

DOCTORSMANAGEMENT, LLC

# Supply Cost Reduction in The Physicians Practice

---

**Michael Lawson**

**3/16/2007**

Lowering supply cost in the physician's office can be a daunting task. This document outlines specific actions that can be taken to achieve that goal.

## Supply Cost Reduction in the Physician's Practice

The cost of practicing medicine continues to rise while reimbursements continue to fall. Add to this the cost of providing employee benefits, which are also rising, and it is becoming more difficult to operate a financially healthy medical practice. Assuming that coding and billing operations are functioning at proper levels of performance and employees are operating at peak levels of performance, there are basically two ways to increase revenue and, hopefully, increase profit as a result: see more patients or take on ancillary services. These are not always options for every practice, so the next opportunity to increase profits is to reduce overhead. Again, there are two basic ways to do this: cut supply cost or reduce HR cost. With each of these, the implication for the practice is the possibility of reduced practice performance and reduced revenue.

Reducing supply cost can be a formidable assignment. A supply program running at peak efficiency requires time, knowledge, resources, and dedication. However, by focusing on what is most within your control, you can achieve substantial savings. The obvious question for the practice manager concerning the cost of supplies and services is this: Am I getting the best balance of price versus product quality and service? In other words, am I getting value for the money?

An old adage states, "The bitter taste of poor quality remains long after the sweet taste of low price is forgotten." The desired result is to not sacrifice quality for price. A cheap price often brings tradeoffs in other areas: service, performance, and durability. A sacrifice in any of these areas will increase the cost of the product through downtime, poor work output, and premature repurchasing.

There are several ways to address the issue of supply cost reduction to determine if a good balance between price and quality is achieved. This article approaches the subject from two angles. First, by looking at actionable steps to lower supply cost and later, looking at the products themselves.

Lowering supply cost can be accomplished by having a focus on several areas:

- A single focal point for supply purchasing
- Bonus program for supply cost reduction
- Inventory control system
- Internet shopping
- RFQs
- Focus on the vital few
- Membership in a purchasing organization
- Hiring a purchasing partner

**A single focal point for supply purchasing** - Assign one person to monitor inventories and purchase supplies. This eliminates duplicate purchasing that occurs when more than one person orders supplies. Clinical supply purchasing and office supply purchasing can be assigned separately. Duplicate or excess inventory is capital unavailable for other uses. By assigning one person to do the purchasing, that person becomes the local supply purchasing expert who will learn important skills and techniques over time, and supply cost will become lower as a result.

## Supply Cost Reduction in the Physician's Practice

**Bonus program for supply cost reduction** - Incentivize employees to contribute to the bottom line. Implementing a basic program to share a small percentage of the savings can yield big rewards on the bottom line.

**Inventory control system** - Start one immediately. Inventory control systems can range from simple pencil and pad systems to more elaborate systems using software and bar code scanners. Electronic inventory systems identify key order points, necessary stocking levels, frequency of use and, of course, minimize unnecessary ordering of supply items. This translates into a more efficient supply system, giving you greater control over where supply dollars are spent. Ask your distributor representative if they have such a system available for your use. Some distributors will supply a basic system for little or no cost if you ask.

**Internet shopping** - The Internet brings the medical supply industry to the desktop. It can be a great source for product research and pricing, but it can become very time consuming if shopping time is not structured. Internet purchasing saves money by eliminating overhead such as warehousing, sales representatives, advertising, etc. so savings are passed along to the consumer. In many situations, you deal directly with the manufacturer or an authorized distributor. Use caution when using the Internet. Some of those great-looking sites may be out of someone's garage. Orders should only be placed from trusted sites. Never send personal information over the Internet, including your Social Security number, bank account numbers, or credit card numbers if you are not absolutely certain the vendor is legitimate and that their Web site is secure.

When searching the web in Internet Explorer, a lock icon appears in the security status bar. This is your assurance that the sight is secure. The security status bar is located on the right side of the address bar. You should also check the URL (Web site address) to see if the site is secure. Secure Web sites will start with *https://* instead of just *http://*. For general Web browsing, URLs beginning with *http://* are fine, but when transmitting personal or confidential information, you want to be sure the site begins with *https://*. Many web sites will display a SSL (secure socket layer) logo at the bottom of the landing page as their assurance that you are on a secure site.

**RFQs** - RFQs (request for quotes) are a tried and true method for determining the best price for the same or similar item from different manufacturers. Knowing the right product for the application is critical to obtaining the right product at the best possible price; this can save a considerable amount of time in product selection. If you are unsure of the product specification or product capability required to perform the intended application, it is quite appropriate to invite vendors to educate you as to why their product is best suited for your needs. Another way to gain product knowledge and get product recommendations is by asking other doctors within your specialty about their experience. Trade shows also offer a great opportunity to see product demonstrations and to request "Trade Show Pricing." Once the decision is made to purchase the item, vendors should be given a deadline to prepare and submit proposals. If you are a member of a group purchasing organization, don't assume that the vendor will offer "group purchasing pricing." Specify that you are a part of a GPO and ask, "Do you offer group purchasing pricing?" This encourages the vendor to respond in an appropriate way. And lastly, be clear that the vendor knows that this is a competitive situation.

## Supply Cost Reduction in the Physician's Practice

**Focus on the vital few** – One important thing to keep in mind is that, while a practice may use hundreds of clinical items or office supply items, the real cost savings will be generated by just a few expensive or high volume items. For instance, a large orthopedic practice was using about 600 different clinical items annually. However, the majority of the expense was in the top fifteen items! Remember the 80/20 rule: Eighty percent of the supply cost is concentrated in twenty percent of the inventory. Don't waste time saving a big percentage on a low cost item. The key is to identify expensive items and concentrate on them and not the inexpensive or infrequently used items. A good start to lower supply cost is to prepare a list of currently used items. Start the list today, preferably in an electronic spreadsheet that can be updated frequently or at least every time the supply invoice arrives. To save some time, ask your distributor for a twelve-month usage report that includes pricing. This is your purchasing information and it should be readily available. The usage report will save you a lot of time.

**Membership in a Group Purchasing Organization (GPO)** - GPOs had their inception in the mid-seventies when a group of hospitals banded together. GPOs are supply chain organizations whose function is to develop purchasing contracts with healthcare product manufacturers and service organizations. Members join GPOs to have access to the contracts. GPOs work by aggregating the spending of its members in exchange for better product pricing. Today some GPOs have annual purchases in the tens of billions of dollars, far exceeding what a large private practice buys. Before leaving this subject, be aware that there is no guarantee of better pricing by simply joining a GPO. Achieving maximum benefit in a complex business requires a great deal of ongoing involvement and follow-through.

**Hiring a purchasing partner** - Medical practices have become more complex, offering a variety of services under one roof; largely in response to decreasing reimbursements. The result is that purchasing within the physician's practice is more difficult and complex. This complexity now requires a greater range of skills and knowledge to navigate a sea of vendors and products to get to the best value. In response to this need, organizations offering purchasing expertise have sprung up to help practices maximize office efficiency and save money on supply purchasing. A thorough understanding of supply chain management may be required just to know how the price is determined. Nonetheless, each of the previously mentioned points, when implemented, will help the practice take control of supply purchasing. Each action by itself will achieve positive results, but each also has a trade-off associated with it: time utilization, use of material resources, human resources that might be better utilized caring for the patient, or importance of saving a few dollars relative to other matters. The message here is that time and other valuable resources expended to save money may eliminate any savings at the expense of something else; in reality, it may actually cost the practice money. Hospitals have always relied on purchasing departments with dedicated men and women who understand contract utilization specializing in product selection, product research, and presenting RFQs (request for quotes) or RFPs (request for proposals). Unlike the person in the physician's practice who may be involved with patient scheduling, billing, coding, HR issues, patient requests, budget preparation, or serving as a clearinghouse for a myriad of things, the purchasing department is dedicated to knowing how to purchase. Firms that offer purchasing partnerships dedicated to the physician's practice provide a service that can yield significant savings with improved practice efficiency.

# Supply Cost Reduction in the Physician's Practice

The next section discusses the products themselves and examines variables that most influence product cost.

Effective supplies purchasing requires a focus both internally and externally. Inside the practice the goal is to maximize the use of resources, minimize waste and inefficiency, and, in the process, save money. Externally, the goal is to align the needs of the practice with those of its suppliers so that the correct supplies meet the practices expectations of quality and price - always with a focus on good patient care. DoctorsManagement, LLC, is a leading company that offers a purchasing partnership component to its clients. Our surveys have determined that physician practices can reduce product cost by understanding the following product selection criteria.

- Product Brand
- Product Contract Price
- Distributor Mark Up
- Quantities Ordered
- Percent of Product Line Utilization
- Purchase Order Cost

**Product Brand** - Walk into any grocery store or big-box store and immediately you see store-branded items sitting on the shelves alongside the familiar name-branded items. These products are always less expensive than their name-branded counterparts. While ingredients appear to be the same, it is not uncommon for the store-branded product to fall short of the expectation set by the branded product. As a consumer, you try the product to see if it “measures up” to your expectations. Does it taste as good? Is it as thick and juicy? Is it filling? If you answer no to these questions, then the next time you know whether to purchase the name brand or the store brand. The same is true with clinical supplies. Is absorbency a problem with the gauze pad? Does the needle create a bigger “stick?” Does the adhesive bandage adhere properly? Which ones work for you? Only you can decide. Ask your clinical supplier for a free product sample. Private label products are common to items such as alcohol packs, table paper, gauze pads, and gloves, but may also include more specialized items. Similarly, GPOs offer their own branded product and most are eager to tell you the product manufacturer's name. Private label products are often made to the specification of the original manufacturer; some are simply repackaged by the original manufacturer and others are made by a third party. If the brand is important to you, GPOs offer many of the name brands at good savings. It might be like having your cake and eating it to. The message is that private label products can save money, but if poorer quality results in the need to order higher quantities than their name-branded counterparts, you are most likely spending more money - not saving money.

**Product Contract Price** - GPOs aggregate purchasing to negotiate lower cost on a range of products for a fixed period of time. However, not every product is available through a contract; the average varies, but exact-matched items are generally considered to be about 50% of the items used in the typical physician's office. The remaining products might be available in an alternative form on contract. Non-contracted items require you to negotiate a good price from the supplier. Knowledgeable purchasing begins with knowing whether or not the product is available on contract and, what the cost of the product or service is delivered to your clinic. For non-contracted items, the floor price, the lowest price you will pay for a product, can be found by

## Supply Cost Reduction in the Physician's Practice

shopping the item through many vendors. Since you are in the healthcare business and not the shopping business, a purchasing partner can provide a valuable time and money saving service to your practice, leaving you more time to attend to the core business of patient care.

**Distributor Markup** - Product cost plus distributor markup are major factors determining an item's cost, but how is the markup determined? Generally speaking, the more money spent with a single distributor the lower the mark-up fee; it is a volume game called tiered purchasing with each successive tier delivering a lower distribution fee. Supplies purchased in low quantity have higher distribution cost. Supplies purchased in higher quantities have lower distribution cost. In unmonitored and uncontrolled purchasing situations, distributor markups may reach the cost of the product itself. Like all businesses, distributors must maintain a profit margin to provide the service, but not all distributors pay the same price for the same item and not all distributors charge the same markup to get it to your office. Shopping your volume is one way to uncover the disparity that exists between distributors, but the best way to gain more control of this area may be to join a GPO or engage a purchasing partner to work on your behalf. In all situations, work with the distributor to find a reasonable compromise so that everyone is happy.

**Purchase Order Cost** - The cost of writing the check or that of cutting a purchase order is not often considered as a supply cost. Shopping and purchasing from multiple vendors can increase the cost of supplies, and so can taxes and shipping. Cost generated in utilizing multiple vendors must be offset by the saving of time, money, service, and product quality. Generating purchase orders and writing checks can add as much as \$15 to \$75 to the product order. Consider vendor and product consolidation whenever possible.

**Quantities Ordered** - A careful review of past orders can help you determine if larger quantities can be ordered - i.e., a case instead of a box. Larger quantities often carry a lower price tag. Ask your distributor representative for a 12-month usage report with the latest pricing. This is a valuable tool that helps expose areas for product consolidation.

**Percent of Product Line Utilization** - Doctors and administrators can be very brand loyal, making it difficult to order from just one vendor. With this in mind, supply cost can be reduced by consolidating product purchasing to one manufacturing line or a particular brand of glove, etc.). Work with the product manufacturer and learn what you need to do to get better pricing.

In summary, physicians and their managers can spend significant amounts of time in activities that bring little value or significance to improving operations, increasing the level of patient satisfaction or the overall running of a successful practice. Let's be realistic for a moment. You can save money by taking the steps just covered, but there are trade-offs associated with dedicating the resources to achieve significant savings. It is easy to fall into the old routine when more pressing matters get in the way.

It may be time to work smarter. It may be time to take control of the things you do best and let go of the things that can be and should be done by someone else. It is not uncommon for physicians and administrators to take on the role of materials management director or purchasing agent. The practice and the administrator might be better served by outsourcing supply purchasing services that require expertise beyond what is typical for an administrator or

## Supply Cost Reduction in the Physician's Practice

physician, to an organization that specializes in purchasing. There are several independent groups eager to help. If your supply costs continue to rise or outcomes are not what you expect, then it is time to do something different.

Good luck and happy savings!

Michael Lawson

Purchasing Consultant  
DoctorsManagement, LLC  
10401 Kingston Pike  
Knoxville, TN 37922

This document is subject to copyright and intellectual property protection. This material may not be copied in whole or in part without written permission from DoctorsManagement, LLC.