



Cover Story

CEOs add strong link to supply chain

By Robert Neil

Managing costs and building consensus

Quick Take

The growing complexities of materials management have led some hospital CEOs to take a fresh look at all aspects of this vital operation. Some are focusing on logistics and forging closer ties with their most experienced supply chain partners to improve performance. Refusing to sacrifice quality just to save a buck, they're taking a data-driven approach to improving efficiency. At the same time, they're finding ways to successfully balance the concerns of physicians with the dictates to materials managers to cut costs.

The rising cost of doing business is forcing hospital CEOs to pay more attention to their supply chain operations than in the past. As a result, the days of a stereotypical CEO being ambivalent to the basement operations of the materials management department are on the decline.

Supplies make up 30 percent to 40 percent of the average hospital's budget, so CEOs have no choice but to be aware of how a materials department affects the bottom line, says Alison Flynn, associate vice president and director of Nexera Consulting, New York.

"CEOs are financially accountable to their boards—even more so under today's difficult environment. So, most CEOs we deal with are involved and are actively engaged [in the supply chain], and we find the more so that is, the more savings can be achieved," Flynn says.

Even though labor is the No. 1 hospital expense, the supply chain has become the logical area to look for savings.

A shortage of registered nurses, pharmacists, laboratory technicians and other health care professionals is forcing hospitals to consider raising employee salaries and benefits rather than making cuts.

Significant opportunities exist within the supply chain to improve not only efficiency and cost savings of an organization, but also the effectiveness and quality of how care is provided, says Glenn Fosdick, CEO of 453-bed Nebraska Medical Center, Omaha.

"But that requires a change in the way things are handled, and it requires a commitment and support from the absolute highest echelon of the organization," he says.

Beating the status quo

Fosdick says he's become more involved in supply chain operations in the last three years, as it became apparent to him the status quo wasn't working. He noticed throughout the industry that individuals lacking specialized training were put in charge of an aspect of a hospital's operation that can account for tens of millions of dollars in the budget.

Historically, most hospitals have chosen to train people within their system to manage materials rather than recruit logistics experts to handle what is a very complicated job that requires a high level of expertise. As a result—and due to a lack of sufficient attention at the highest levels of the hospital—many materials management departments have tended to pursue savings mainly by focusing on seeking price cuts, he says.

Group purchasing organizations have therefore been employed to reduce costs based on economies of scale, but Fosdick notes there's a limit to how many dollars can be saved that way—the real savings in any business are achieved by fine-tuning operations.

"In most cases, you don't find huge savings because somebody left the door open and things are falling out the back of the truck," he says. "It requires you to get a better handle and manage a very complicated process and do it better."

Fosdick says he realized improving the management of Nebraska Medical's supply chain would best be handled by people with a great deal of experience in running an efficient supply chain.

So, in 2002, he turned to Cardinal Health, McGaw Park, Ill., for a specialized business agreement.

Finding the right partner

Cardinal purchased the hospital's entire med-surg supply inventory, which was about \$4.8 million worth of products at the time, and the company has taken the lead role in running that portion of the hospital's supply chain. Cardinal has installed its Pyxis system, which consists of dispensing cabinets electronically connected to replenishment and patient charge systems. Under the setup, the hospital isn't charged for products until they're removed from one of the cabinets.

"This is their forte," Fosdick says. "Our forte is taking care of very sick patients."

Nebraska Medical expects to see a savings of \$3 million in med-surg supply costs this year, and Fosdick attributes that to Cardinal helping the hospital run its operations more efficiently. He says with so much money running through the supply chain, a 1 percent to 3 percent improvement in efficiency can lead to significant savings.

Greater efficiency also allows materials management and the clinical staff to foster better relationships, heavily dependent on having the proper inventory of products on the hospital floor at all times.

"When nurses get jumped on because they're lacking gloves or something, they [nurses] correct for that," Fosdick says. "So they stockpile enough gloves somewhere to make sure they won't be chewed out again in the next three to four years. That happens all the time."

The relationship with Cardinal has addressed this problem, and now, when an item is needed on the floor, more than 99.6 percent of the time the product is available. Fosdick is so pleased with the outsourcing agreement, he plans to expand it, and Cardinal will take responsibility for the medical center's operating rooms in early 2006, and the pharmacy department eventually will follow that.

He says the deal with Cardinal illustrates why a hospital's top-level management needs to pay attention to the supply chain.

"There's a tendency to think 'I have someone taking care of materials management for me, so I don't need to think about it,'" he says.

Joining forces

This is an area where CEOs have made mistakes in the past, says Flynn, who notes that in today's market, chief executives can't afford to be unaware of what's going on in materials management.

Henry Milkey, president of materials management for MedCenter One Hospital, Bismarck, N.D., says he and his team know that as they work on standardization and utilization projects, his department has the support of the hospital's CEO, James Cooper.

However, Milkey points out it's not blind support, and the materials department doesn't always get everything it wants.

"We know that if we go to Mr. Cooper, he's going to listen to us, but he might also ask questions we might not have considered, and that forces us to look at things in a different way."

The balancing act is to listen to both physicians and the materials management department and find solutions that aren't focused on price, but on value, Cooper says.

"You have to use outcome data, cost data and other data that provides the best evidence you can get," he says. "Reasonable people will all have different opinions, but when you get the data-driven decisions, you have a much greater chance of getting good buy-in to the process."

It's a team effort and the emphasis is on making everyone from the storeroom clerks to surgeons aware that they are part of a process.

"We haven't had the problem of physicians complaining to the CEO about something we're doing in materials, and then suddenly we're told [by the CEO] to do what the physicians want," he says.

The physician-materials' interaction is such an important one that a CEO needs to take responsibility for making sure it runs smoothly, says Gary Duncan, CEO of three-hospital Freeman Health System, Joplin, Mo.

The arrangement at Freeman is more than the standard value analysis committees many hospitals have established. Physicians at Freeman are in charge of a great deal of product selection and determine what is best for the health system based on price as well as

quality and necessity. Conventional industry wisdom has been such that if you allow physicians to choose products, costs will quickly rise because price would become a secondary consideration to a group that doesn't have to pay the bills.

However, Freeman is employing a tactic that lost favor in the 1990s, but is making somewhat of a comeback today—using a large number of hospital-employed physicians rather than contracting with various physician groups. About 90 percent of the health system's admissions come from Freeman's 175 employed physicians. Physicians are allowed to select the products they feel will lead to the best quality of care, but they're also motivated to go an extra step to find the best prices to achieve that quality.

There's an understanding that saving money on supplies means the hospital will have funds to invest elsewhere that ultimately will benefit the physicians. "If we do well, the docs do well because we're able to provide more capital to build heart institutes and cancer institutes," he says. And we've been able to maintain that kind of business relationship with the doctors, and we still really try to get the best things for the system."

Like everyone else, physicians want to be part of a successful organization, and their practices benefit from having the ability to admit patients to a hospital that's progressive and has some of the latest technology that some other facilities might not have, Duncan says.

The doctors always have the final say on whether a product will be used, and that decision is made after the physicians evaluate and discuss the benefits of a product with their peers. The strategy is to have doctors working on product selection and communicating with materials management before a product is ever brought into the system.

Quality not quantity

Purchasing the right supplies is not just something the doctors and materials management are doing; it's a systemwide plan that Duncan says requires him to attend many early morning strategy meetings.

"And I'm showing up at many of those meetings, not because I know a lot about the equipment, but because I want people to know ... if we are going to continue to prosper, then we've got to manage these costs."

He says it's also his job to let doctors know he's on their side and that he's not going to compromise quality. At the same time, he's on the side of the hospital, which must continually work to do well financially. He admits it's a complicated balancing act, but as CEO, it's his job to bring both sides together. It's true teamwork. The industry is well known for having sales representatives who go directly to doctors with products rather than through any other established channels a hospital may have. A lot of hospitals have trouble getting physicians to rebuff sales reps who take this approach, Duncan says.

"Our doctors are actually coming to us and saying 'Hey, somebody talked to me about this product. Has that been through our preplanning committee? Is it something we have on contract or is this something we've taken an initial look at?' That's much better than having doctors pound the desk and say 'Hey, we've got to try this!'" He quickly adds some vendors take longer to understand the way the health system operates, but with materials management, physicians and the executive staff all working from the same blueprint, it's not easy for a vendor to thwart the plan.

However, regardless of what tactic a hospital will use to bring down costs, he says it's imperative the CEO become involved. Incentives have to be aligned in all departments and only a CEO can lead that kind of effort.