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Memorial Hermann Hospital System  
Cleveland Clinic  
Cooks Children’s Hospital  
St. Joseph’s Hospital System  
Health Partners/Regions  
Mountain States Health Alliance  
Carolina’s Healthcare System  
Sentara Healthcare

Scott and White Hospital  
Billings Clinic  
Walgrens  
Cottage Health System  
Baylor University Medical Center  
Geisinger Health System  
Lutheran Homes of Michigan  
Interim Healthcare of Wichita  
Bristol Hospice  
Sutter Care at Home  
Bethany Home  
Turenne & Associates

Planned Parenthood  
LifeLine Medical Associates  
Surgery One  
Cooperative Services of Florida  
National Association of Community Health Centers  
Wireless Life Science Association  
Advantage Trust Purchasing Group  
Prairie Health Ventures  
Parallon/HCA  
Clinical Pathology Lab
The Health Industry Distributors Association launched the Thought Leaders initiative to provide insights to its members on the unprecedented changes occurring in healthcare markets. HIDA enlisted McKinsey & Company to conduct in-depth interviews with dozens of healthcare provider executives across healthcare settings. HIDA’s own Thought Leaders then met with the McKinsey team to evaluate the provider input and develop recommendations for the industry as a whole.

**Top 5 Recommendations**

1. Fix the contracting process
2. Link products and outcomes
3. Implement and champion data standards
4. Partner in standardization/streamlining efforts
5. Enable the home setting

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Backdrop: Forces Driving Change

The healthcare landscape is at an inflection point. The Affordable Care Act (ACA) will combine with other trends to accelerate change in the next three to five years. Two overarching issues are on the minds of healthcare providers: the evolving reimbursement landscape and changes in the healthcare delivery model.

“'Our entire margin is expected to evaporate starting in 2014 because of lower reimbursement.”

– VP supply chain, IDN

Factors in the evolving reimbursement landscape

- Declines in government reimbursement/implications of the Affordable Care Act
- Changes in commercial insurers
- Rise of consumerism and patient payments

Factors in healthcare delivery changes

- Impending physician shortage
- Aging population
- Movement away from acute care into alternate care settings
- Increasing adoption of information technology
Unprecedented change

The most striking finding from McKinsey’s provider research is how drastically providers are expecting revenues to decline, and their resulting willingness to make dramatic changes in their operations.

“We are facing 15-20% hard-line reimbursement changes. We need to start making reductions in costs right now,” said one integrated delivery network (IDN) executive. Another reported: “Our organization’s leadership has said we need to be willing to change everything with the exception of our primary value proposition that the needs of the patient come first.”

What the changes are forcing providers to do

These changes are causing providers to rethink their operating models and address issues that have been on the table for quite some time, but now have become imperative to resolve in the near term. These include:

• Implementing broad-ranging cost control programs, including lean operations, back-office cost control, and reduction of clinical variability (“Medicare margin” efforts).
• Building sufficient scale in core operations (through in-region mergers and acquisitions or outsourcing), and expanding across the continuum of care (such as acquiring physician practices or surgery centers) to drive economies of scale/skill and improve care coordination.
• Aligning physicians to create efficiency and quality improvements, capture a disproportionate share of the commercially insured, and improve care coordination.
• Exploring the full range of innovative reimbursement models (including episode-based payments, accountable care organizations (ACOs) or even IDNs) and piloting these new approaches in selected markets (while remaining cautious of strength of the associated strategic and business model rationales).
• Investing in electronic health records (EHR) and information technology to allow for data exchange, cost and quality reporting, and optimization of processes.
• Strengthening retail capabilities, including more sophisticated value-based pricing, direct-to-consumer and direct-to-employer supplemental care products, and even co-branded products with payers to offer on exchanges.

Providers participating in the Thought Leaders interviews said they are looking to manufacturers and distributors to increasingly act as partners across their supply chain to help them address several of the issues they are attempting to address in the coming years.
Driving the Next Level of Supply Chain Savings

Provider organizations expect reimbursement cuts to force reductions in operating margins of up to 30% through 2015. While all costs are on the table, supply chain is universally considered the top priority.

Providers are ready to look beyond product cost and examine end-to-end supply chain costs, and are looking to manufacturers and distributors to help them become leaner and more effective. Panelists believe that a key component for success will be the universal adoption of data standards.

### Top Four Recommendations

1. Implement and champion data standards.
2. Fix the contracting process.
3. Address end-to-end supply chain cost.
4. Expand the scope of products in distribution.

### Key takeaways:

- Quantify the opportunity for stakeholders, demonstrating how data standards adoption leads to pricing accuracy and savings.
- Align stakeholders across the value chain: software providers, customers, manufacturers, distributors, and group purchasing.
- Create a working team of experts across companies to discuss adoption processes and identify requirements (e.g., distributor, manufacturer, and customer experts).
- Create a campaign to promote data standardization.

**Implement and champion data standards**

**Distributor:** “It all starts with data standards...we need to remove the ‘leap of faith’ mentality associated with adopting data standards.”
Fix the contracting process

Distributor: “We’re all doing these incremental customer agreements individually, independently. This adds a cost for all of us. What we need to do, as an industry, is unite for a standard contracting process.”

Key takeaways:

• Create transparency and clarity in product price/tier qualification across all parties involved.
• Move to all-electronic contracting model, eliminating waste that occurs in/results from non-standard approaches to negotiations, letters of commitment, sign-offs/approvals.
• Develop and adhere to an industry-wide standard for the turnaround time for pricing/contracting changes. Participants endorsed a practice of 45 days’ notice from manufacturer to distributor in advance of contract/pricing changes.

Address end-to-end supply chain cost

Acute care distributor: “A hospital and distributor together can get more accomplished than a distributor on its own.”

Key takeaways:

• Partner with customers to jointly assess waste in the supply chain from manufacturer all the way to patient (e.g., logistics, inventory management, data management, formulary development, customer demand management).
• This will require more data sharing and “hand-in-hand” partnership.
• Enable and promote shared savings goals that generate savings from both physical and data standards.

Expand the scope of products in distribution

Supply chain executive, IDN: “We would like our distributor to distribute preference items…but they are perceived as large, monstrous organizations, how could they possibly do a preference item?”

Key takeaways:

• Expand the scope of products moving through distribution to improve provider logistics and lower “cost to serve.”
• Include opportunities with physician preference products. This may require diverging from the standard “cost-plus” economic model for distributors.

“ If doctors have to choose between cutting labor, capital, and supply costs, they will always choose supply.”

– VP supply chain, IDN

“We need consolidation of different providers to facilities. I would like to see 12 trucks instead of 64 trucks.”

– VP supply chain, health system
Moving Beyond the Acute Care Setting

The ongoing shift from inpatient to outpatient care will require new thinking and new capabilities from healthcare suppliers.

Outpatient care has grown faster than inpatient care for the last decade. Thought Leaders expect this trend to accelerate, since outpatient care is less expensive for payers and more convenient for patients.

Within the outpatient segment, home care will likely continue to outgrow other sites of care and will increasingly integrate with other acute and non-acute care settings.

Enable the home setting

VP supply chain, IDN: “...the more you push care into the home the more difficult it is to get product to them...we clearly need help there.”

Key takeaways:

• Anticipate a major shift in care settings and prepare to efficiently deliver to different care environments. In particular, servicing the home setting will require a very different distribution and service model and a true B2C (instead of B2B) mindset and capability set.
• Explore opportunities to improve outcomes in the home through technology, service, and end-user education, especially as practitioner shortages drive the need for more remote monitoring and telehealth capabilities.

• Be prepared to educate health system decision-makers about cost-to-serve differences for the home and similar settings such as assisted living.

• Look for ways to enhance monitoring of patient behavior and treatment compliance, for example, by tracking orders filled and communicating this information to the patient’s physician or practitioner. Focus on chronic diseases as a key opportunity.

• Be aware of possible disruptors to this space such as Amazon and brick and mortar retailers, and build differentiating services including linkages to other sites of care.

Support new front-line care models

Distributor: “A different kind of primary care model is likely to emerge, and we as distributors need to be at the forefront, helping providers make sound investments in their front-line care models.”

Key takeaways:
• Be prepared to support the new front-line care models being tested in response to the growing physician shortage and the increase in patients seeking care (including those newly covered by the ACA).

• Understand the opportunity with community health centers, which are expanding fast due to increased government funding; these centers require a broad range of products and services.

• Enable providers to achieve greater efficiencies in these new settings. Apply learning from other similar sites of care (e.g., physician office) to help these sites deal with scale/supply chain issues.

• Be aware of potential new competition for these new front-line providers (e.g., Wal-Mart).

Leverage non-acute data

Device manufacturer: “Data will be powerful moving forward. Many providers have limited visibility into their performance in the non-acute setting making this information highly valuable.”

Key takeaways:
• Embrace unique device identifiers which will allow distributors and manufacturers to know where the volume is going and use this information to help customers track purchases and understand utilization trends by site of care.

• Push for interoperable systems to allow acute and non-acute settings to share data and drive efficiencies across sites of care.
Managing Risk, Supporting Outcomes

In a word, the trend in healthcare is toward risk: more accountability for outcomes, more services bundled into a single payment.

Increased risk heightens the need to deeply understand the linkages between clinical procedures, product utilization, and outcomes. The opportunity for both manufacturers and distributors is to create new product and service offerings out of existing or new product and data assets.

Link products and outcomes

Device manufacturer: “The tools we provide have to have a knockout effect that ties to bigger issues including outcomes and total costs. Otherwise, we could give the product away and not have enough impact to help.”

Key takeaways:

- Help providers with analytics on key metrics for which they are now accountable: patient satisfaction scores, readmissions, infections, etc.
- Retrain and/or restructure the sales force to ensure that representatives are competent to discuss clinical outcomes, productivity, finance, and other critical business challenges with providers.
- Increase collaboration between manufacturers and distributors to share customer insights, develop proof points, and educate representatives to discuss product outcomes.
- Ensure that compensation and incentives support these priorities.
Leverage data to create actionable insights

Acute care distributor: “Right now within the walls of a hospital or health system there is a hard wall between supply chain information and medical records. We must connect that data in order to link products and outcomes and aid provider decision-making.”

Key takeaways:

• Work with providers to gain visibility to what happens to a product after the customer buys it.
• Help providers sync up product usage data and EHRs to provide real-world data sets for systems to leverage.
• Build insights into provider usage patterns across sites and procedures.
• Represent data in terms that are relevant to the way providers are now paid (bundled payment, episode, etc.).

Partner in standardization/streamlining efforts

VP supply chain, IDN: “We really need to better understand value... sometimes it is the cheaper product with the same quality and sometimes we can spend more upfront in supply to reduce overall costs of care. We need help identifying which is which.”

Key takeaways:

• Support providers’ efforts to drive evidence-based clinical protocols and product standardization; provide resources and services to encourage physicians and nurses to adopt these practices.
• Structure agreements that drive standardization and cost benefit.
• Partner in streamlining efforts across care settings and locations.

Prepare to shoulder some risk burden

Acute care distributor: “If we sell something and say it will increase productivity, whatever, we should take the risk of standing by what we say, essentially, putting our money where our mouth is.”

Key takeaways:

• Consider various approaches to risk-sharing:
  » Per-patient-per-day (PPD) pricing – requires a large, homogeneous patient pool on which to base pricing decisions; may not work well in some healthcare segments.
  » Accepting financial responsibility that products and services will perform as promised.
• Be cautious about arrangements that involve only risk-shifting, not risk-sharing.

“ The biggest trend is to population-based care... Before an orthopedic surgeon didn’t care what implant they used, but once the payment is bundled to take care of entire episode, everyone will care about reducing the costs.”

– CEO, group purchasing organization

“ The biggest opportunity you see for improvement in supply chain management would be having data analytics and getting it to the user level.”

– VP supply chain, IDN
Restructuring for an Integrated, Consolidated Market

Provider consolidation is pressuring manufacturers and distributors to innovate service models for customer organizations which are larger in scale, smaller in number, and more complex in scope.

Reimbursement changes are accelerating provider consolidation. In fact, some studies show that hospital-owned physician practices now outnumber independent practices two to one. As provider networks become bigger and more complicated, their leaders are seeking new approaches from their supply chain partners to coordinate activities across sites of care and to drive significant cost savings.

Provide greater transparency to product and service costs

Regional distributor: “IDNs say they are looking for ‘one price’ across their network; what we need to do in response is clearly represent the net cost for a delivered product in each of their sites. This will allow us to align incentives and price for value not volume.”

Key takeaways:

• Invest in systems/technologies that make delivered cost for each site of care transparent to customers. This information can be used to draw customers into a more collaborative conversation about how
their decisions affect cost, and how they can work together with distributors and manufacturers to reduce costs.

- Pursue new pricing and contracting models to align economic incentives. The historic blended cost-plus model with volume-based price tiers is poorly suited to integrated systems because it obscures true costs.
- Structure pricing and contracting models to drive compliance – not just volume – and product standardization.
- Collaboratively develop and promote “preferred product” product formularies to reduce supply chain costs without sacrificing quality.

Evolve the go-to-market strategy

Device manufacturer: “We cannot hide from the structural changes that are affecting our customers and their marketplace. We need to focus on serving a particular type of customer across care settings in a way that is more integrated.”

Key takeaways:

- Broaden the business model and the sales/marketing structure to accommodate the diverse needs of very large customers OR develop a niche offering that is compelling enough to offset customers’ desire to consolidate purchasing with fewer vendors.
- Evolve the role of the sales representative.
  - Reps working at the system level must have the skills to interact with C-suite economic decision-makers as trusted advisors rather than transaction facilitators. This requires additional relationship, leadership, and negotiation skills.
  - Reps working at the individual facility level must be equipped to help promote standardization and efficiency rather than simply selling products.
  - Distributors must also be prepared for the “no rep” request, and understand how to effectively service customers who view salespeople as an unnecessary cost.
- Actively monitor the development of accountable care organization (ACO) models to understand how the care continuum will continue to evolve (and which provider types will be “driving”) and to identify new opportunities for service and sales.

Aggressively strip away supply chain costs

VP supply chain, IDN: “We need to start making reductions in costs right now, and our partners will have to start changing the way they operate as a result.”

“Bigger economies of scale generate 2-3% increase in margin, so there is natural migration into larger health systems. If I were a distributor, I would be watching the consolidation in the industry and how this will affect their function.”

– VP supply chain, health system

“The sales rep model is archaic and dying; I don’t see that continuing going forward. We want service, knowledge resources, not selling.”

– COO, children’s health system
Key takeaways:

• Pursue business model transformations to aggressively reduce overall supply chain costs and distributor operating costs. The purpose of distribution is to make the transition of products from the factory to the point of use as efficient as possible and this focus will be even more important as reimbursement pressures increase.

• Collaboratively seek out solutions to help customers reduce waste, avoid preventable events, and improve the quality of care.

• Increase automation, standardize and simplify processes to reduce transaction costs between manufacturers, distributors, and providers. Further technology and systems investments are likely to be part of the solution, but process improvements (for example, in contracting and pricing) are equally or more important.

• Maintain conversations with self-distributors to understand the role that the supply chain plays in their businesses and to determine ways to save them money.

Invest in new capabilities to enhance service across care settings

VP supply chain, regional health system: “There’s a real opportunity for distributors to expand their model by providing logistics support and consulting around distribution/services. It can’t just be about delivering boxes.”

Key takeaways:

• Provide customers with tools that enable them to understand and reduce costs. These will likely include a range of online and self-service resources that streamline ordering and provide visibility into product availability, usage, and more. They should not, however, be limited to tools that require the customer to take the initiative themselves to save money.

• Develop capabilities to help IDNs centrally manage the product usage and ordering patterns of their physician offices to increase transparency into utilization and to facilitate cost savings.

• Invest in creating the flexibility to serve different types of sites from an integrated delivery network at extremely low cost.

• Offer greater visibility into the true cost of delivered products, including what it costs to provide perpetual product availability, disaster recovery capabilities, and other service options.

“The model of paying list price then getting a rebate: everyone knows the model is broken and flawed yet no one wants to admit it... it was a model that worked in the 40s. Distributors are stuck in a very inefficient model.”

– VP supply chain, self-distributing IDN

“More physicians are seeking shelter under the umbrella of a hospital – it’s more predictable, more stable. It’s getting too complicated to run their own practices.”

– CEO, group purchasing organization
Providers interviewed for this project noted that changing healthcare models will require new skills sets in order to succeed.

“People need to recognize that in the past, you may have just needed to be a good negotiator to do your job. If so, then your world is going to change soon,” said one IDN executive. “You need to figure out the value of your strategy and how you can contribute. The bottom line is that our organizations need to figure out how to deliver care more cost effectively.”

HIDA will continue to work to help its members and their customers navigate the changing healthcare environment. The insights obtained through the Thought Leaders initiative will inform the association’s strategic priorities and guide the development of education and other resources to help organizations develop the strategies and skill sets necessary to succeed.

As the CEO of a nursing home company put it, “The times we are in are unpredictable, but these are the times when transformative change can actually happen.”

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**HIDA**

The Health Industry Distributors Association (HIDA) is the premier trade association representing medical products distribution. HIDA members primarily serve the nation’s hospital, long-term care, and physician/alternate care markets.

**HIDA Educational Foundation**

The HIDA Educational Foundation is an education and research organization committing to building a more effective and efficient healthcare supply channel. It receives support from 130 industry companies.