Orthopedic companies may face a headwind on implant pricing

Orthopedic companies could be facing a headwind in their ability to keep raising implant prices. Hospitals may finally get a break. For years, hospitals have faced rising costs and written the checks, while companies cultivated surgeons, who chose implants without necessarily paying attention to their cost.

Now a Wall Street analyst is warning investors that orthopedic companies face challenges as the prices hospitals are paying become more transparent. The wide variation in prices hospitals pay for implants is “unsustainable,” analyst Bruce M. Nuddell said in June, based on his survey of 100 facilities.

Meanwhile, orthopedic companies face a new round of subpoenas from the US Department of Justice. Five manufacturers said in June they had received subpoenas as part of a federal antitrust investigation.

The investment community seems to be waking up to economic challenges hospitals have faced for a long time. Implant prices have been climbing by an average of 8% to 10% annually, according to Orthopedic Network News, eating up a larger percentage of hospitals’ Medicare reimbursement for joint replacements.

In his survey, Nuddell, with Sanford Bernstein & Co, found striking price variations. The average paid for a primary hip implant was $4,937. But there was a big disparity. Highlights:

• Volume made little difference in pricing. Even among hospitals with similar volumes, there was “enormous variation” in the average implant price, ranging from under $2,000 to $9,000.
• Even for high-volume hospitals, there was a 2-fold variation ($4,000 to $9,000).
• The variation was not explained by differences in the mix of implant types used (eg, all-cemented, hybrid, and cementless models). On average, high-tech implants made up 30% of a hospital’s mix.
• There was no relationship between the payer mix and the average implant price; in other words, hospitals with a higher percentage of Medicare patients didn’t pay less. On average, 63% of primary hip implants are paid by Medicare or under Medicare rules.
• Standardizing on implant vendors hasn’t helped bring prices down. Hospitals who buy most of their implants from a single vendor don’t receive lower prices, Nuddell found.

Hospitals not aware

Some hospitals that pay high prices don’t seem to be aware of it. Of 37 hospitals in the survey that pay more than 10% above the mean for hip implants, 27 thought they were getting the same prices as their peers. Findings were similar for knees.

Nuddell predicts that once hospitals become aware of this “true pricing environment,” they’ll become more aggressive on controlling costs.

He also thinks companies will have a harder time getting higher prices for newer products, such as knee implants targeted specifically at women (see Editorial) and products for minimally invasive surgery.

He didn’t discuss the fact that many hospitals already belong to benchmarking services for implant pricing and probably have a good idea of what others pay.

New round of subpoenas

Regarding the Department of Justice subpoenas, the companies that received...
them—Biomet, DePuy, Stryker Corp, Zimmer Holdings, and Smith & Nephew—said they were cooperating with the probe, which stems from possible criminal violations in the manufacturing and sale of orthopedic implants. The subpoenas requested documents starting from January 2001.

Little is known about the probe because the government doesn’t comment on such investigations.

Biomet’s CEO, Daniel Hann, told analysts the subpoena the company received was “very broad” and related to “pricing and bidding” but could not provide additional information.

In 2005, orthopedic companies received subpoenas from the US Attorney’s office in Newark, NJ, related to consulting arrangements with surgeons. At that time, observers thought the investigation would cause more distance between the companies and surgeons, which could be an advantage for hospitals.

**Ongoing investigation**

Regarding the new subpoenas, an analyst for Lehman Brothers, Bob Hopkins, said that the fact that the Justice Department’s Antitrust Division is in Washington, DC, and national in scope “strongly suggests the original investigation has been escalated.

“There is a possibility this is a completely separate investigation, but it is likely the two are related,” he wrote in a June 26, 2006 report. “Either way, the involvement of the Antitrust Division and the wording of the subpoena suggest a serious investigation that may be ongoing for some time.”

Hopkins added that he thinks changes in the market are coming, which “should ensure that the balance of power will continue to shift incrementally towards the hospitals.”

The investigations along with more awareness of pricing may give hospitals more clout in contract negotiations, which have been weighted heavily in favor of the orthopedic companies and their strong relationships with surgeons.