



How To Create A Consignment Strategy



This has been a frequent subject of conversations we have with inventory managers in procedural areas of hospitals. Many hospitals that we've visited have a mix of consigned and owned products in their inventory. However, when you dig deeper you'll find that many supplies were added to inventory as consigned or owned for inconsistent reasons. And digging even deeper, you find that oftentimes a decision to own or consign an item was made years ago and the decision hasn't been re-visited in years. Other than departments that chose to consign everything or own everything, we have rarely come across a hospital that has a specific consignment strategy that is documented and followed consistently.

This Whitepaper covers:

- Why Hospitals Choose to Consign Inventory
- The Pros and Cons of Owning Inventory vs. Consigning Inventory
- Recommendations on a Repeatable Strategy For Optimizing Your Owned and Consigned Inventory Mix



Infrequently used supplies

One of the main reasons we have seen customers consign some supplies is due to the uncertainty of whether the supply will actually be used in a procedure. This method may be used to stock certain devices or sizes that are rarely used, but kept around in case of an emergency. This strategy may also be used when a new physician requests a supply that they used in a previous hospital. Because the new hospital has not previously stocked the supply, they may choose to consign the supply to begin with and see how it goes. Another unfortunate reason for consignment is driven by the vendors – they may “stuff the channel” with consigned items as a way to get their supplies on the shelf of a hospital in the hopes that they will one day be used. This is not a strategy that we would recommend hospitals allow vendors to adopt at their facility.



Reduce cost of expiration

Hospitals that are suffering from high costs of expiration from slow moving inventory may solve the problem by consigning those supplies. The vendor will now manage the expiration of the supplies it is stocking and replace supplies about to expire with newer items. This can be a short-term quick fix for a hospital to reduce expiration costs, but there will be some unforeseen costs from adopting this strategy, as we'll discuss in the next section.



Reduce management time

By having vendors manage inventory, they pass on the administrative time required to manage consigned supplies from themselves to the vendor. This may not be the big time-saver that staff are anticipating as they now have added the relationship with the vendor as a new complexity to their supply chain tasks. They also still have to keep a close eye on inventory levels to make sure they aren't running out, just as they were before. If consignment is being used as a strategy mainly to alleviate administrative time spent on managing inventory, the department will more likely than not fail in its mission.

Consignment vs Ownership

Pros

- Reduces carrying costs
- Potential to eliminate expiration costs

Consignment

Cons

- Increased cost per item
- Tendency to overstock
- Burden of proof on hospital

Ownership

- Lower cost per item
- 100% control of the hospital's shelf space

- Expiration risks
- Carrying costs

Consignment


Pros

Reduces carrying costs. The main financial advantage of consignment lies in its ability to free up working capital for the hospital. When a hospital owns a supply in inventory, that item permanently sits on that hospital's balance sheet until they decide to stop carrying it. Even when one item is used, it will be replaced with a new one. The cash that is "tied up" in inventory can't be used for other money-generating projects at the hospital. Any dollars that can be freed up from moving items from owned to consigned inventory can then be used by the hospital to pursue other projects.

Potential to eliminate expiration costs. If your consignment inventory is also vendor-managed, where they take on responsibility for tracking and replacing expiring items at their cost, the loss from expiration of those products can be eliminated. However, make sure to read the fine print. You may assume that the cost of expiration is going to be absorbed by the vendor, but that may not always be the case.

Cons

Increased cost per item. The biggest drawback to consigned inventory is the increase in item cost. Most vendors won't be transparent with their ownership vs. consignment cost as this is not an often-discussed practice. From anecdotal evidence, we have seen the average price increase in a consigned vs. owned item to be in the 15% range. If you are being led to believe that you aren't paying any more for your consigned inventory than if you owned it, you can rest assured that there are hidden costs. The vendor has increased their carrying cost, risk and administrative burden in order to offer consigned inventory. The vendor has to recoup these costs somehow, and those costs will be passed on to the customer one way or another.



Tendency to overstock. When hospitals let vendors manage their inventories, conflicting priorities come into play. Hospitals want to keep as little on the shelf as possible in order to maximize efficiency in their operations. Vendors want to put as much inventory on the shelf as possible in the hope that one day, each item will be used and billed for. Vendors tend to win this battle and the result is an extreme overstock of inventory when they “stuff the channel”, to borrow a term from retail. The cost to manufacture a medical device can be 10% or less of the product’s sales price, depending on the type of device. The vendor is risking an occasional expiration in order to maximize the odds that their product, with a mark-up of 10x or more, will eventually be used if it sits on the shelf long enough.

Burden of proof on hospital. Instead of paying for inventory when it is purchased, consigned inventory is only paid for when used. Therefore, the vendor and hospital are again at a conflict, where the vendor wants to maximize the amount of inventory used while the hospital wants to minimize it. But when it comes to billing, the burden of proof lays with the hospital. If a vendor does their inventory count and there is a dispute about the usage of 1 or 2 items, the hospital will have to pay for those missing items unless they are able to prove that they are still unopened. This is not to say that a vendor will do anything malicious to increase sales, but this misalignment will be sure to happen from time to time.

Ownership




Pros

Lowest cost per item. While ownership does result in a higher carrying cost, the main advantage of ownership is that it will provide the lowest cost per item over the long run. The hidden costs of consignment (explained above) will drive up the cost of consigned supplies on a per item basis. Maximizing ownership of fast-moving supplies will ensure the lowest total costs for a hospital.

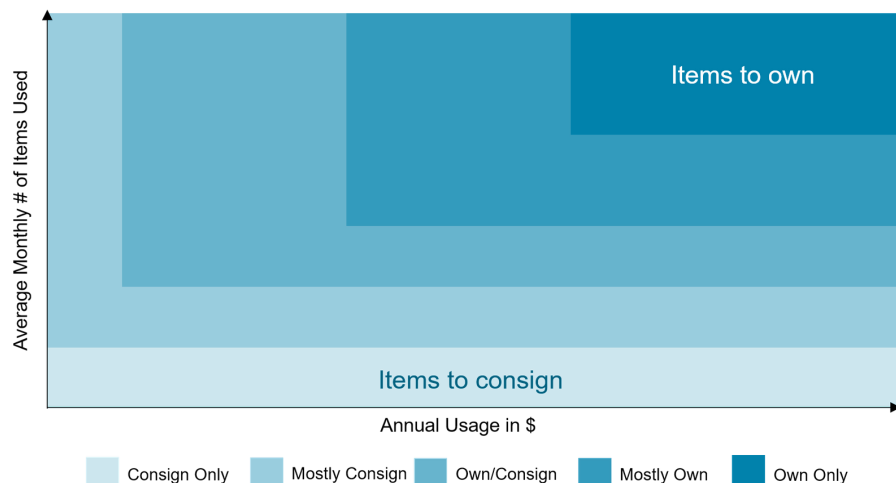
Cons

Expiration risks. When an owned item expires, the cost of that item most likely will be eaten by the hospital (with some rare exceptions). In order to mitigate against this, hospitals should have a strong system to manage inventory expirations and should be able to identify any upcoming expiring items with minimal effort. Hospitals should also negotiate with their vendors to include language in their contracts whereby expiring supplies can be exchanged for new ones before their expiry date.

Carrying costs. The true cost of owning inventory is the opportunity cost of the working capital that is tied up in owned inventory. The hospital will not be able to use those funds tied up in inventory to pursue other revenue-generating or cost-cutting projects.



When to Own and When to Consign



How to Conduct Your Own Consignment Analysis:

1. Create a scatter plot of your current product mix by analyzing usage data for the past 12 months. You can choose to plot all of your data, or select a certain sub-segment of highly utilized or high expense items.
2. On the x-axis, use the usage in dollars of each product over the last 12 months as the variable.
3. On the y-axis, use the average monthly # of items used for each product over the last 12 months as the variable.
4. Choose one color for the data points of your owned products, and a contrasting color for the data points of your consigned products.

Create Your Own Consignment Strategy

Review consigned/owned mix at least annually, more often as needed

At least once a year we recommend that you look closely at your own/consignment mix for your top 20% of supplies in terms of annual spend per product. Depending on the size of your department and the type of procedures you're doing, those top 20% typically represent between 60-80% of your annual spend on supplies. These fast-moving supplies are the best candidates for ownership. They are being used frequently (confirm that in the data) and you are spending a lot on them. If you can shave up to 15% off some of these items by moving them from consigned to owned, you can realize significant, recurring savings for your department.

At the same time, review if there are any supplies that are not being used often and are currently owned. They may be candidates for moving to consignment, as the costs of expiration of these items will surpass any additional costs realized by moving them to consignment. You may even make the further decision to permanently remove the supply from inventory if the rest of the clinical team can agree to this.

Data is King

The only way to truly gauge your own/consign decisions is to have accurate usage and on-hand data ready at your fingertips. With this data, analyses can be conducted and

evidence-based decisions can be made to the physicians and clinicians who may also need to buy in. Without the data, anecdotal evidence or "gut feel" may not be enough to convince the other decision makers to go along with the decisions.

Conduct ad hoc analysis as needed

There may be specific events that trigger an ad hoc analysis of your owned/consigned supply mix. One such event may be whenever a physician leaves the department. When this event occurs, run a quick analysis to see if there were any supplies over the last 12 months that only the departing physician was using. These supplies may be candidates to move from owned to consigned, or may be candidates to be removed from inventory altogether.

How Mobile Aspects can help

Mobile Aspects' iRISupply system for hospital inventory management will arm you with the data you need to make the best own/consign decisions possible. Whatever your department decides its strategy is for consigned inventory, iRISupply will provide the actionable, real-time information you need to make the hard decisions that will drive benefits for your organization. Mobile Aspects supply chain experts can also sit down with you as part of our best-in-class customer success program to discuss strategies to optimize your owned/consigned inventory mix and review the data behind those suggestions.