The Supply Chain’s Role in Making or Breaking Hospitals’ Margins, Competitive Edge

John H Cunningham
Senior Vice President, Client Operations
MedAssets, Inc.

Steve Chyung
Vice President Supply Chain Management & Real Estate
SCL Health System
Learning Objectives

By the end of this session, we will be able to:

• Identify leading supply chain principles to strengthen operations as a source of strategic advantage
• Adapt industry models to the unique environment of healthcare supply chain
• Identify the critical business processes within the scope of Procure-to-Pay
• Unlock savings potential by creating controls and a managing framework for Procure-to-Pay
• Calculate opportunity cost from overlooked processes
Topics Covered

- Supply Chain Overview and Healthcare to Industry Parallels
- Procure-to-Pay Business Processes
- Maturity Scale
- Collaborative Supply Chain/Procurement Structure (SCL Case Study)
- Automation Technology
- Opportunity Costs
Provider Challenges

- Narrow view of supply chain management and its importance to overall performance
- Lack of executive support for supply chain improvement initiatives
- Supply chain leaders unsure of how to engage leaders and demonstrate organizational impact
- Marketplace changes creating increased pressure on revenue
- New, better technology (e.g., devices) increase supply expense
- Physician preference driving up costs
- Supplier and physician relationships
- Lack of physician interest or engagement in managing supply cost with the hospital
- Rapid introduction of new technology requires organizational alignment for decision making
Supply Chain Overview and Healthcare to Industry Parallels
The retail and manufacturing industries are continually improving their supply chain operations as a source of competitive advantage.
In general, the healthcare supply chain has lagged in adoption of supply chain best practices as a means for economic sustainability.
Leading practices from industry, adapted to the unique environment of healthcare can produce effective cost management in healthcare

**Industry Leading Practice**

- Articulate job requirements clearly and consistently
- Match pay scales to worker demand shifts
- Instill culture of continuous improvement
- Optimize workspace layout for process flow
- Understand Total Cost of Ownership
- Align corporate and supply chain strategy
- Evaluate service and salvage in purchase decision
- Optimize utilization before making investments

**Healthcare Adaptation**

- Publish open shifts to preferred audiences first
- Integrate credential management with requisitioning
- Adapt terminology to fit service environment
- Educate staff to think in processes and not activities
- Partner with suppliers to lower cost of goods.
- Engage clinicians in sourcing decisions
- Elevate the Supply Executive within the organization
- Negotiate using pre-approved technology acceptance
- Design facilities and position equipment to optimize throughput
Supply Chain Organization Development Curve, Vision, and Strategy
Supply Chain Management
Organizational Development Curve

Improving Supply Chain Management Capabilities Delivers Greater Value To The Business

Baseline
- Transaction Focused
- Inconsistent Compliance

Conventional
- Price Focused
- Total cost
- System Policies

Advanced
- System Integration
- Data Quality
- Mature Supplier Relationships

Leading
- C-level
- Market Influence
- Risk sharing

Maturity

Value
Vision and Strategy – Create an Integrated Supply Chain

- Centralized control of supply chain process with self service deployment
  - Centralized contract management
  - Standardized processes and methods
    - Custom Catalogue
    - Database maintenance
  - Self service electronic purchase requisition/order, receipt and custom reporting

- The alignment of trading partner incentives
  - 100% price accuracy guarantee
  - Non contested return policy
  - Vendor owned and managed inventory
  - Electronic order/credit to payment management
  - Co-management of the procurement database
  - Evaluated receipt settlement

- A decision support system that will “self-regulate”
  - Fulfillment and Inventory
  - Receipt and payments
  - Customer service and quality assurance center
  - Audits and dashboards
Focus on Four Key Levers that Impact Performance

Technology Enhancement (Data, Applications, Technology)

Strategy Development

Core SC Processes:
- Source and Request
- Obtain
- Pay
- Evaluate and Improve

Business Process Improvement

Organizational Deployment
Begin by Capturing the Total Supply Chain Spend

# Total Operating Expenses FY03

<table>
<thead>
<tr>
<th>MEDICAL CENTER OPERATING EXPENSES FY03</th>
<th>Cost</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physician Salaries</td>
<td>$62,323,155</td>
<td>13%</td>
</tr>
<tr>
<td>Staff Salaries</td>
<td>$190,034,612</td>
<td>38%</td>
</tr>
<tr>
<td>Employee Benefits</td>
<td>$50,677,769</td>
<td>10%</td>
</tr>
<tr>
<td>Medical Surgical Supplies</td>
<td>$44,195,763</td>
<td>9%</td>
</tr>
<tr>
<td>Pharmaceuticals &amp; Drugs</td>
<td>$21,744,736</td>
<td>5%</td>
</tr>
<tr>
<td>Administrative Supplies</td>
<td>$5,605,782</td>
<td>2%</td>
</tr>
<tr>
<td>Administrative Other</td>
<td>$1,628,112</td>
<td>1%</td>
</tr>
<tr>
<td>Purchased Services</td>
<td>$11,851,388</td>
<td>7%</td>
</tr>
<tr>
<td>Utilities</td>
<td>$2,278,152</td>
<td>1%</td>
</tr>
<tr>
<td>Facility Costs (excl Depreciation)</td>
<td>$10,721,934</td>
<td>3%</td>
</tr>
<tr>
<td>Other Controllable Expenses</td>
<td>$1,894,609</td>
<td>0%</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$16,648,162</td>
<td>3%</td>
</tr>
<tr>
<td>Insurance</td>
<td>$21,345,499</td>
<td>4%</td>
</tr>
<tr>
<td>Charges (To)/From PSU</td>
<td>-$7,215,404</td>
<td>-1%</td>
</tr>
<tr>
<td>Intracompany Funds</td>
<td>$48,523</td>
<td>0%</td>
</tr>
<tr>
<td>Other Non-Controllable Expenses</td>
<td>$20,447,609</td>
<td>4%</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td><strong>$454,230,401</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Drugs, Supplies & Consumables: $72 Million

Other Controllable Non-Labor: $28 Million

Total Supply Chain Expense: $100M+ per year
Purchased Services is a significant spend category and largely untapped. Often the “forgotten” categories (in healthcare) but with just as much opportunity for financial, quality and service benefits.
Procure-to-Pay Business Processes
The healthcare supply chain value stream is dynamic and complex.
The purchasing workflow has many touch points.
Collaborative Supply Chain / Procurement Structure
Organizational Structure Change Provides Additional Collaboration Opportunities

Reorganizing and adding departments outside the traditional Supply Chain organization like Accounts Payable, Travel, Process & System Performance and Stewardship has allowed for a more collaborative environment, breaking down silos.
SCLHS Case Study
Accounts Payable and Procurement Collaboration

- Ineffective Procurement Control
- High Cost of Paper Invoices
- Too Many Exceptions
- Lack of Compliance
- Lack of Payment Controls

Collaborated in addressing the following SCL Health System Concerns:
- SOD concerns within P2P functions
- Direct Billing of Hotel stays
- Random Fuel Credit Cards
- Recurring Payments w/o current Contracts

- 28% Reduction in AP Costs per invoice dropping from $5.14 in 2012 to $3.65 in 2014 due to collaboration on Email, Fax and OCR technology
- 78% Reduction in PO Invoice Discrepancies down from 12,300 in 2012 to 2,600 in 2013 due to collaboration with Buyers
- Collaborated on technology to systematically confirm appropriate Stark Law Review & Approvals
- Collaborated with the Integrity and Compliance group to ensure Professional Service contract adherence
- 92% Reduction in late Payments from 2012 to 2014 leveraging collaboration & technology
- Credit hold occurrences are currently averaging 1.5 each month
- 47% Reduction in the Average Days from the Invoice Date to the Check Date, down from 48.9 days in 2012 to 25.9 days in 2014
Use Collaboration Partners in Identifying and Resolving Discrepancies and Exceptions

At the Point of Requisition

- Key Discrepancy Drivers: Requisition templates not correct, not maintained well, or requisitioners not using them correctly leading to incorrect items being purchased, wrong pricing, wrong UOM, etc. Additionally, there is a lack of transparency & KPIs for this area, i.e. X-Type project reduction

At the PO Creation

- Key Discrepancy Drivers: Keying errors, incorrect vendor is used during PO creation. PO script is not used, manual PO’s, not using PO reports to correct pricing, UOM or description inconsistencies.

In the Contracts

- Key Discrepancy Drivers: Items are identified as not being on contract when they actually are under contract. Pricing in the PO doesn’t match the contract. ERP price and Contract Catalog price don’t agree with contract price.
Use Collaboration Partners in Identifying and Resolving Discrepancies and Exceptions

**In the Vendor Master**

- **Key Discrepancy Drivers:** Vendor consolidations that are not communicated or are not completed in a timely or correct manner. Wrong vendor record associated with an item.

**In the Item Master**

- **Key Discrepancy Drivers:** Vendor discrepancies. Poor descriptions, incorrect UOMs or manufacturer codes. Too many additions being communicated directly by the sites. A lack of standard abbreviations. Multiple item masters due to consolidations. A lack of good interfaces back from other cath lab and perioperative systems.

**In the Invoices**

- **Key Discrepancy Drivers:** Items being invoiced are not on the PO. Invoices provided are missing or have incorrect information on them. No PO # listed for PO invoices. Credit / rebills and chargeback issues.
Use Collaboration Partners in Identifying and Resolving Discrepancies and Exceptions

In the EDI Electronic Confirmation

- **Key Discrepancy Drivers**: On-boarding process isn’t clean and well tested. Recycled invoice #’s. PO lines not valid. Items with unique characters cause EDI failures. Dispute process doesn’t allow enough time to process correctly.

In the Uploads

- **Key Discrepancy Drivers**: Bad data in the upload. IC12 doesn’t have the correct vendor. Vendor is not set up in the Item Master correctly.
Procure-to-Pay System Level Progress Metrics

- 96% Reduction in Backlogged invoices
- 27 pp Reduction in Checks issued
- 7 pp Increase in POs issued
Procure-to-Pay System Level Progress Metrics

- **79% Reduction in Invoice Discrepancies**
- **72% Reduction in Past Due Invoices with (Cost Exceptions)**
- **25% FTE Reduction since 2012**
Top 10 Things that should be considered during Procure-to-Pay Collaboration

1. **Focus on the 80:20 Rule to address large vendor issues first.** SCL focused on O&M, Cardinal and J&J in a collaborative manner to reconcile statements, doing root cause discrepancy research, analyzing outstanding amounts due and follow-up with regular communications to a larger team for the resolution of complex issues.

2. **Need to establish a good baseline and measure the metrics that you want to improve.** AP and SC gathered benchmarks of what other companies were measuring to understand the best-in-class and the averages for similar companies regarding P2P processes.

3. **Find some early wins and communicate them.** AP & SC communicated some early wins following the successful conversion of Exempla Associates to WebNow, the Non-PO Approval Hierarchy transition, the gains in ACH Direct Deposit enrollments and the automation available for vendors regarding emailing and faxing of invoices.
4. **Perform Root Cause Analysis to address issues.** SCL identified vendors with repetitive and recurring issues and worked directly with these vendors and our GPO to address areas that kept repeating.

5. **Enforce compliance to the Policies and Procedures.** SC and AP collaborated with other departments on policy and procedure changes to guide the appropriate Care site and System office behaviors in support of the desired P2P initiatives. An example: The changes in how SCL reviews and approves requests for payment from contracted Professional Services.

6. **Manage supplier performance.** SCL AP and SC initiated a robust Vendor Add process, requiring each step of the process to be met prior to a vendor being added to the SCL Vendor Master.

7. **Collaborate on creative solutions to support the needs of the business.** AP and SC are collaborating creative solutions for SCL associates and our vendors, examples include: P-Card options, Debit Card for CME expenses, SPS and CCR Rebate opportunities, capturing Discount Opportunities during Contract negotiations etc.
Top 10 Things that should be considered during Procure-to-Pay Collaboration (cont.)

8. **Collaborate on end-to-end compliance areas to minimize the risks to the company.** AP and SC collaborated to address segregation of duties (SOD) issues and are partnering to establish Internal Controls for the procedures that we leverage daily to pay our vendors and associates through the P2P processes.

9. **Collaborate to review and implement new P2P technology.** SCL has all stakeholders at the table to review proposed P2P changes and to make sure that moving forward makes sense for the company as a whole.

10. **Collaborate to provide internal controls and remove bad processes within the company.** SC, AP and often other departments are asked partner in changing or removing bad practices and addressing process gaps. SCL departments have used these opportunities to brainstorm and implement better alternatives and minimize risks to the organization.
Maturity Scale
Hospitals who operate “best in class” procurement operations can reduce their supply-chain costs by 5-15%¹

Companies who operate best in class procurement operations are among the most profitable in their industry

<table>
<thead>
<tr>
<th>Category</th>
<th>CULTURE:</th>
<th>AUTOMATION:</th>
<th>STAFF:</th>
<th>ANALYTICS:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Best in Class</td>
<td>Supply-chain viewed as strategic value add. Defined standards &amp; processes</td>
<td>High, 90% of PO’s sourced from eReq. 80%+ of all PO’s sent via</td>
<td>Professional personnel focusing on high-value strategic tasks</td>
<td>Routine analytics with savings opportunities &amp; key performance indicators</td>
</tr>
<tr>
<td>Functional</td>
<td>Keeping up with day-to-day. Standards &amp; processes loosely defined</td>
<td>Limited, 40% of PO’s sent EDI, eReq in use but not widely adopted</td>
<td>Administrative, spends 55% of time managing transaction exceptions</td>
<td>Ad-hoc reports from ERP &amp; financial systems manipulated using Excel</td>
</tr>
<tr>
<td>Developing</td>
<td>Focus on short-term fixes and solutions to keep up with day-to-day</td>
<td>None, 100% of PO’s phone or faxed</td>
<td>Clerical, spends 65% of time managing transaction exceptions</td>
<td>Limited to canned reports available from ERP &amp; financial system</td>
</tr>
<tr>
<td>Reactive</td>
<td>Highly reactive transactional based</td>
<td>None, 100% of PO’s phone or faxed</td>
<td>Clerical, spends 75% of time managing transaction exceptions</td>
<td>None</td>
</tr>
</tbody>
</table>

¹Gartner: Supply Chain Consultants and Outsourcing Providers for Healthcare Delivery Organizations – July, 2011
If not managed, cost drivers within the procurement process can make a significant financial impact.
Opportunity Costs
## Procure-to-Pay Solutions – Readiness Assessment

<table>
<thead>
<tr>
<th>Functions</th>
<th>Value</th>
<th>Typical Hospital</th>
<th>Leading Practice</th>
<th>Self Assessment</th>
<th>Opportunity Y/N</th>
<th>Potential Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Using Electronic Purchasing</strong></td>
<td>Automates POs</td>
<td>20% of PO’s EDI</td>
<td>55% of PO’s EDI</td>
<td></td>
<td></td>
<td>$3/PO</td>
</tr>
<tr>
<td><strong>Managing the Item Master</strong></td>
<td>Improves data integrity</td>
<td>30% of item file contains inaccuracies</td>
<td>&lt; 5% of item file contains inaccuracies</td>
<td></td>
<td></td>
<td>$7.61 per inaccurate item file record</td>
</tr>
<tr>
<td><strong>Using Electronic Requisitioning</strong></td>
<td>Contract compliance and operational efficiency efficiency</td>
<td>55% contract compliance</td>
<td>85% contract compliance</td>
<td></td>
<td></td>
<td>3% per $ moved to contract</td>
</tr>
<tr>
<td><strong>Centralizing Purchasing</strong></td>
<td>Automates POs for non-EDI suppliers</td>
<td>35% of contracted PO lines</td>
<td>85% of contracted PO lines</td>
<td></td>
<td></td>
<td>$8/discrepant PO Line</td>
</tr>
<tr>
<td></td>
<td>Improves price accuracy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Leveraging Payment Exchange</strong></td>
<td>Automates payment</td>
<td>20% of supplier payments automated</td>
<td>55% of supplier payments automated</td>
<td></td>
<td></td>
<td>$6.50/payment plus 1% rebate</td>
</tr>
<tr>
<td><strong>Leveraging Invoice Management</strong></td>
<td>Automates invoicing</td>
<td>1 AP clerk for every $17M spend</td>
<td>1 AP clerk for every $64M spend</td>
<td></td>
<td></td>
<td>73% reduction of AP labor ($49.2k/FTE)</td>
</tr>
</tbody>
</table>
Summary
Summary

• Leading supply chain principles to strengthen operations as a source of strategic advantage
• Industry models to adapt to the unique environment of healthcare supply chain
• Procure-to-Pay savings opportunities are often less visible than supply price
• Purchasing workflow has many potential breaking points
• Procurement operations maturity scale
• Collaborative procurement structure, metrics and considerations
• The use of technology to automate
Thank you for attending the webinar today.

For more information on building a strategic supply chain for a competitive advantage, please contact MedAssets today at solutions@medassets.com or call 888.883.6332