The 10x Medical Device Conference
from the Medical Device Group

Global Medical Device Channel Management

Eric Knudsen: Essentially I'm actually going to talk about where. I'm going to talk about market selection today. I think it's one of the most important things that a company needs to consider when entering or deciding to invest in a certain region or in certain markets. I think oftentimes it's something that's missed when considering to go overseas or considering to invest more in certain markets. So there's a number of questions here and I'll sort of go over them as we move forward.

I bring up this example of Home Depot, and if you go to a business school class on international marketing or international distribution today, oftentimes they bring up Home Depot, and unfortunately they've made some mistakes in going abroad. In this instance, they lost well over a hundred million dollars in trying to expand in China and not doing well, and fundamentally the CEO admitted that they didn't understand the Chinese market nor did they understand the Chinese consumer. They didn't understand them yet they went and built a bunch of stores in China. So they learned, unfortunately by experience, in this case it cost their shareholders quite a bit of money.

So as I said, I think "where" is the most important question that you should ask when you're considering either investing or increasing your investment in foreign markets or if you're a smaller company and deciding where to go, more so than which distributors, which products, what foreign market works best. And I call this "stumbling into foreign markets" and I like this picture because I've seen this a lot in different companies where essentially you decide to go overseas and you line up a whole bunch of distributors and you say, "Go," and they start running. And before you know it, a few of them have stumbled, a few of them are falling behind, and one or two of them are leaping ahead. In this instance, the UK looks like they're doing fairly well, but there's a few markets that are flat on their back and they should have never been in the race.

And so in order to do this well, I like to look at a comparison of how attractive the market is versus your own company's organizational abilities. I mean, let me ask a question. What's the best medical device market in the world today?

Everyone's heard of the BRIC, right? I mean, this was really a buzzword a few years ago. Dave and I would be in meetings with some senior management at Covidien and they would say,

"We need to increase our presence in the BRICs. We need to be there. What's our plan? What are we going to do?"

And they were looking at the big numbers, the GDP numbers, the growth numbers, but there's areas within the BRICs, and I apologize if you can't read this, but essentially there's a number of qualitative and structural barriers within BRICs and within all markets that make it somewhat difficult to go there, and this is very challenging for a smaller company deciding to go overseas.

For those of you that have entered Brazil, you know, quickly discover that they're highly protectionist, that a product shipped into Brazil often lands, so the distributor buys it from you for 100 dollars, by the time he gets it out of customs it's 200 dollars, and then they need to sell it into a resource-constrained market.

May be very challenging.

I've often seen companies discover this after they've spent a lot of time, resources and energy setting up a distribution outlet in Brazil and then discovering, "Oh, it's really costly to get my product in there," and they wonder why they're not being as successful as they could be.

So this brings me to market analysis, and I would encourage both large and small companies today to really do preemptive market analysis and looking at where you want to invest prior to making those investments. And it sounds obvious, but unfortunately I think we're just anxious to get into these markets. We hear the buzz of the BRICs and the other key markets without measuring some of the attributes of the market and how they compare to our organizational abilities.

So one way to do this is called the P.E.S.T. analysis. This is somewhat textbook. You would see this in a textbook for international marketing perhaps. It's essentially an international SWOT analysis but I think it's a good way to start, and with the limited time we have today I'll go through a few examples.

But essentially, when you look to enter in a market, look at its political system, look at its economy, look at the social and cultural issues around that market, and finally, look at the technology they're currently employing and try to decide whether or not that technology is a good match for additive to your product offering.

So look at a few examples of this in the political area. Economic freedom. I think this is highly important, essentially looking at a market's rule of law, the role of government. We'll talk a bit about regulatory efficiency, and not only approval for your product but regulatory efficiency in terms of gaining a business license, rights ascribed to your partners, and market openness.

This map here is from the Heritage Foundation. They do a great job every year of scoring openness and economic freedom of each market, and essentially the color code is the redder the market is the more difficult it is in terms of corruption, the more closed the market is, the more difficult it is to essentially operate it. What you may be accustomed to with Western business standards.

The more green it is the more open the market, the more business-friendly they tend to be. So in this instance, if you want to go into Latin America, you may want to decide that Argentina and Venezuela are not necessarily the best markets for you because they have a lot of issues.

Been a lot of talk, I think the TUV guys did a great job of explaining the complexity of gaining international OUS regulatory approval. 10-20 years ago, if you had FDA approval, there was a lot of reciprocity where a market may say, "Well, yeah, FDA, it's essentially we'll let you in."

That has changed dramatically, and so the burdens that you have to get through when you're entering an international market can be very challenging.

One thing I want to point here and I see this a lot in my M&A role is rights assigned to a distributor. So you've entered into a market, you've got a great distributor, you've been working with them for years, you've got a great partnership, suddenly you decide to sell your company.

We as a larger company or corporation come in, we buy the company, and we discover that the distributor has rights to that product. They share the rights by law with the manufacturer, and if you're a large multinational company you may have not intended to take on that distributor, and it can be a real challenge.

And as a smaller company, if you're an entrepreneur looking to sell your company, this is something you should really look into in international markets because it will degrade the value of your company. This will be a knock against the valuation of your company.

Stability. This is really important, and I think it's somewhat obvious but there's also perception and reality here. If you were working on a two-year tender contract in Ukraine and over the last few months you're going to be disappointed in that investment, and I think if you do your homework and look at stability of a country, their government turnover, the stability of that government, you may avoid making some mistakes or some investment. So you may choose to invest elsewhere.

Safety is really important, and again this is where perception and reality…when I started in international distribution, Colombia was a really difficult place to go to. You needed a security detail. Colombia’s turned around. It's a relatively safe place to visit and do business now. The opposite is true in Venezuela and Argentina.

I was mugged at gunpoint in Venezuela. That was not a good day.

And I think if I had done a little more research—that was a few years ago—I probably wouldn't have chosen to start making an effort in distribution in Venezuela.

Same thing in Paraguay: I was taken out of a cab in Paraguay by a police officer and shaken down for a bribe simply because I was an American driving in the street early morning. Honestly, if I had done my market analysis, I never would have gone to Paraguay with my product.

I had a 10,000-dollar brain function monitor. It had no business being in Paraguay. It was for a number of reasons including safety. Not a great market for that product.

So now we switch. We're doing PESTs. So we've done political; now we're going to go to economic. There's a number of ways and things to look at. One tendency we have is looking at, you know, we want to be in the big markets.

We want to be in China because that’s just such a big market. We want to be in India because that’s such a big market.

But you really need to look at large market versus limited resources. Yeah, China’s a great market, but can you find a distributor or distributors? Do you have your own resources to manage those distributors? Those are all questions you need to ask.

And then, opportunity cost, and this is something again I see on the mergers and acquisitions side and it has to do with points of diminishing return. You may have a company where if you add a sales rep in the United States—and every time you add a sales rep after a certain amount of time that investment becomes accretive and you're gaining 50,000 dollars to the bottom line each year.

And then you decide, “Oh, I'm doing great, so I'm going to go overseas,” and now you set up international distribution and every support person that you need to add for international loses 25,000 dollars to the bottom line.

But then you're ready to sell your company and you come to a major acquirer and say, “Look, I'm global, it's great.”

I as an acquirer will not be impressed.

I'm going to look at that and say, “I'd rather have you add more sales reps in the United States and be accretive and have a more profitable company than you're spreading your resources amongst several different countries and trying to be a global.”

So if things are doing well in your core market and you're becoming profitable, don’t necessarily rush out to be global just to be global. We at ZOLL have a product line well over 400 million dollars. It's growing well above 20%.

We're in two international markets because we're doing well in the United States and we're going to take it very slow and we're going to be meticulous in how we expand internationally because we haven't reached the point of diminishing return in some of our core markets.

Size of market from a GDP perspective. I bring this up because oftentimes a lot of the larger GDP markets are some of the ones that are sort of slow and boring. I'd never been in a meeting when I was with Covidien where the senior management was saying, “We need to invest more in France.”

We were in France but they were all concentrated on the emerging markets. None may have been a good opportunity for them, looking at that, but don’t discount. My point here is don’t discount the developed markets. There's still a lot of opportunity there, and that has to do with per capita gross domestic product as well.

Speed of growth. A lot of companies say, “Well, we need to be in the fast-moving markets. We need to be where it's really fast and the economy’s growing.”

And that's true, and I think in China is a very good example of why China’s so attractive, because one, it's large, and two, it's growing rather quickly. But some of the other fast-moving markets, you may have some political and social, technological issues that you need to deal with in addition to the economic that might look encouraging. So in this slide you've got Libya and Iraq as the two fastest-growing economies in the world right now. Economically, that might look great. Politically and socially and safety, for example, you may have some thoughts there. And that’s an extreme example, but…

Healthcare per capita. I think this is one of the most important measures that you can take as you consider moving internationally. You go where the money is and particularly the per capita. In China, the per capita healthcare cost is still relatively low and the same is true for most of the bricks.

The higher per capita healthcare expenditures are generally the slower-moving Western European countries, the Nordic countries, but for your product, if you're starting out, it might be an appropriate place for you to invest your time and energy, especially with limited resources.

So moving on to social, the social aspect of the P.E.S.T. analysis, first start with cultural issues. I think culture gets discounted quite a bit. I've got a quote here from a famous—I believe he was Dutch—anthropologist who looked at culture and saw it as a cause of friction more so than synergy.

I think as Americans, for the Americans that are in the audience, we're very open-minded. We're an open-minded society and we strive to be multicultural, but we're also Americans. We have an American mindset. And so when you go overseas, you've got to understand that people think differently, cultures behave differently, and that not everyone bends to the American mindset of doing business.

And so as you plan to invest or to enter foreign markets, consider the culture that you're going into. In the Middle East, they do business very differently than we do here in the United States. My company ZOLL Medical was acquired by a Japanese company about 18 months ago. We're learning a lot. The acquisition has actually gone very well, but the Japanese business culture and the American business culture are different, and the folks at Asahi Kasei, our parent company, did a lot of hard work before entering the US market and making a two-billion-dollar acquisition of ZOLL to make sure that they had the integration right. And the same is true for international distribution.

What’s a talk without talking about circumcision?

I’ll get everybody’s attention with this one.

There are social norms and cultural norms in medicine. I think we have a perception that medicine is a…everyone’s anatomy is roughly the same regardless of borders and medicine is generally practiced universally, but that’s not the case. And I bring up circumcision here, but the same is true for the practice of anesthesia and other medical specialties.

I had a son. My first son was born in Holland. I have two sons and my second son was born in Boston at Mass General.

When my first son was born in Holland, my wife who is a medical researcher had done the research, looked at the American Academy of Pediatrics recommendation, and they more or less say circumcision’s a good thing, that the medical benefits outweigh the drawbacks and it's a procedure that should be considered.

In Holland and in most of Europe, however, they look at it as cruelty, cruelty to an infant that has no say in the procedure. They look at it as something that should actually be considered to be barred illegally.

And so it was an interesting conversation for us being on both sides of the pond when our respective sons were born. First, I think we were called barbarians in Holland when we asked about the procedure. I think that was the word that the pediatrician used.

And then when my son was born in Boston, my second son, they just picked up Theo and said, “Okay, we're taking him for the circumcision.” We're like, “Wait a minute, we want to talk about this a little bit.” I won't get into details, but…and the American pediatrician looked at us like, “Oh, you weirdo. Come on. This is something you got to do.”

So, and hopefully not too personal stories here, but the point here is that there's definitely different norms in medicine and that you need to consider that, and you don’t want to find this out too late after you've done a lot of work in entering that market.

So second to last slide for me, and then I'll turn it over to Dave, this sounds obvious but I've made this mistake in terms of technology – is the market that you want to enter in ready for your technology?

And I've seen this a number of times where you've captured the early…or I shouldn't even say early adopters but in many of these markets you're looking at the top of the pyramid, the top 5 to 10% of the economic healthcare curve where these institutions can afford your technology but the rest can't, and you need to consider that.

I was in an operating room much like the one at the top of the screen there in Latin America and I was selling a very expensive piece of technology and I almost—these guys had other priorities.

These guys needed modern or up-to-date anesthesia machines that were relatively basic and not something that was highly advanced that would be more appropriate for the operating room below. So really as you go through this you need to assess whether the market’s ready for your product.

And then finally, this is sort of how you bring it all together. This is called the McKinsey Matrix or GE Matrix. Boston Consulting Group does something similar. You've probably seen these before.

But really the idea here is to rank the opportunities before you enter or you invest more into an international market. We do this at ZOLL.

We do it once a year to understand where we want to invest more internationally, where the markets are working well, where there's good opportunities. And essentially, the x-axis is your organizational ability, the y being the market attractiveness, and the size of the circle is the size of the underlying market.

And so those things in the top right-hand corner seem to be very good opportunities. It's something that should be exploited.

Things in the top left-hand corner are opportunities that might be attractive but you'll need to change some of the organizational capabilities for you to exploit.

And then, things in the bottom left corner you more than likely should just…that's a market that you shouldn't be entering into.

So with that I'm going to turn it over to Dave, who's going to talk to, once you've found the right market, how to get the right partner and execute with them.

Dave Sheppard: So executing with the right partner is really key. So once you have found somebody, you can't…it's very challenging for companies to manage them, and what I've seen is sometimes companies will go, "Hey, I got this great distributor in Germany, they have this great track record, and so I'm just going to let him go."

And I can tell you just from experiences for myself and others that I know, that's one of the worst things that you could ever do. No matter how good they are and the track record is, you have to stay aligned with them and you have to be able to measure them and to manage them.

So in terms of engaging the right type of distributor—Eric brought up a lot of comments—one of the things just to point to consider on all that is, what type of distributor have you met in that market? And something to consider…and Eric had direct experience with this in terms of when he was at Aspect. He set up distributors in certain regions both in Europe and in South America as he talked about. And so that's one way to go about it.

Another is to think about some of the major OEMs. For example, Covidien, that is one of the ways that they have grown some of their businesses over time. In one of their major divisions, two of their last four major acquisitions came from companies that they had previously distributed their product.

They didn't distribute it everywhere, but they had taken select markets where maybe Covidien wasn't as strong in certain areas and they needed some additional bench strength in terms of products. And the company needed to have a distributor, so instead of going to a local distributor they went to Covidien and said, "Hey, would you be interested in growing this product? You're in this particular market." And then it's a good opportunity as a test case for both companies to see, are you a potential fit to work together on a larger basis down the road? So keep that in terms of your toolbox as far as thinking about who your partners might be.

Also, don't just take partners that select you. If they call you and they say, "Hey, I'm the best guy in Germany, trust me on that," don't just take their word for it. Make sure you'd check them out. Make sure they really have capability to take to market and make sure that you are taking all control over your marketing strategy. Even though it's a different market, it's still your product and your strategy. So yeah, they need to do the translation but it's still your product. You need to make sure it's positioned in a proper way.

And then, once you have the right partner, then start to treat them as long-term partners, not just, "What are you going to do for me in the next six months?" Instead, what we can do together in the next six years?" You need to think about those types of things.

You want to make sure that your partner matches the channel strategy that you have. Are they in tie with the consumer? Do they understand the consumers that you're targeting in that specific market?

Do they have the relationships with those types of customers? And that's one of the things that you really need in a channel partner, is somebody who understands how to connect with that consumer and ideally already has relationships with those consumers in that market, with clinicians, certain type of doctor, especially, whatever it might be.

Or if you're in the US, if you're going to go with a rep, get reps that are right in the market. That will save you many dollars. It's worth spending a little bit more on a rep group or a distributor that has the relationships, they're trying to build somebody who might be a good salesperson and has a good track record but wasn't in that particular market.

If you're in a direct sales team, you can afford to take more chances in terms of hiring somebody who's good in sales and teach them your market, but in distribution you really want to get people that are good in that market that you're in.

So when you're negotiating the deal, what are some of the things that you want to think about?

Well, you want to think about the marketing activities, and one of the things that I can tell you from experience is that don't assume anything.

When you think, "Okay, this company has been in business for a long time. They're very successful in Germany. I know they know what they're doing, so I'm not going to really worry about it. We're going to sign the deal, they're going to pay this much for my product, and they're going to go sell and we'll set some kind of a forecast in volume."

Well, what about the marketing? What's going to happen? So if you assume that they're going to take care of it all, you may assume wrong.

You might be right, you might get lucky; however, it's important in the framework of the deal to set up all the expectations that could be critical to your success, and marketing is definitely one of the things critical to your success in each market.

And sometimes you may need to tailor the message to that particular market besides just the language. I think we were talking yesterday about maybe some claims because of regulation they may be able to make in some markets and not in other particular markets.

Selling time. What is your expectation of the selling time?

We always tend to believe when we innovate and develop our product that that's the best product out there, and now this guy's going to take it on or this gal is going to take this on and, wow, they're going to be just gung-ho because they told me they would be gung-ho about it.

Well, find out what else is in there in their bag because they may not think that your product is a priority; however, they're happy to have it because it looks cool and if a doctor asked me about it I might go ahead and bring it out.

So set some time, expectations around selling time and how much time is each of their reps going to spend on selling your specific product.

And then, pricing. Are you going to be volume-based? Is it going to be margin-based? Because there are different types of collaborations that you can set up.

And then you have measuring result in terms of, how often do you want to do to be able to have [00:31:25] **reporting with** that [00:31:26] **in terms of** minimum volumes? And obviously, you're going to have a little bit of a growth curve as you first start up, but you really want on a regular basis to be checking in, are you meeting the minimum volumes? Why are you meeting the minimum volumes? Why are you not meeting minimum volumes?

Sales call reports. I personally, when I'm leading the sales team or working with a distributor, I want to see what's actually happening on the street and I want to know what happens in those sales. And I often go first, so the ones that didn't work out so well, because I want to know, why are we not being successful? Why is our message not getting across? So it's important to be able to read them, and especially when you're first getting going, read them yourself and take charge.

And then lead generation. Who's going to do the lead generation between the two companies? Sometimes the manufacturer does, sometimes the distributor does. Then, develop the pipeline – how are you going to do that? How are you going to have accountability? I'd recommend quarterly review at least if you're going to have that.

And then there's always going to be a big question around exclusivity, and as Eric mentioned, that's something you really want to think about carefully. Maybe exclusivity for five to seven years could be okay because you develop in the market together, but maybe you have an exit strategy to be out in seven years or maybe your investors have and exit strategy to be out in seven years. And if you've just given something exclusive for perpetuity for China for the next 50 years, and maybe China is important to that company that might acquire you, you've just lost your deal. You've lost one of your exit possibilities. So think about those things carefully, and then also your payment terms.

There are a lot of different ways that you can set up a scorecard. I don't have time to go into them in a 45-minute presentation, but that's something you can find tools online or I could help somebody set something up like this if you need some help.

And same thing in terms of measuring the results. There are ways to be able to look at on a regular basis, "What did we expect to achieve? What are we achieving together?"

And really, that's the core about working with a channel and a partner, is after you take the time to find the right partner, then you really want to be able to take the time to make sure you're measuring them, managing them, working with them so that you're successful together.

And that’s really just going to take a lot of work. Please do not expect somebody just to take your product on and go run with it because that’s going to go in a different direction than you like.

Take the time to work with them, get in the market with them and help them grow, and you'll be very happy with the results.

At the end of the day, the manufacturer should be happy with a little quicker speed to market, channel partner will be happier with the innovation access that they have. You can read the rest of them, but the bottom is you are looking for that win-win between the manufacturer and the channel partner.

So with that I think I'm close to my time, so I'll just ask for any questions.

Joe Hage: First question comes from Joe Hage…

Dave Sheppard: Yes.

Joe Hage: …and he would like to know if the two of you are available to join us again next year. That was awesome.

And I have a lot of questions and I'm sure people in the audience do, and those people in the audience do.

Like you said, you scratched the surface. There are so many things that go into successful distribution, and following your talk we have Seth Goldenberg from NAMSA who’s going to talk more about getting into international markets. It's a hot topic.

It comes up over and over again in the group. There's a high demand for your services, which is good for you young entrepreneurs.

Dave Sheppard: Okay. Oh, [laughs] with some gray hair. So thank you much. I've already got the days marked in my calendar.

Joe Hage: Okay, fair enough. Okay.

Brian Blachly: I just want to agree with you about Brazil. [Laughs] I sell a product in Brazil and I had to build a factory to do it in Brazil.

Dave Sheppard: We actually at Covidien at one point, we had one of our products, so it was so challenging to get into Covidien and we actually thought about how we would actually just set up a separate plan just to make it there, to be in there. It has been a very challenging market, so I was encouraged by what I heard earlier by the regulatory people that they might be opening up a little bit. That would be nice.

Michael Kohlman: It's kind of a two-part question. One is that—this is based on some personal observations I had moving into Asia—how important have you seen it to have sort of the headquarters advance team in ahead of time before you move into a market, in other words, getting exposure before you actually even pull the trigger?

Have you seen that make a difference? And the second one is expats – has that made a key difference as you're entering markets, getting people in there who basically have sort of seen both cultures?

Joe Hage: Michael, if you wouldn't mind, not everyone knows that second term.

Michael Kohlman: Expat? It just means ex-patriot, so somebody who's native US who spent expensive time, say, in China.

Eric Knudsen: Okay. So I'll answer the second question first. Alright, I'll do this. So expats are great. I had the opportunity to move abroad for a few years in Europe. It was a great experience for me and…okay, so it was great…alright.

Joe Hage: Come on, Dave. What's going on?

Eric Knudsen: It's the microphones. So, great experience for me. I think the…and it does help bridge that cultural divide and…you know, the home country versus the foreign market you're trying to enter.

They're very expensive. And so…and the other thing is that the global business education, the level of talent globally is much greater than it was 20, 30 years ago. And there's tons of MBAs in Europe, tons in Asia as well, and so they're not…I think American expat is not as necessary as it may have been from a managerial point of view. You can find someone that can implement the standard management practices that are there. So there's definitely a role for them but there's tax implications. It's a lot more expensive, yeah.

Michael Kohlman: Yeah, and the reason… I was actually involved in probably about four or five projects in Asia and one of the differentiators that I noticed almost immediately is that the projects that were highly successful versus the ones that were kind of mediocre, the highly successful ones, there were sometimes nine, 12 months advance exploration going on in those markets before they actually pulled the trigger. I know from IT and infrastructure standpoint, in Asia for example, I was scouting, helping scout Asia markets almost 14 months before we decided to move.

Eric Knudsen: Yeah, I think that’s the point of our presentation today, is you do that advance work, you're going to save a lot of heartache in the future. It's like anything, right? Prepare, and then when you execute it's a lot easier.

Dave Sheppard: One example that I can give for that is I'm working with one smaller company right now, early stage emerging technology, very bright innovation, and they really were thinking about a lot of things that they could do not only globally but then also different innovation market segments.

So I took them over to MEDICA last year for two purposes: One, so they could see the European market firsthand, and while I was there I took them actually to a couple of German clinics that happened to be in their market segment so they can get some direct market feedback. they're probably two or three years away from launch, but that early feedback was very crucial to them in terms of their product development or thought process but also their market development thought process as well, and also in segmentation because I was able to convince them that there was a certain part of their market segments that they were thinking about developing products for that was going to be a waste of their time because I was able to show them a hundred other people at MEDICA that were already doing what they were thinking about doing. So it is good for the management to get out and see the market.

Joe Hage: I'll admit to a bit of an American bias in the questions, frankly, that the whole group fields because that’s where I'm from and that’s what I personally know best, but I came to Alberto and Debbie you're next, I'd especially like to know and I'll let them ask, what’s it like not being from the US and either entering the US market or, you know, basically looking for distribution in any country other than your native one, and any perspective you might have on that? Alberto?

Alberto Rodriguez-Navarro: I want to ask, do you have any experience as a big company to modify the product in order to fit the needs of the market that you want to enter?

Dave Sheppard: Well, I would say at Covidien there certainly was the capability to do so; however, I'm very hesitant to do so.

I mean, that was also part of their challenge in…they were very successful in certain products in the emerging markets and still are today. They're going very well in all of their markets. However, they probably in hindsight could have been a little faster growth in certain market segments if they would have tailored the products to the markets they were entering instead of just taking the product that worked in the US and just throwing it in there and seeing what happens, which is what happened in certain cases.

Eric Knudsen: And Alberto, I think the idea of reverse innovation is so important. I think what…I was very impressed with your talk yesterday in that understanding the market needs and…because today's point, you know, I can have a ventilator and take some features off and make it less expensive, but those features may be very important to your market.

And if I don't understand that, cost isn't the only, and you made this point yesterday, that cost is not…might not even be the only barrier but…or concern. So I think the whole concept, we don't have time to talk about it, but reverse innovation where we're taking ideas from the market itself and then applying the certain strengths that we have as a major multinational to apply to a customized product.