Procurement Optimization: A Holistic Approach

A GHX White Paper for Healthcare Executives
One of the biggest challenges faced by healthcare providers today is gaining control of the purchase of physician preference items (PPI), such as orthopedic implants, cardiac stents, pacemakers and other advanced medical devices, which can be among the most expensive items that hospitals buy. With profit margins already narrow and increasing financial pressure as a result of healthcare reform, providers simply can’t afford to spend more than necessary on medical-surgical supplies. This is particularly true for high-cost items such as PPI, which often are sold on consignment and don’t go through a hospital’s materials management department and traditional process. It is imperative, therefore, that providers find a better way to manage their spend, especially by departments outside of materials management.

Best-in-class healthcare organizations, spurred by growing recognition of the supply chain’s role in achieving both cost and quality objectives, are beginning to address this challenge by taking a more holistic approach to procurement. These organizations no longer view procurement as a tactical supply chain function, but rather as a strategic imperative at the enterprise level. Hospital supply chain leaders convened by the Association for Healthcare Resource & Materials Management (AHRMM) noted that “implementation of aggressive and proven supply chain best practices has the potential to deliver a 10 to 20 percent positive impact on the bottom lines of healthcare organizations nationwide.”

Leading organizations are breaking down the boundaries that have traditionally separated supply chain participants from one another and are integrating the procurement process with other aspects of the organization, including the revenue cycle.

Brent Johnson, chief purchasing officer for Intermountain Healthcare, understands the challenge well. With six different supply chains within his organization, managing procurement in areas where there is little visibility can be nearly impossible—and Intermountain is recognized as one of the most efficient healthcare organizations in the country. Even with highly efficient and standardized processes, the Intermountain team is challenged with managing procurement that takes place in areas such as the lab, pharmacy, operating room and emergency room.

This white paper provides a perspective on procurement in today’s healthcare environment, and suggests some guidelines for how to use technology, people and processes to optimize procurement. Topics addressed include:

- Why procurement optimization is important
- How PPI purchases affect the bottom line
- The five main challenges of procurement optimization
- How creating a tighter linkage between the revenue cycle and supply chain can lead to real, measurable benefits
- Four steps to achieve an optimal procurement function

“AHRMM, Thought Leader Roundtable, July 20, 2009
The Business Case for Procurement Optimization

An IBM survey of 300 senior executives—including 95 chief procurement officers (CPOs)—demonstrates the rapidly rising importance of procurement for an enterprise. Sixty-four percent of those surveyed said enhancing procurement strategies would generate greater savings for their companies, while driving future growth and competitiveness.

But what about healthcare? If anything, procurement is even more important in the healthcare industry than it is in other industries. The economic collapse of 2008 brought instability to the credit markets, limiting hospitals’ access to capital. At the same time, under the new healthcare reform law, reimbursements from the Centers for Medicare & Medicaid are expected to decline by $145–$155 billion over the next 10 years. These factors have been a catalyst for change in healthcare, with hospitals operating more like businesses and paying closer attention to the bottom line. So it’s no surprise that procurement is becoming a key performance indicator for healthcare systems that need to better manage spend and contract compliance, as well as link costs, efficiencies and clinical outcomes.

A strong procurement strategy also is important to hospitals that have traditionally been good at managing item master content but not contract data. Datamonitor Group, a provider of global business information, estimates that 40 percent of the average hospital’s annual spend is non-file, i.e., it is not in the hospital’s enterprise resource planning (ERP) system or materials management information system (MMIS) and, as a result, not easily managed. Converting even a small percentage to managed spend can offer significant hard-dollar savings, while improving clinician satisfaction. By getting spend under control, hospitals can focus on what matters most—providing better, safer patient care.

How Physician Preference Items Affect the Bottom Line

The ECRI Institute, a nonprofit research firm based in Plymouth Meeting, Pa., releases a list each year of important technologies and technology-related issues affecting hospital C-suite executives. For 2010, orthopedic physician preference items (PPI) ranked number four on the list, and for good reason. PPI purchases are estimated to be growing at a compounded average rate of 17 percent, compared to less than 3 percent for commodity items like sutures and gloves. And the institute expects the use of orthopedic implants to grow as the result of an aging population and the corresponding increase in demand for orthopedic procedures.

PPI frequently account for as much as 40 percent of a hospital system’s medical-surgical supply spend, according to Datamonitor. For some supply-intensive procedures, such as artificial knee and hip implants, the cost of the supply itself can account for up to 80 percent of the total cost of the procedure.

In addition to cost, PPI present challenges to hospitals due to the non-standardized way in which they are purchased. They are often handled as consignment, bill-only orders outside of the purview of the materials management department. Rather than being associated with a requisition, supplier sales representatives often simply create a replenishment notice when a product has been used. With a lack of visibility into these purchases, providers often have little control, not only over which items are purchased, but also over whether or not they are purchased at the correct contract price.

“Both payers and hospitals are navigating an environment in which they are trying to figure out how much they should pay and be reimbursed for such devices and whether there is any evidence to distinguish clinical benefits of one brand over another,” the ECRI Institute said in its report.

“60% of my OR spend is on consignment products and I have zero visibility into what I’m spending.”
- Provider, VP Supply Chain

“We closely track our $500,000 in hospital supplies, but I have a closet with over $3 million in consignment inventory that I am not tracking at all.”
- Provider, Director Materials Management

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Historically, many C-level healthcare administrators have been willing to quietly overlook the inefficiencies and costs associated with allowing medical staff to use whatever products they prefer. But with increasing operating costs and declining profit margins, those administrators today are taking a closer look at ways to reduce operating expenses and, in particular, better ways to manage PPI and other high-cost supplies. Consider these statistics from the Healthcare Financial Management Association (HFMA): The average U.S. hospital has an average net operating margin of 2 percent. Such a hospital would need to raise $10 million in additional revenue to achieve the same positive impact on the bottom line created by a $200,000 reduction in operating expense.iii

The Challenge: Gaining Control Over Spend
GHX has found that five main challenges typically face providers as they work to optimize their procurement process:

• **Data churn.** Most hospitals are understaffed and don’t have the technology to ensure that data sources are accurate and up to date.
• **Lack of visibility** into which products are on contract and a way to measure contract compliance, especially around PPI.
• **Lack of clinician support.** Clinicians may be resistant to change initially even if it will have a positive impact farther down the line because of previous unsatisfactory interactions with materials management.
• **Lack of technology** to create enterprise-wide access to accurate data in real time and automate manual, time-consuming procurement processes.
• **Lack of standardized processes and procedures** to maximize the value of technology.

Addressing these challenges requires focus and planning by hospitals to ensure that they are using accurate data and capturing demand electronically while also realizing greater visibility into their supply chain. As with many business problems, the best results come from a combination of technology, process synchronization and resource alignment.

The Business Solution
**Accurate, Up-to-Date Data**
Healthcare supply chain data is constantly changing. GHX reports that it handled 2.2 million changes in contract data from group
A Case Study: Taking Control of Consignment Spend

Using technology from GHX, healthcare organizations are already recording spend management successes. One of those organizations, a three-hospital integrated delivery network in the Mid-Atlantic region, relied on a disjointed, manual PO process for consignment, bill-only orders for implantable devices. A supplier representative would attend a physician in the operating room (OR) to provide implants, which were not always on contract. He or she would then write a paper requisition for the products used. The requisition would usually include a price for the products, but not necessarily the correct contract price. A nurse auditor would then compare the handwritten requisition with the OR implant log to confirm that the products noted on the requisition were the products actually used in the procedure. Once the requisition was approved, a buyer would look up the part numbers and prices in the materials management system, manually create a PO and send it via fax or e-mail to the vendor.

As a result, there was a huge gap in the provider’s supply chain—the organization had little control over which products were being purchased and whether they were being purchased at the correct contract prices. The provider’s suppliers were dissatisfied with the process as well. It took days for the provider to approve requisitions and generate POs, which delayed the invoicing process. Furthermore, the provider’s buyers and the supplier’s representatives or customer service personnel had to spend countless hours on the phone trying to resolve PO discrepancies.

With GHX, the provider has completely automated the requisition process for consignment, bill-only orders. The organization has built a catalog that contains only those consignment products that have been approved for purchase by the hospital, along with the correct contract prices for those products. The technology integrates with the provider’s Lawson MMIS to facilitate a fully automated, electronic PO process from start to finish.
purchasing organizations (GPOs) over the past year alone. Data changes also may be required as the result of mergers, divestitures or acquisitions and when manufacturers introduce new products and/or enhance existing ones. With most hospitals understaffed, manual processes and technology limitations make it difficult to ensure those responsible for requisitioning products have the most up-to-date information to source the right products. At the same time, demand for PPI is increasing, and a lack of visibility into purchases of those items prevents health care organizations from analyzing trends and determining where they can achieve efficiencies and cost savings through new contracting opportunities.

With limited staff, many providers have chosen to outsource the data management function in order to keep on top of constantly changing data. Content and contract management software tools also are available that, when used in combination with requisitioning automation, can provide a complete technology roadmap for procurement optimization.

Visibility
To minimize “rogue” procurement of products that are not on contract, clinicians who requisition products must be able to see which products are on contract. GHX provides technology today that can deliver sound content, accurate contract price validation and contract alignment to decision-makers during the procurement process, rather than after the fact. This technology solution enables healthcare providers to procure products from the most recent supplier catalog while also ensuring they are selecting products on contract. In this way, providers can significantly reduce non-file, off-contract spend prior to creation of a purchase order (PO) and begin to gain control over the purchase of PPI.

This procurement application employs a cascading search function that enables users to seamlessly access validated product and contract data repositories through their MMIS or ERP system. From there, users can search for products they want to order, identify which are on contract and then bring those items and their associated contract pricing back into the MMIS/ERP system, helping to ensure they get the right product at the right price.

Clinician Support
Finding a way to simplify the procurement experience for clinicians provides greater assurance that they will receive the products they need and can focus their attention on what matters most, the patient. But as with any change, resistance may be an issue.

To overcome resistance to change, health care organizations should begin by engaging clinicians, especially physicians, to help them understand why change is needed and how it will benefit them and the organization. Sometimes there is a lack of clinician support because of previous unsatisfactory interactions with materials management; physicians may also be worried about giving up control over which products they use. The key is to seek input from clinicians up front, involve them throughout the change process and, most importantly, let them know what’s in it for them.

Nancy LeMaster, vice president of Supply Chain Operations at BJC HealthCare in St. Louis, has seen the relationship between her supply chain group and her clinical teams continue to improve as her organization has been able to bring better information on the clinical outcomes of various products to clinicians to assist them in their decision-making. LeMaster says that “any time you’re making a value decision, you need to look at both cost and quality.” To do that, BJC has set up a Center for Healthcare Quality that does evidence-based research on products, and uses best-practice exchange teams to engage physicians so that they will want to choose products that not only generate the best outcomes, but also are available on contract.

A Case Study: Procurement Resource Alignment
One provider, a two-facility system in the Southeast that serves the residents of 13 counties and represents the only major medical facility in a 150-mile area, engaged GHX Business Solutions to help with contract and price management after changing GPOs. The work involved aligning the provider’s item master and its purchase order spend to its portfolio of contracts with the new GPO, which included hundreds of thousands of contracts, as well as 50 local contracts. GHX helped identify contracts for which the system was eligible or in which they had the opportunity to participate. Business Solutions also looked at each contract to determine if the system qualified for a better tier level and the potential savings if it were to take advantage of that pricing. As a result, the provider has saved $950,000 over the last nine months.
“When the clinicians trust the information we bring them, they begin to rely on us to give them insight into the relationship between quality and cost,” LeMaster said. “We all share the same end goal of providing exceptional patient care. And we become a partner with them, enabling them to provide that patient care.”

**Technology**

Many providers have chosen to centralize their purchasing, regardless of department or products, through a single ordering platform and procurement solution. Those responsible for placing requisitions for products can access catalogs with approved products from their desktops using browser-based technology. Requisitions can then be routed through an approval process, which can alert supply chain leaders to potential off contract purchases. Requisitions that meet the approval requirements, on the other hand, can be automatically converted into purchase orders.

By aggregating spend through a central platform, healthcare organizations also have a more enterprise-wide view into purchasing, which can create visibility into new contracting opportunities. Without this aggregated view, they may not recognize how much of a single product they are buying nor the potential for a new or better contract for that product.

Most hospitals recognize that an electronic order is considerably less expensive to process than a manual order. On average, GHX has found that an order placed via electronic data interchange is approximately 35 percent less expensive than a manual order, and an order placed via GHX is more than 70 percent less expensive. That’s because, in addition to the time savings enabled through automation, GHX provides real-time visibility to order status and discrepancies that can be addressed proactively, avoiding costly exceptions later in the process. These can include notifications as to when the price being charged does not match the contract price on file.

**Standardized Processes and Procedures**

While technology can improve productivity and visibility, true procurement optimization requires standardizing processes and procedures. In other words, technology is only as good as how it is used. Standardizing processes takes discipline and buy-in from everyone involved in sourcing and procuring supplies. Making processes easier to understand and follow encourages everyone to “do the right thing,” BJC’s LeMaster has found.

Here are some questions providers may want to ask as they fine-tune their procurement process, from demand capture through invoice payment:

- What workflow do we need to define for the proper approvals, etc.? For example, once a requisition is turned into a PO, what is the process?
- What are the roles and responsibilities of the people in that process?
- Do the roles and responsibilities align with the people’s goals and objectives?
- What are the service-level agreements for the process, e.g., if requisition approvals do not happen within 24 hours, are they routed to the next-level manager?
- What type of visibility is required that will ensure accountability?
- Does my buyer need to review the PO before sending it?
- What percentage of orders is sent electronically?
- What percentage of orders is confirmed electronically?
- How many people are rekeying invoices? Are opportunities for early-pay discounts realized or does the process take too long?

**Turning Procurement into a Strategic Asset**

Best-in-class healthcare organizations have moved from managing item files to proactively managing contracts. As a result, they are experiencing the evolution of procurement from traditional sourcing, operational and
transactional activities to a more strategic function that drives and creates value for the entire organization.

At most healthcare organizations, departments operate in silos, with materials management having little understanding of the rules and reimbursement codes employed in the billing department. Patients are being billed by a department that lacks information on what is actually being paid for products. Meanwhile, almost none of the hospital departments understand the complexities of contract negotiations, tier pricing, group purchasing organization fees and rebates, or how supplies are procured.

GHX has learned from working with the majority of hospitals in the U.S., as well as hospitals in Canada and Europe, that you can’t operate a healthcare supply chain in a silo. It takes everyone working together, from the CFO to the administrator to the doctor in the operating room and the nurse on the floor. And it doesn’t matter how good a hospital’s supply chain is if it doesn’t cascade back through the revenue cycle. Although there is still a gap between procurement and finance in many healthcare organizations, that gap is narrowing as executives see the value of taking a holistic approach to procurement.

Following are some considerations for healthcare providers interested in turning their procurement operation into a strategic asset:

- **Go beyond the supply chain to look at data across the enterprise.** Consistent, timely and accurate information on product utilization can give caregivers and managers the power to make informed decisions and lower operating expenses.

- **Help support clinical outcomes.** Healthcare providers will be increasingly rewarded for quality and efficiency; optimizing product sourcing and the procurement process can provide visibility into products that can help improve outcomes and reimbursements. This is the necessary first step towards value-based healthcare.
• **Promote end-user adoption.** Everyone in the organization needs to understand how to take advantage of the contracts that the procurement organization has negotiated and why it’s important to do so.

• **Create a tighter linkage between the revenue cycle and supply chain, providing better visibility to the source of truth—the contract.** With visibility into non-file spend, for example, providers can identify areas in which they need to focus on establishing new contracts.

### Steps to Success

Today, healthcare organizations are under more pressure than ever before to control costs without compromising quality. But they also have an opportunity: they can take procurement to the next level, making it a strategic asset to help them achieve their vision of providing high-quality patient care in a cost-effective, efficient manner. The best way to do that is by taking a holistic approach to procurement.

Here are four fundamental steps to achieve an optimal procurement function:

1. Map the current procurement process, the people it affects and the technology leveraged
2. Define an optimal process
3. Develop a plan to migrate to the optimal process that includes a technology implementation, a testing plan that will cover all scenarios driving toward the desired results and a training plan
4. Actively help people understand and embrace the change

Procurement optimization, like any other business transformation, isn’t easy. It takes time, discipline and commitment by everyone involved. But the rewards that can be realized make it worth the effort, especially in light of the difficult financial environment in which today’s healthcare organizations operate.

To download a copy of this white paper, go to http://www.ghx.com

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3. HFMA Supply Chain Solutions, Positioning Your Supply Chain for Strategic Success, July 2006.