Executive Summary

Despite well-documented evidence of significant competitive advantage and cost reduction resulting from supply chain management (SCM) practices, the healthcare industry has been slow to broadly embrace best practice processes and infrastructure. As the healthcare industry shifts to risk-based reimbursement and population health management, it is imperative that supply chain management processes are effective, efficient and aligned with other core management activities. This article draws from FTI Consulting client experience across the healthcare industry supply chain to propose a practical approach to the assessment of SCM processes.

Background

Healthcare reform and widespread consolidation of provider organizations are simultaneously putting pressure on providers’ top-line and creating an intense pressure on providers to leverage scale and shared services to reduce operating costs. As a consequence, providers will need to be nimble and operate, profitably, at Medicare level reimbursements. The following table summarizes industry megatrends and the resulting implications for operators:

The supply chain’s ability to help improve patient safety and satisfaction, structure more flexible purchased services and improve financial performance cannot be overstated.

An often overlooked but critically important role of the supply chain management team is working with clinical leaders and finance to control the introduction of new technology and reduce product variability in the patient care environment. New technology that comes in through the side doors is a more significant cost driver than inflation and can lead to tragic outcomes if support systems are incompatible or users are not properly trained. Unnecessary variability of patient care supplies confounds predictive modeling and cost accounting, complicates replenishment, compromises standards of care and represents a potential safety risk for staff and patients.

With a foot in each world - fee-for-service and risk-based payment - it is important for hospitals to flex operating costs to patient volume. However, the typical provider has a relatively rigid cost structure that is insensitive to small changes in patient care volume. Supply chain can help optimize the delivery of support services and process “make or buy” decisions related to service acquisitions.

Total Supply Chain Expense (TSCE), including drugs, supplies and purchased services varies depending on the provider type (teaching, community, tertiary, etc) somewhere between 12 and 24% of total operating costs and represents one of the few large, manageable, first-tier variable expenses. Supply chain management influences EBITDA through process efficiency, product utilization and product prices. At the same time, SCM impacts working capital through inventory investments and accounts payable terms. Ultimately, supply chain management can impact the organization’s competitive position by helping the organization maintain the ability to hire the best talent and recapitalize through expanded debt capacity.

The performance of supply chain management processes vary widely. Barriers to achieving optimized supply management include a scarcity of talent, insufficient ability to capture and manage data and misaligned incentives in decision-making processes. However, recent trends including provider consolidation, access to market (price) intelligence, affordable data management services, new GPO models and improved alignment within ACOs have reduced the influence of these barriers.

In the emerging healthcare delivery environment, providers need to radically improve their supply chain management capabilities, raising them to world-class standards. The goal is to maximize the value of the supply chain function to the organization by shifting the focus from transactional competence to integrative strategic excellence.
Self-Assessment

A supply chain management self-assessment will help baseline the current performance of your supply chain and provide a basis for developing a high-level roadmap to position your organization to achieve business objectives. This article will define the core functions of supply chain management and recommend key performance indicators appropriate for each function.

**Step 1 Quick Test:**

The supply chain management acid test compares your organization's actual total supply chain cost (TSCE) on the basis of NPSR, TOE, adjusted patient day and adjusted patient discharge against very good performances within a relevant peer group.

**Step 2 Functional Assessment:**

Although strong cost performance is a fundamental requirement for leading practice organizations, given the necessary convergence of clinical effectiveness, payor contracting and supply chain, is it important to evaluate the supply chain along critical dimensions including:

- Data Capture and Management
- Supply Chain Organization
- Supply Chain Processes
- Technical Infrastructure

FTI uses a maturity model approach to support a high-level evaluation of the strategic direction and state of development of an organization’s supply chain because it is fairly easy to communicate findings in the context of best practice. The following maturity model follows the function's capabilities along the four critical dimensions from “early” development to “integrated” operations. Notice there is an additional demarcation between stage two and stage three, since successful operation in the risk-based environment will required at least stage three capabilities. Comparison of the characteristics observed in your organization against the attributes of each stage will give a good sense of the state of the supply chain. Most organizations resemble the model attributes at various stages. For example one organization might be relatively advanced relative to standardized processes, yet possess inadequate data management capabilities.

**Conclusion**

The convergence of powerful industry trends including Health reform, provider consolidation and the availability of new supply chain management tools has accelerated the pace of supply chain development. Given that optimizing the supply chain can help flex total operating expenses with patient volume and have a beneficial impact on financial performance and patient safety, best practice supply chain organizations are exploiting supply chain management for a competitive advantage.

**Author's Note**

FTI will provide additional benchmarking assistance at no cost.

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