

# Building Supply Chain Capabilities in the Healthcare Provider Market – Part 1 - the current environment



UPS Supply Chain Solutions<sup>SM</sup>

**Our Insight.**  
A UPS Supply Chain Solutions White Paper

Despite the supply chain representing the second largest expense for hospitals after labor costs, within the provider side of the healthcare industry, accomplishments appear to be limited on the supply chain side of the operations. Thus, the supply chain represents significant opportunities. Consider the following key health care industry related findings which illustrate the supply chain as a significant area for operational improvements and bottom line savings:

These are compelling reasons for hospitals to reevaluate their supply chains.

- Managing materials, supplies and the associated costs consumes 15 to 30 percent of net patient revenues. Hospital supply expenses alone represent 25 to 30 percent of spend.<sup>1</sup>
- Hospitals overpay suppliers for contracted medical and surgical products from 2 to 7 percent of the available contract price.<sup>2</sup>
- Purchasers spend approximately 40 percent of their time, and accounts payable spend more than 60 percent of their time, on manual processing of transactions.<sup>3</sup>
- Approximately 35 to 40 percent of hospital supply related costs are devoted to handling, moving and processing materials/supplies as compared to other industries where it is less than 10 percent.<sup>4</sup>
- A 5 to 15 percent savings in supply chain costs would equate to a 1 to 3 percent improvement in a hospital's operating margin.<sup>5</sup>
- A single paper-based purchase order may cost anywhere from \$75 to \$140 to process. Process that transaction online and across the Internet, and it can be as low as \$6 to \$10.<sup>6</sup>
- Current use of EDI within hospitals only covers 30 to 40 percent of transactions available for automated processing.<sup>7</sup>

These are compelling reasons for hospitals to reevaluate how their supply chain operations impact the bottom line and consider ways to improve. The hospital supply chain contains a variety of easily identifiable opportunities to reduce costs. Businesses in other industry sectors have been quick to embrace these opportunities,

<sup>1</sup> Kamani, Priya "Hospital Supply Chain Savings," *Ascet*, Volume 6, 2004

<sup>2</sup> "The Value of eCommerce in the Healthcare Supply Chain: Industry Study Report," Anderson, June, 2001

<sup>3</sup> "The Value of eCommerce in the Healthcare Supply Chain: Industry Study Report," Anderson, June, 2001

<sup>4</sup> Grossman, Robert L., *Health Forum Journal* 2000

<sup>5</sup> "Online Healthcare Marketplace," Millennium Research Group, June 2001

<sup>6</sup> "Hospital Web Operations Gear Up," *InternetWeek.com*, [www.internetweek.com/transform/transform101899-1.htm](http://www.internetweek.com/transform/transform101899-1.htm), October 18, 1999

<sup>7</sup> "The Value of eCommerce in the Healthcare Supply Chain: Industry Study Report," Anderson, June, 2001

methods and approaches to reduce costs and improve supply chain operations. But for many hospitals, improving the supply chain remains a low priority, which begs the question – why?

### **What is Ailing Potential Users of Supply Chain Management Services?**

The best way to diagnose the problem is to look at the symptoms or, put another way, examine the trends.

First, hospitals have limited funds for investments and are under intense pressure with issues related to:

- Industry and government regulations
- Patient privacy and safety
- Rising costs and inflation
- Pricing
- Insurance complexities
- Changing technology
- Competition and consolidation
- Development of specialty hospitals

Faced with cost pressures that stem from declining profitability, low margins and reimbursement struggles, hospitals have tough decisions to make when committing their resources to more visible areas like clinical technology versus less visible areas like the supply chain.

The chief executive officer (CEO) of most hospitals can readily point to any number of examples where advances in medical technology make patient or hospital care more efficient. The dilemma is that these advances are not related to the hospital's real business processes that include materials and the supply chain. Legacy systems, manual business processes, and paper intensive operations can lead to excessive inventory and sub-optimal supply chains.

The priority improvements are usually highly visible, have a direct impact on patient wellness and receive a high vote of confidence from physicians and the medical community. Highlights from healthcare reports illustrate the emphasis on clinical investments — magnetic resonance imaging (MRI), computer-based patient record systems (CPR), electronic medical records (EMR) adoption, computerized physician order entry (CPOE), patient safety, and picture archiving and communication systems (PACS) are all newsworthy items which capture the media's and public's attention.

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Reducing healthcare costs through an item utilization review, vendor/supplier rationalization program, spend analysis, or analysis of freight costs are not as well received by the health care community because of their intense focus on clinical initiatives. When faced with such decisions — advanced clinical technology versus supply chain management — CEOs will likely opt for the former. In addition, resources devoted to health care information systems and technology focusing on medical and clinical care improvements will continue to be a higher priority than systems, technology and operational processes impacting the supply chain.

### Business model focus

A second trend within the provider market is that of belatedly adopting proven supply chain management processes effective in other industries, e.g., consolidated purchasing across facilities, spend analysis, and vendor rationalization.

Hospitals have been slower to modify their business models and adapt to changing business environments and conditions when compared to other industries. Information systems have also followed this trend resulting in hospitals being more focused on infrastructure which has become more efficient rather than business processes which remain uneconomical.

Many manual and outdated legacy systems still exist. The use of EDI in today's hospital environment only covers 30 to 40 percent of the transactions available for automated processing. Providers are limited in their use of procurement technology and automation which includes e-procurement, trading exchanges, and the Internet. This means today's purchasing staff can spend as much as 40 percent and the accounts payable staff more than 60 percent of their time on manually processing transactions.

Another reason that supply chain management opportunities have lagged within hospitals is that historically they have been afterthoughts. In most hospital organizations, the materials manager, who is closely linked to activities focused around procurement, is normally leading the supply chain management effort. Rarely does this supply chain authority report directly to the CEO who could elevate the visibility of the supply chain and provide the attention required.

As a result, the importance of supply chain management is oftentimes not recognized either for its current contributions or its additional abilities to reduce healthcare costs, improve margins, and add value to the bottom line.

## Conflicting Diagnoses

One of the perceived problems is that supply chain management is viewed as requiring a heavy investment in systems and technology in order to be effective. This is not the case. Simple, rudimentary improvements within the supply chain can yield considerable cost efficiencies. Part II of this whitepaper will examine several opportunities for supply chain improvements that do not require significant investments in technology.

However, technology can be an enabler to supply chain improvements. One of the challenges is for hospital executives to recognize the situation. A recent study indicated that the information technology (IT) spend within the health care industry is currently at 3.9 percent of revenues. Compared to other industries, the IT spend is at 5.3 percent for financial services, 6.6 percent for government and almost double at 7.9 percent in the telecom industry. However, hospitals are reevaluating their spend for IT and the projected growth is expected to be more than 12 percent for the next three years.<sup>8</sup>

It is not clear how much of the future IT spend will be devoted to improving the supply chain. Based on the past, the IT spend is more likely to occur in high patient impact areas and customer service applications such as CPOE, patient privacy, patient safety, and electronic medical records.

## Strategic Planning

What remains most disconcerting is the appearance that hospitals are not promoting the vision and strategic plans required to advance the importance of supply chain management. From year-to-year the key goals for the supply chain or materials manager remain focused on additional savings, oftentimes in the same areas where previous savings were attained. Though some accomplishments are noteworthy, top management remains focused on areas of higher visibility.

## Where are the Opportunities?

Supply chain management and materials managers on the provider side have the same goals as their counterparts in other industries — lower costs, improve services and increase efficiencies in the supply chain. One benefit of not being on the leading edge of supply chain efficiencies is being able to take advantage of the experience, expertise and technologies developed and proven by their counterparts in other industries.

<sup>8</sup> Warner, Melanie, "Under the Knife," Business 2.0, February, 2004.

... opportunities for supply chain improvements are numerous ...

Many improvements can be readily adopted and implemented without significant investment. Hence, opportunities for supply chain improvement are numerous and the following focus areas will be examined in Part II of this whitepaper:

- The supply chain vision
- Product management
- Sourcing and contracting
- Distribution and inventory management
- Technology

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