



5 Ways to Address Rising Healthcare Supply Chain Costs

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Supply Chain Challenges

The U.S. healthcare delivery system is experiencing an unprecedented rate of change, and costs are continuing to escalate. The healthcare supply chain is vast, complex and although effective for the most part, costly and inefficient in many respects. Logistics and just in time inventory has not advanced nearly as rapidly in healthcare as it has in the food industry and several other industries. The entire supply chain must play a critical role in the transformation that the healthcare industry must make in order to provide quality care in a sustainable and affordable manner.

Organizations within the supply chain such as manufacturers, wholesalers, distributors, group purchasing organizations (GPOs), and care providers are working hard to ensure the right products and supplies are on-hand when required to meet patient treatment needs, despite the complexities and challenges they face. Healthcare leaders recognize that they must take costs out of the supply chain and improve its efficiency, but must do so without negatively impacting the quality of patient treatments and service levels. They are acutely aware that their actions have a direct impact on the lives of millions of stakeholders including patients, clinicians, and payers.

Gartner Research affirms that supply chain costs are continuing to escalate and represent 40 to 45 percent of hospital or healthcare system operating expense. Gartner estimates that healthcare delivery organizations can reduce those costs by 5 to 15 percent if they better analyze, plan and control the purchase and use of goods and services. Organizations throughout the healthcare supply chain are searching for ways to reduce costs and bring them under control. With profits being squeezed by changes such as lower Medicare and Medicaid reimbursements, providers such as hospitals, medical practices and integrated delivery networks (IDNs) are being forced to reduce costs associated with both the acquisition and the use of pharmaceuticals, medical devices, and other products and services.

Three major groups comprise the healthcare supply chain - manufacturers, intermediaries and providers. Manufacturers are those companies that make pharmaceuticals, medical devices, and healthcare products and supplies. Intermediaries are wholesalers, distributors and group purchasing organizations (GPOs) which help bring healthcare products to the marketplace. Providers include hospitals, medical practices and integrated delivery networks (IDNs).

Providers must work within their own organizations and in partnership with manufacturers and intermediaries to address end-to-end supply chain costs and challenges that are effecting their costs and service levels. Here's a look at some of the most significant opportunities for meaningful results improvement for healthcare providers in the purchase and use of medical goods and services.

Aggregated Purchasing

Although the largest healthcare provider systems may have the size, scale and purchasing power to negotiate most favorable pricing, terms and conditions - small and mid-sized providers should aggregate their purchasing power. Aggregating purchasing power with other healthcare providers creates a significant opportunity for cost reduction and containment due to the consolidated purchasing volume and subsequent negotiating power of intermediaries such as wholesalers, distributors and GPOs.

Aggregating Purchasing - Group Purchasing Organizations (GPOs)

A GPO is an organization that helps healthcare providers such as hospitals, medical practices and IDNs realize cost savings and efficiencies by aggregating purchasing volume and using that leverage to negotiate discounts with manufacturers, distributors and other vendors. GPOs are often owned by the hospitals, medical practices and IDNs they serve, and negotiate contracts with vendors on their behalf. They are able to negotiate lower prices than any one provider could get on its own by aggregating the combined buying power of many healthcare organizations. According to the Healthcare Supply Chain Association, approximately 72% of hospital purchases are now conducted through GPO contracts. Because GPOs are closely aligned and often owned by their members, they share many of the same supply chain concerns and are motivated by many of the same supply chain goals.

GPOs do not purchase or buy any products, however. Their role is merely to negotiate contracts that members can use when making their own purchases. With input from members, GPOs negotiate favorable pricing, terms and conditions that accrue to the benefit of all members. After a group purchasing contract is created, it is still up to the healthcare provider to decide which products are the most appropriate in each circumstance, to make the most appropriate purchase decisions and to manage the supply chain.

Aggregating Purchasing - Wholesalers and Distributors

Healthcare companies have been slower than those in other industries to outsource their supply chains. That, however, is now changing. Likely reasons for the shift include increased complexity, industry cost pressures, the increasing need for expertise in areas such as regulatory compliance and product protection, and expansion into new markets. Wholesalers and distributors save healthcare providers money by not only aggregating purchase volume, but improving efficiency and removing costs from logistics operations as well. Buying from a wholesaler or distributor simplifies procurement by letting the provider receive many products from many vendors in a single order, single shipment and single invoice.

In addition, wholesalers and distributors are able to work with healthcare providers to develop replenishment models that are tailored to meet their specific needs and to address their specific circumstances, such as order size, delivery frequency and distribution requirements throughout the provider's building(s) and campus(s).

Aggregating Knowledge, Data, and Sharing Best Practices

Aggregating knowledge, data, and sharing best practices with other healthcare providers directly or through manufacturers or intermediaries creates a significant opportunity to improve sourcing,

purchasing and usage decisions. One of the challenges in reeling in supply chain costs is that most hospitals have historically focused their efforts on lowering the price they pay for products, which is only part of the total cost equation. They have neglected to look at, or focus on, other cost drivers and other ways to reduce direct and indirect supply chain costs—things such as product stock assortments, inventory management systems and practices, product use and consumption, process efficiency and effectiveness, data accuracy and availability, to name just a few.

Healthcare providers must understand the key drivers of their particular supply chain, which is typically influenced by a few key attributes such as stock assortment, lead time, inventory levels, demand variability, economies of scale, storage space, risk, etc. It is important for providers to identify key driver attributes based on their supply chain's data, analyze them thoroughly and identify their specific opportunities for improvement.

Many intermediaries are now offering value-add supply chain services to address these “other” cost drivers, and healthcare providers are increasingly relying on them to help manage the complex system of purchase decision making. Services such as data collection, analysis, modeling and e-commerce help healthcare providers make sound sourcing and purchasing decisions to ensure the right product is delivered to the right place at the right time.

GPOs provide a unique mechanism for a group of hospitals to coordinate not only purchasing power, but also brain power. By drawing upon their broad-based memberships or client base, GPOs give doctors, nurses, pharmacists and other clinical experts a way to evaluate new products and assess their impact on the quality of care.

Product Assortment Standardization

A significant opportunity for reducing supply chain complexity and cost is to reduce the number of products utilized by standardizing the assortment of approved products, where feasible without negatively impacting patient treatment and satisfaction. Identify low volume, high variability, low margin products and look for opportunities to standardize and consolidate usage with high volume, low variability and high margin products. Be sure, however, to always offer at least two sources and selections for any given product, so there's always an available, alternative.

Physician Preference Items (PPI) are another source of duplication and excessive inventory. PPI products, including implants and medical devices, must be identified and analyzed in order to determine which items are “preference” driven versus procedural requirement driven. Standardization of these PPI items will require education, training and acceptance on the part of physicians and clinicians, but the inventory reduction results will be worth the time and effort invested.

As large healthcare systems merge or acquire smaller providers or systems, the trend is a greater push toward product standardization and stock assortment reduction. Healthcare providers should ensure all their operating units are buying the same products wherever possible, which not only leverages their purchasing power, but reduces their overall supply chain costs.

Inventory Management

As an increasing number of care providers are outsourcing some, many or all of their supply chain functions to wholesalers, distributors and GPOs, they are receiving the products and supplies they need more frequently and more reliably. But that has not totally resolved the out-of-stock and excess inventory issues that have plagued them in the past, and continue to plague them today. They are finding out that product costs and complexity problems aren't all externally driven or supply chain driven. Product costs are also being driven by problems associated with their own internal data, systems, processes, procedures and controls. As a consequence, providers are continuing to struggle with overstocks, out-of-stocks, high supply costs, high labor costs and dissatisfied clinical staff.

To address these issues, care providers need to have greater visibility into product purchasing, delivery, utilization and inventory across all of their systems and facilities, and an integrated solutions approach. The lack of data standardization, visibility and an integrated approach is a common challenge to achieving supply chain excellence. With better visibility into data, greater integration with clinical operations, and improved business systems, processes, procedures and controls, providers can address many of the inventory management challenges facing them today.

Hospitals that have overcome problems associated with current inventory management systems and processes have reduced the cost of supplies and labor, while increasing nursing satisfaction. A study of more than 270 hospitals over a four-year period conducted by Oracle Healthcare Insight noted that "healthcare providers that make greater investments in back-office automation and process improvement enjoy operating cost ratios that are 2 to 4 percent better than those of their peers."

Consumption and Waste

Another cost reduction opportunity lies in improved consumption practices and eliminating waste throughout the system whenever and wherever possible. Hospital workers need to ensure they utilize the right products and supplies for a particular procedure in the right quantity. Examples of inappropriate consumption include wasteful practices such as utilizing sterile products for a non-sterile procedure or opening a prepackaged kit and only utilizing one of the items in the kit.

Lack of product standardization can also lead to waste. Supply chain managers need to standardize commonly utilized products and supplies and train the staff on nursing floors and in procedure rooms to use the most effective products available at the best prices, while maintaining a high standard of care.

Conclusion

In conclusion, the winners in tomorrow's healthcare marketplace will be those providers that have created integrated, agile, efficient, and flexible supply chains. Now is the time for companies to take action, to make the strategic supply chain changes that will allow them to capitalize on opportunities to improve efficiency and effectiveness while reducing costs.