Performing Supply Chain Cost-Reduction
When the new presidential administration assumed power in January, many industries found themselves in uncertain territory. One of the most debated topics has been the future of health care in the U.S.

The Health Industry Distributors Association, in its Healthcare Supply Chain 2015: Insights for the Industry report with McKinsey, provided five recommendations to get a handle on rising health-care industry costs. They are: fixing the contracting process; linking products and outcomes; implementing data standards; standardization and streamlining of efforts with partners; and enabling the home setting.

For most companies, these factors will require cooperation and insights from multiple internal partners — and supply management will be central to cost-reduction strategies.

We asked four supply management professionals in the health-care industry to discuss some of the drivers for reducing costs in what’s considered an expensive industry, and to share best practices for doing so without sacrificing quality.

Our panel:

Robert J. Hairston, CPSM, CPSD, is director, strategic sourcing for HealthTrust in Nashville, Tennessee. HealthTrust is a GPO that serves more than 1,600 acute-care facilities and members in more than 26,000 other locations, including ambulatory surgery centers, physician practices, long-term care and alternate care sites.

Eric Hiam is category manager, supply chain operations
become more efficient in our operations and supply expenses. We’re constantly looking at ways to optimize our purchases and relationships while bringing value to our surgery network. We have partnered contractually with our large spend supply base. This ensures that our critical relationships are proactively managed and that there’s commitment to grow their business within our network in return for aggressive pricing and contractual terms.

**Metcalfe:** The unknown is a continuous driver for us. We are preparing for what is expected to be a further reduction in revenue, so we’ve got to counterbalance that with an aggressive supplier management strategy. Handling this takes skill. Thus, I tend to think of it as the art of supply chain: It requires creative talent and experience. There is no one-size-fits-all approach to drive down cost without sacrificing quality. In general, I think the higher-performing health-care camps will leverage supply management talent to address nontraditional spend categories such as HR benefits and pharmacy benefits management, while working with engineers to identify returns on investments.

**Rajakrishnan:** Supply management professionals, in coordination with HR management, should look at holistic cost reduction within health care, which

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**Gary Metcalfe** is vice president, supply chain and support services for Tidelands Health in Georgetown, South Carolina. Tidelands is a health-care services supplier, with three hospitals, nearly 50 outpatient providers and more than 200 physicians in its network.

**Senthil Rajakrishnan** is senior director at HBR Consulting in Chicago, where he specializes in advisory services on performance optimization, cost reduction and procurement operations.

**What are the drivers for supply management professionals to cut costs in the face of uncertainty regarding attempts to repeal the Affordable Healthcare Act (ACA)?**

**Hairston:** All indications are that hospitals will need to extend services to a greater number of patients not covered by health insurance. This need may extend beyond current projections for operating expenses, which means added focus on current supply chain cost drivers, such as regulatory compliance; physician preference items (PPIs) like orthopedic and cardiac implants; inventory and order management costs; data standardization; and supply chain security. As the basis of our operation, our contracting objectives are structured on providing value for the membership, total cost effectiveness and clinical evaluation. Our contract approval process ensures that these elements are addressed.

**Hiam:** Due to class of trade, the reimbursement for cases performed in a surgery center environment is less than in an acute-care setting. This forces us to
may be dictated by the future of the ACA. However, a subset of these costs can be addressed or impacted in the same way, regardless of the outcome of the ACA. We help our clients focus on administrative costs, non-medical subsets of insurance (for example, pharmacy benefits) and controls on ever-rising costs. HBR takes a data-driven approach to this by reviewing historical spend, claims and enrollment; and industry trends and best practices to work with insurance providers directly, or via our client or their broker, to negotiate enhanced terms in line with best practices.

**How can supply management handle cost control programs or ideas without sacrificing quality or accuracy?**

**Hairston:** Member-led advisory boards approve all contract decisions — ensuring the highest-quality products align with suppliers’ best prices. We also guide providers in customizing contracts for PPIs and purchased services, as well as conduct aggregated sourcing events in new categories of interest across industry sectors. In addition, we use engagement tools like clinical and spend analytics to improve purchasing habits in high-cost areas that include blood products, waste disposal, drug-eluting stents and orthopedic implants. And finally, we plug into operator experience, pricing intelligence, and understanding of local market dynamics and supplier tactics to make sure savings endure for the long term.

**Hiam:** There are several simple ways to optimize current spend patterns. For instance, in long-term contracts, include multiyear fixed pricing and capped escalation clauses for when and if the contract renews, and add other non-price values such as discount payment terms, growth rebates and revenue-share opportunities. Within the contract period, you’ll likely encounter changing market dynamics, new technologies and supplier consolidation.

For critical categories with a high level of impact on your organization, meet with off-contract suppliers to learn what new technologies could add incremental value in price or time saved for procedures. I also recommend conducting supplier business reviews by comparing the last 12 months of spend data with your suppliers’ data to ensure you’re aligned on spend trends and commitments. Discuss performance issues before they become more serious problems down the road, and schedule level-setting meetings about once a quarter. Also, listen to the voice of your customer or end user base. Reach out to your clinical network and ask a lot of questions regarding their experiences with the current supplier and if they would be open for conversion opportunities if the emergent supplier can meet certain business terms.

**Metcalfe:** From a quality perspective, we need to address cost-control issues hand-in-glove with our physicians. We have an internal value-analysis program that’s comprised of approximately 12 teams, clinically-driven. We partner intensely with our physicians and clinicians to identify exactly what quality is and isn’t.

During these value analyses, we provide everyone with financial analyses and identify from a high-level perspective what the economic impact would be if we were, for example, to standardize items in a category. There might be three suppliers in that category, and we ask the clinician to tell us which of those suppliers makes the most sense to use from a clinical-quality outcome perspective. From there, we focus on contracting, negotiations and the like. It’s becoming more of a total-sum game. The days of having multiple choices from an efficiency standpoint are likely coming to an end.

**Rajakrishnan:** We focus on indirect costs or costs that do not impact plan design or quality of service. These initiatives include third-party administrator (TPA) costs, administrative services only (ASO) costs, stop-loss insurance, and contractual and achieved pharmaceutical discounts. This could also be applied to items such as professional liability insurance.

**What specific contracting and negotiation best practices do you recommend?**

**Hairston:** For suppliers of PPIs, we set up our contracts to ensure that members have flexibility to customize them as dictated by current market conditions. We make sure our contracts incorporate high standards for performance on both cost and quality fronts in all areas from custom sourcing to collections and payment.

**Hiam:** Use a Kraljic portfolio matrix to determine high-financial/high-risk suppliers through low-financial/low-risk suppliers. There are typically three categories to consider when attempting to bring the best value to the company. Commodity items such as high-volume, non-unique products (such as patient positioning foam) can be negotiated with a price-only strategy in mind. Clinical preference items have many suppliers with common attributes, and price/brand awareness and service performance are the differentiators from one supplier over another. The third category with the highest financial impact and highest risk is PPIs. These companies have strong brand preference in the marketplace with a large sales force, substantial technology, clinical buy-in and marketing investment.

“We focus on indirect costs or costs that do not impact plan design or quality of service.”

— Senthil Rajakrishnan, HBR Consulting
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GPOs are becoming more commonplace in this industry. What cost reduction benefits are possible when working with a GPO?

**Hairston:** As a GPO, we can address workforce challenges by providing the team, process and tool sets to help labor management and maximize productivity. Also, we offer a managed services provider program for North America, removing the distraction of supplier engagement so clinicians can wholly focus on quality patient care. A natural extension of supply chain and talent acquisition teams, our contingent labor team helps manage all aspects of contract labor engagement. The program is cost-neutral and completely supplier-funded, delivering, on average, 3 percent to 8 percent cost savings. We reduce compliance risk by employing hands-on credentials verification and facility-preferred terms.

**Hiam:** There are many pre-negotiated contracts with a GPO’s larger supply bases, and the key is to be creative and leverage the supplier relationship to add value to your specific situation. For instance, this could mean a custom price tier in return for preferred pricing or status, a specific payment term, or rebate schedule for spend thresholds not currently in the GPO’s standard agreement but amendable for your specific company. There is plenty of room here to optimize what works best for you.

**Metcalfe:** As most issues do, it all begins with data. We need to have real-time benchmarking and analysis and awareness of how we perform on a national and/or regional basis. Whether it’s an incumbent, a competitive negotiation or a solicitation for proposals, we must know what the market is willing to bear in relationship to where we are. And the outcome of that equation is where our opportunity is. It’s then a matter of renegotiating or recontracting accordingly.

**Rajakrishnan:** We work with brokers and insurers to understand, negotiate and better manage costs. However, we find that working closely with our clients (insured entities) to facilitate and navigate these discussions with their suppliers provides the best results. We are impartial and focused on arriving at the most cost-efficient solution for our clients. Certain agreements, such as those covering pharmacy benefits, require ongoing monitoring to make sure that any guaranteed pricing from the negotiations (such as discounts or rebates) are achieved. We recommend monitoring against the contract language for any shortfalls that can be recovered at the end of each year.

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Rajakrishnan: GPOs add another layer to the mix — similar to a broker, pharmacy benefit manager (PBM) or other advisor. Like most organizations, they are in it to make money; however, they often make money — sometimes more money — when their clients’ costs rise. This is the challenge with commissioned-based incentives in the health-care industry. We are focused on reducing costs and helping our clients optimize the benefits they gain from utilizing a GPO while having visibility into the underlying cost of achieving those benefits.

If you could see a few years into the future, what will your segment of the health-care industry look like, and will there be any supply chain-specific advances or concerns?

Hairston: The GPO segment will continue to grow, but it will prioritize contracting with requirements that address the following concerns: (1) the need for access to data, data analytics, and data standards, (2) pricing transparency, overall costs and cost of care, and (3) clinical variation, value-based purchasing and value analysis.

Hiam: We’ll have better data systems in place to instantly see and compare spend data and trends. Also, expect to see more consolidation within the industry between suppliers of major product categories. With the changing health-care environment, now is the time to reassess who your long-term strategic supplier partners will be for the next five years. Work on establishing strong, mutually-beneficial relationships on a long-term, contractual basis to protect your company’s profit margins while still providing the best patient experience and outcomes. Overall, stay knowledgeable about this ever-changing market and adjust your sourcing strategies accordingly.

Metcalfe: We expect to aggressively expand our market share through ongoing outpatient care growth. One of the challenges in our health-care system is we have approximately 40 locations, and from an ongoing logistics perspective, we have a lot to carefully manage in terms of geography, access, service and many other factors.

Rajakrishnan: In terms of cost-reduction techniques, we expect more focus on negotiating the non-medical cost components of health-care coverage, as most organizations are seeking ways to mitigate continuously rising costs without impacting the benefits their employees receive. To consistently control costs going forward, procurement and supply management resources need to work closely with human resources and benefits administration. ISM