



The healthcare supply chain dilemma: Rising supply costs vs. demands on supply chain to rein in costs

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I want to talk about a major dilemma in the healthcare supply chain that we've witnessed at many client sites: supply costs are continuing to rise while supply chain management is expected to come up with savings.

Supply costs – particularly medical devices – continue to be the second largest expense item at hospitals, after labor, and can constitute as high as 40% of the total expense budget at hospitals with a high Case Mix Index (CMI). The medical device industry as a whole is growing, evidenced by an increase in the largest device manufacturers' revenue each year; market research suggests that the industry will continue to grow at a rate of 5% to 8% annually, depending on the specialty. This growth is due in large part to the fact that health systems are simply spending more on devices. Some of this is accounted for in greater volume and variety, while some is due to the purchase of more sophisticated and expensive items.

Given how difficult it is to get a better price for something when the variability and proliferation of SKUs are growing, what are the options available to a supply chain executive who has the responsibility of lowering expenses and saving money? The primary go-to is usually trying to lower the per item price. Although many hospitals have savvy negotiators, or rely on GPOs, and may get good results for some items, the sheer scale of SKU growth makes any gains in better pricing for particular item categories ultimately negligible in making a real dent in overall cost reduction efforts.

When the C-suite asks for savings with the assumption that the supply chain will go after better prices and that this will do the trick, which metrics are they using to measure these savings? Presumably, it has something to do with comparing the overall supply spend from a previous time period to that over the next time period (note: spend is not the same as utilization). This metric assumes that all other factors remain the same: case volumes, CMI, physicians, and products.

For commodity supplies, this is probably sufficient. But for physician preference items (PPI), more often than not these factors do not remain the same: for example, halfway through the next time period, the next generation of products comes out and is requested by the clinician, thus requiring negotiations, contracting time, and resources, and thereby diluting the potential savings. In the cardiovascular and GI areas, for example, we've seen an increase in average cost per SKU of 15% to 20% for on-hand inventory values in the last year – largely for this reason.

So, is focusing on item pricing alone relevant, let alone sufficient, in making a dent in cost reductions? I would argue that this approach sets up the supply chain for failure. No matter how savvy a contracting organization is, or how many resources it has, it can never keep up with so much variability and constant churn. Plus, in many organizations supply chain has no control over ordering and inventory management, and no visibility into utilization in the areas where PPIs are used.

I believe that a better way to look at this is through the lens of overall cost effectiveness and operational management. If supplies and implants constitute the largest expense after labor and are essential elements of patient care delivery, then we've got to look at how inventory management impacts those costs in the context of care delivery processes and desired patient outcomes. This means that we need to examine utilization, supplies management, reordering decisions, and value analysis protocols, and involve all the key constituents in the procure-to-pay cycle, as well as clinical leadership, in reviewing the data and making the appropriate changes.

Consider these numbers:

- Up to 25% of owned on-hand clinical supplies inventory (in value) in procedural areas sit around for at least 12 months and are never used.
- Up to 30% of on-hand inventory (in value) is over and above the levels needed to support actual utilization.

In order to prevent waste and rein in costs, supply optimization and consolidation must occur. And to achieve this, actionable Key Performance Indicators (KPIs) that measure waste and excess – and show the connections between supplies and performance – are critical. They provide hospitals with the data visibility that is necessary for guiding and achieving inventory optimization and cost savings goals, and controlling supply spend.

When such metrics or KPIs are supported by an effective data collection and analysis technology solution, only then can supply chain management hope to come up with the cost savings being demanded of them, as well as to manage the risks associated with the increasing complexity and cost of care.