How to Optimize Medical Surgical Distribution Relationships for Healthcare Providers

Published 11 November 2020 - ID G00733479 - 11 min read

By Analysts Eric O'Daffer

Initiatives: Logistics Strategy and Operations

The COVID-19 pandemic has changed the distribution needs for transparency to inventory and 3PL-like services for critical supplies for many healthcare providers. This research will help supply chain leaders optimize their medical surgical distribution agreements for the next three to five years.

Overview

Key Challenges

- Medical surgical distribution agreements are typically evaluated every three to five years. Changing capabilities from distributors in serving the logistics needs of acute care, serving nonacute points of care and balancing how much you want a local logistics partner versus a private-label/global-sourcing medical surgical supply partner are hard to unwind.

- The COVID-19 pandemic challenged most integrated delivery networks (IDNs) on mission-critical personal protective equipment, causing a reevaluation of supply chain risk in distribution relationships. Limitations in global supply availability, pandemic stocking, allocation and growing pressure for many IDNs to have their own reserve stock complicate the distribution relationship.

- Segmented logistics needs across acute and nonacute settings create supply chain segments that are not always best served by a one-size-fits-all distributor.

- Absence of a structured demand forecast program, end-to-end inventory visibility and governance across providers, manufacturers and distributors can impede supply chain resiliency.

Recommendations

Supply chain leaders responsible for logistics strategy and operations at IDNs:

- Conduct a value stream mapping exercise to evaluate distribution partners for acute and nonacute locations, private-label/global sourcing and risk management/business continuity for key supply lines.
Introduction

Historically, medical surgical distribution relationships have been one of the most collaborative for many IDNs. Sometimes, this has been by default rather than design. But when we look at the types of collaborative relationships in our model, there is a tremendous opportunity to expand these relationships based on the changing needs of healthcare providers and the expanding capabilities of the distributors (see Figure 1).

Figure 1. The Gartner Partnership Value Curve

The Gartner Partnership Value Curve
Illustrative

In the past five years, many distributor relationships focused on a trade-off of cost savings versus quality of logistics service to maintain higher profit margins. Using a distributor’s private-label/globally sourced supplies, risk management, segmenting supply chain, aligning goals and committing to actively manage the financial and service agreement. Align goals and investment in your local distribution relationship for better demand planning and inventory management at your IDN and with your supply partners for medical surgical.
sourced products as a large part of the medical surgical spend has changed the dynamic from primarily logistics-focused agreements to a combination of logistics and sourcing options for commodity products. The pandemic causes a rethinking of this relationship due to the challenges in cross-industry visibility, failure of the allocation models and a questioning of the low unit of measure reliance on distributors by many of IDNs’ senior leadership. In some cases, this reassessment may drive supply chain leaders at IDNs to pursue opening their own consolidated service center (CSC). This note won’t cover that option (see Make the Right CSC Decision for Your IDN’s Supply Chain). If optimizing your current logistics and sourcing partner relationship is your path, then if you are seeking a change, the answer may be to lean into a more collaborative relationship. This research details three ways to think about changing your relationship with an incumbent or making a change to another third-party distributor.

Analysis

Determine the Role You Want a Distributor to Play in Supporting and Improving Logistics Capabilities

In the past decade, IDN complexity has increased the demands they place on the logistics provider. Private-label supplies/global sourcing and local services have become intertwined in the value propositions from the largest three IDN distributors dominating the market today. Determining the role you need a distributor to play is the most critical step in the distributor selection process. Your alternative, of course, is to develop your own logistics capability to supplement your own sourcing capability (see Make the Right CSC Decision for Your IDN’s Supply Chain). But most market participants still use a distributor as a primary logistics in-service partner for their IDN. The three main roles to evaluate through value stream mapping are:

- Logistics services for acute and nonacute locations
- Private-label/globally sourced medical surgical supplies’ manufacturing
- Risk management/business continuity for key supply lines

Logistics Services for Acute and Nonacute

For most IDNs, using a distributor or building a CSC is the largest decision to make. Increasingly, IDNs that serve multiple states opt not to create their own distribution capabilities, which means they need to orchestrate a distribution partnership to fill that logistics role throughout their enterprise. Most of the national third-party distribution firms in the U.S. have 30 to 40 distribution locations to serve the major markets and are set up to meet this requirement for acute care hospitals.

Nonacute locations represent a different challenge, and for many IDNs, another key step is assessing if they need to segment these nonacute locations from acute locations in determining a service distribution logistics partner. The capabilities across the big three distributors vary widely. There are two primary national nonacute distribution companies and many local nonacute distributors to fill those
needs (see Growth in Nonacute Points of Patient Care at IDNs Drives the Need for Supply Chain Segmentation).

Once the logistics network decisions are made, IDNs need to think about the level of service needed. Services range from bulk delivery to the dock to just-in-time delivery in low units of measure to the individual units served within an acute care environment. Space and cost trade-offs are made at this point, and many health systems already have a well-developed service philosophy for using these logistics partners. Some healthcare leaders have indicated that a low unit of measure, just-in-time service is not the way of the future. The answer for most is more nuanced, however. Not all products are created equal, and segmenting the service response and designing a resilient supply chain using all of the levers available are the more likely solution for most.

Private-Label/Globally Sourced Supply Manufacturing

Over the past two decades, the large distributors have moved farther down the path for private-label/globally sourced supply partners for IDNs for commodity medical surgical products. In some distribution agreements, we see incentives to source up to 60% of the volume from distributor-manufactured and private-label products. This private-label/global-sourcing shift has made it a good time to reevaluate your distribution relationship because the overall cost decreases if you are willing to combine your logistics and private-label/global-sourcing supply needs. There are product cost savings from many of these broad product conversions but also a lower overall distribution markup related to higher levels of mix management product. Make no mistake, the distributor profits from these conversions and uses this profit to offset your distribution markup savings.

The big question is whether your IDN can make the conversion targets to optimize the financial proposal. Is the product quality high and is there any service benefit to a more vertical supply chain partner that does manufacturing and last-mile logistics for your IDN? Determining how intertwined your IDN wants this relationship to be is a critical step in the distributor selection process. Many of the agreements we see today have private-label/globally sourced commitments well above 50% to receive the best transactional markup for logistics services. Determining how compliant your organization can be to these private-label offerings is a key component in determining your true cost for this distribution service.

Resiliency

Supply chain resiliency, including risk management and business continuity, aligns directly with the more reliant you are on a distributor’s private-label products, the more dependent you are on them as an organization to serve your patients effectively. The recent pandemic and weather-related events, like hurricane Maria, have highlighted the challenges of this reliance. Determining what role and how much visibility your IDN has to the availability of these private-label/globally sourced products is an important part of the equation. Likewise, knowledge and availability of additional local space to stock emergency pandemic and other emergency supplies is growing in need for many IDNs. The prospect of building a shadow distribution center to serve pandemic supplies in many markets is redundant. A good alternative
may be to have distribution services, which you already pay for, develop a third-party-logistics-like (3PL) relationship with a distributor for your product. This as opposed to building and developing your own, independent warehouse and tending to all the complexities associated with inventory management, loss and expiration, and stock rotation. For most IDNs, our guidance is to create a pandemic/emergency management playbook that reduces the need for keeping inventory of all personal protective equipment. The focus should be on logistics services for those items you cannot reduce, conserve, reprocess, substitute, self-manufacture or locally source (see Why a Business Continuity Plan Is Crucial for Healthcare Provider Supply Chains).

A Four-Step Plan to Optimize Your Distribution Relationship

Once your needs have been identified through the value stream mapping exercise, the next step is to develop a process for evaluating the market. Distribution is a local business, and the national distributors vary on their service capabilities and the teams that support each market. Understanding and trusting the local team that serves each region of your IDN is a big part of the process for selecting the right logistics partner.

For larger IDNs with more complexity, going beyond the local market and developing an executive-level relationship with a selected distribution partner is merited. Challenging financial conditions, for some, and the interconnection with sourcing and risk management make this distribution relationship one of the most strategic your IDN will have going forward.

**Step 1: Submit an RFI to National and Local Distribution Partners Based on Your Value Stream Map Exercise**

Consider highlighting new areas of risk management, 3PL services, demand planning/inventory management capabilities, inventory transparency and allocation models and alignment to savings/service goals for medical surgical products (see Ignition Guide to Creating an Effective RFP for 3PL Warehouse Providers and Ignition Guide to Creating a Service-Level Agreement and a Contract for a Logistics Outsourcing Engagement).

Most distributors need these requests to be spelled out directly. Submitting direct questions concerning the $50+ million (and in many cases way more) relationships are what a collaborative partner should expect. Learning upfront how the distributors are prepared to serve your logistics needs and risk management/resiliency challenges should be a top priority.

**Step 2: Create a Comprehensive RFP Based on RFI Responses**

Build an RFP, based on RFI responses, incorporating your value stream mapping work and segmenting the different needs of acute and nonacute if appropriate.

The next step is to use a simple decision matrix based on the RFI responses on what is important to your system. Many RFPs Gartner reviews have over 100 requests embedded, and most decisions are made on cost alone or expand to weighing many variables that are not equal. Our guidance is to weigh five main
things and then have many other components serve as an affirmation of the capability. The main components are typically:

- Service determined by your past experience or deep dives into the references provided
- Transparency to inventory and allocation models, resources, realistic cost to effort trade-offs between the mix of private-label/globally sourced products and distribution expense
- The role of 3PL services in your resiliency game plan for business continuity
- Trust of the local team

Gartner also advocates aligning product standardization, service improvement and total delivered cost reductions into the equation, bridging the gap from service provider to partner.

**Step 3: Negotiate Best Terms Possible for Service, Risk Integration and End-to-End Cost**

The market has changed, bringing cost reduction opportunities in distribution services over the past decade to many providers. Orchestrating what you really need out of this relationship may mean trading off cost for service and resiliency. It is important for you to review your value stream map and assess the accountability of all partners and how your own demand capabilities in inventory and point-of-use management layer into the equation.

**Step 4: Establish Service and Financial Reconciliation Value-Capture Cadence on a Monthly Basis**

Most IDNs are pretty good at establishing a cadence early in their relationships with distributors, but the addition of resiliency makes this step even more important to get consistency and accurate measurement layered in early. Building demand forecasting and predictability for your own use is part of this equation and may take investment and effort in order to optimize your distribution relationship with any partner.

**Align Goals and Investment in Your Distribution Relationship**

The pandemic has highlighted the need for better end-to-end visibility for all supplies, including commodity medical surgical that have long been taken for granted by senior management, clinical end users and even supply chain leaders. Technological capabilities are now expected, and many IDNs have worked diligently in the past six months to create transparency and help IDNs understand the value of having the right product at the right place at the right time. Aligning this key distribution relationship and expecting more from your distribution partner should be part of your process for selecting the right distributor for your organization.

Start by looking at your internal point-of-use and inventory management capabilities. Many IDNs have a disconnected network of point-of-use solutions to determine product availability, service levels and risk to the organization. Creating transparency and partnership from distributor to point-of-use, including connected technology solutions provided by either the third party or the distributor, can be a critical part of this solution.
Gartner’s Hierarchy of Supply Chain Metrics for IDNs has moved demand forecasting to a less prominent role based on a lack of capability of most IDNs in this key area (see Hierarchy of Healthcare Supply Chain Metrics for Integrated Delivery Networks Version 2.0). Our expectation is that in the next five to 10 years this demand forecasting capability will grow exponentially, and the relationship between distributors and IDNs at the highest level of maturity may be the best demonstrated practice of an end-to-end supply chain response from sourcing to the point of care. If signing a long-term, five-year or longer agreement with the distributor, gaining or building a roadmap to significant improvement in this transparency should be part of any new terms of relationship.

Recommended by the Author

Hierarchy of Healthcare Supply Chain Metrics for Integrated Delivery Networks Version 2.0
Make the Right CSC Decision for Your IDN’s Supply Chain
Why a Business Continuity Plan Is Crucial for Healthcare Provider Supply Chains