

While direct orders cost five times as much as distributor orders, the typical hospital purchases only one-fourth of its medical-surgical spend through distributors.

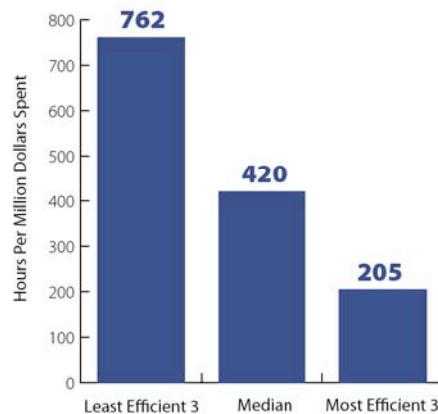


HEALTH INDUSTRY DISTRIBUTORS ASSOCIATION
Serving Medical Products Distributors Since 1902

HOSPITAL PROCUREMENT STUDY: Cost Savings Opportunities Through Distributor Relationships

Hospital purchasing decisions often focus on the price paid for medical products, but price-based negotiations are no longer sufficient for controlling supply costs. As a result, medical products purchasers are seeking additional cost savings opportunities that maintain margins without compromising clinical goals. HIDA research has found that hospitals' internal ordering costs are five times greater for a direct manufacturer order than for an order to a distributor. However, a typical hospital places only 25.6% of its medical-surgical spend through distributors.

Efficient Hospitals Use Fewer Staff Hours
Per Million Dollars Spent on Med-Surg



- The top hospitals use less procurement time overall, but are able to allocate approximately the same percentage of time spent on procurement activities to purchasing and buying staff. The least efficient hospitals require close to 3 times more hours per million dollars of med-surg spend from the purchasing/buyer function than the most efficient hospitals.
- Management/administration staff generally have the highest salaries on a hospital procurement team. As a result, the most efficient hospitals minimize their procurement role, using roughly half as many hours per million dollars of procurement spend than the least efficient hospitals. As a share of total hours, however, efficient hospitals allocate more procurement hours to management and administration than the least efficient hospitals. This helps to reduce the involvement of ancillary, clerical, and nursing personnel in the purchasing process.
- Salaries for receiving staff tend to be lower than those for purchasing/buyer and management/administration staff. However, efficient hospitals still control receiving staff time in the procurement process.

KEY FINDINGS

Overall Performance Gaps

KPMG's survey indicates that a wide efficiency disparity exists among hospital procurement organizations. While the most efficient organizations use 205 staff hours per million dollars of medical-surgical spend, the least efficient use 762 hours. The most efficient hospitals spend \$8.90 per purchase order (PO) compared to \$15.90 for the least efficient organizations.

Procurement Staff Efficiencies

The most efficient hospitals spend the bulk of their procurement hours on three key functions: purchasing, management/administration, and receiving. These functions account for 94.9% of procurement time spent by the most efficient organizations, compared to 75.7% for the least efficient hospitals.

Supply Chain Efficiencies

Efficient hospitals maximize their distributor relationships by processing 90% more POs than the least efficient hospitals, each of which includes 12% more item lines. They also minimize freight expenses, paying approximately one third the amount spent by the least efficient hospitals.



Other Efficiencies

Efficient hospitals use approximately three fewer full time equivalent (FTE) employees in their procurement organizations than the least efficient hospitals. They also reduce the amount spent on med-surg supplies per adjusted patient day by about one-third.

RECOMMENDATIONS

The most efficient hospitals capture cost savings by undertaking several steps, beginning with the decision to emphasize procurement through a distributor. Top hospitals:

Choose a strategic channel. Items ordered directly from a manufacturer can have premium procurement and freight costs, and often require a manager's approval for non-standard procurement. On average, the salary cost of a PO to a manufacturer is \$47.81 greater than that to a distributor. By making a strategic choice to use a distributor, the hospital strengthens its control of staff allocation and costs.

Reduce clinical and management time in routine orders. Orders placed using management and clinical staff cost \$15.28 per line, compared to \$3.64 per line for orders by clerical staff. While the replenishment of complex products may require clinical staff expertise, ordering more routine supplies generally does not. Hospitals are making gains in implementing standardized product usage, but can continue to streamline purchasing practices to maximize procurement efficiency.

Move purchasing to EDI, E-commerce, and the Internet. E-commerce is an underutilized, cost-saving supply chain management tool that can significantly lower labor costs associated with procurement. An electronic order costs a hospital \$3.00 per line, compared to \$13.17 for a manual order transmitted by telephone or fax. Electronic data interchange (EDI) can save hospitals 77.2% off the cost of ordering

Manufacturer POs Cost More than Distributor POs

Difference between Salary Cost of Manufacturer PO and Distributor PO

	Average	25th Percentile	Median	75th Percentile
Ancillary	\$6.91	\$6.81	\$5.53	\$7.11
AP	\$2.77	\$5.39	\$1.19	\$0.81
Clerical	\$2.60	N/A	\$2.60	\$1.86
Mgmt./Admin.	\$12.18	\$9.45	\$13.51	\$14.91
Nursing	\$2.38	\$2.66	\$1.82	\$2.51
Purchasing/Buyer	\$15.48	\$15.39	\$17.52	\$15.55
Receiving	\$5.49	\$5.27	\$7.10	\$5.71
Total Premium	\$47.81	\$44.98	\$49.27	\$48.45

manually. While 76.3% of distributor orders are sent electronically, only 26.5% of direct-to-manufacturer orders are sent through EDI or other electronic means.

Control delivery, freight, and warehousing costs. Reducing incremental steps can potentially save up to 3,900 hours per year on average. For example, orders received through distribution tend to be shipped to a central stock room, while products ordered from manufacturers go to departments within the hospital. Receiving multiple individual shipments increases the internal costs to a hospital, so that each line on a direct-from-manufacturer PO costs \$9.56 to process, which is five times the cost per line of a distributor order.

THE STUDY

HIDA commissioned a study by KPMG's Health Advisory Service to identify new procurement savings opportunities for hospital supply chain organizations. In a sample, the survey team identified the most and least efficient hospitals based on the number of staff hours spent on procurement activities. HIDA published KPMG's research results in April 2005.

Your Distributor Can Help You!

- Product training and demonstrations
- Information for product evaluation
- Product samples
- Education about compliance requirements

For copies of the full *Hospital Procurement Study*, contact your medical-surgical distributor or HIDA directly at (703) 549-4432.

FOR REPRINTS of this Consultative Selling Tool visit www.HIDA.org or call (703) 549-4432.