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Choosing The Right Channels For Your Products



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Distribution Channel Considerations For Medical Products Manufacturers



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A Decision-Making Framework

Health Industry Distributors Association | HIDA.org

Distribution Channel Considerations For Medical Products Manufacturers







Channel Strategy Should Be Based On Maximizing Value To Customers *Not Just Minimizing Costs*

Manufacturers should:

- Begin with understanding **customer needs** and expectations
- Consider the nature of their own **products and markets**



Manufacturers with a wide array of products may find that different channels fit for different products.

What Do *Customers* Need?

Service Levels



- 98%+ fill rates
- Same or next-day delivery
- No/low minimum order quantities

Space And Budget



- Inventory buffers without need to tie up cash or space

Special Programs



- Low unit of measure delivery programs
- Procedure kits
- Pricing optimization

Most manufacturers' distribution model decisions are driven by *customer* requirements.

What Do *Manufacturers* Consider?

Service Levels



- Meet customer expectations for fill rates and lead times
- Provide inventory buffers for customers

Target Markets



- Reach fragmented markets including non-acute and post-acute

Investment



- Deal directly with a few distributors rather than many end customers
- Reduce investments in warehouse management, A/R, and other functions

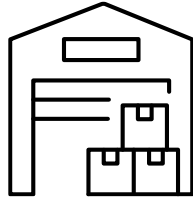
Focus



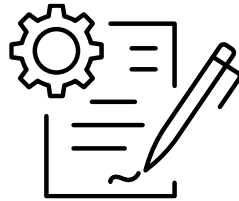
- Maintain focus on product quality and sales growth rather than logistics

Again: Most distribution decisions are driven by *customer* requirements.

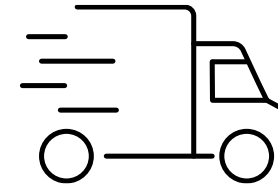
Functions To Consider When Evaluating Channels



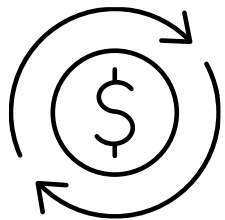
Receiving and storage



Order processing and fulfillment



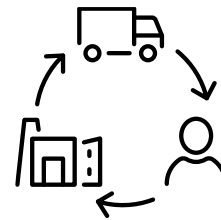
Outbound transportation and delivery



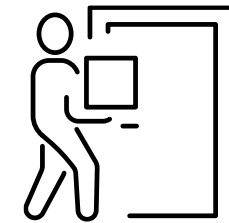
Bill and credit management



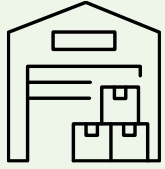
Information and data services



Returns and customer service



Prospecting and demand generation



Meeting the ups and downs of customer demand for products requires having inventory on hand in the supply chain

Commercial Medical Distribution Estimates (U.S.)

- 500 distribution centers
- 76 million square feet of warehouse space
- 5500 manufacturers served
- Average inventory levels of ~30 days (varies by product)

Receiving And Storage

Costs Of This Function Include

Warehouse • Equipment and technology • Inventory carrying costs • Warehouse labor

Customer Expectations

- Customers want short lead times and high fill rates
- Back orders or shortages can directly impact patient care
- Many providers want frequent, smaller deliveries due to limited storage space

Manufacturer Considerations

- Customer service level requirements: Difficult for most manufacturers to provide the fill rates providers expect
- Opportunity costs: Holding inventory ties up capital that could be invested elsewhere
- Control: Direct model allows control over inventory storage, levels, and allocations
- Risk: Distributed model transfers cost and risk to distributor

Order Processing And Fulfillment



Manufacturers must engage in order fulfillment activities regardless of the distribution channel they choose, but the level of effort and investment differs greatly between models.

Costs Of This Function Include

Equipment and technology • Warehouse and order processing labor

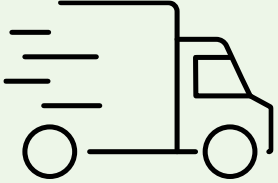
Customer Expectations

- Preference for fewer, larger shipments
- Complete orders in a single shipment
- Low/no order minimums
- Often, low unit of measure or just in time services

Manufacturer Considerations

- Number of transactions: Direct channel involves exponentially more order/fulfillment transactions
- Customer contact: Direct channel can provide closer connection with end customer
- Kits: Many products are sold to healthcare providers as part of kits. Kitting makes it less feasible for a manufacturer to sell certain products directly to customers

Outbound Transportation And Delivery



Once product is manufactured, it must be delivered either to a distribution center or directly to a healthcare facility.

Costs Of This Function Include

Shipping • Vehicle costs • Driver/delivery/shipping personnel • Equipment and technology

Customer Expectations

- Providers generally prefer to receive fewer shipments, to reduce receiving labor costs
- Some facilities, especially those in urban areas, are space-constrained and can't accommodate tractor-trailer deliveries

Manufacturer Considerations

- Number of transactions: Distributed channel involves fewer, larger deliveries
- Customer contact: Direct channel can provide full control over delivery and installation
- Environmental advantages: Consolidation of shipments reduces emissions

Billing And Credit Management



Credit management includes assessing creditworthiness, invoicing and collections, and importantly, assuming bad debt risk.

Costs Of This Function Include

A/R carrying costs • Credit and contract administration labor • Technology • Bad debt

Customer Expectations

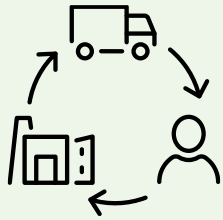
- Customers generally prefer to reduce their total number of invoices, reducing the staff time necessary to manage payables
- Customers experience slow reimbursement from insurers and are therefore often slow payers themselves
- Providers expect suppliers to invoice them using the most favorable appropriate GPO pricing tiers

Manufacturer Considerations

- A/R days outstanding: Distributors tend to pay more quickly than healthcare providers
- Risk: Bad debt is typically lower when selling to distributors than to end customers
- GPO contract pricing:
 - Distributors are adept at optimizing contract pricing for the customer
 - However, the direct channel eliminates the need for the manufacturer to deal with chargebacks

Group purchasing organization (GPO) contracts make billing management more complex.

Returns And Customer Service



Support before and after the sale is critical for healthcare customers. Products need to be exchanged or returned, product recalls are sometimes required, and questions have to be answered promptly and correctly.

Costs Of This Function Include

Customer service staff • Technology and software • Return shipping

Customer Expectations

- Customers expect prompt service and ability to efficiently return products

Manufacturer Considerations

- Direct channel gives the manufacturer control over service levels and return policies; reduces steps in the returns processes
- Distributed channel saves the manufacturer from dealing with smaller customers and low-dollar issues; can improve sales force effectiveness
 - Manufacturer reps focus on growth while distributor manages service issues

Sales And Marketing Support

Manufacturers who self-distribute are more often those with high-dollar physician preference devices who want maximum customer control. Manufacturers that use distributors benefit from making their products more widely accessible to customers, and may receive some level of sales and marketing support as well.

Costs Of This Function Include

Sales staff • Marketing staff • Advertising and marketing • Website costs • Technology

Customer Expectations

- Customers expect easy access to customer information when they need it
- They may prefer not to see sales reps otherwise

Manufacturer Considerations

- Control: Direct channel often maximizes the manufacturer's influence over customer buying decisions
- Customer intelligence: Distributed channel can give the manufacturer access to market data across a wide base of customers
- Lead and/or demand generation: The distributor's sales force can complement the sales and marketing activity of manufacturers' representatives and provide more frequent customer contact
- Target markets: The value of distributor sales support is often strongest for manufacturers serving non-hospital providers, because the markets are so fragmented

A manufacturer's channel strategy should complement its sales and marketing strategy.

What Kind Of Channel Partner Is Needed?



Logistics:

Product storage, order management, delivery, billing and credit management



Sales and marketing support:

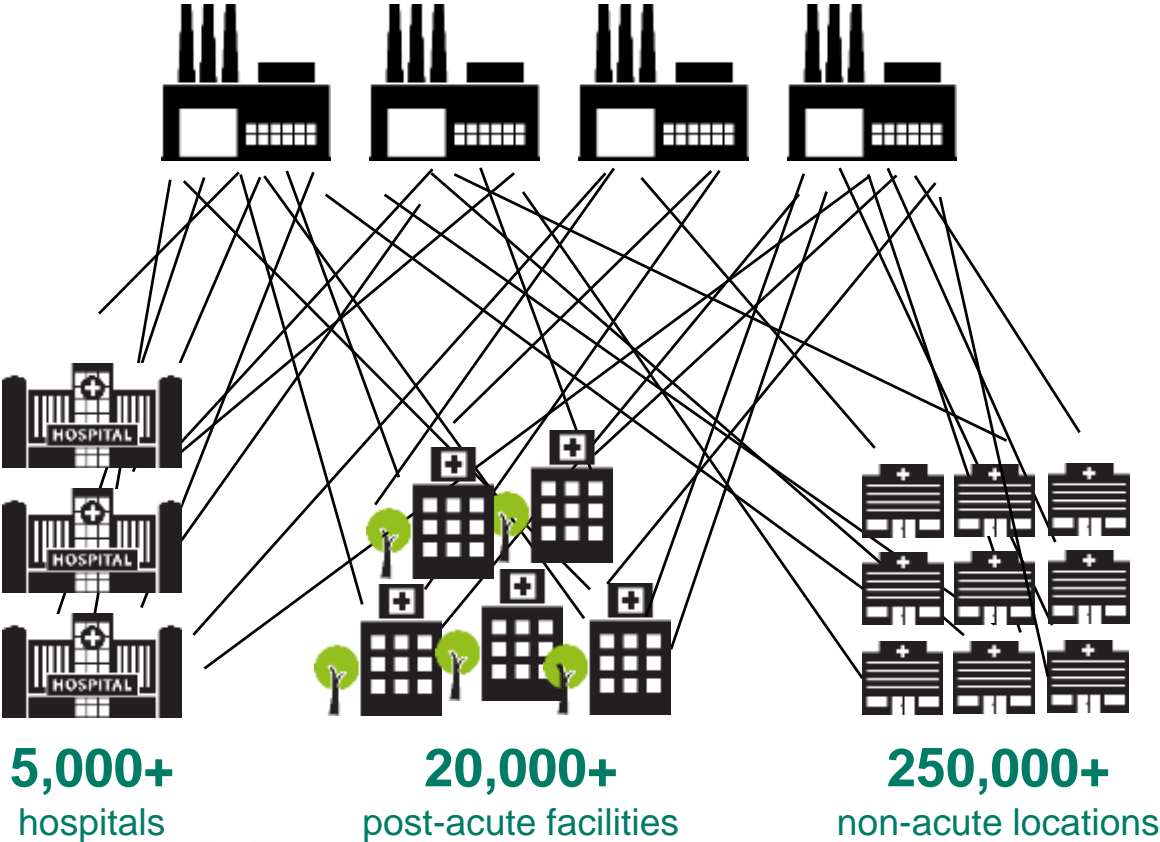
Prospecting/lead identification and/or demand generation

- Most distributors can provide either or both
- Other resources can provide one or the other (3PLs, independent manufacturer reps, etc.)
- Margins and fees depend on specific expectations

Distributors Aggregate Customer Demand

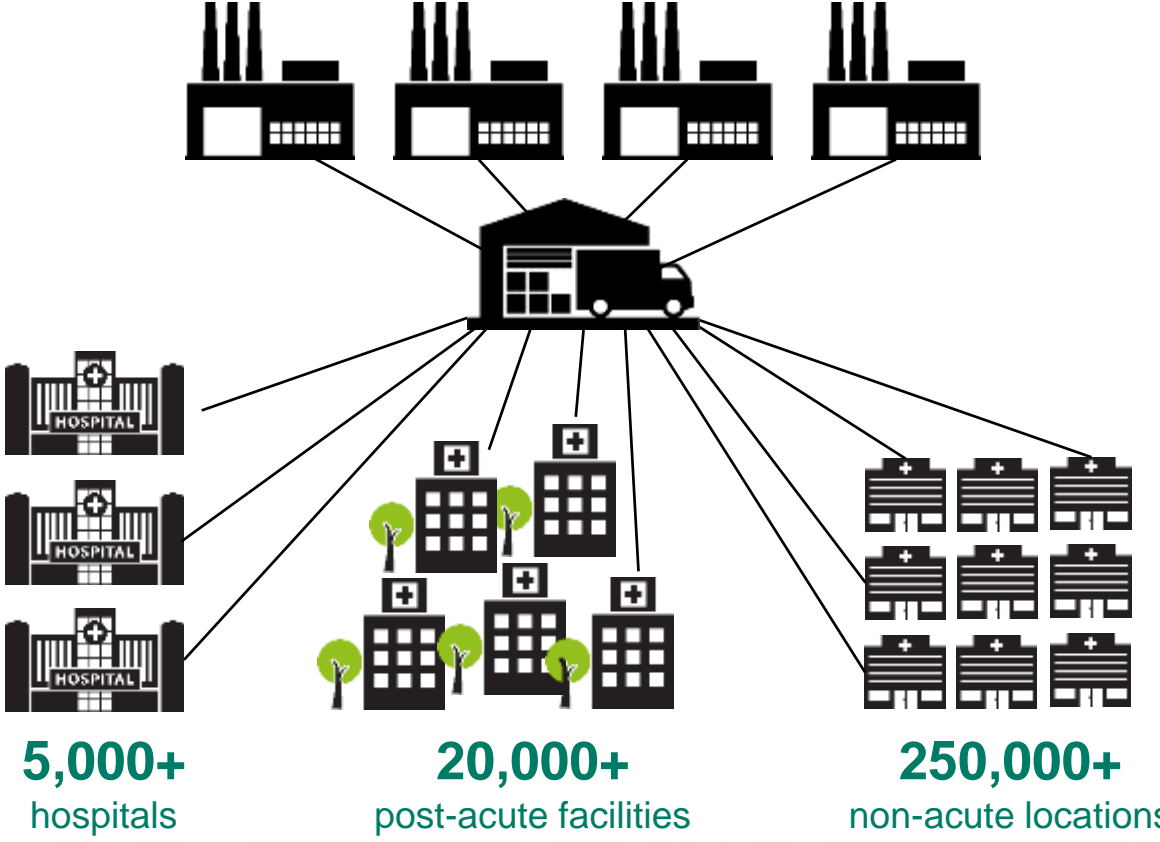
Manufacturer Direct

15,000+ manufacturers



With Distribution

15,000+ manufacturers



Fewer Transactions = Reduced Overhead For Manufacturers And Providers

Manufacturer Direct: Many Transactions, Big Infrastructure Investment



Logistics transactions:
product storage,
order picking,
deliveries, returns



Financial transactions:
purchase orders,
invoices, credit,
collections



Service transactions:
product
questions, order
status, returns



5,000+
hospitals

20,000+
post-acute facilities

250,000+
non-acute locations

With Distribution: Fewer Transactions, Less Investment



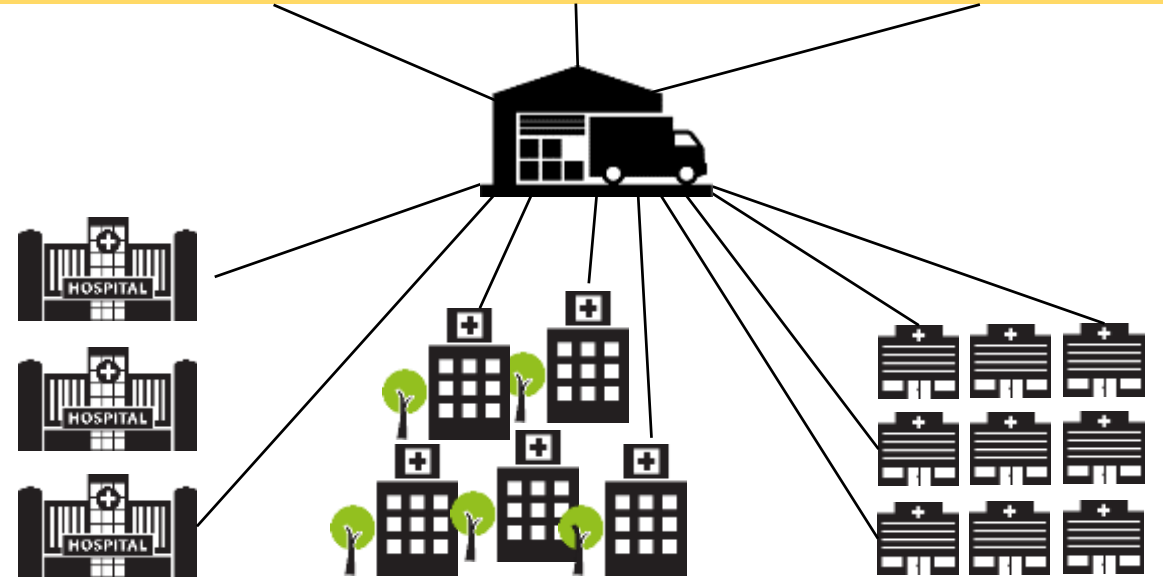
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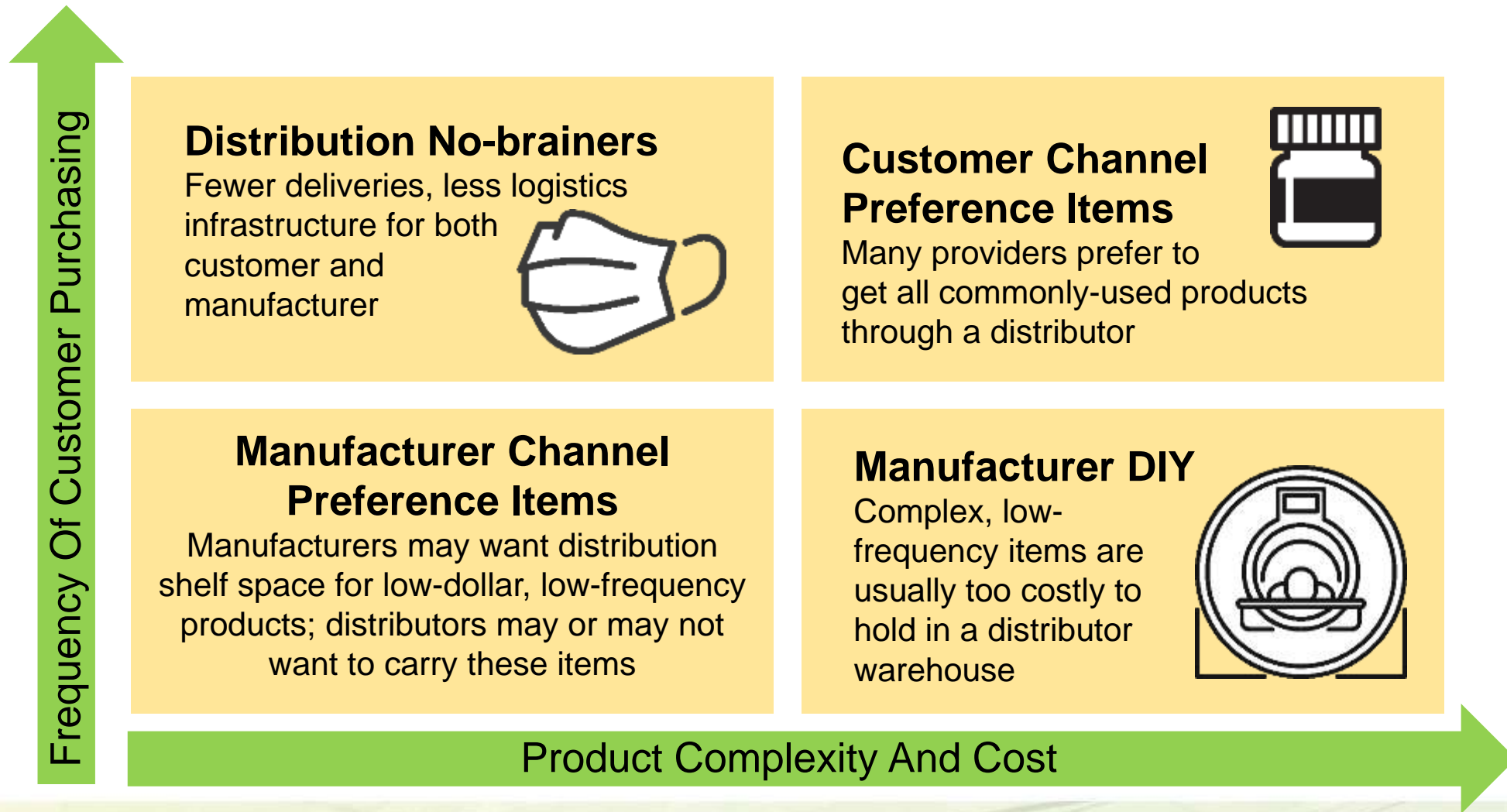


5,000+
hospitals

20,000+
post-acute facilities

250,000+
non-acute locations

Is This Product A Fit For Healthcare Distribution?



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