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Life Sciences Practice

The transformation imperative: Igniting value creation in medtech

Leading medtech companies are embarking on bold transformations and evolving their operating models to unlock sustainable growth and create efficiencies.

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February 2025

The medtech sector continues to face challenges in achieving profitable growth, causing some companies to embark on bold transformations to unlock value. Value creation and potential efficiencies are difficult to capture because they are often deeply interconnected across functions, requiring an evolved operating model and cross-functional collaboration to unlock. Executing a successful transformation in medtech can catalyze change by helping companies refocus on sustainable growth, reigniting a cycle of efficiency improvement and driving stronger performance overall.

Continuing challenges with growth and margin expansion in medtech

As discussed in *Medtech Pulse: Thriving in the next decade*, the medtech sector has struggled to deliver value creation and has lagged behind the S&P 500 since 2021.[1] Our recent research further highlights a divergence in growth and value creation between leaders and laggards, with most of the sector's growth in TSR driven by top-decile performers.[2]

The approach to value creation is also evolving. While revenue growth remains crucial, investors are also placing increasing emphasis on margins. Before the COVID-19 pandemic, industry margins were on an upward trajectory, but that trend has reversed in recent years. Industry margins have dipped below 2019 levels, and only one in four medtech companies grew profitably above the industry average (Exhibit 1).[3] Industry leaders face persistent pressure on margins because of rising input costs from labor and raw materials, and slowing growth puts further pressure on profitability. In particular, bottom performers in margin have deviated further from the median since 2023.

Specifically, we find that top-quartile performers in medtech have above-average revenue growth, while bottom-quartile performers lag behind peers in margin (Exhibit 2). Looking forward, only 25 percent of companies are expected to improve both revenue growth and EBITA margin in the next two years.

In addition, the industry is simultaneously confronting other challenges:

Slowed pace of innovation. Among incumbents, the pace of innovation has been slowing with R&D becoming more expensive, partly driven by a rising standard for clinical evidence and increasing difficulty identifying breakthrough opportunities. This has created opportunities for new competition, especially from China and India, to emerge.

Continued impact from supply chain challenges. Supply chain leaders are still grappling with the labor shortages and raw material cost inflation that came about during the COVID-19 pandemic, together with production delays and volatile demand. Many companies are still in the process of resetting their manufacturing and supply chain cost base and returning to the discipline of continuous cost optimization.

Complex global markets. Challenges in demand propelled by evolving regulatory and reimbursement landscapes, along with infrastructure investment considerations in nearshoring and localization, need to be managed with a new global playbook.

Why medtech requires a bold transformation approach to unlock value

While most companies have initiated strategic initiatives to improve productivity and ambitiously manage cost, medtech companies face a particularly challenging set of hurdles when embarking on the transformation journey for several reasons:

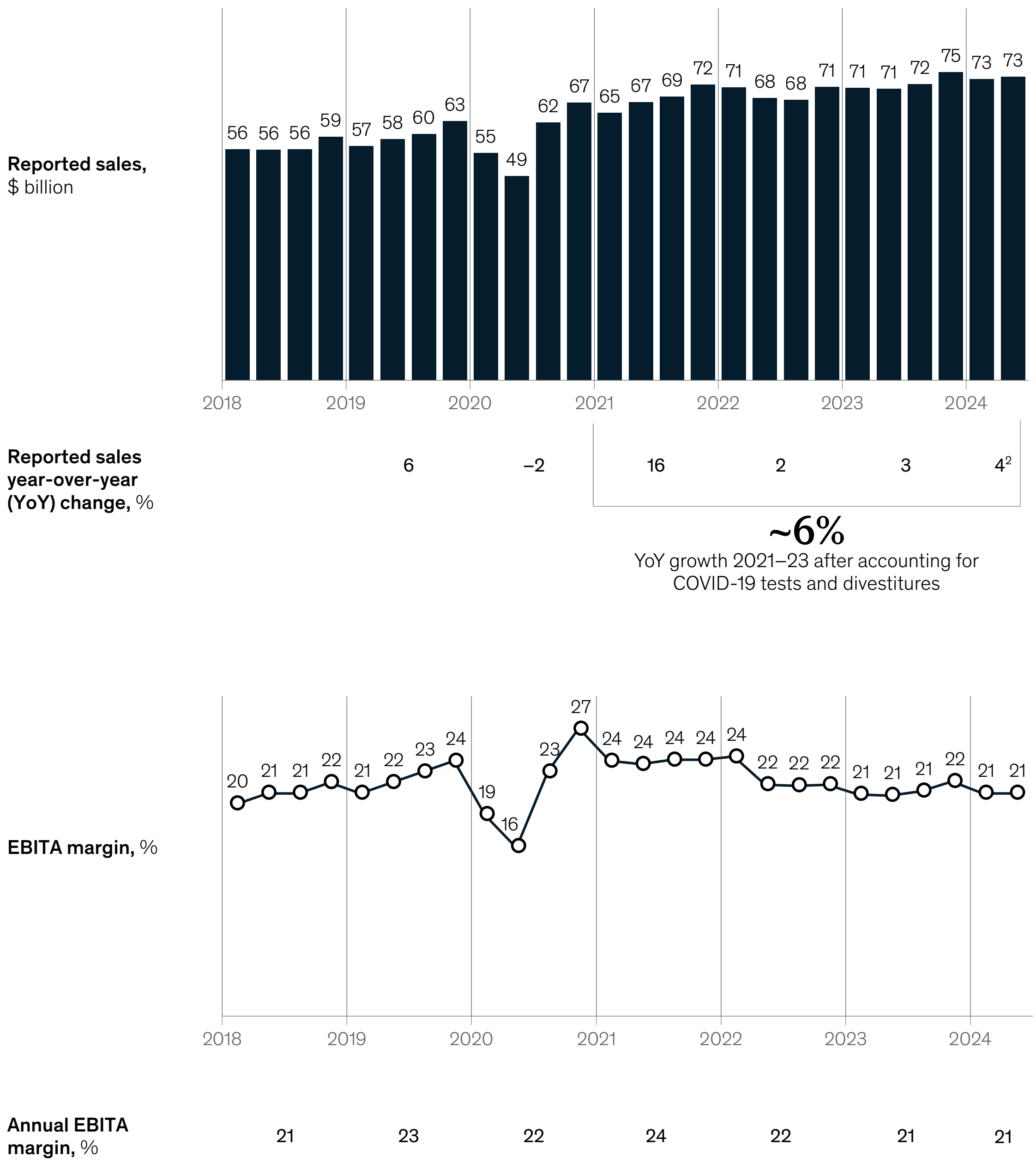
Value levers are deeply interconnected across functions. Efforts to improve gross profit and reduce manufacturing costs, for example, require close collaboration among platforms (portfolio optimization, product mix, and life cycle management); commercial (contracting and tenders); R&D (product innovation and design to value); and supply chain (network strategy and

1 *Medtech Pulse: Thriving in the next decade*, McKinsey, September 15, 2023.
2 Delphine Nain Zurkiya, Gerti Pellumbi, Peter Pfeiffer, and Tommy Reid, "Value creation priorities shaping medtech," McKinsey, October 16, 2024.
3 Based on McKinsey analysis of company filings by the top 20 medtech companies by market capitalization. Data from S&P Capital IQ, accessed August 31, 2024.

Exhibit 1

Medtech growth has slowed, and margins remain suppressed.

Reported sales and EBITA margin of top ~30 global medtechs,[1] 2018–24 (Q2)



[1]Top ~30 medtechs by 2023 sales with 2018–23 data available, as of Aug 22, 2024.
[2]Calculated as Q2 2024 sales vs Q2 2023 sales.
Source: S&P Capital IQ, accessed on Nov 13, 2024

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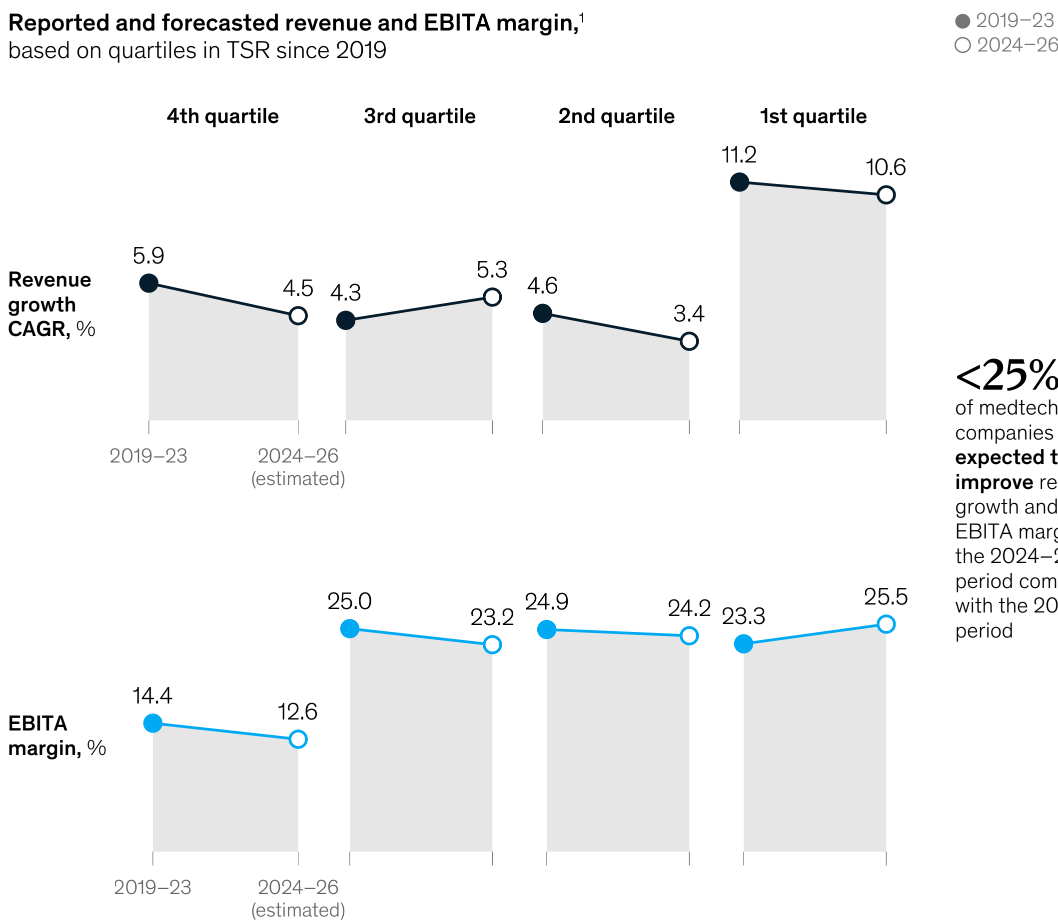
Exhibit 2

Top-quartile performers in medtech have above-average revenue growth, while bottom-quartile performers lag behind peers in margin.

Reported and forecasted revenue and EBITA margin,[1] based on quartiles in TSR since 2019



<25% of medtech companies **expected to improve** revenue growth and EBITA margin in the 2024–26 period compared with the 2019–23 period

[1]Top ~60 medtechs with 2018–23 data available.
Source: S&P Capital IQ, accessed on Nov 13, 2024

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procurement), to name a few. It often takes months or even years for medtech companies to align these diverse functions—each with its own priorities and timelines—to execute a single meaningful change. Without cross-functional collaboration, medtech companies will continue struggling to achieve transformative results within and across functions.

Potential efficiencies are difficult to capture. While many medtech companies have already undertaken cost transformations, their efforts have often been limited to easy-to-do, one-off actions that do not deliver recurring value. Potential efficiencies in core operations such as network design and simplification are often difficult to extract, in part because of the number of decisions involved and the complexity of the operating model. Individual efforts to simplify a specific portfolio or streamline the network for one business unit may not be able to deliver the full value, given overhead and stranded costs in functional areas, without other actions. A holistic approach would consider where these capacities and costs can be redeployed to support additional value-creating activities and higher-growth opportunities.

Operating models hamper speed and clear end-to-end accountability. The operating models at many large medtech companies have evolved over decades into siloed, functional organizations with complex matrices and diffused decision making. With few exceptions, organizations' business units are primarily responsible for portfolio management and R&D, regions manage commercialization, and operations oversees all manufacturing and supply chain functions. In the spirit of centralizing across units to identify operational synergies and consolidating expertise, companies traded in speed, agility, and proximity to customer feedback. This has hampered major decision making by increasing communication cost and reducing direct accountability of performance across profit and loss (P&L).

Successful companies break existing silos to reset the operating model, often streamlining decision making and appointing clear business and initiative owners to steer end-to-end activities and address cross-functional interdependencies. This reflects a prevalent industry trend characterized by a return to a divisional organizational model (for example, reintegrating supply chain and R&D functions into business units) to reinforce end-to-end accountability. We observe many companies rebuilding the organizational muscle needed to achieve end-to-end P&L. And business leaders, having come through commercial or marketing functions in many cases, are adapting to a culture of end-to-end decision making, especially in cost and operations.

How medtech transformations work: Managing interconnected levers

Successful transformations start from the top with a clear vision of the company's growth and margin aspirations and the biggest hurdles to overcome. There is no single medtech transformation playbook, given the different business models and innovation cycles across verticals, even within the same medtech company. Typically, successful transformations are anchored on one or two primary objectives that address a unique challenge for end-market customers and achieve the greatest shareholder value. The transformation framework then comprises initiatives and activities that address these objectives, and the framework ensures a cross-functional approach to resolve dependencies (Exhibit 3).

The six interconnected levers of medtech transformation

Six common, interconnected levers unlock value for medtech organizations.

Portfolio strategy. Portfolio strategy is a critical starting point in transformations because it provides focus and guides resource allocation based on market attractiveness and a company's right to win. A strategic assessment of the growth and margin profile of each segment helps prioritize incremental innovation and commercial investments that drive further differentiation.

In addition to achieving excellence in portfolio planning (with R&D investments, acquisitions, and divestitures), effective strategies also closely coordinate with the commercial and supply chain organizations to manage regional differences and unlock value through simplification and efficiency.

Working closely with global commercial teams, portfolio strategists need to manage increasing regional differences in user preferences, contract and tendering needs, and competitive dynamics. Portfolio teams can create value by enforcing best practices in life cycle management, such as accelerated product upgrades, SKU rationalization, and timely product discontinuation.

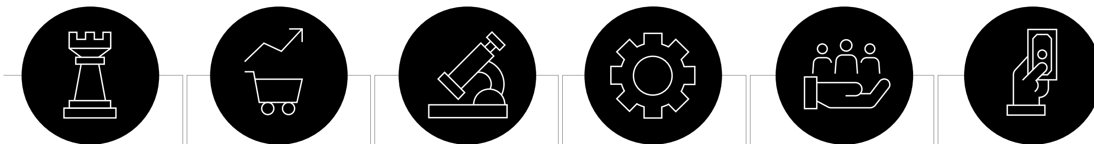
Portfolio teams can also engage with supply chain organizations to unlock potential for operating margin improvement beyond annual targets through efforts such as supplier optimization and network simplification. To capture maximum value, choices (such as product mix and prioritization) often need to be coordinated across the portfolio, commercial, and supply chain functions.

Commercial excellence. Elevating commercial capabilities and performance to drive growth through better execution is a no-regrets move. A full assessment of potential opportunities will span pricing execution, commercial model innovation, spending optimization, and launch excellence. Enhancing commercial performance requires medtech companies to upskill their sales forces with digital and AI-enabled capabilities

Exhibit 3

Successful medtech transformations comprise six interconnected levers and cross-functional support.

Aspiration setting
Bold transformation ambitions, clear performance targets, and timelines for the future



Portfolio strategy	Commercial excellence	Product development and innovation	Operations, network, and supply chain	General and administrative	Cash optimization
Strategic choices on where to play and how to win (eg, portfolio optimization and business models) with implications on commercial focus and network simplification	Commercial performance improvement with capability building Value capture through contracting and distribution model design	Prioritization in R&D to drive efficiency Internal vs external innovation model Design to value with operations	Improvements linked to portfolio and R&D strategies, including SKU rationalization, design to value, supplier rationalization, procurement, and inventory	Tech-enabled solutions to improve efficiency and cost accountability in general and administrative	Improving cash flow through inventory reduction and streamlining contracting and invoicing to fund growth

Operating-model simplification
Cross-functional teams to plan and implement initiatives, with realigned functional organizations (eg, supply chain and R&D) to work more closely with business units on end-to-end ownership

Transformation architecture and clear accountability
Single source of accountability and tracking discipline to advance large strategic initiatives

Culture and change management
Effective employee engagement on the mission and common purpose, and empowering change with new ways of working

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and develop customer segmentation and tailored engagement strategies.

In addition to driving growth, commercial functions can also meaningfully contribute to efficiency and identify hidden value across the value chain. Exploring the gross-to-net waterfall may reveal additional levers in contract compliance and invoicing, the distribution model, and commercial inventory that can also add to transformation success.

Product development and innovation. Improving R&D efficiency and output is a top item on the industry's agenda, but more-complex products and regulatory requirements make it more challenging to do so. Enhancing the performance of R&D organizations often entails reviewing processes, structure, and governance to ensure they effectively, and above all, propel strategic prioritization of resources to create the biggest impact in the near and long terms. Conversations about the role and effectiveness of internal versus external innovation models (including acquisitions and build-to-buy investments) are also crucial as companies reassess how to best meet customer needs and maintain agility.

Operations, network, and supply chain. Operations still has substantial potential for optimization. True transformation in medtech entails elevating the role of supply chain across the organization—instead of treating it as an afterthought—and pursuing systematic approaches to reduce complexity.

As noted above, improvements in operations are closely linked to portfolio and product development strategies. Optimizing the portfolio and rationalizing SKUs reduce complexity within the network, which often enables an organization to optimize investments as well. Working with product development teams earlier in R&D cycles with a continuous design-to-value approach while exploring supplier optimization and resilience ensures a cycle of gross margin improvement.

Furthermore, systematically reviewing procurement capabilities and inventory management practices often generates sizable cash optimization. Capturing value from all of these drivers requires close coordination among operations, supply chain, and other functions.

General and administrative (G&A). New technology-enabled solutions—including those using generative AI—have shown potential to greatly improve efficiency in G&A functions. Establishing clear cost accountability and mature tracking mechanisms ensures transparency and control over expenses. This approach helps companies streamline operations and reduce overhead costs.

Cash optimization. Extracting near-term value from working capital is vital for funding business investments. In both commercial and operational levers, medtech companies have an opportunity to streamline contracting and invoicing processes and improve cash flow by pursuing inventory reduction strategies. These measures enable reinvestment in growth and innovation priorities.

Cross-functional support for medtech transformations

These levers are enabled by three additional critical elements that distinguish a transformation effort from routine functional business improvement and that increase the chances of success.

Operating-model simplification. Transformation offers an optimal opportunity for organizations to simplify complex matrices with unclear decision points across platforms, regions, and functions. As cross-functional teams come together to plan and implement initiatives, successful transformations often take the opportunity to role model new ways of working that foster streamlined and data-driven decision making. This takes different forms depending on the organizational starting point. In some, it involves realigning functional organizations such as supply chain and R&D into the business unit with a stronger focus on resource prioritization; in others, it involves sharpening the role of business leadership and involvement in critical global markets to synchronize commercial execution strategies across regions.

Transformation architecture and clear accountability. Medtech organizations often struggle with advancing large, strategic cross-functional initiatives due to the lack of a clear, accountable owner and an inability to track initiatives. Transformation programs present an ideal opportunity to bring siloed functions together and unlock the full potential of integrated processes. Cornerstones of a successful transformation office include a single source of accountability enabled by integrated data sources to create visibility and transparency, as well as cross-functional initiative-tracking discipline with clear individual ownership. In our experience, many companies that go through transformational programs embed and incorporate these new ways of working into their business processes beyond the defined initiatives.

Culture and change management. Increasing employee engagement across the global organization is crucial to transformation success. Transformations come with change and disruption, and they can alter long-standing organizational habits and ways of working. To galvanize the organization’s “will to transform,” it is important to reignite a patient-centric mission and ground changes in a common purpose. A three-step approach centered on elevating a strong core of employees across levels to lead, empowering a broader group of change leaders to embody new ways of working, and energizing all employees to transform will help create the inertia to act.[4] Reinforcing common goals, in which winning together

[4] “Going all in: Why employee ‘will’ can make or break transformations,” McKinsey, September 6, 2024.

is valued over winning as individual functions, fosters a collaborative environment.

How to embark on a successful transformation

While the impetus for transformation varies for each organization, major strategic events such as M&A and divestitures, preparation for major portfolio launches, quality and supply challenges, or investor activism often serve as catalysts to ignite the cause for change. While bringing together the entire organization to respond to internal and external challenges, leading medtech companies use those moments to reposition themselves for long-term success by adopting a transformative approach.

Successful transformations embed strategy in the core at the start.[5] Rather than striving for incremental improvement, organizations can apply optimistic and imaginative thinking to set ambitious goals and align transformation objectives with those of the broader business. Setting high aspirations, clearly articulating program objectives, and identifying early-impact levers are at the core of creating enterprise momentum. By translating a top-down assessment of the full potential opportunity, companies can build transformations upon an objective fact base to validate opportunities and build consensus on what is achievable among business and functional leaders.

Initiating a transformation starts with commitment from the C-suite and the board on a shared vision for the organization and clear goals. Leaders must embrace the aspiration and collective accountability for results, taking a holistic view beyond functional silos or business lines for the company's greater objectives.

Delivering on a transformation requires a strong core team with the right accountability, authority, and infrastructure to engage the organization broadly. To drive effective change, it is important to allocate enough high-performing and high-potential talent to work on the transformation and ensure sufficient dedication and focus from other priorities. Long-term success requires that companies realize initiatives and targeted impact but also cultivate enthusiastic employees equipped with the right skills and mindset to translate the program into action. To achieve this, companies can consider incorporating collective metrics on transformation and celebrating contributions and leadership.

By embedding into the organization's DNA a culture of continuous improvement in growth and efficiency, as well as new ways of working emphasizing collaboration and accountability, medtech companies can sustain the impact of a successful transformation for the long term.

[5] Kevin Carmody, Louisa Greco, and Rob Montgomery, "Defining your 'true north': A road map to successful transformation," McKinsey, May 22, 2024.

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The authors wish to thank Cailah Carroll, Gerti Pellumbi, Kevin Carmody, and Rob Montgomery for their contributions to this article.