By Vicki L. Smith-Daniels

Supply Chain Strategies in Troubling Times

Traditional cost-cutting measures may not be enough to overcome economic realities. Today's challenges require new strategies that can benefit your hospital in the long term.

Many of today's economic challenges are unprecedented. As a result, there are no standard responses or proven strategies that you can use to navigate through these troubling times. Rightfully so, healthcare executives are focusing on financial fundamentals such as reducing costs, maximizing revenue, and preserving days of cash on hand.

At the same time, most suppliers are experiencing their own challenges that require new approaches and business models. Healthcare organizations that hold onto traditional recessionary thinking are likely to miss opportunities to gain financial benefit from these new business models—and may find that the troubling times are more troubling than they bargained for.

The Same Old Strategies May Not Work

Managers frequently use business cycle principles to guide their decisions during a recession. For supply chains, these economic principles translate into shrinking everything—production, inventory, and workforce—until the economy starts moving again.

But today's economic times require much more than downsizing operations. Most manufacturers, suppliers, and retailers are struggling to find the cash flows and short-term credit needed to keep their supply chains moving. The weakened dollar makes matters worse, as many medical-surgical products, medical devices, and pharmaceuticals, have higher levels of components and supplies manufactured outside the United States than in the past. Depending on exchange rate contract terms, manufacturers may find themselves paying more for components, materials, and supplies.

In addition, higher energy costs and worldwide carbon emissions regulations are increasing transportation costs. Add to the mix the fact that product and supply shortages are likely to become more frequent and more severe, and you have all of the elements of a perfect storm.

Here are a few strategies for not only riding out the storm, but also helping to ensure smooth sailing thereafter.

Refocus on Contracts

Lower patient volume leads to lower demand for products and supplies. Because most contracts are based on quantity-based discounts and rebates, healthcare providers can expect supply cost as a percent of the total cost of care to increase unless hospitals takes immediate action to reconfigure their supply chain.

Many healthcare providers are working closely with their group purchasing organizations to counterbalance this problem by more effectively utilizing their existing contracts. Hospitals should also attempt to offset these supply cost increases by moving more off-contract spend to on-contract. These strategies make sense for almost all hospitals. Before taking action, healthcare organizations should follow other industries and make sure new and existing contracts also consider cash flow, product availability, currency exchanges, transportation costs, and service delivery.

Ensure Product Availability

During recessionary times, customers use existing inventories rather than new production to meet demand. Health care is no exception. Once inventories are deleted, manufacturers need to replenish these supplies (assuming, of course, that the suppliers have available short-time credit to finish the supply cash flow). The problem is that many lower-tier suppliers are no longer in business, especially in low-cost countries such as China, where plant closures are quite common these days. To ensure product availability, your healthcare organization should consider one or more of the following strategies:

> Negotiate safety stock guarantees and more favorable shortage allocation rules for guaranteed purchase volumes.
> Dual source critical products and supplies.
> Increase self-managed inventories and distribution.
> Develop a structured, efficient product substitution and expediting process.

Preserve Cash on Hand

Cash is king for most hospitals today. Although in the past hospitals may have been pursuing discounts for fast payments, these economic times may require holding onto cash as long as possible. It goes without saying that CFOs are working on cash flow preservation. Yet, few hospitals and ambulatory surgery centers are thinking about how suppliers may be sources of cash flow.

Needless to say, manufacturers and distributors are also worried about cash flow and maintaining market share and are likely more motivated to accept contract terms that have previously been off the table. Supply chain strategies to preserve cash include:

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> Increasing days of cash on hand through longer payment cycles to off-contract suppliers
> Negotiating or renegotiating contracts with longer payment terms and reduced acquisition prices
> Developing a sourcing strategy that aligns with your cash flow strategy (i.e., move cash in larger or smaller increments)
> Renegotiating fast payment discounts to balance the tradeoff between the discount and improved cash flow

Anticipate Service Reductions

For quite some time, manufacturers and distributors have been competing on no-charge services to win the business on the product side of the equation. Manufacturer's representatives deliver a wide range of mission-critical services in the operating room (OR) and, except for the price of the product (i.e., implants, stents), hospitals are not paying directly for these services.

Not surprisingly, however, manufacturers and distributors are reducing customer service in almost every industry. In the future, hospitals may experience a reduction in perioperative services and an increase in instrumentation costs. Distributors, like their manufacturing counterparts, are likely to offer fewer no-charge services and charge higher premiums for customized services.

Healthcare organizations that pursue one or more of the following strategies are more likely to be prepared for the negative impacts on service reduction:

> Document a standard process for manufacturer's OR services.
> Include services in physician preference item cost-value analysis.
> Consider in-sourcing service functions to the clinical staff.
> Expand self-managed distribution funds and/or share regional solutions with local partners.

Call for Action

Some hospitals are better positioned to navigate through these troubling times. Other hospitals may believe that the costs of pursuing these strategies are not worth the financial benefit. If your organization is one of these hospitals, you may want to consider:

> Will your hospital be at a disadvantage in the next round of negotiations if other hospitals successfully implement these strategies?
> How will your hospital respond to product shortages when these products are available at other hospitals?
> How will your physicians react to reduced services from manufacturer representatives in your OR when the same level of service is offered in another hospital?

Making it through the rough times is not enough. Effecting long-term change by implementing new strategies that respond to the changing business models of suppliers and manufacturers will help hospitals to make it through the rough times and into brighter days ahead.

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Protecting Scarce Resources through Enterprise Risk Management

Flawless execution of strategic objectives ensures that an organization's goals are realized and limited resources are not wasted. Enterprise risk management contemplates all the variables that might knock an organization's plans off course.

Here are seven steps for managing risk when executing a strategic plan:

> Clearly identify the issue and the implications to the corporate strategy.
> Establish accountability. Who are the stakeholders? Who is the champion? Who is needed to help assess the risk and mitigation options?
> Assess the primary risk factors and any subsequent secondary risk factors. Understand what is controllable.
> Develop a mitigation strategy. Identify the implications and impacts of the mitigation and address any potential consequences. The strategy should include expected outcomes that are measurable.
> Communicate the strategy to all the stakeholder groups—including external groups, such as vendors and union representatives.
> Execute the plan. Allow for adaptation and unforeseen obstacles. Be prepared to reconvene and reassess any new secondary impacts.
> Measure and monitor results on a regular basis to ensure mitigation actions continue to address the need.

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