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Healthcare Reform & Supply Chain Obesity: Where Else Can Medical Device Manufacturers Cut the Fat?

by Jon Winsett, CEO, NPI
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The healthcare reforms passed by Congress earlier this year have dealt a formidable blow to medical device manufacturers. Despite the fact that many companies are barely turning a profit, a new tax increase of 2.3 percent will soon be levied upon this sector to help fund healthcare reforms across the country. Politics aside, the timing of this tax increase means that the medical device manufacturing industry has a tough road ahead.

The industry itself has expressed its disapproval clearly, citing the negative impact that these measures will have on innovation and growth within the medical device sector. Companies are already facing boardroom and shareholder mandates to further lower operational costs to offset this tax increase and stabilize shrinking profit margins. Coming on the heels of a recession, many manufacturers feel there is nothing left to cut to save workers and R&D. Their operations are lean to the point of starvation. Or, so it would seem.

The truth is that a majority of supply chains, including those of medical device manufacturers don't realize they are overspending – especially in the areas of technology and transportation. While plant floor and corporate operations may be running ultra-lean, most companies still grossly overpay their technology and logistics vendors for the solutions they deliver.

In other words, it's not a matter of over-consumption or gross negligence. It's a matter of under-management of spend. Billions of dollars in overspending by manufacturers are lost each year and the impact is far-reaching – from Wall Street to small supplier compliance. Even the largest procurement organizations and the most diligent lean supply chain gurus simply don't have the resources to stop the bleeding.

So, what's the root cause of overspending? Clearly, factors ranging from varying levels of procurement best practices to vendor portfolio redundancies are at play depending on the organization's procurement and vendor management strengths and weaknesses. But, the biggest culprit is the lack of vendor pricing visibility. Technology and transportation are two complex spend categories that exist in the marketplace with little transparency into fair market pricing. In other words, you may pay 30 percent more for a software purchase or shipping service than your closest competitor. There is little rhyme or reason to which companies receive which rate structures and discounts. It's simply a game of how much money a vendor can extract from your budget.

For this reason, medical device manufacturers should stop looking at line items to cut from their operational budget and infrastructure – and start focusing on core processes like procurement and vendor management. Going back to the bargaining table with logistics and technology vendors, benchmarking spending and renegotiating contracts are fast, feasible ways to help offset the tax increase. Furthermore, they are a fundamental part of a spend management strategy that can yield immediate and long-term savings, not to mention save companies from having to lean their staff even further or sacrifice the competitive edge they gain from R&D. Other best practices include improved collaboration between the procurement teams and the teams that define logistics and IT needs and projects, as well as ongoing vendor management best practices that ensure maximum savings throughout the vendor life cycle.

Think a billion-dollar problem can't be solved so easily? Think again. A 2.3-percent tax increase on a $500m company would result in an average of an additional $11.5m in taxes due. Typically, a company of this size spends 3 to 4 percent of their annual revenues on shipping expenditures and another 2 to 3 percent on technology spend.

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Companies should benchmark their annual spend in complex spend categories like transportation, technology, telecommunications and energy. It's impossible to manage spending if you don't fully understand where your dollars are going. To ensure you are getting fair market pricing from your vendors, you must acquire the necessary industry specific data and cost-to-serve insight to gauge fair market value.

For the sake of math, let's say that Company A spends 3 percent on each – amounting to a total of $30m a year on shipping and technology. Through improved vendor contract negotiations – including renegotiating all major IT, telecom and logistics contracts – Company A could realize $9m in immediate cost savings. Now, factor in other spend management tactics, like vendor portfolio consolidation and more rigorous invoice auditing, and the offset becomes apparent.

To jump-start any initiative to eliminate overspending, companies should focus on the following tactics:

1. **Benchmark spending –** Understanding how much you spend annually on transportation and technology, and compare it to what other companies are spending on the same products and services.

2. **Renegotiate contracts –** Good vendor relationships are valuable. Rather than threatening to put your contract out for bid right off the bat, inform your vendors that you want to renegotiate for fairer pricing, terms and conditions.

3. **Require vendors to justify annual maintenance/rate increases –** Fuel surcharge increases, accessorial charges, maintenance increases…they happen every year. However, more often than not, the rate increase is either fully or partially unjustified. Demand that all rate increases be justified based on market conditions. For example, if a software vendor raises its maintenance agreement from 18 percent to 23 percent but has no plans to release major upgrades for the next 12 months, you shouldn't have to pay.

4. **Put contracts out to bid –** In some cases, putting your contract out for bid and re-entering the RFP process is the smartest move. It levels the playing field entirely and motivates current and new vendors to raise the bar in just pricing, discounts and overall performance.

Overspending in technology and transportation is a concern for all manufacturers. However, those in the medical device sector face an acute need to improve business performance while neutralizing the impact of a tax increase. Eliminating this overspending is one of the few solutions that simultaneously protects human capital investments and promotes innovation, allowing for a leaner supply chain and wider profit margins.

Source: NPI