

(Source: Sample case from BCG website)

Context

Your client is GenCo, a large, international, diversified company with a health care division that produces a wide variety of medical instruments and related services. Five years ago, it expanded into the health care software industry by purchasing MedCount, which markets administrative systems to large U.S. hospitals. These systems are designed primarily for back-office functions; they are not designed for managing patients or providing other physician and technical support. Since it was purchased, the software division has failed to deliver the growth needed to justify the multiple GenCo paid for it. GenCo feels it has already squeezed margins as much as possible, and now is looking for new sales opportunities. MedCount turned to BCG to help identify potential ways to increase revenues. How would you approach this problem?

Establish understanding of the case

Interviewee: First, let me make sure I understand the problem. The parent company produces medical devices and services, but before the acquisition was not involved in health care software. The company it purchased, MedCount, sells only administrative systems software to large hospitals. It is now looking for opportunities to increase revenues.

Interviewer: That is correct.

Interviewee: Could I take a moment to jot down a few thoughts?

Interviewer: Sure, that would be fine.

Set up the framework

Interviewee: I would suggest using the following structure to approach the problem:

- First, I'd want to understand the market size and growth rates for MedCount's market and related software markets.
- Next, I would like to explore the competition and their market shares.
- Third, I would like to examine customer requirements and then, given those external conditions, look at the division's capabilities to understand how well prepared it is to meet the needs of the marketplace.

Interviewer: That sounds fine. So what do you want to know about the market?

Evaluate the case using the framework

Interviewee: Well, the first hurdle would be to identify the markets the company would be interested in. Besides administration systems, what other types of medical software systems do large hospitals purchase?

Interviewer: There are many software systems, but for the sake of time, the team focused on three primary markets: administration systems, patient administration, and physician support systems.

Interviewee: What do those systems do?

Interviewer: Patient administration includes systems such as admissions and tracking. Physician support systems are more specialized, for individual physician procedures.

Interviewee: I would like to know how large each market is and how fast each is growing. I would use secondary sources such as press releases, analyst reports, and published market studies, to obtain this information.

Interviewer: Great! That is what we did during the market study. Our information revealed the following market sizes and growth rates.

	Administration	Patient administration	Physician support
Market size (\$M);	1,500	1,000	1,200
Growth rate	5%	5%	12%

Interviewee: From a size and growth perspective, physician support systems looks like a very attractive market. I'd like to know a little about the customers themselves. The client is currently targeting large hospitals. Approximately what percentage of the market do they represent?

Interviewer: We were unable to get an exact breakdown, but we know that these hospitals make up the vast majority of the total medical software market.

Interviewee: That would make sense, since the more sophisticated procedures at a hospital might necessitate more advanced software solutions. I know that there have been a lot of changes in the industry as a result of managed care. I don't know much about the industry, so I would want to look at market studies and press clippings to get a better sense of the hospital market in general and any technology or software trends more specifically.

Interviewer: Okay. Let's say that you did that and were presented with this summary of market trends:

- **Consolidation in the industry, with three to four large hospital networks dominating 45 percent of the market**
- **Cost controls instituted, particularly as these large hospital networks acquire smaller hospitals (centralization of functions being a key cost issue)**
- **Many hospitals seeking to consolidate their vendor base**
- **With regard to technology, many hospitals upgrading their older systems**

Interviewee: If hospitals are consolidating vendors, perhaps our client has an advantage in being part of a larger medical company. Maybe the client could also gain some advantages by expanding into other software segments. Are the people responsible for purchasing software at the hospital the same for all three segments?

Interviewer: Like all things, it differs by hospital, but the larger hospital networks, have tried to consolidate their purchasing not only within but also across hospitals.

Interviewee: Is the decision maker for medical software the same as for medical instrumentation and devices?

Interviewer: In some cases, the head of purchasing influences both decisions, but the person who makes the final choice is different. Software decisions are usually made by the hospital IT function, and those for instrumentation by the medical staff.

Interviewee: I think I have a pretty good understanding of the market for now. Let's look at competition next. We could identify all the competitors and build up the market shares using a combination of public data and estimates.

Interviewer: Well, let's assume that you don't have an infinite amount of time to look at all the competitors. You can only look at the top five competitors in each market. You are given the following data:

Administration Systems	Sales (\$M)	Growth (%)
MedCount	700	4%
HCS Software Systems	100	7%
Morningside Software	80	3%
Admin Systems Solutions	70	2%
HTI Software	50	15%

Patient Administration	Sales (\$M)	Growth (%)
HTI	300	5%
Registration Software Solutions	240	4%
Signup Software	60	3%
HCS Software Systems	30	16%
Patient Software	20	-1%

Physician Support	Sales (\$M)	Growth (%)
HCS Software Systems	150	16%
Physician Support Systems	100	11%
Medical Technology Inc	25	18%
HTI	20	32%
MedSys	5	15%

Interviewee: Very interesting. The first thing I would note from the data is that the market concentrations are very different. In administrative systems, the top five competitors control 66 percent of the market and in patient administration, they control 65 percent. But in the physician support market, they control only 25 percent.

I would want to know what gross margins look like in each of these markets as well. I might turn to analyst reports and look at competitors' financial statements to deduce whether they are making money in each market.

Interviewer: Gross margins vary, of course, but the analyst reports have margins of 25 to 30 percent for administrative systems and for patient administration. For physician support, the margins tend to be higher, more like 45 to 50 percent.

Interviewee: I see that two competitors, HTI and HCS Software Systems, have very large revenue growth in all three sectors, although they each dominate one. I would want to look at their financials, annual reports, and press releases to find out a bit more about their strategy in each of these areas.

Interviewer: You'd find that they recently entered these noncore markets. Why might they have done that?

Interviewee: Perhaps, like our client, each had a strong position in its own segment, HTI in patient administration and HCS Software Systems in physician support. Maybe they too decided to branch out into the other segments to find additional growth.

Interviewer: That is a very good hypothesis. Let's say there is evidence in the sources you consult that supports your assertion.

Interviewee: Well, if that were true, these two companies could be a threat not only in the other two segments, but also in our client's segment, administrative systems. It looks as if the client is slowly losing market share in its segment, since it is growing more slowly than its market.

Interviewer: Good observation.

Interviewee: The market and competitor trends could also suggest that the client may want to enter these other markets. In particular, the physician support market looks attractive, given it has high growth and lack of a dominant competitor. The higher gross margins may provide attractive returns on the necessary investment in software development.

However, the patient administration market may also be attractive. Although it is more concentrated and offers lower margins than physician support, the client may be able to enter this segment with a smaller up-front investment. Given the trend toward upgrading existing computer systems, it may be important for MedCount to have a product offering in each of the three market segments. That should not be too difficult, since the company is already in the software industry.

Interviewer: Perhaps, but you should think a little more closely about these types of software. Are all software systems alike?

Interviewee: Well, let me think about that for a moment. I suspect patient administration would have relatively low entry barriers. From your earlier description, these systems appear to be pretty basic, dealing primarily with admissions and patient tracking. However, the entry barriers in physician support might be higher, since these systems are more complex and there are probably multiple systems for the various physician procedures. I guess it would be harder to get into those types of systems.

Interviewer: That would make sense.

Interviewee: Since the company might want to go into only some of the segments, I would want to know how important it is to have products in all three segments. Do we know if the competitors are marketing their products as a bundle?

Interviewer: How might you find that out?

Interviewee: Since it would be difficult to talk to a competitor directly, I would probably target a competitor's customer, particularly one that just converted from our client's software.

Interviewer: Let's say you get an interview with a customer that recently switched to HTI. You discover that the competitor was offering it a better pricing deal and service for software products in all three segments.

Interviewee: How were MedCount's software and service perceived in relation to those of competitors?

Interviewer: **The customer thought that its administrative systems were adequate, "the old standby," but not stellar.**

Interviewee: Were there any other key reasons it switched from MedCount's system?

Interviewer: **When it decided to upgrade its systems, it tried to contact MedCount, but could never get a representative to describe its options.**

Interviewee: Interesting. How did HTI perform?

Interviewer: **The HTI representative had heard that the company was considering switching software vendors and provided a sales representative to pitch HTI's administrative product the next day.**

Interviewee: It definitely sounds as if there was a problem with the sales function and that customer relations need to be improved, particularly for the larger hospital chains. There also seems to be an advantage from both a marketing and sales perspective in having multiple software products. I would want to confirm those views by doing further interviews.

Interviewer: **Let's say further interviews support those assumptions.**

Interviewee: Since we have already looked at the external conditions, I would like to move on to the client itself. I'd like to know more about its marketing and selling organization as well as its software development skills.

So far, we know that our client offers administrative software and that there may be a problem with sales and marketing. Could you tell me a little about the marketing department?

Interviewer: **The marketing department is organized regionally. Teams are assigned to hospitals within each state or geographic region, such as New England.**

Interviewee: That could explain some of the problems with MedCount's marketing and sales. If hospital purchasing is centralized, the marketing organization may be outdated. Does the company have any teams dedicated to the four or five biggest hospital networks?

Interviewer: **No, there are no dedicated teams. They talked about doing that for a while, but it conflicted with the regional structure it had in place.**

Interviewee: With regard to software, does the company feel it has any strengths or weaknesses?

Interviewer: **It feels that their administrative product is very strong ("best of breed") and is the dominant technology. Also, the product is modular in design, which allows for easier upgrades. Although the company has never branched out into other market segments, the software developers believe that certain modules could be used to build the foundation for other administrative software programs. The company feels customer support is also an area in which it excels.**

Summarize and make recommendations

Interviewee: Let's start with our client's market. The client dominates the administrative software market, which is fairly large but growing slowly, and the company appears to be slowly losing market share. Patient administration is also growing relatively slowly.

Interviewer: Both markets are relatively concentrated and appear to offer lower margins than physician support. The physician support market is large and less concentrated, and could potentially provide higher margins, but would require a larger investment. The hospital market itself is becoming more concentrated and is pushing to consolidate vendors. The purchasing agent is often the same for the three types of software.

Interviewee: Looking at our client's competitors, two, HTI and HCS Software Systems, appear to be particularly threatening. Each has a dominant position in one segment and is branching out into other areas. They appear to be marketing their products and services as a bundle and are using service as a key point of differentiation.

The client offers only one type of system and appears to have some weaknesses in its marketing organization, particularly in marketing to the larger hospital networks, which offer the most promising market opportunities.

Interviewer: How would you recommend proceeding?

Interviewee: The first priority should be to fix the marketing organization, particularly for the large hospital networks. MedCount will have trouble expanding into new markets if it can't defend its current position and shore up its existing customer relationships. There should be a team dedicated to each of the major chains. The client should also look at improving customer tracking so that it is clear when its customers are going to upgrade. There should also be clear contacts so that the customer can easily keep in touch with MedCount.

Next, I would recommend that the client explore entering the other market segments by leveraging its dominant position in administrative systems. At first glance, patient administration does not appear to be very attractive, with slow growth, low margins, and large, dominant competitors. There appears to be some advantage, however, in having products across the product range. I would recommend that we interview some of MedCount's existing customers to better understand their needs and future IT requirements. If the customer base is interested in one software provider for both back-office administration and patient administration functions, this segment looks promising.

If the client does decide to enter this market, it should look at the lowest-cost method of entry, either developing a product internally or acquiring a competitor. The modular design of its existing administrative software suggests internal development of the patient administration product may be the way to go, but we would need a more thorough comparison of the internal development and acquisition options, including both cost and time to market. I think that physician support offers our client an exciting growth opportunity, given its high margins, high growth, and fragmented competition. I would definitely think about an acquisition strategy, since the client may lack the technical capabilities to enter this specialized market. I would recommend going for one of the larger companies, as that would give the client a stronger position. Smaller companies would probably not offer an important enough position in the market. More research would be needed, however, for us to better understand the intricacies of the market and each potential acquisition.

Interviewer: Those are very interesting conclusions. Thank you.