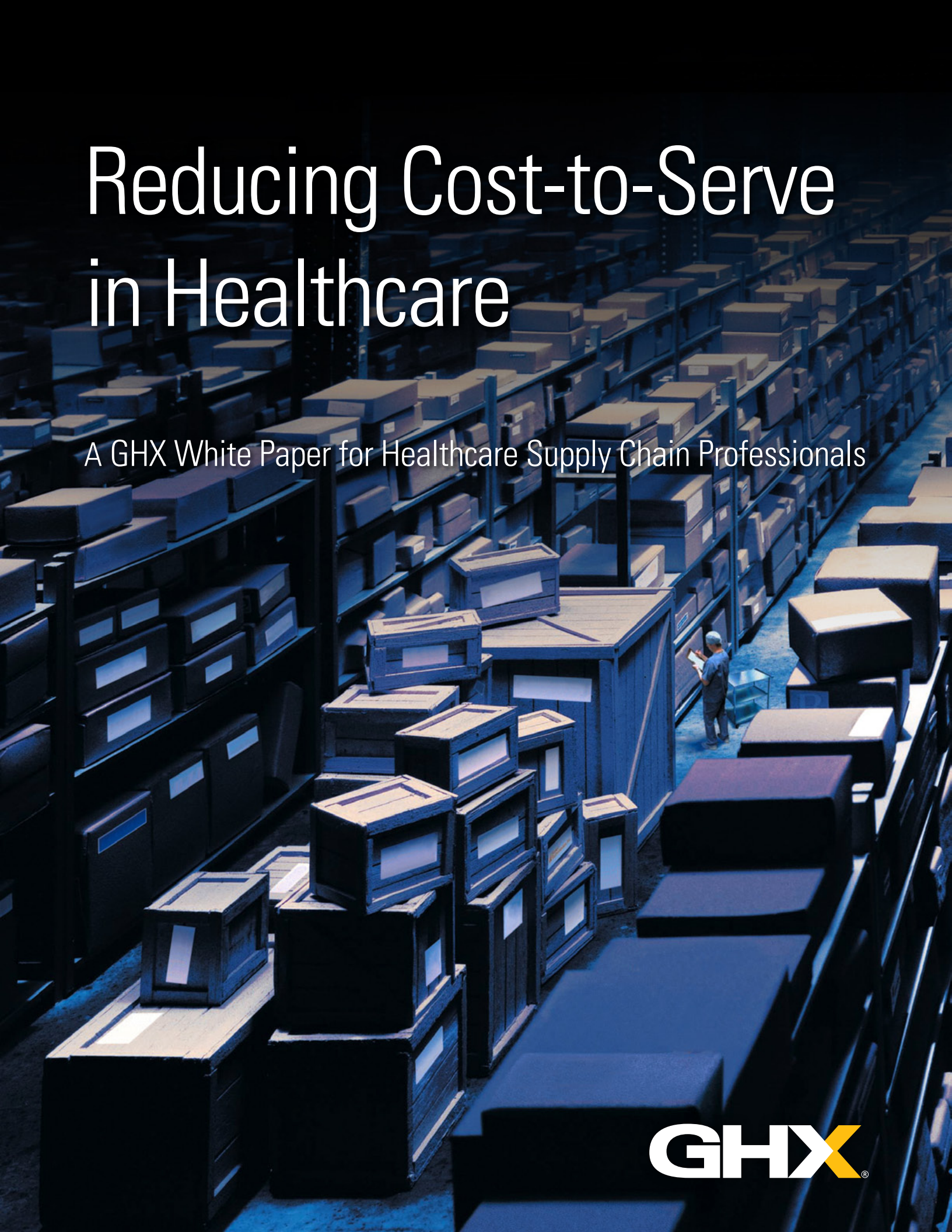
Reducing Cost-to-Serve in Healthcare

A GHX White Paper for Healthcare Supply Chain Professionals



GHX®

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Introduction

Because the relationship between healthcare providers and suppliers is focused primarily on the buying and selling of products, when these parties seek ways to reduce costs in the healthcare supply chain, the conversations immediately turn to product price. Providers often view their suppliers as aiming to secure the highest possible price for their products while many suppliers accuse their customers of trying to procure products for less than their market value.

While most providers and suppliers spend countless hours hashing out issues around product price, few have examined an area that presents a greater area of savings for both parties – the actual total delivered cost of a product, including direct and indirect costs required on both sides of the supply chain to deliver the right product to the right place at the right time. Because the healthcare supply chain crosses organizational boundaries, the actions of one party in the supply chain affect all of the other parties with which it transacts. In many cases, trading partners unintentionally increase labor and costs for one another, never knowing the consequences of their actions.

> "I'm not going to make a difference in my organization by sitting across a table and beating on my supplier to reduce the cost of a product by $2. We have to push beyond the boundaries of where we've traditionally focused our efforts to areas where we can truly make a difference because pricing is low on the totem pole in the grand scheme of things."
>
> *— Régine Honoré Villain, MPH, Director of Supply Chain Management, Medical University of South Carolina*

Healthcare providers and suppliers that have collaborated to address the inefficiencies and costs associated with procuring and delivering finished goods, known as Cost-to-Serve, have not only made tremendous gains in process efficiency but also achieved significant hard dollar savings. By coming together to examine how they conduct business with one another, trading partners have identified outdated and ineffective business practices and worked together to implement more efficient and effective processes that eliminate costs rather than shift them from one party to another.

Over the past year, GHX has facilitated forums in which healthcare providers and suppliers have engaged in open discussions on Cost-to-Serve, identifying cost drivers in the supply chain and exploring ways trading partners can work together to streamline processes and reduce costs beyond product price. In this paper, we'll present key findings, citing specific examples from leading provider and supplier organizations.

Cost Drivers and Solutions

During the GHX Cost-to-Serve forums, participants identified numerous reasons why Cost-to-Serve in healthcare is much higher than other industries. Many pointed to outdated business practices as a root cause of the issues. When questioned why they perform a task in a certain way, healthcare providers and suppliers will often respond, "Because it has always been done that way." As trading partners seek out new ways to increase revenue and reduce costs, they are turning a more critical eye toward their procure-to-pay activities.

"I've been in this industry for over 30 years and much of how we handle the purchasing and delivery of products has not changed significantly during that time," said David Reed, vice president of Operations and Healthcare Business Solutions, corporate compliance officer, Cook Medical Incorporated. "No one made a purposeful decision to make this process expensive and inefficient. It's that no one has made a concerted effort to look at what is really driving costs around the purchase and movement of products from the manufacturer to the bedside. The difference today is that organizations are wringing out the washrag to find every single penny of every dollar to save. As a result, Cost-to-Serve has come to the forefront as a strategic initiative for many organizations."

In this section, we explore activities that increase Cost-to-Serve in healthcare, as identified by the forum participants, and suggestions they have for addressing them.

Process Standardization

Régine Honoré Villain, MPH, director of Supply Chain Management for Medical University of South Carolina (MUSC), cites lack of process standardization in the healthcare supply chain and the duplication of processes as two factors that drive up costs for providers and suppliers alike.

"Supply chain here at MUSC is completely different than supply chain in a hospital up in New York or a hospital right up the street from us for that matter," said Honoré Villain. "If you envision a supplier that has 5,000 customers each with their own unique supply chain processes, it becomes clear why it's so challenging and expensive to conduct business in healthcare."

Participants noted how the use of common technology platforms, automation and standardized data bridges many of the gaps and helps overcome differences in internal processes among trading partners. Dale Locklair, vice president of Procurement and Construction for McLeod Health, commented on how his organization is participating in a pilot program for an industry-wide, end-to-end collaborative solution to manage the implantable device process, which today is non-standardized, non-uniform and involves dozens of stakeholders.

"We have to find ways to work together like a system – the manufacturer, GPO, distributor and healthcare provider – for the best interest of the patient," said Locklair. "We have to sit down and practice together, and as partners, look for the opportunities to improve together and make progress together. To do this we need standardized platforms that can interface with all of our systems so that we don't have hundreds of different organizations doing the same thing in hundreds of different ways."

Order Frequency

"About two years ago I was giving a talk on healthcare supply chain and mentioned that within the past 90 days one healthcare system had ordered from us over 60 times in one day, shipping to the same location. Somebody in the audience responded, 'What's wrong with that?,'" said Reed.

The practice of placing multiple, redundant orders increases costs for suppliers and providers alike. Both sides of the trading partner relationship must allocate resources to manage these orders and someone pays for this added labor, whether the supplier absorbs the cost or passes it onto the provider.

> "We get mired in pricing but at the end of the day we need to have a different type of conversation. We need to find ways that we can come together to provide the most care for the lowest cost. Those kind of conversations should draw us closer together – not push us farther apart – that's really critical."
>
> *— David Reed, Vice President of Operations and Healthcare Business Solutions, Corporate Compliance Officer, Cook Medical Incorporated*

"Every time we get an order, process an order, put it into a box and ship it, that is cost," said Reed. "Providers and suppliers need to work together on how we can aggregate POs to minimize incoming orders because we can't afford to operate like this anymore."

Participants in the GHX Cost-to-Serve forums agreed that suppliers, providers, and in some cases distributors, must come together to evaluate current ordering and shipping practices and find ways to reduce the volume and frequency of provider orders. It was also suggested that trading partners should collaboratively segment medical-surgical product categories to determine which products would be most cost-effectively delivered via distribution versus direct shipment.

At McLeod Health, Locklair and his team took at hard look at orders received through distribution and determined that their distributor's truck arrived every day but only partially full. They corrected their internal procurement processes to consolidate orders so that they were no longer placing orders every day. They

then collaborated with their distributor to rework reorder points and streamline deliveries. This collaborative effort reduced labor and costs for both McLeod Health and its distributor.

Harold Richards, system director of Materials Management at Edward-Elmhurst Healthcare, conducted a similar exercise. The healthcare system's distributor had been delivering twice a day, three days a week for a total of six deliveries a week. Richards and his team requested that the distributor drop one delivery a week, which saved money for both the healthcare system and the distributor without impacting the availability of supplies. Now the distributor comes to Richards and his team with ideas to further increase efficiencies and reduce costs. For example, Edward-Elmhurst Healthcare previously threw out the plastic wrapping around pallets. By switching to reusable wrap, which they return to the distributor, the healthcare system has reduced its environmental footprint and waste disposal costs.

"Our distributor is a great business partner and I want to be a great customer," said Richards.

According to Rick Alvarado, controller, Getinge USA, Inc., it's not only how often providers order products but when they order that impacts labor and costs. Alvarado points out how consistent ordering practices promote a more efficient and cost-effective supply chain across the board.

"Traffic is a great analogy," said Alvarado. "You can be bumper to bumper with everyone going 65 miles per hour because you have that perfect spacing of cars with one car going one mile per hour faster and another one mile per hour slower and the throughput is tremendous. But then a car breaks down. Although the road isn't blocked, some slow down to look and the car that was going 66 miles per hour didn't see the person in front of them break and rear ends them. The system just can't handle all of the variability that occurs.

"It's the same thing with supply chain. If everyone can be consistent, with facilities ordering a set number of items on a regular basis, the system can easily keep up with this demand. Even if one customer suddenly needs a large quantity of products tomorrow the supplier can usually deal with it. But if multiple customers do that at once it disrupts the system. The supplier bleeds through inventory and now a product that's usually in stock and arrives at a customer's facility in two days goes out of stock and customers are waiting five days for it. And it's not just the customers placing the large rush orders that are impacted. Even those placing their usual orders are thrown out of whack. Everyone ends up having to jump through hoops and that creates problems and adds costs."

Freight Charges

Participants identified freight charges as low-hanging fruit that healthcare trading partners can quickly and easily address to reduce the Cost-to-Serve. They pointed out that many products are unnecessarily shipped in expensive ways (e.g. overnighted, via air). In some cases, the freight charges end up being more expensive than the products themselves.

They urged providers and suppliers to work together to find more effective ways to ship products, such as comparing the cost effectiveness of direct versus distribution methods. For example, it is likely more cost effective to deliver large, heavy products via distribution versus shipping them via common carriers such as UPS or FedEx.

In regards to direct shipments, it was proposed that the healthcare industry apply lessons learned from the grocery sector and consolidate shipments through a common carrier on a regional basis, exchanging guaranteed volume for lower shipping rates.

Honoré Villain explained how her team at MUSC is currently working to reduce freight charges through collaboration with clinicians and carriers. By evaluating where carriers are based in relation to their facilities and educating clinicians on shipping methods that will ensure products are delivered in both a timely and cost-effective manner, they've found ways to cut costs in this area.

"We're based in Charleston and if we're using FedEx, which is based in Memphis, to place an order, even if we request standard shipping, the package will still arrive the next day by 2:00 p.m. So there's no need for us to choose overnight shipping and pay an excessive fee," said Honoré Villain. "We are also working with key clinical departments, such as perioperative areas, interventional radiology/cardiology and labs, to better understand when they need products so we can plan ahead rather than placing a rush order where we incur a $500 shipping fee for a $20 product."

Scott McCallum, vice president, Enterprise Solutions at Zimmer, relayed how his previous employer conducted an investigation of customer ordering practices in an attempt to reduce unnecessary freight charges. One specific customer consistently used next day shipping to replenish cardiovascular stents. When McCallum and his team followed the products to the customer's receiving docks they determined that while the product arrived from their company the next day, it sat on the dock for two to three days before reaching the floor. They determined that switching from overnight to two-day delivery would cut freight charges by over a million dollars and the product would reach the floor in the same time as it would if shipped overnight.

Inventory Levels

Many participants cited inventory hoarding as increasing Cost-to-Serve in the healthcare industry. They noted how clinicians often order and store excess inventory in fear they will run out. In one instance where a facility was hoarding products, McCallum and his team conducted an experiment to determine when clinical staff accessed the excess product for use in patient care. They determined that the inventory sat in a closet for over a month without being used. He noted in cases such as this, trading partners lose money when products expire and must be discarded.

"I used to work on the provider side and recognize there's always a concern that a clinician won't have the product they need for a specific case or specific type of therapy," said Reed. "That's a very real concern but there's got to be some balance. You don't need to overstock products to the point where you have inventory downstream that's thrown away. Today many are taking a hard look at what clinicians need, when they need it and what's the most effective and efficient way to get it there."

At MUSC, Honoré Villain and her team have overcome this issue by working more closely with clinical staff to determine what and when they need products. She states:

"If I know my OR is scheduling five knee cases on Friday I won't order 10 implants. There's got to be collaboration between the physicians, supply chain team and vendors if we are going to be as lean as possible with our inventory."

Reed agrees with this approach, stating, "We've got to stop treating inventory management as though everything is an exception or emergency. That's going to take supply chain – both of the provider and supplier side – gaining a better understanding of patient flow. To do this, both sides – clinicians and supply chain – must come together in a collaborative way to determine how much inventory a facility really needs to be comfortable, a block and tackle plan for managing inventory on a daily basis, and a plan for addressing emergent or truly unexpected situations."

Getting Started

Most providers and suppliers recognize that Cost-to-Serve in healthcare is high but the day-to-day challenges in supply chain seem so overwhelming they don't know how to begin to address them. During the GHX Cost-to-Serve forums, we asked participants who have successfully driven out costs and non-value added activities for their advice on launching a Cost-to-Serve initiative. They identified the following key steps.

Identify Your Collaborators

Honoré Villain points out that most provider and supplier organizations intuitively know which trading partners are ready to move beyond the transactional level and engage in higher-level discussions on the direction of healthcare as an industry. They have ideas of how they want to change their businesses in the years to come to adapt to economic, regulatory and patient demands.

"Look for those trading partners that are proactive and think outside the box," said Honoré Villain. "Both parties need to be willing to get out of the trenches and push the boundaries of what's possible. There's not a lot of trading partners willing to do this today but you are likely to find a few who are ready to start that dialog."

Many participants pointed out that it's not just about identifying willing trading partners but identifying the right people within those organizations who have the knowledge, experience and authority to enact change. In most supplier-provider relationships, it's the supplier's sales representatives and provider's clinicians who have the most face time with one another. But Reed notes that these are typically not the right people to initiative supply chain improvements. He believes supply chain personnel on both the provider and supplier side must come together to collaborate for change.

McCallum agrees and provides some tips on how to connect the right people.

"The first time someone from supply chain within a supplier organization tells a sales rep they want to speak with their customer's supply chain staff it probably won't go over well since sales reps tend to be protective of their relationships," said McCallum. "To alleviate fears, set some ground rules and explain that you won't be talking price or products. Assure them that you'll keep the conversation pure and focused on processes and operations."

Forum participants noted that once supply chain personnel on both sides of the equation come together to discuss Cost-to-Serve and achieve benefits from this collaboration, supplier sales representatives often begin requesting that their companies' supply chain staff engage with additional customers to provide added value and strengthen relationships.

On the provider side, McCallum encourages healthcare facilities to push their suppliers to engage in Cost-to-Serve initiatives, to the point where he proposes that they include Cost-to-Serve collaboration as a requirement in their requests for proposals (RFPs).

"Tell your suppliers you expect them to help you not only with product price, but also on reducing Cost-to-Serve and the total cost of care," said McCallum. "There is a tremendous amount of opportunity to reduce costs outside of products. If this is not in your RFPs then you are sending your suppliers the message that it's not important."

According to McCallum, a major challenge is many supplier organizations have "leaned out" their supply chain resources to the point where there is little capacity for them to collaborate with customers. He notes that if enough providers request support for their Cost-to-Serve initiatives, supplier organizations will see this as a priority and make the necessary investments to accommodate these demands.

Engage Clinical Staff

While provider supply chain teams should take the lead on reducing Cost-to-Serve in their organizations, it is critical that they engage clinical staff in their efforts. As Honoré Villain points out, the term "supply chain" says it all – there are many links in the chain from the manufacturer to the patient and all are likely to be impacted by supply chain process changes, particularly clinicians who want to ensure product availability.

Honoré Villain notes how clinicians are often distrustful of supply chain staff because of times when "supply chain has dropped the ball" and products were unavailable when needed. If supply chain teams want to reduce Cost-to-Serve in ways that could potentially impact how products are ordered and how often, when they are delivered and how many are housed in inventory, they will need to secure the trust of and support of clinicians.

"I've been here at Medical University of South Carolina for three years and I've spent the last two and a half building up the reputation of supply chain," said Honoré Villain. "I've found that every time we perform the small tasks right, it builds credibility among clinicians so we can then engage their trust in bigger projects. You have to earn your wings."

According to Locklair, supply chain teams have to serve as "good sales people" when working to secure clinical staff support for Cost-to-Serve initiatives, communicating how supply chain improvements will benefit the organizations as a whole and ultimately the patients.

"We have to take the same approach as suppliers with our clinicians – selling them on how we can improve patient care," said Locklair. "We've worked hard to demonstrate to clinical staff how it's the supply chain's job to relieve them of burdensome work that takes time away from patients. Now that we've earned their confidence and trust, nurses now come to us for help in solving their supply problems."

Once a supply chain team has secured the trust of clinicians, then they can help clinicians understand how their actions increase costs and engage them in meaningful change. At McLeod Health, Locklair and his team noticed clinicians in one area were consuming a high quantity of a specific product. Upon further examination they found every patient was receiving this product, even when it was unnecessary. When Locklair and his team presented the costs around this particular product's usage, the clinicians understood why change was necessary and were willing to get on board.

"Initially they didn't understand the cost of their actions," said Locklair. "We in supply chain have to give clinicians this type of

> "These conversations are unchartered territory for most of us. They require a level of trust that is lacking within most healthcare trading partner relationships. If Cook Medical and its customer agree to reduce inventory levels within the customer's facilities, the customer has to trust that its clinicians will have the products they need when they need them, and we must trust the customer won't switch to a competitor's products just because that competitor has more inventory on the facilities' shelves.
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> "We've found starting with simple improvements builds trusts on both sides, enabling us to tackle more complex and riskier issues over time. Addressing low hanging fruit, such as freight charges, goes a long way in building trust and demonstrating value. Once you've established that baseline, that's when the real change can begin to happen."
>
> *— David Reed, Vice President of Operations and Healthcare Business Solutions, Corporate Compliance Officer, Cook Medical Incorporated*

actionable information so that they can make the best decisions for our organizations and their patients."

GHX Cost-to-Serve forum participants identified over-ordering and inventory hoarding as drivers of inefficiency, cost and waste. To rein in clinician purchases, they suggested provider supply chain staff work to educate clinicians on the consequences of their ordering patterns, demonstrating how excess inventory and frequent deliveries drive costs for the organization.

Start the Conversation

Once a provider or supplier has identified a trading partner with which to collaborate on Cost-to-Serve and identified the appropriate individuals within the organization with which to work, the next step is to have an open, honest conversation on those non-value activities that increase costs.

McCallum notes how suppliers often assume there are reasons why their customers need products the next day and the underlying issue is that they never ask them "why." He stated suppliers should question their customers about their ordering practices to determine if both parties can work together to reduce the Cost-to-Serve. McCallum also noted trading partners often don't realize the challenges they create and pressures that they place on each other. For example, at McCallum's previous company, a customer would mark product packaging during the receiving process, which meant the company could not resell the product if it was returned.

At Cook Medical, Reed and his team set up a Healthcare Business Solutions team to collaborate with customers on ways to improve efficiency and reduce costs in the supply chain. The team sits down with customers and discusses where in their organizations they need Cook's products and what are the optimal ordering frequency and inventory levels to meet clinician needs without adding unnecessary costs or generating waste.

"Even though there are major financial implications coming at the healthcare industry like a freight train, not everyone has teams in place to deal with these types of conversations," said Reed. "We are definitely engaged with those customers that want to be engaged."

Build Trust

Richards points out that providers are often fearful of working collaboratively with their suppliers because they do not want to appear as though they are giving certain supplier's preference or enabling them to influence clinical decisions. He stresses that providers must overcome these fears if we are to enact real change as an industry.

"I'm not ashamed of having partnerships with my suppliers," said Richards. "I spend millions with them so why can't we work together to improve our mutual business processes?"

Honoré Villain notes how healthcare providers must move beyond antiquated notions about supplier-provider relationships if they are going to foster a collaborative environment for change. She stresses that this requires give and take.

"Suppliers need us in order to sell their products and we as healthcare providers need their products in order to care for our patients so there's opportunity and risk on both sides," said Honoré Villain. "Once we get that established, let's agree to have a frank and open conversation around how we are making life more difficult than it needs to be with the understanding that we will support one another."

Reed agrees there is risk on both sides of the equation when trading partners agree to trust each other and become more transparent in their supply chain operations. But for Cook Medical, this has been a risk the company has been been willing to take.

Conclusion

Faced with increasing expenses and declining revenues, healthcare suppliers and providers have no choice but to cut costs and operate more efficiently. In most organizations, staff and budgets have been "leaned out to the max," as one provider put it, to the point where further reductions would begin to impact operational, and in some cases clinical, performance. The supply chain presents an area of untapped opportunity for most organizations, an area of inefficiency and waste where improvements can generate significant savings. Because the supply chain crosses organizational boundaries and touches so many different parties – and so many different parties touch it – collaboration among trading partners is critical to reducing Cost-to-Serve in healthcare and enacting the meaningful and sustainable change necessary if we as an industry are to survive and thrive today and in the future.

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