trocars (Disposable, Resposable, Non-Bladed)     |                                |                 |                 |
| Disposable Instruments                           |                                |                 |                 |
| Endoscopic Staplers                              |                                |                 |                 |
| Endosutures and Devices, Specimen Retrieval Bags |                                |                 |                 |
| SUBTOTALS  | \$                             | \$              | \$              |
|  |                                | % Compliance    | %               |

- Sales of product tray components are reflected in their respective product category.
- Includes NOVAPLUS™ products.

(PAGE 1 OF 2. PLEASE PHOTOCOPY THIS FORM.)

## Example of The Monopoly Multiple Model The Pulse Oximetry Market

- Masimo is an excellent example of how difficult it is to break monopolies.
- Despite Masimo's new GPO contracts, the established Tyco monopoly remains well entrenched.



# The Union Model

- Like unions, GPOs were tasked with collective bargaining.
- Unlike unions, GPOs were given exemptions from anti-kickback laws.

# The Union Model

- Two fundamental differences between GPO collective purchasing and union collective bargaining.
  1. Fees
  2. Duties

# The Franchiser Model

- GPOs are not collective bargainers but, rather, franchisers.
- The franchises are often exclusive, or *de facto* exclusive.
- GPOs also up-sell other services to franchisees and to hospitals.

# The Franchiser Model

Why would hospitals allow franchises?

- Part owners of the franchising operation.
- Income excluded from reimbursement computations.
- Convinced of savings, although the GAO and others dispute such savings.

# The Franchiser Model

- Why would suppliers agree a franchise license is needed?
  - Exclude competitors.
  - Establish a monopoly.
- Absent that exclusion, there are strong indications dominant suppliers may not be interested in a franchise.

## Example of The Franchiser Model

- In 2002, Consorta put out a request for bid which, for that time and place, was progressive.
- J&J declined to participate.
- The result?

# Conclusion

A Time for Change