Gaining Control of Your Hospital's Fastest Growing Operating Expense

A GHX White Paper
for Healthcare
Executives

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Executive Summary

As healthcare organizations look for innovative ways to deal with healthcare reform and economic uncertainties, the supply chain is assuming an increasingly important role. Healthcare executives recognize that for their organizations to have the best chance to survive and thrive in today's environment, they need to take advantage of every strategy at their disposal to control operating expenses while still delivering superior patient care. The supply chain plays a pivotal role in achieving those goals.

Consider these facts: Supply chain costs are second only to labor as the largest expense for healthcare provider organizations. And they are increasing faster than any other operating expense. Faced with declining revenues, leading healthcare organizations are adjusting their supply chain strategies and business processes to bring these costs under control.

One area that shows great promise for delivering savings is contract management. More effective contract management has been a goal in healthcare since the 1996 Efficient Healthcare Consumer

Response report identified billions of dollars in potential savings, a portion of which were related to contracting. Subsequent reports added more weight to the case for healthcare providers to use contract management to gain visibility into and control of their fastest growing operating expense. Those reports called for real-time synchronization of pricing data and a central repository for all contracts.
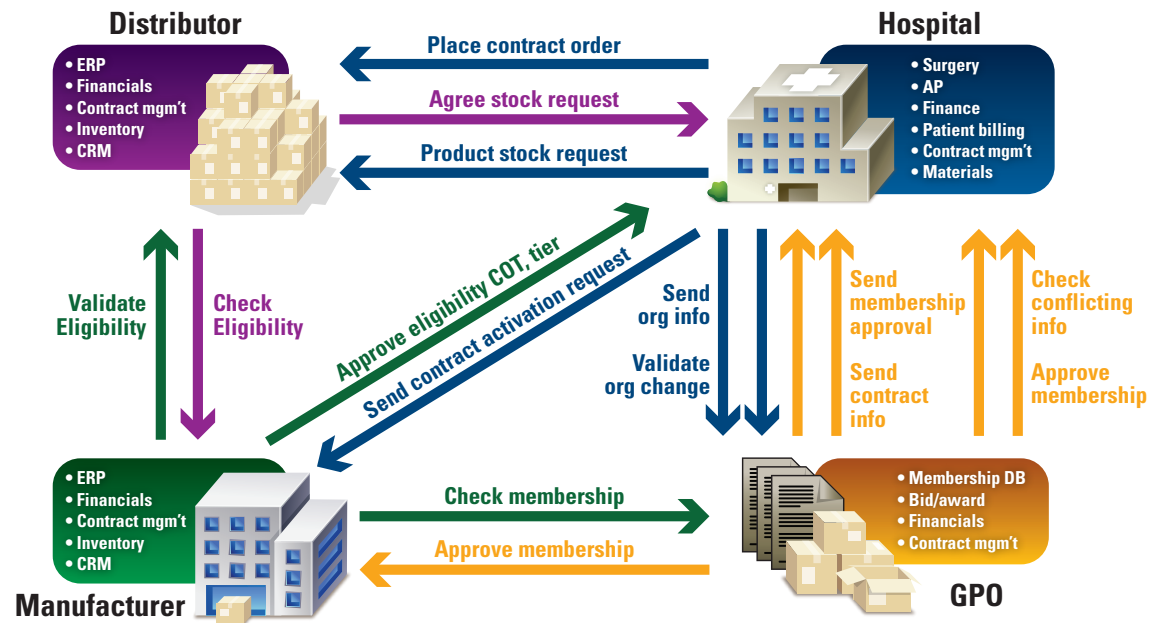
This white paper will explore methods for improving an organization's contract management performance through automation and process and resource optimization. It will outline steps to help an organization:

- Maximize the value of negotiated contracts, both group purchasing organization (GPO) and local
- Receive the best negotiated price every time, including tier pricing opportunities
- Create and maintain one contract repository for both medical-surgical and non-medical-surgical products
- Reduce operating expenses by reducing discrepancies and lowering the cost to resolve them when they do occur
- Transition from reactively managing item files to proactively managing contract pricing

Highlights

This white paper offers strategies to address the following business issues:

- Getting the right price, every time
- Reducing operational expenses and providing business predictability
- Reducing the time required to keep up with contract changes
- Controlling the purchase of high-cost physician preference items

Distributor
- ERP
- Financials
- Contract mgm't
- Inventory
- CRM

Hospital
- Surgery
- AP
- Finance
- Patient billing
- Contract mgm't
- Materials

Place contract order
Agree stock request
Product stock request

Validate Eligibility
Check Eligibility

Approve eligibility COT, tier
Send contract activation request

Send org info
Validate org change

Send membership approval
Send contract info

Check conflicting info
Approve membership

Manufacturer
- ERP
- Financials
- Contract mgm't
- Inventory
- CRM

GPO
- Membership DB
- Bid/award
- Financials
- Contract mgm't

Check membership
Approve membership

Contract Pricing: A Moving Target

Managing contracts more effectively—from creation to renewal or expiration—can deliver real value for healthcare organizations. Yet because of its complexity, contract management may be one of the most underutilized tools for maximizing cost savings in healthcare. Disparate IT systems that don't share information and lack of widespread adoption of industry data standards for product and organizational/location identification all contribute to this complexity.

Also making it difficult for providers to address the issue of contract management is the large number of contracts, frequency of pricing updates and changes, and new activations and additional contracts to cover new products. GHX studies have found the average hospital has more than 1,200 GPO and local contracts in its portfolio and activates contract pricing for more than 40,000 new line items every six months. Adding to the complexity is the fact that contracting in healthcare involves multiple parties and procedures.

Healthcare organizations purchase hundreds of thousands of supplies every year, and for the average hospital, GHX has found that up to 85 percent of those supplies are covered by a local or GPO contract. Yet providers often don't have the time or resources to help ensure they are paying the correct price, to research exceptions or variances from the contract price, and to look at each product category or GPO contract for pricing opportunities. As a result, they may be paying more than they need to for supplies.

Andersen study defined scope of the problem

The problems inherent in healthcare contract management were defined 10 years ago in the groundbreaking Andersen Industry Study Report, "The Value of eCommerce in the Healthcare Supply Chain."[i] That report identified contract database management as a "core value driver" in the healthcare supply chain, and measured and quantified both tangible and intangible benefits from management of existing and future contracts between providers and suppliers. Among the study's findings:

- It is very difficult for provider organizations to manage item files and contracts effectively. Often, several prices are paid for the same item within a provider's system.
- Most contracts and pricing files are paper-based and require manual input into a provider's materials management information system (MMIS) or enterprise resource planning (ERP) system.
- Tiered pricing and complicated contract terms not only cause incorrect purchase order (PO) pricing, but also create back-end rework associated with errors and credits.
- Rebates and other contract incentives are completely dependent on the information provided by suppliers and GPOs.

In its study, Andersen called for an integrated e-commerce tool to serve as the catalyst for enabling providers and suppliers to interact with each other. Such a tool, Andersen said, could provide a Web-enabled contract repository to assure the alignment of pricing and units of measure, and minimize the need for rework and assure that the proper price was being paid.

Other opportunities for improvement identified

Two other groups joined Anderson in calling for improvements in healthcare contract management. The Strategic Marketplace Initiative, a non-profit organization of healthcare executives dedicated to improving the healthcare supply chain, called out contract synchronization among trading partners as an area needing improvement.[ii] Among the issues still to be resolved, the group said, was a "lack of industry process consistencies about contract loading and data management to ensure that all parties implement the negotiated terms by the mutually agreed upon effective date."

In a 2006 report, the Health Industry Distributors Association's Supply Chain Council addressed what it called "an out-of-sync, error-prone healthcare supply chain," and made a number of recommendations for improvement.[iii] Its report said, in part, that "The Council believes the best solution will come in the future with the creation and utilization of an industry wide electronic central repository that all supply chain partners can access."

Best-in-Class Contract Management

What does best-in-class contract management look like? In a 2009 study[iv], Aberdeen Group, a consulting firm, analyzed contract management. It concluded that effective management of the contract creation process, combined with the development of greater analytics and reporting capabilities around contract compliance, can deliver real value and returns for organizations.

Among key findings of the Aberdeen study of more than 170 enterprises were the following:
- Best-in-class organizations experience four times less savings leakage than others.
- Best-in-class organizations realize 15-20 percent lower contract creation and approval cycle times than their competitors.

- Best-in-class organizations are able to place 59 percent more spend under management than others.
- Best-in-class organizations are able to place 42 percent more spend on contract than their peers due to more effective contract management.
- More effective management of procurement contracts has led best-in-class organizations to capture 46 percent more of their negotiated discounts and rebates.

How Does Your Organization Stack Up?

The first step toward improved contract management is assessing an organization's current state. GHX has identified seven critical questions an organization must answer to determine how well they are performing key contract management functions:
- Do we always pay the correct contracted price for stock, non-stock and non-file items that we purchase?
- Do we know the expiration date of all of our contracts?
- Are we on the right tier level for every contract?
- Could we easily locate a specific contract we are looking for and be able to do this for all contracts, both GPO and local?
- Is our item master automatically updated whenever contract price updates occur?
- Can we analyze our contracts across a vendor, manufacturer or product line?
- Can we quickly calculate how much of our total spend is on-contract versus off-contract?

If an organization answers "no" to one or more of these questions, it is not taking full advantage of all opportunities to cut costs from its supply chain. And the last question is particularly important if the goal is to gain control over high-cost physician preference items (PPI), which create challenges when processed as consignment, bill-only orders outside of a hospital's standard purchasing process. With a lack of visibility into these purchases, providers often have little control over which items are purchased and whether or not they are purchased at the correct contract prices.

The remainder of this white paper will look at how an organization can maximize its people, processes and technology to achieve greater cost savings and gain visibility into every dollar spent through proactive contract management.

Automation: Key to Creation and Management of Contracts

As more healthcare organizations become part of large health networks and develop increasing numbers of complex commitments and obligations to facilities, customers, partners and suppliers, the use of contracts has grown substantially. Yet many of those organizations continue to rely on cumbersome and time-consuming manual processes to manage their contracts, commitment levels, rebates and item master updates.

Hospitals that manually upload contract data to their MMIS or ERP system face a number of challenges. Often, they lack visibility into current contract pricing for weeks or even months. During that time, they may be overcharged for products and spend valuable time trying to identify and recoup those overcharges. Worse yet, they may not have the time to research and seek the refunds, and either miss out on the savings or have to hire third parties to manage this process. It's far more difficult to recapture overpayments retroactively than it is to identify and deal with exceptions in real time.

A central repository for all contracts

The right automation approach can enable an organization to achieve contract compliance while helping to drive identification of additional savings opportunities. Electronic management of an organization's contract portfolio is the key to addressing contract issues that may prevent the organization from achieving the full measure of available cost savings. A technology solution exists today that enables an organization to store and access its contracts and current pricing in one place, and to easily monitor contract activity and compliance. By providing a three-way price match between PO, purchase order acknowledgment and contract price in real time, this solution enables hospitals to work with their suppliers to correct pricing prior to the invoicing process. The solution also eliminates the need to manually key price changes and new contract prices into the item master.

The benefits of this solution include the ability to:
- Electronically review and manage contract and price updates to reduce contract price exceptions
- Reduce time spent handling exceptions
- Increase "early pay" discounts
- Electronically load current contract information into an organization's MMIS or ERP system to increase invoice match rates
- Automatically activate contract data as it becomes effective
- Validate current and accurate pricing
- Monitor contract activity across all of an organization's spend
- Evaluate new contract opportunities

Automating the pricing synchronization process

For efficiencies to be recognized by all participants in the contracting process, all four parties—provider, manufacturer, distributor and GPO—must be able to share information electronically. A way to automate the pricing synchronization process is available today, and is the industry's only four-way collaborative platform enabling all parties to a contract to agree on key terms and conditions. Parties to a contract generate an electronic letter of commitment (eLOC) in real time, and can have the contract integrated with a distributor on the same day it is executed, in turn activating new pricing with all parties in less than a week. Without the platform, it can take up to 60 days to synchronize contract data.

Healthcare now has the "industry solution" called for in some of the earlier industry reports. This makes it easier for trading partners to share, in a timely manner, accurate information related to factors such as tier pricing and commitments, customer eligibility and price activation dates, providing a neutral platform through which all parties to a contract can be confident that the price being paid is accurate.

Making People a Part of the Equation

When Cindy Kassotis became director of Materials Management at Torrance Memorial Medical Center, she faced a challenge. It quickly became apparent to her that a very small percentage of Torrance Memorial's annual supply spend was on contract. "Although there was a contracts manager in place and she was doing a great job, without the proper structure and a centralized repository for contracts, the task of managing contracts was daunting," Kassotis said.

Kassotis' vision was to have a centralized repository for all contracts, those negotiated by Torrance Memorial's GPO, as well as contracts that it negotiates locally. She also wanted incoming requests to the Purchasing department and outbound orders processed electronically. Finally, she wanted to provide the right tools and training to the Materials Management staff—enabling them to do their jobs accurately and efficiently and ultimately leading to the cost savings Torrance Memorial wanted to achieve.

Kassotis recognized that she would need the right technology to achieve her vision and selected a solution. Next, gaining the trust of the rest of the organization for Materials Management and developing a contracts team to implement the necessary changes were equally important. So she hired a system administrator for her materials management system and a data analyst; shored up the contracts team by promoting the contracts coordinator to contracts manager and hiring two contract analysts; and made sure that everyone—from requesters through approvers and buyers to Materials Management staff—was trained to use the new technology and follow new processes.

To build trust for her department within the organization, Kassotis established a value analysis program that involved a steering committee and six teams representing everyone involved in the procurement process at Torrance Memorial—cardio/imaging, service and technology, surgery, patient care, lab and pharmacy. While Kassotis admits it wasn't easy, she believes that by involving all stakeholders in the process, Torrance Memorial was able to overcome some of the hurdles that could have derailed its supply chain transformation efforts.

Leveraging Technology with Process Improvements

An organization can implement the best, most innovative technology to help it manage contracts, but if it relies on the same processes it has always used, it will miss the opportunity to maximize its return on investment. Recognizing this, Torrance Memorial made a number of improvements to its procurement processes. It developed a process flow for approvals that electronically routed requisitions to managers for approval. In addition, security classes were modified so that only MMIS analysts

could make master file additions, changes or deletions. Finally, a set of procurement policies and procedures was developed.

"By automating our processes and cleaning up our data, we were able to gain greater visibility of our spend," said Kassotis. "We can now apply resources where they will be most effective."

Memorial Hermann, the largest not-for-profit healthcare system in Texas with an integrated network of 11 hospitals, also realized its in-house contract management system was inefficient, costly and in need of an overhaul. Memorial Hermann chose the same technology chosen by Torrance Memorial, while acknowledging the need to improve departmental integration processes at the same time.

"You can't just flip a switch and make it happen," said Scott McLaughlin, director of Purchasing and Contracting Services at Memorial Hermann. "You can't operate in silos, so we went through an education process that enabled all departments involved with contracting—from Materials Management to Accounts Payable—to understand the benefits to them and to the entire organization of what we were doing."

Memorial Hermann also examined processes and implemented changes to leverage the contract management technology it chose. The result: everyone involved with contracting spends less time resolving discrepancies and shares confidence they are paying the right price for items.

Increased Visibility, Accuracy and Timeliness Create Value

Today's provider organizations are operating with razor-thin profit margins and increasingly are finding that procurement is one of the last remaining areas where they can achieve substantial cost savings. Assuming an organization's operating margin is 2 percent, one dollar of expense reduction is worth $50 in gross revenue, according to the Association for Healthcare Resource & Materials Management.[v] Or, stated another way, $100,000 in supply chain savings is equivalent to $5 million in gross revenue.

GHX has found that by being able to automate the process of inputting contracts into a hospital's

MMIS or ERP system, providers can help eliminate contract errors costing up to $30 per error, as well as thousands of dollars in contract overpayments. Purchasing at the correct contract price, on the correct tier and on the primary contract can help hospitals save up to 3 percent of the total amount they spend on contracted items, according to GHX value studies. With the addition of other contracts, such as those for managed care, leases, physician agreements, and maintenance and service, savings can be as high as 5 percent.

High Point Regional Health System in High Point, N.C., maximized its contract management opportunities by going beyond traditional contracts for products negotiated with GPOs and directly with manufacturers to include other contracts the hospital had created. In partnership with GHX Business Solutions, High Point loaded as many contracts as it could into its materials system, from physician contracts to lawn services, providing it with a "one-stop shop" where everyone in the organization has visibility into all contract agreements.
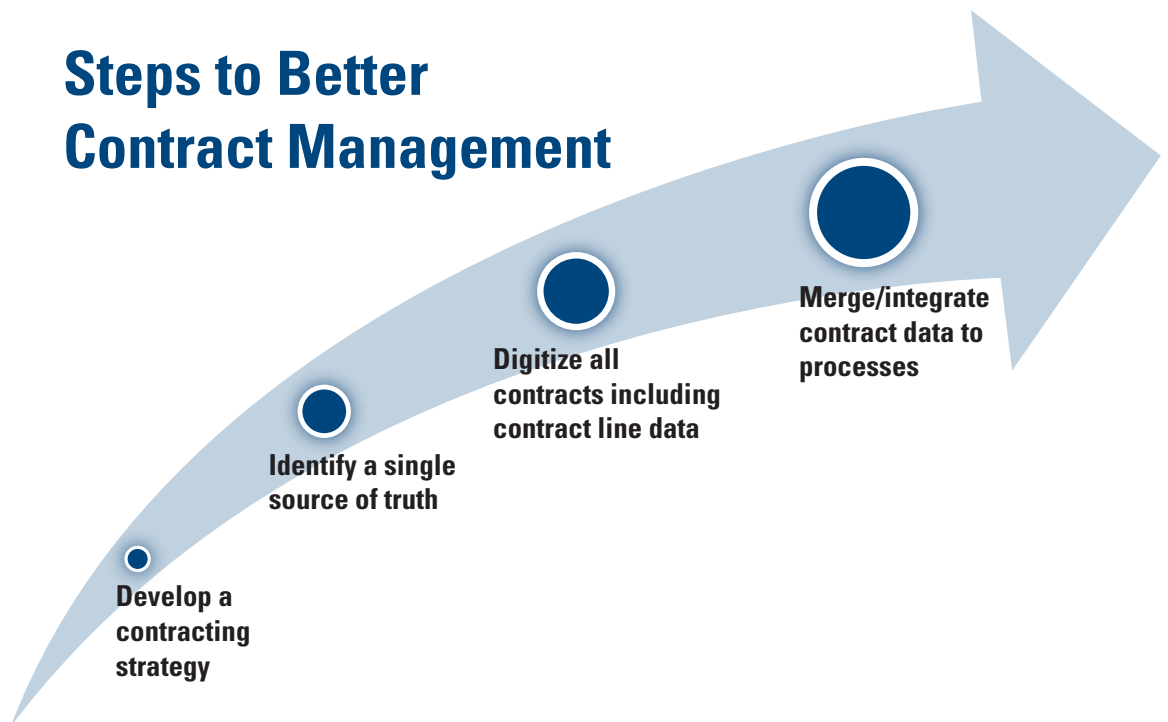
Managing non-file, off-contract spend

Increased visibility into what they are spending, and with which vendors, enables healthcare providers to identify thresholds—the point at which products have been purchased in large enough quantities to qualify for better contract pricing. But the greatest measure of value from proactive contract management can be achieved by moving non-file spend to contracts.

According to Datamonitor Group, a provider of global business information, 40 percent of the average hospital's annual spend is non-file and, as a result, is not easily managed. Working together with customers, GHX has found that converting even a small percentage of non-file spend to managed spend can offer significant hard-dollar savings.

By reducing non-file, off-contract spend prior to creation of a PO, providers can gain control over the purchase of PPI, such as cardiac stents, orthopedic implants and pacemakers. These advanced medical devices frequently account for as much as 40 percent of a hospital system's medical-surgical supply spend, yet they don't go through a hospital's materials management department. Because of lack of visibility, hospitals find they have little control over which items are purchased and whether they are purchased at the correct contract price.

Steps to Better Contract Management

Merge/integrate contract data to processes

Digitize all contracts including contract line data

Identify a single source of truth

Develop a contracting strategy

Conclusion

A variety of forces, some longstanding and others set to take effect in 2011 and beyond, will make it difficult for hospitals to maintain current levels of profitability. The worst case scenario would have some hospitals forced to shut their doors. As a result, today's healthcare leaders are looking for strategies to help their organizations maintain profitability so they can continue to provide the same high level of care their patients expect and deserve. With the supply chain one of the last remaining areas of substantial cost savings opportunities, having a contract management strategy in place just makes good sense from a business standpoint.

By leveraging the right price management technology with optimized contract management processes and better resource alignment and utilization, healthcare providers can transform their contract management function into a strategic asset. The potential benefits are substantial and can help organizations achieve the competitive advantage they seek in today's challenging environment. ✗.

To download a copy of this white paper, go to http://www.ghx.com

[i] Andersen, "The Value of eCommerce in the Healthcare Supply Chain," June 2001.

[ii] Strategic Marketplace Initiative, "The Challenges of Achieving Contract Data Synchronization," 2007.

[iii] Health Industry Distributors Association, "Best Practices for the Healthcare Supply Chain," August 2006.

[iv] Aberdeen Group, Inc., "Procurement Contracts: Real Value, Real Returns," March 2009.

[v] Association for Healthcare Resource & Materials Management, Issues Paper, 2009.

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