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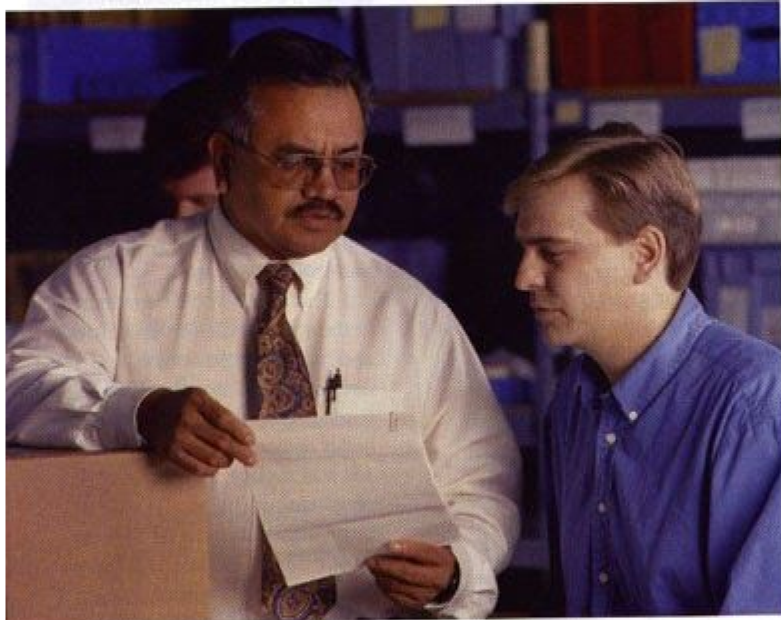
Increase Revenues and Cut Overhead with a Well-Managed Supply Procurement System

BY MICHAEL RACIOPPI



One of the most overlooked and under-managed responsibilities in medical groups today is supply procurement. It's a vital yet time-consuming task that is often delegated to an administrative manager or billing person—or sometimes simply to whomever happens to find that there are no more gauze pads in the supply cabinet.

This situation has become more pronounced as managed care pressures and consolidations push supply procurement lower down on the list of priorities. Perhaps this is because only an estimated four percent of revenues are generally spent on medical supplies, an average of about $6,000 to $11,000 per doctor. Payroll, on the other hand, can comprise 40 percent of overhead. It's no wonder less attention is paid to ordering supplies. Unfortunately, when the process of supply procurement is not managed well, a host of revenue-draining, overhead-inflating problems occur. It can take superior sleuthing to uncover these financial leaks, because often they are hidden.

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Administrators don't always realize that the "process" of supply procurement, if mishandled, may be more costly than the "products" themselves. The main reason is that procuring supplies—ranging from cotton balls to examination tables—may become a huge human resource drain. What is invariably lost is staff time and energy that could have been spent focusing on revenue-enhancing tasks such as making appointments, running diagnostic tests, collecting accounts receivables, or submitting for insurance reimbursement.

Thus, implementing a well-managed procurement process can result in significant savings, and ultimately increased revenue for the practice.

A Success Story

Clinical Associates, a multispecialty practice in Des Plaines, Illinois, with 20 physicians and a clinical and administrative support staff of 70, is a typical case study of what can happen when supply procurement is not well managed. It is also a shining example of the benefits that can ensue when an administrator takes the time to uncover the problems and put a controlled ordering system in place.

"Before we got a handle on our procurement situation, we were buying from three vendors and spending about $144,000 annually on just medical supplies," says Loretta Wright, executive director of Clinical Associates. "After we looked at what we could do better, including eliminating one vendor entirely, we were able to save $36,000 a year." Of that cost savings, more than half was due to freed-up staff time—about 120 hours a year—that the practice now puts to better use.

Finding Hidden Overhead

The experience of Clinical Associates illustrates many of the hidden variables that, when combined, eat away at profits. For the most part, they fall into two main categories:

Searching for the Cheapest Price

This mindset—looking exhaustively for the best price on every product—ultimately results in a practice having too many suppliers. Estimates show that, on average, office personnel spend between 20 and 60 minutes processing each order. Using this yardstick, a practice placing 40 orders per month with multiple vendors is spending 10 to 30 hours more per month on procurement than one placing only 10 orders with one or two vendors. Chances are, those extra hours of staff time (which can range from $25 to $75 per hour, on average) are not worth whatever minor price savings may have been achieved on everyday medical and office supplies.

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Perhaps a more striking analogy is grocery shopping. A typical supermarket shopper has neither the time nor the energy to go to one store for a sale on milk, another for a sale on eggs, and a third for the least expensive produce. Food shoppers generally accept the principle that, while not everything in a particular supermarket is the least expensive, overall the outlet they have chosen is the one that best meets their needs—for price, service, convenience, and quality.

Valuable time is lost on more than just researching price. Once the orders arrive from multiple vendors, someone has to be available to receive the cartons, unpack them, store the items, and handle all the bookkeeping for each individual shipment and invoice.

Procuring supplies this way, largely in reaction to price, also can lead to ordering too much or not enough of a product, or the wrong product. And, with no internal resources to measure the actual cost being expended, overhead continues to inflate.

Poor Inventory Management

It's probably safe to say that most large practices with no centralized procurement systems probably keep too much inventory on hand.

Clinical Associates was one such practice. "We'd order too far in advance, sometimes six weeks before a product's anticipated use," says Ms. Wright. "So we paid for things before we needed them and didn't get reimbursed for another 90 days. Meanwhile, the supplies would sit on

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the shelf and expire." Clinical Associates now uses a "real time" scenario, stocking only a week's worth of supplies.

Like the scenario cited by Clinical Associates, overstocking generally means there's a long lag time between paying for product and getting reimbursed, not to mention the interest that money could have earned. And it comes with other thorns.

There's the cost of real estate to actually warehouse the products; in expensive metropolitan areas, this cost can be prohibitive. "Instead of an 8 by 10-foot room, we're now using a 4 by 4-foot closet," says Ms. Wright. "At $25 per square foot, that's an incredible savings. We cut our warehousing costs by 80 percent." It's best to let a supplier be the warehouse and use newly found clinic space for more profit-oriented activities.

There's also the cost of insuring the inventory. And there's the very real possibility of expiration prior to its use, especially for certain pharmaceutical products with a short shelf life, such as immune globulins. Finally, once again, there's the human cost of managing and accounting for large quantities of materials.

Focus on the Process, Not the Product

Getting a grip on a disorganized procurement process doesn't have to be difficult. But it does take commitment. A practice that suspects it has a procurement problem should start with an inventory audit.

Take a good hard look inside the supply room. Then take an even closer look at, and under, people's desks. Is the staff squirreling away supplies? Does each person keep a large stock of syringes, bandages, and other miscellaneous items handy "just in case we run out?" Ask why they need to stockpile. Hoarding products to an excessive degree leads to over-purchasing, because no one can get an accurate handle on how much is on hand and what is actually being used.

In addition, is there an understanding among the office staff as to how often certain items are ordered and why they are purchased at that frequency? Is there a system to ensure that products are used in advance of their expiration dates? Is there a method in place to account for everything in the supply area? As a general rule, the key is to centralize supplies in one place as much as possible, to account for each item, and to monitor the flow of products on a daily, weekly, and monthly basis.

It's also smart to whittle the vendor list down to as few suppliers as possible who can meet all the practice's needs. Ideally, a practice should view its suppliers as procurement "partners" rather than simply vendors. When this happens, procurement actually becomes less of a focus; it becomes a seamless part of a well-run office. If necessary, issue a Request for Proposals (RFP), to ensure that all requirements are being met.

Finding the Right Procurement Partner

Issuing an RFP that covers all your bases will make the job of finding a supplier more efficient. Make sure your RFP addresses the following points:

What is the supplier's fill-rate?

This is one of the most important questions to ask. Fill-rate is the percentage of products ordered that can be fulfilled in one shipment. Look for a fill-rate of at least 97 percent and ask for proof. Understand the criteria that each vendor is using to ensure that your comparisons are reliable. Be aware that the average for most suppliers is about 90 to 92 percent.

What is the inventory at the distribution center?

Fill-rates are likely to be higher with vendors who ship from very large distribution sites with large inventory. Otherwise you will have to contend with multiple deliveries from multiple locations just to fill one order. Your distribution center should warehouse a minimum of 20,000 items. That way you're more likely to get everything you ordered in just one shipment.

Can the supplier offer contract pricing?

A significant benefit of buying most of your supplies through one vendor is their ability to offer you contract pricing. On average, about 20 percent of the items you order comprise 80 percent of the dollars you spend on supplies. The key is for a vendor to help you identify those key items and offer you the best possible contract price for them.

In negotiating a contract price, the vendor may suggest less expensive alternatives of similar quality, for example, a clinically acceptable generic brand of tape instead of a name brand. Or if each doctor in the group prefers a different kind of soap or glove, the vendor may be able to achieve economies of scale by suggesting an alternative that works for all or most of these physicians.

A contract price can lead to the creation of a standing order that automatically comes every week, which is a huge time-saver.

Does the supplier offer electronic or online ordering?

See if the vendor can customize an electronic "shopping cart" that the office manager can simply revise and submit as needed. Obviously, this is quicker than starting from scratch with an order form in a catalog.

It's estimated that less than two percent of all supply orders are placed electronically and the Internet, especially, hasn't yet made a big impact as a purchasing tool among physicians. However, larger group practices with business-savvy administrators are beginning to recognize the time and money that can be saved by handling supply procurement this way.

Will the supplier be a conduit of information?

In a true partner relationship, the vendor will keep the practice in the loop on important issues. For example, suppliers should communicate new Medicare CPT reimbursement

codes and data on new products as it is released. It's incumbent upon the distributor to gather this information, decipher it, and bring it to the attention of practice administrators as needed.

For instance, when there is more than one reimbursement billing code, as is the case with certain diagnostic tests, you may be able to maximize fees by using a different code.

Does the supplier offer more than just medical supplies?

Find a distributor that stocks not only medical supplies, but also pharmaceuticals, vaccines, equipment, and office supplies. The staff time saved alone will make this worthwhile.

How will the supplier help you pinpoint exactly where you can save money on procurement?

Ask for a procurement audit. See if the vendor will analyze your old supply invoices. The vendor should examine what products are ordered and the quantities of each, how many orders are placed and how frequently, price paid, etc. Ask the vendor to customize a cost-saving procurement plan based on your office's particular level of usage. Do not settle for a supplier that focuses merely on offering the best price.

Overall, the goal is to get a handle on the entire cost of seeing a patient, and how supplies fit into this big picture. Office administrators must understand not just how, but why each product is purchased, and when it will be used. The initial effort put into setting up this process can pay handsome dividends for years to come.

Reference

1. Based on results of the Socioeconomic Monitoring System 1997 Survey reported in *Socioeconomic Characteristics of Medical Practice 1997/98* by the American Medical Association Center for Health Policy Research.

***Michael Racioppi** is president of the Henry Schein Medical Group, based in Melville, New York.*

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