

How Consolidation Will Impact Hospitals and Health Systems in 2017

A reflection by Stephan Sonderegger, CEO of Swisslog Healthcare





A System in Transition

No matter what direction healthcare legislation takes in light of political leadership changes, or what the overall construct of the US healthcare delivery system ultimately is, consistent themes in US healthcare include growing patient access demands, rising drug costs and amplified demands for improved outcomes and quality. The changing payer mix is leading to shrinking reimbursement per patient, negatively impacting profitability. As hospitals and health systems struggle with these challenges, a strategy that continues to attract interest is the concept of consolidation and centralization, whether it be organization or service line driven. In this paper, I will review the current trends in this area and share my expectations for the future on this topic.



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Hospitals & Health Systems Will Continue to Pursue Affiliations, Acquisitions & Mergers

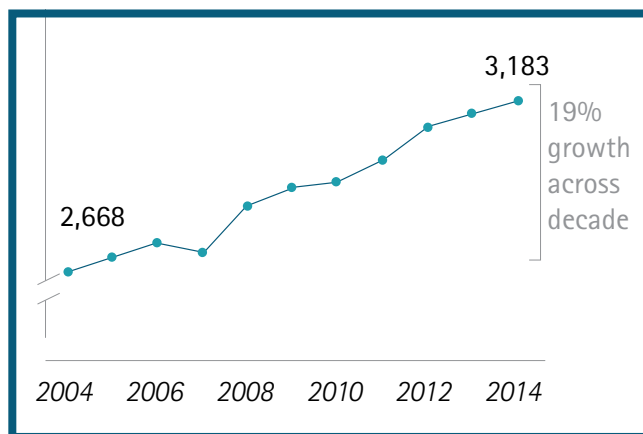
The rapid growth of hospital systems in large part is becoming focused on moving away from a perspective of treating individual patients to a larger perspective of population health management. With the increased accountability for outcomes, health systems are attempting to integrate in order to be able to influence all aspects of the care for patients they are responsible for. Consistent with this shift in perspective, hospitals and health systems are looking at rapid growth that can drive improvement in financial bottom lines and enhance their brand to support capture of more business. Rapid growth through merger, acquisition and affiliation may allow increased market share and volume gains, increased economy of scale and efficiency, which translate to cost reduction, increased ability to leverage more favorable payment arrangements and improved quality-of-care options with more consistent care delivery across larger patient populations.

However, while increasing in size and breadth offers some attractive upside, the accompanying complexity of combining disparate cultures, technology and operations presents an equally challenging landscape for hospitals and health systems considering a growth strategy around merger, acquisition and affiliation. To date, I have seen numerous organizations embark on this path but few have yet to reach the ultimate goal of "systemness" that will produce the desired outcomes. In general, organizations that are attempting to apply this strategy fall into one of three phases in the strategy life cycle:

1. Affiliation
2. Coalition
3. System

In the affiliation phase, senior leaders get together and agree on the positive outcomes that can be achieved through combining operations and creating a rapid growth opportunity. The logos on all of the hospitals and health care services change and major branding efforts occur, but in reality not much else changes in terms of actually creating consistent programs that will achieve the desired operational, quality and financial endpoints. In terms of overall operations each hospital and element of the new organization continues to operate primarily on its own with little to no system infrastructure or consolidation.

Number of Hospitals Part of a Health System

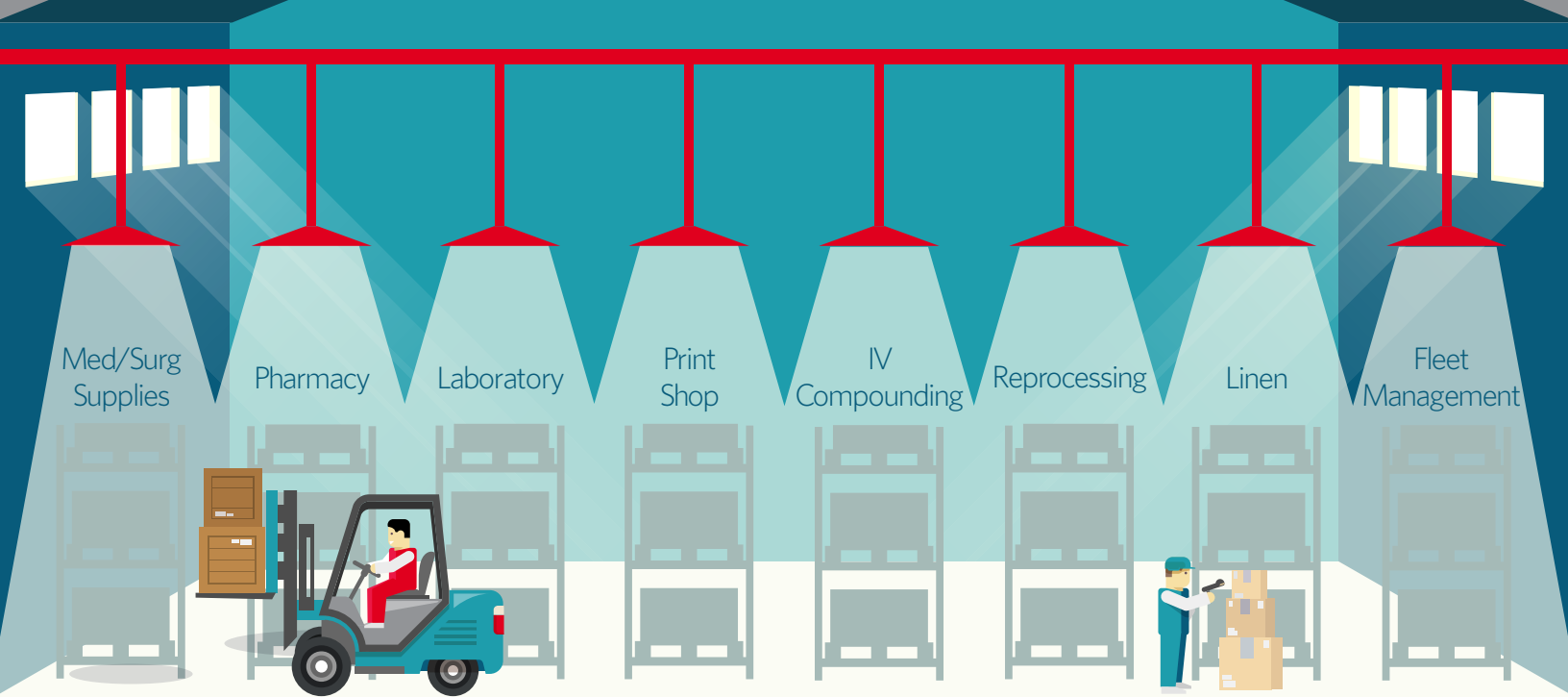


Source: *Becker's Hospital Review*, "The Year of 95 Hospital Transactions," 2015, available at: www.beckershospitalreview.com; *American Hospital Association*, Fast Facts 2016, available at: <http://www.aha.org/research/rc/stat-studies/fast-facts.shtml>; *Health Care Advisory Board* interviews and analysis.

In the coalition phase, all the elements from the affiliation phase occur and the organization begins to move toward the ultimate goal of system efficiencies and market share that will help them achieve their goals. Programs around common elements such as purchasing, information technology, revenue cycle management and supply chain operation begin to form. However, overall governance structure and operations for the system remain a confused process of "states' rights versus the federal government." Generally there are far too many "dotted-line" reporting relationships and informal operational structures and competing local priorities to truly achieve the desired economies of scale and effective integration.

In the final phase of systemness, organizations have reached their goal of creating a system that truly has shifted in focus to managing large populations across the continuum and sites of care, and have created a common culture, governance structure and operational infrastructure. The ability to capture more market share, improve patient care outcomes, reduce cost and ultimately improve their operating margin is readily apparent.

I expect that hospital and health system mergers, acquisitions and affiliations will continue throughout 2017 and beyond. Unfortunately, while this strategy will continue to be pursued, the majority of organizations that have embarked on this path will still be working in the coalition phase. The most significant opportunities in this market lie in accelerating the life cycle for these coalition organizations to help them achieve the benefits of systemness.



Supply Chain Management and Centralized Service Centers Will Be A Key Strategy to Drive Operating Efficiencies and Cost Savings

As noted above, as hospitals and health systems begin this transformation process, one of the key areas often identified for eliminating duplication and waste is in their respective supply chain management structures and processes. Consolidation and/or centralization of med/surg and other supply item inventories used within the healthcare organization, along with standardization of ordering and receiving processes, are typically viewed as an expedient path towards systemness and thereby, rapid margin improvement. As such, there is significant effort expended from an organizational perspective to corral and standardize department-based procurement, receiving and inventory management processes, typically under a singular administrative structure. In addition, the creation of a consolidated service center (CSC) is often a focal point of these efforts.

The literature is clear that centralized Supply Chain Management (SCM) processes, combined with decentralized logistics to address lead time and demand requirements, is likely the preferred operating model. In essence the strategy and process / procedure design is held at the system level (e.g., process owner) and the day-to-day execution of these strategies is held at the unit level (e.g., business owner). This approach, in combination with a CSC, likely holds the most promise for extracting additional value from an organization's SCM program. The value of a CSC comes not only from the physical consolidation of inventory and distribution processes, but also from the opportunity to

automate these processes, reducing picking and delivery errors as well as optimizing manual workflows and process steps. In addition, improved facility design and space utilization allows increased operating capacity, thereby decreasing capital needs for additional space or new facility leasing or construction.

It is clear to me that the utilization of CSCs and the continued refinement of supply chain organizational structures and processes within hospitals and health systems will continue in 2017 and beyond to address continued pressures for cost reduction, eliminate unnecessary operational variation and reduce waste. However, this refinement must be combined with other formalized processes, such as the implementation of a Product /Value Analysis Team, to assure ongoing clinical, operational and financial stakeholder involvement in product identification, evaluation, selection and utilization, discussions and decisions (much like that of a Pharmacy and Therapeutics Committee). This enhanced strategy allows hospitals and health systems to focus on standardization as a patient care initiative, focused on overall value as defined by quality improvement, risk reductions and meaningful, positive clinical outcomes. Focusing only on the typical supply chain strategies of lowest unit cost, discounts and rebates and percent utilization will likely result in less-than-optimal standardization and thereby decreased cost savings or other outcomes for the healthcare system.

Pharmacy Program Consolidation and Centralization Will Be A Key Strategy in 2017 And Beyond

Over the past several years, Pharmacy departments within hospitals and health systems have also begun to evaluate and, in some cases, implement consolidated or centralized operations and/or support services. From a process standpoint, many health systems have consolidated their formulary review, selection and drug utilization evaluation processes through the use of a system-level Pharmacy & Therapeutics committee. Likewise, several health system pharmacies have consolidated or centralized their supply chain processes for pharmaceutical contracting and procurement, often under a single administrative structure. With increasing frequency, the strategy, operational design and oversight of pharmacy operations and medication use system program elements such as supply chain, automation, informatics, financial, risk management, and accreditation and regulatory functions are found at the pharmacy health system level.

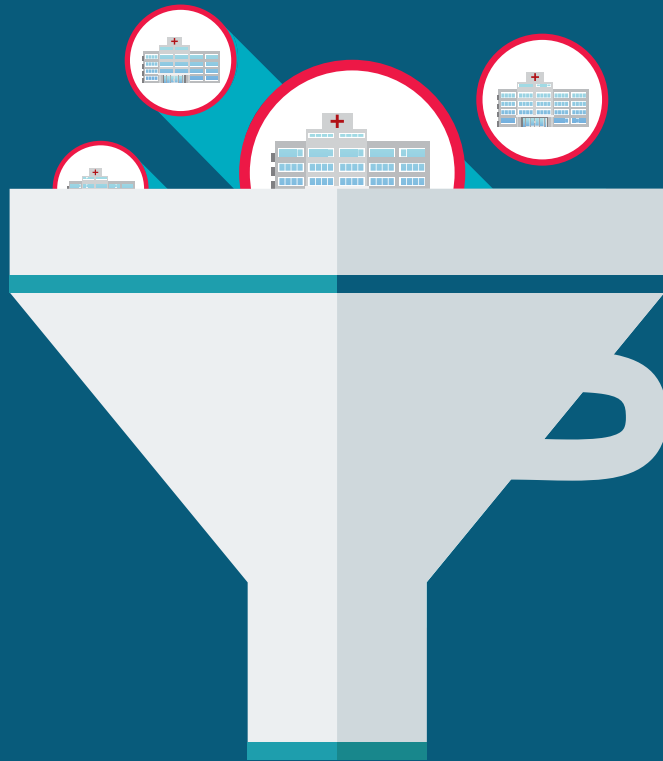
Some health-system pharmacy departments have also begun to consolidate and/or centralize medication use system preparation and dispensing activities at the system level. Inpatient and clinic medication order review and verification functions by pharmacists are increasingly being performed in a centralized manner. Likewise, pharmacist management of patient chronic disease states and/or patient population management programs through centralized call centers is becoming increasingly utilized. Unit-dose repackaging and decentralized automated dispensing cabinet restock processes are also being consolidated in centralized locations at both on-campus and at off-site locations, often referred to as central-fill distribution centers. The recent FDA guidance on batch compounding of sterile IV products can be problematic for some healthcare organizations due to the required segregation of patient-specific and non-patient-specific

anticipatory compounding, along with the geographic limits of what can be considered as a healthcare campus, and the significantly enhanced operational and quality requirements should a 503B sterile compounding level be required. However, despite these challenges, there is continued interest and evaluation of consolidating and/or centralizing the sterile compounding and production of these types of pharmaceuticals within hospitals and health systems. Finally, many health systems have consolidated outpatient pharmacy mail order, refill and specialty prescription processing within a designated large pharmacy or in an off-site location, along with the requisite call center.

All of this gives rise to the concept of a health system pharmacy located within a CSC, where further economies of scale can be gained and leveraged from a capital and/or operational perspective. In this regard, consideration should be given as to whether a pharmacy distribution/service center should be a standalone facility or housed within other health system centralized functions such as a med/surg supply chain management distribution center for even further economies of scale. Automation support for inventory management, including product preparation, repackaging, picking, dispensing and shipping will be key to the effective use and operation of these types of facilities as more are developed and come on line in the next few years.

I foresee the continued evolution and expansion of both standalone and combined centralized pharmacy distribution centers in 2017 and beyond. For pharmacy however, this must be balanced with the ability to meet urgent operational and patient care needs from a consolidated or centralized facility or through a combined centralized / decentralized supply chain model.





Moving Forward

The move for hospitals and health systems from affiliation to systemness is typically difficult and slow for a variety of reasons including professional practice preferences, facility, financial, cultural, leadership and other factors. However, for 2017 and beyond, those that move more quickly in addressing these challenges will likely have more success, both short-term and long-term, in their respective markets. As noted above, there are significant opportunities for hospitals and health systems to take advantage of the paradigm shift from independent healthcare provider to a truly integrated healthcare and wellness system. What is equally clear is that regardless of how political leadership changes impact our legislation, these same challenges and opportunities remain in the effective and efficient provision of health care now and in the future.

These issues are at the heart of everything we strive for at Swisslog. As we look to 2017, we will continue to invest in solutions that address supply chain challenges and create connections across the continuum of care, driving integration and systemness throughout hospital networks.

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About Stephan Sonderegger

CEO of Swisslog Healthcare since April 2016, Stephan Sonderegger has also been President of Swisslog Healthcare North America since 2014. From 2011 – 2014 he was responsible for managing the Asia business unit for Swisslog Healthcare based in Singapore. Previously, Stephan worked for Tecan, a leading global provider of laboratory instruments and automation solutions and Rieter, an industrial supplier of textile machinery and components. Sonderegger earned a Master's degree in Industrial Management and Engineering from The ETH Zurich with a focus on supply chain management and information technology. He lives with his family in Denver, Colorado.

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