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Low-Cost Orthopedic Device Firms Aim To Shake-Up Market

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As pressure builds to restrain U.S. health costs, small companies are surfacing to offer steeply discounted orthopedic devices by forgoing expensive sales tactics.

Heavyweights like Johnson & Johnson (JNJ) and Zimmer Holdings Inc. (ZMH) still dominate the \$37 billion global orthopedics market, and small discount suppliers have been operating on the margins for a while. But hospitals' growing focus on controlling costs is drawing new interest and potentially boosting opportunities for cheaper products.

"The market forces are moving in our direction," said John Marotta, chief executive of Emerge Medical, a private device-maker that launched last year and aims to offer savings of at least 40%.

Like other small firms, Emerge Medical is targeting a "trauma" market, including products like screws, plates and drill bits used to repair broken bones, led by Synthes Inc. (SYST.VX), which Johnson & Johnson (JNJ) is buying for \$21.3 billion. While individual devices can be relatively inexpensive, trauma kits with an array of parts can cost thousands of dollars, according to Orthopedic Network News, a publication that tracks device costs.

Marotta, a former Synthes sales consultant and manager, said the idea for Emerge Medical "came from the customers." Synthes spokesman Gilgian Eisner said the company doesn't see so-called generic orthopedics as a threat at this time, and that Synthes isn't currently planning to join the market.

Low-cost orthopedic parts aren't like generic drugs -- which are Food and Drug Administration-approved copies -- but rather cheaper versions offered with a no-frills sales approach. This typically means not sending sales representatives into operating rooms to advise surgeons, which is a common but cost- and labor-intensive practice.

"In certain cases the reps are getting paid more than the surgeons," and they're also trying to up-sell pricier wares, said Itai Nemovicher, president of another recent start-up called The Orthopaedic Implant Company. He is also a former Smith & Nephew PLC (SNN) representative.

In the pharmaceutical sector, companies have significantly cut sales staffs to help control costs as big drugs face competition from cheaper generics. Different market forces in the devices sector, like more aggressive hospital bargaining and slowed growth for top products, have raised expectations device companies also will have to slice selling costs.

Costs can be considerable. Zimmer, the largest stand-alone orthopedics company, spent \$1.76 billion on selling, general and administrative expenses last year, about 42% of total sales. The company anticipates SG&A will be 40% to 41% of sales this year because of restructuring efforts and sales growth.

Companies offering cheaper products see room to ditch the full-court sales press, at least for devices used in simple procedures. But wary surgeons could slow the uptake in discount products, especially when more complex devices are involved. Michael Parks, a replacement-joint surgeon with the Hospital for Special Surgery in New York City, and also a Zimmer consultant, believes company representatives have useful product knowledge in a field where implants and instruments can vary greatly.

Surgeons also are cautious about the potential for quality issues among new, unproven companies, especially if they have made subtle changes to well-known devices.

Device makers have long depended on surgeons as a conduit for maintaining high product prices, but the way the market works is changing. Hospitals -- under pressure from high unemployment and changes from the U.S. health-care overhaul law -- have been buying out doctors' practices, a move that more closely aligns doctors with budget-focused hospital administrators. Emerge Medical's Marotta doesn't think his firm would have done well before these pressures forced hospitals to think about the bottom line.

"Providers are looking for more and more ways to take costs out," said Gene Kirtser, president and chief executive of Research Optimization & Innovation, the supply chain manager for the non-profit Sisters of Mercy Health System in the Midwest.

Emerge Medical will get a tryout in one of the system's 30 hospitals, and could go system-wide, Kirtser said. The supply chain manager is also in earlier-stage talks with other low-cost providers.

Big, traditional manufacturers like Zimmer, Stryker Corp. (SYK), and J&J's DePuy said they aren't involved in this low-cost market. Their marquee products -- pricey replacement hips and knees -- are also viewed as a tougher target for low-cost competition because of increased complexity.

One established company is testing that market, though. Small manufacturer Wright Medical Group Inc. (WMGI) launched a business called "White Box Orthopedics" last year that offers cheaper versions of the company's replacement hips and knees through a more bare-bones sales approach.

Wright's Chief Financial Officer Lance Berry acknowledged White Box is more "an initiative" with an immaterial financial impact thus far, but Wright is hedging on where the industry could be headed.

The venture offers "an opportunity for significant savings," he said.

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