SIG 2006/7

For HITF Strategic Implementation Group, 14 November

Effect of procurement policy on decision-making in the healthcare devices industry: investment and innovation

Context/background

1. This note has been prepared in response to the discussion at the HITF SIG meeting on 16 August, where evidence was requested of the extent to which *"the balance had been tipped, for example if it could be demonstrated that procurement was adversely affecting industry's investment and inhibiting innovation"*.

2. This response from industry addresses two distinct perspectives:
    a. What can be measured precisely at this point and how we can measure it.
    b. A more general perspective on how industry interprets signals it receives from Government; and what influence such signals have on strategic decision making in business.

What we can measure at this point and how we can measure it

3. Trade associations receive information about their members partly through systematic survey and partly through informal contact and anecdote. Since the August SIG meeting, ABHI has published the results of a survey carried out on its behalf by Ernst & Young. The report suggests that the UK market is falling in its value relative to export markets and raises some concern over the continued attractiveness of the UK as a market for companies to invest in. The report's executive summary is annexed – the full document can be found at
http://www.abhi.org.uk/multimedia/primed/4-8/Business_Trends_Survey22.8.06.pdf

4. That survey was based on larger companies. ABHI is now working with Ernst & Young to survey SMEs, probably in considerably greater numbers (and including the 80 UK companies in the ABHI group at Medica in November), for comparable data. At present, drawing on information gathered informally from contacts with smaller UK companies, for example those exhibiting at a recent trade exhibition in Singapore, the picture sketched in the recent Ernst & Young survey is strongly supported: smaller companies are tending to say that, without an overseas market, they would see little prospect of breaking into any market at all and certainly not in the UK. Whilst no more than anecdotal, the frequency with which this view is repeated carries significance for trade associations.

5. Data of a different kind is available for several larger companies, which have a strong international presence, more choice about where they carry out their R&D, and may make strategic investment decisions on

the basis of comparative advantage among different markets. Two particular recent instances may illustrate industry perception of adverse procurement and investment circumstances. In one instance, a large UK company stated that it would not launch innovative products in the UK as the market would not bear the price. In another, more recent and more specific, a large multi-national with very substantial R&D and manufacturing facilities in the UK was faced with unilateral price reductions in the order of 75% on innovative products; it will no longer sell those products in the UK and some jobs associated with those products will go.

How industry interprets signals it receives from Government; and what influence such signals have on strategic decision making in business

6. Whilst the observations above remain anecdotal, it is important that we convey to Government the way such experiences of the market are interpreted by companies. Many companies have a strong international presence and strategic choices to make, whether about the marketing strategy for new products (UK or not UK) or about where R&D effort should be located: and such issues arise whether or not they are UK domiciled companies. In the context of the Government's Technology Strategy (April 2006), which identified bioscience and health as one of its main planks and medical devices as one of the key themes, recent trends in NHS procurement may make it difficult to continue to attract or to retain new investment.

7. This is not primarily an argument about the ability of industry in general to continue to innovate. Rather, it concerns the propensity for industry (whether UK owned and/or funded, or foreign owned) to invest in innovation in the UK. The Arthur Little report commissioned as part of HITF[1] concluded that R&D in particular was important in the healthcare technology value chain and that a number of sub-sectors demonstrated continuing emergence and growth: for example, advanced wound care, diagnostics and orthopaedics. In response to the International R&D Scoreboard update, published in October by DTI, one commentator observed that "All the evidence shows that firms are influenced more than anything by the market. If we can stimulate the demand for innovative goods and services, then firms are stimulated to increase their R&D"[2]. The healthcare devices industry currently operates with a positive balance of trade. On the basis of signals to industry in the period since the publication of HITF, it is increasingly difficult to be certain that investment in innovation and R&D will continue to drive development of this significant sector of the economy.

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[1] UK Sector Competitiveness – analysis of six healthcare equipment segments, May 2005: http://www.dti.gov.uk/files/file10462.pdf

[2] FT – 'Companies shown to reap what they sow' - 30 October 2006

Annex

ABHI/Ernst & Young Business Trends Survey

Executive Summary:

The data from respondents shows the total value of revenues, across all revenue streams within both the UK and export markets, increased by 3.97% between HY1 2005 and HY1 2006.

However, revenues from sales in the UK grew by only 2.7% in value terms across this period, whilst those respondents exporting UK manufactured goods saw revenue growth of 7.7% in value terms. This resulted in a fall in UK revenues as a percentage of total revenues from 74.4% in HY1 2005 to 73.5% in HY1 2006.

Whilst 100% of those companies exporting UK manufactured goods showed year on year growth, only 54% of companies experienced growth in revenues from sales in the UK.

Within both capital and consumable goods the growth rates for export sales significantly outperformed growth rates from UK sales. Revenues from diagnostic sales in the UK market did perform better, with 7.95% growth against export growth of 3.1%. However, sales of diagnostics make up only 2.7% of total revenues in HY1 2006 (2.6% HY1 2005).

The employee data from respondents suggests that companies have continued to invest in the UK, which showed a 4.5% increase in the total number of employees attributable to the UK market between HY1 2005 and HY1 2006. With only 8% of respondents reporting a decline in the number of employees directly attributable to the UK market.

The combination of a 4.5% growth in the number of UK employees and the 2.7% growth in UK revenues resulted in a 1.7% decline in the average £ revenue per employee, for employees directly attributable to the UK market, between HY1 2005 and HY1 2006.

When viewed in real terms, adjusted for inflation, a growth in revenues of 2.7% in value implies the UK market has, at best, only delivered marginal growth between HY1 2005 and HY1 2006. Together with a decline in the average £ revenue per employee, this raised a level of concern over the continued attractiveness of the UK as a market for companies to invest in.