

EXECUTIVE BRIEFING

Efficiencies of Your Supply Chain

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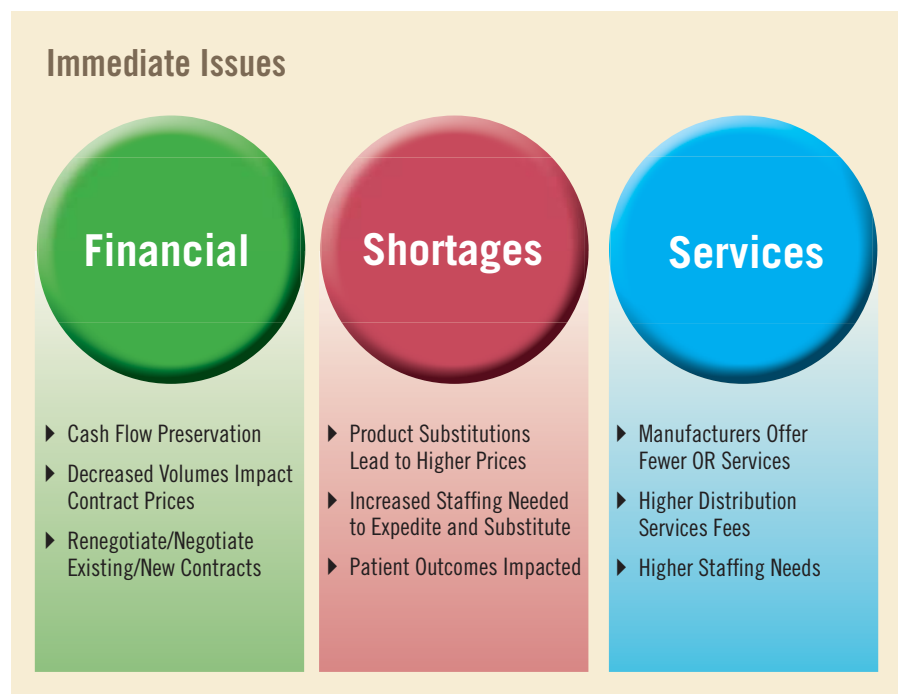
TODAY'S TOUGH ECONOMIC TIMES HAVE A LOT OF HEALTHCARE EXECUTIVES ASKING, "WHEN ARE WE GOING TO RETURN TO NORMAL?" The answer may be never. While the markets will recover, many economists, business leaders and global thought leaders expect that the economy is moving toward a "new normal." What that means is that the current challenges will give rise to new business models that will change the way healthcare providers, medical suppliers, pharmaceutical companies and all other companies work.

With this shift, managing the supply chain will take on an increased importance for healthcare. Every healthcare executive needs to:

- ▶ Understand the severity of the challenges affecting the supply chain
- ▶ Identify actionable strategies for immediate implementation
- ▶ Explore new strategies for engaging trading partners, physicians and clinicians in supply chain improvement

Understanding the Challenges

There is no need to detail how difficult the past year has been economically. Instead, it is important to look ahead and be aware of the likely long-term challenges for



healthcare providers. These range from declining profitability, to shortages in the medical device supply chain to weakness of the U.S. dollar.

Profitability

Profit is top of mind for healthcare executives. Recent Healthcare Financial Management Association (HFMA) surveys predict that hospital profit margins will continue to fall and a significant number of hospitals will be losing money. These predictions apply to organizations of all types and sizes, from large health systems to

small community hospitals. Successful providers will create new ways to balance revenues and expenses to thrive.

Cash on Hand

Financial analysts, chief financial officers and executives are all very concerned about current decreases in cash on hand, or cash immediately available to pay obligations like worker salaries or supplier invoices. Some hospitals hold less than 30 days' cash on hand. That is quite a serious situation and one healthcare providers need to keep in mind when addressing the supply chain.

While the challenges are large, healthcare organizations have a number of levers available to help balance the factors of financials, shortages and services.

Decreased Reliability of Product Delivery

Product shortages are on the horizon for almost every industry. Inventories are at historic lows, and neither distributors nor manufacturers have the money to ramp up quickly when the market recovers. Winning healthcare organizations will secure their supply now to ward off problems later.

Effects on Care Delivery

Supply shortages will directly affect delivery of care. Providers will have to make more product substitutions, which are likely to lead to more safety incidents and lower clinician productivity as staff adjusts to new products or waits for shipments. Product integrity also becomes an issue as more devices and pharmaceuticals are manufactured in China where regulations are less stringent. Healthcare executives need only to think back to heparin supply issues that were encountered a few years ago to understand the effects of a quality issue.

Declining Revenues, Increasing Costs

Declining revenues mean declining volume, and that alone can increase costs. Most organizations are using group purchasing organization (GPO) or self-negotiated contracts with tiered pricing based on purchase volume. Smart providers will proactively identify risks and address them, instead of multiplying losses by doing nothing.

Decreased Service Levels from Device Manufacturers and Distributors

Medical device manufacturing reps who previously worked along with physicians in the surgery room are starting to withdraw services to save money. Similarly, distributors facing increased transportation and inventory costs are repackaging services at an increased price. Leading healthcare providers are either locking in current service levels, arranging separate payments for services or bringing work in-house.

Weak U.S. Dollar

The pharmaceutical and medical device supply chain is highly global, so a weak U.S. dollar hurts profits for hospitals' suppliers. Currency exchange clauses in many GPO and manufacturer contracts have already kicked in, which means higher contracted prices. The currency exchange is also driving transportation costs and prices for physician preference items up. The weak U.S. dollar is likely to be a long-term issue, and strong healthcare organizations will find savings in other areas to offset the currency effects.

Identifying Actionable Strategies for Immediate Implementation

While the challenges are large, healthcare organizations have a number of levers available to help balance the factors of financials, shortages and services. Providers who start now may even be able to make the current markets work to their advantage.

Why Supply Chain?

Targeting supply chain improvement is the single most effective way to improve profitability, address cash on hand and ensure reliability of product and service delivery. Here's why:

- ▶ A dollar saved in the supply chain goes right to the bottom line, making a bigger impact than a dollar gained in revenue.
- ▶ In most healthcare facilities, supply chain is the second largest cost – in some cases even surpassing care delivery.
- ▶ The supply chain affects numerous key performance areas, including logistics, distribution, safety, product integrity and a number of healthcare standards initiatives.

Cost Containment

A good first step in supply chain savings is to identify ways to contain costs on existing purchases. Price reductions may not be possible in some cases, because current economic forces are pushing prices up. Medical and pharmaceutical suppliers are paying more for the materials needed to manufacture their goods, and they are passing some of those increases on to healthcare providers. One cost containment technique is to examine spend and utilization on current contracts to find savings opportunities through small utilization changes or substitutions.

Multi-Product, Multi-Source Contracts

Providers that pursue cost reduction without mitigating supply chain reliability risks may find themselves without critical supplies. There are too many unknowns – supplier bankruptcy, manufacturing disruptions and quality issues, for example – for healthcare organizations to feel safe opting for sole-source agreements. Instead, industry leaders have already started comprehensive analysis of their contract portfolios with an eye toward multi-product, multi-source arrangements. The new best practice is to drive toward increased standardization and consolidation, but without increasing sole-source risk.

Manage Cash on Hand

It is time for healthcare organizations to borrow one of their suppliers' strategies – extending payment terms to preserve cash on hand. By working with the financial team, providers can run risk-adjusted financial analysis to determine whether price reduction or increased cash on hand holds more value. If cash on hand is critical, requesting extended payment terms, instead of lower prices, from off-contract suppliers is a good place to start.

Integrated Supply Chain

In the past, the focus has been solely on getting the right quality product at the lowest possible price. An integrated supply chain model synchronizes the materials, information and financial flows to get a complete picture of what is really best for an organization. Using this model allows healthcare organizations to plan for both short-term and long-term scenarios.

Supply Chain Staffing

In the face of decreasing revenues and volumes, forward-thinking healthcare executives will fight calls to reduce full time equivalents in the supply chain team. The looming product shortages may mean that providers actually need more supply chain employees to find alternate suppliers and expedite orders. Last year's latex glove shortage is a perfect example. Supply chain teams spent significant energy looking for gloves and getting them into the facility. Supply integrity issues could have the same effect.

Data-Driven Negotiations

Providers are succeeding when they bring data and tools to negotiations with suppliers. Numerous tools, such as total cost of ownership analysis, can reveal cost drivers and identify ways to optimize solutions with trading partners. Providing comparative data from benchmarking through a third party can also drive successful negotiations. A number of supply chain references are available to help healthcare organizations determine what information to share and what to keep in-house.

Engaging Trading Partners, Physicians and Clinicians for Supply Chain Savings

The changing business models are affecting all players in healthcare, from device manufacturers to nurses. In an environment where everyone needs to innovate to survive, there are opportunities for new partnerships that benefit all involved.

Identify the Real Cost Drivers with Your Partners

Total Cost of Ownership examines:

- ▶ Total Delivered Costs
- ▶ Indirect Downstream Costs
- ▶ Inter-organizational Cost Structures

Reveal Hidden Cost Drivers

Optimize Joint Solution

Identifying the Total Cost of Ownership

Current Situation	Hospital	
	A	B
Supplies as a Percent of Operating Budget	15.0%	19.0%
Freight/Distribution as a Percent of Supply Costs	4.0%	6.0%
Acquisition Price as a Percent of Supply Costs	78.0%	83.0%
Potential Impact		
<i>Freight/Distribution Increase 50%</i>		
Supplies as a Percent of Operating Budget	15.2%	19.5%
Operating Expense Percent Increase	0.3%	0.6%
<i>Manufacturer Materials Cost Increase of 15%</i>		
Supplies as a Percent of Operating Budget	16.5%	20.9%
Operating Expense Percent Increase	1.8%	2.4%
Combined Impact - Percent Increase		
Supplies as a Percent of Operating Budget	2.3%	2.3%
Operating Expenses	2.1%	3.0%

V. Smith-Daniels, "Do You Know Your Supply Chain Drivers?"
HFMA Cost Containment, May 2008

In an environment where everyone needs to innovate to survive, there are opportunities for new partnerships that benefit all involved.

Physicians

This concept is not new, but now is an ideal time to engage physicians and clinicians in negotiations with manufacturers for cost reductions. By working with physicians, healthcare providers can understand where they have leverage with manufacturer representatives. Historically, forging these partnerships has been extremely challenging, but over the past few months, barriers have started eroding. Some tips for success include bringing the right amount of data to physicians, showing physicians that the team is committed to learning about their concerns, not playing favorites, and anticipating pressures against the plan from physicians and from manufacturers.

Healthcare providers need to embrace new supply chain strategies and revenue sources now to be ready to compete.

Clinicians

Clinicians can help fill the gap as medical device manufacturers pull back on free services. Several hospitals have succeeded in approaching the operating room (OR) nursing staff and asking what services they could take over. In most cases, the nursing staffs have surprised executives with long lists. As a result, the healthcare providers were able to avoid new charges for services or even negotiate a discounted implant price, because they did not need the same service level.

Other Regional Healthcare Providers

Rising transportation and inventory costs are prompting distributors to cut services and increase markups. Partnerships with other healthcare providers to self-manage distribution functions can help eliminate these effects. Providers can also join together to share consignment inventories, particularly in the OR. GPOs can be good facilitators for these discussions.

The CFO

Healthcare supply chain managers may not be used to working with the CFO to look at supply inventories, contracts and cash on hand, but this has been common practice in manufacturing for 10 to 15 years. It is important for them to start having these discussions.

Distributors

Healthcare organizations can offset supply delivery risks by partnering with a distributor. In addition to making sure contracts have shortage allocation rules, some providers are implementing volume guarantees, self-managed inventory and consignment to ensure supply.

Conclusion

As the economy begins to recover, business is moving to a “new normal.” Healthcare providers need to embrace new supply chain strategies and revenue sources now to be ready to compete. Innovative executives are already changing the way they interact with physicians, assessing how emerging government regulations will affect profits and care, planning for increasing labor costs and mining the supply chain for new cost reduction opportunities.

The key is to stop viewing the supply chain only within the constraints of the facility’s walls and start looking at all the upstream and downstream relationships to find new ways to maximize value. The winners will turn the economic downturn into an opportunity to better manage their supply chains and increase profitability.



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About Amerinet

As a leading national group purchasing organization, Amerinet strategically partners with acute and alternate care providers to reduce costs and improve quality through its performance solutions. Built on a foundation of data, savings and trust, and supported by a team of clinical and supply chain experts, Amerinet enriches healthcare delivery for its members and the communities they serve. To learn more about the Amerinet difference, visit www.amerinet-gpo.com

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