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the future of supply chain expense management

AT A GLANCE

Supply utilization misalignments are commonly found in eight areas:

- > Standardization
- > Over-specification
- > Under-specification
- > Too many hand-offs
- > Missing the big picture
- > Value mismatches
- > New technology
- > Old technology

Supply costs are our enemy, and we must always be on the attack.

This truth becomes especially compelling as standardization is achieved in most categories of purchase, leading to declining price savings from group purchasing organizations. How can healthcare organizations that want to maintain their supply expense savings momentum keep their supply savings humming in the new healthcare economy?

The answer lies in the largely untapped area of supply utilization management. It involves a new supply chain discipline that is similar to medical utilization management, which ensures the appropriateness, timeliness, necessity, and efficiency of the procedures and services that clinicians request, perform, or use in their medical practice. To receive the full payback of this powerful cost-control discipline, healthcare organizations need to enlarge their utilization management scope to encompass all of the products, services, and technologies they are buying. The approach is a natural evolution of what they have been doing for decades.

Why Supply Utilization Management Is Needed

For years, healthcare executives have focused on so many savings opportunities that they have not invested many resources in supply utilization management. But as savings from price, capitation, standardization, and contract diminish, the percentage of supply chain savings residing in utilization increases. Today, that percentage may be as high as 79 percent, with savings that could translate into as much as \$11,998 to \$17,039 per occupied bed. That's 7 to 15 percent of an average healthcare organization's annual supply spend.

Newly uncovered savings come not from reduced prices, but from eliminating waste, inefficiency, misuse, and value mismatches of the products, services, and technologies healthcare organizations employ.

Waste and misuse result from not monitoring their use. Few healthcare organizations hold anyone responsible for monitoring the 18,000 to 46,000 products, services, and technologies after they are purchased. Staff often fail to put items to their easiest and most convenient use, nor do they consider whether their use of the items is wasteful or inefficient.

For example, staff at one hospital used only primary IV sets on patients for one year without anyone questioning the practice. No secondary sets had been purchased,

leading to unnecessary costs of thousands of dollars that year. This is an example of *utilization misalignment*: a condition where a product, service, or technology is not properly aligned with its optimal cost, quality, or efficacy for its intended use. It is not unusual for healthcare organizations to have millions of dollars in utilization misalignments in their supply streams.

Eight Categories of Utilization Misalignment

Eight types of utilization misalignment are common in healthcare organizations.

Standardization. Healthcare organizations often standardize their supplies, services, and technologies to save money, yet standardized products do not meet all of their internal customers' unique requirements. Customizing products to customers' exact requirements can actually reduce an organization's supply chain expenses. Otherwise, the healthcare organization's money is wasted on unnecessary functions and features.

For example, one hospital had purchased a \$5.56 IV set with all of the bells and whistles for use throughout the hospital. However, when the hospital's department heads were polled on their IV set requirements, only the operating department and emergency department required the top-of-the-line IV set specifications. For all other departments, a \$3.37 IV set worked just fine. This change in the hospital's IV set product mix resulted in a \$282,929 annualized savings.

Over-specification. Hospitals often purchase products with components or features that are not medically, legally, or functionally required. For example, hospitals spend millions of dollars a year on pacemakers and defibrillators with unnecessary features that are not medically indicated. Some surgeons implant the same pacemaker (mostly out of habit) in hundreds of their patients in various age groupings, diagnosis categories, and conditions for years, wasting considerable sums on products that have unnecessary features for patients who could just as well receive a less expensive model.

Under-specification. Too few components, wrong components, or missing critical features in products,

services, and technologies are another common cause of utilization misalignment. One example of this practice occurred at a hospital that purchased a uterine kit with a 16-inch tube and then replaced that tube with a 32-inch tube because the hospital needed that size and the manufacturer does not provide a 32-inch tube with its kits. This is a classic example of correcting a defect instead of special ordering the kit with the right components or buying the kit from a different manufacturer that includes a 32-inch tube with its kits.

Too many hand-offs. Handling a task more than once—whether it involves linens, drugs, food, supplies, or forms—is another area where utilization misalignments can occur in hospitals. Studies by the Murphy Institute have shown that this time waster can occur in 34 percent of a hospital's activities.

A much bigger problem that was identified by the Murphy Institute is "information gaps," or information not being available on an accurate and timely basis, which can occur more often than not in many healthcare organizations. One example of this type of misalignment is disposable glove utilization. Hospital staff members may be confused over which glove they should be using (some hospitals have as many five glove choices), so they use the most expensive glove by default, thus unnecessarily costing their healthcare organization thousands of dollars a year. Posting accurate information about the type of glove to be used in different departments would solve this costly problem.

Missing the big picture. Hospitals need to understand why clinicians make the choices they make to understand their buying decisions. For example, in one hospital, an ear, nose, and throat (ENT) specialist was told, as he began an operation, that his preferred brand-name anesthetizing drug had been replaced, without his permission, with a generic drug that did not meet his needs. The decision angered him. Someone had decided that all of the anesthetizing drugs used by the hospital should be the same, without regard for the ENT physician's real need for a specific product. This inattention to detail cost the physician and hospital valuable time, productivity, and money because his operation was delayed until he received the correct drug.

Value mismatches. Many healthcare organizations are bloating their supply budgets with costly products, services, and technologies that are not functionally required. These organizations often fail to look for available lower cost functional alternatives that can meet or exceed the customer's requirements. A good example is the avoidance by many hospitals of buying generic equivalents in every category of their supply purchases, such as kits, trays, paper, pens, drapes, and instruments. We have found that hospitals with the lowest supply cost per patient day purchase more generic equivalents than those that do not.

New technology. New technology often is untested, prone to errors, and confusing when it is first introduced into a healthcare environment. For example, one hospital had purchased a glucose bedside monitoring test system for all of its nursing floors that cost four times as much as what its peers were spending for the same type of product. An investigation of the reason for this high cost disclosed that the product's test strips were defective, so two strips were required to obtain good test results. The replacement of this monitoring system with a new one quickly solved this nagging and costly problem. This type of shortcoming is all too common with new technology that a hospital purchases before the bugs are worked out of the system. To avoid this pitfall, all new technology needs to be closely monitored for at least three months to ensure that it is meeting or exceeding the manufacturer's performance specifications.

Old technology. All technology—whether elevators, IV pumps, anesthesia machines, or imaging systems—has a useful life of a certain number of years, but once that technology passes its useful life, it is not cost-effective for the hospital to continue to maintain it. For example, an analysis of the repair expenses at a 250-bed hospital in the Northeast found that the hospital's equipment repair costs were 10 times the repair costs at other hospitals with the same operating characteristics. The reason was that the hospital had not bought a new piece of equipment in 10 years. Instead, the hospital was repairing its old equipment repeatedly at great expense. All technology should be replaced once it has reached the end of its life cycle.

What CFOs Can Do

Supply chain price savings have flattened, with little room for additional price concessions. That is why managing supply utilization misalignment is so important for hospitals and health systems.

Healthcare finance executives should champion for this new supply chain discipline. They can start by expanding the scope of their value analysis teams to encompass utilization management as well as price and standardization. Next, they can develop their own utilization analytics by employing the time-tested activity-based costing methodology and then seeing how their metrics compare with metrics of their peers. Finally, they can monitor the internal demand for their products, services, and technologies (measuring their velocity, intensity, and frequency over time) to uncover the misuse, misapplication, and misappropriation in their organization's supply streams. These instances of utilization misalignment will become apparent once finance executives start to track, trend, and analyze their demand data.

Looking to the future, supply utilization management is an emerging recommended practice that will enable healthcare organizations to dig deeper and more broadly into their supply chain expenses to harvest new and even better supply savings. It is mission-critical for finance executives to embrace this new supply chain discipline if they are to keep pace with the diminishing payment from all sources that has been forecast for the next decade. In fact, this new discipline is the future of supply chain cost management. ●

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