

(non) Profitability in Healthcare

THE JOURNAL 2023

Begoña San José

From For-Profit to For-Value: A Journey to a Sustainable Healthcare Model

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The Power of Healthcare Procurement – Its Relevance, Use and Impact for Better Affordability, Quality, and Innovativeness in Healthcare

Procurement plays a crucial role in achieving affordability and profitability in the healthcare sector. With ever-rising healthcare expenditures, the focus on procuring products and services efficiently and effectively is essential.

Collaboration between healthcare providers as buyers and with their suppliers is vital. By embracing a broader notion of responsible procurement, healthcare providers can promote innovation, sustainability, and better healthcare outcomes for all.

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key points

- Procurement is a crucial lever for achieving affordability and profitability in the healthcare industry.
- Collaboration on many fronts is essential.
- Dealing with the systemic challenges highlighted during the COVID-19 pandemic requires systemic change.
- This, in turn requires a new market- (not just supplier-) oriented perspective on responsible procurement

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Healthcare Procurement – An Important Lever for Affordability

Healthcare expenditure is high, ever-rising, and playing an ever-greater part in the economy (Figure 1). Typically, after payroll, the second largest expense for healthcare providers is product acquisition and services, at some 30-50% of annual budgets. So, we cannot discuss

affordability and profitability in healthcare without paying close attention to the suppliers of products and services and procurement effectiveness. Procurement strategies and practices directly influence costs and consequently quality and innovativeness of care. Even the smallest changes in how and what products and services are bought by healthcare providers can significantly impact the healthcare system and its affordability.

The bar is rising for procurement teams in healthcare. Pressures are increasing, driven by multiple factors, including outsourcing of services, rising supplier prices (a function of costs and profits) and changing patterns of care enabled by the adoption of new technologies. It's worth noting that procurement in healthcare has tended to lag behind that of other sectors (e.g., the automotive industry) in mobilising suppliers. Leading manufacturers invest in procurement because it plays a vital role in delivering the firm's innovation strategy and long-term competitive advantage. A similar logic applies even where profit is not the buying organisation's primary motive. Rather than gaining an advantage over competitors, the 'advantage' being sought relates to delivering better health outcomes for the wider communities served.

Recent systemic shocks, such as COVID-19, have provided new insights into long-running, deep-rooted procurement and supply chain management (PSCM) challenges. Based on our own recent research and insights from research in other sectors, in this article, we argue that buyers need to cooperate with others in the supply chain, collaborating in various ways both with other buyers and suppliers. We review some more conventional approaches to securing affordability and

value with and from suppliers and advocate some less well-established approaches.

The Basics of Collaboration—Levels and Axes of Collaboration (and Rivalry)

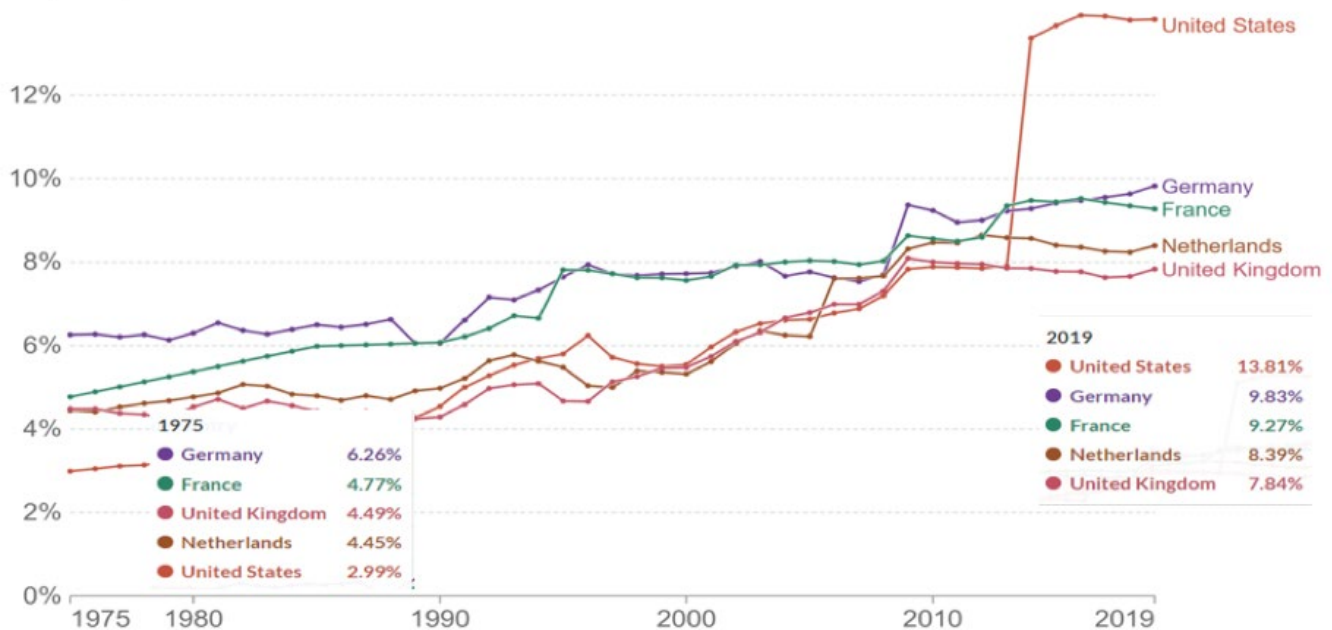
The value of group purchasing organisations (GPOs) is widely recognised. Better prices and lower transaction costs are primary motivations for joint buying, but there are also significant risks and drawbacks at various levels in the system (Table 1). Some of the concerns are the long-term, market-level consequence of decisions which – at the level of the individual care provider – yield short-term price benefits.

Learning from Crises— The Collective Influence of Buyers on Markets

The COVID-19 crisis led to a great many lessons in PSCM. Research provides insights into the 5Rs (refuse, reduce, reuse, repurpose, recycle) and better ways of working in times of resource scarcity. Figure 2 summarises various strategies that stakeholders followed during the pandemic to ensure the security of supply and demonstrates the key role played by procurement in improving resource access. Dysfunctional allocation of resources was found at

Government health expenditure as a share of GDP, 1975 to 2019

This metric captures spending on government funded health care systems and social health insurance, as well as compulsory health insurance.



Source: Our World In Data based on Lindert (1994), OECD (1993), OECD Stat

OurWorldInData.org/financing-healthcare • CC BY

Note: Health spending includes final consumption of health care goods and services (i.e. current health expenditure). This excludes spending on capital investments.

Figure 1: Rising health expenditure as a share of GDP, 1975 to 2019. Source: Our World in Data

several hospitals studied, with individual departments stockpiling supplies, at the expense of other departments experiencing scarcity. The intervention of procurement professionals at the intra- and inter-hospital level resolved helped distribute the product fairly within the system. At the interorganisational level, price-gouging and counterfeiting by suppliers, governments ‘hijacking’ of supplies, unchecked rivalry between buyers and inventory hoarding were just some of the problems encountered by healthcare institutions. There were multiple points of system failure.

Contracting for personal protective equipment and vaccines brought PSCM, as well as buyers’ successes and failures and companies’ (anti)competitive practices, to the public’s attention. That attention continues today due to rising inflation and Russia’s invasion of Ukraine. More questions are being asked about suppliers’ pricing strategies and profit levels, especially given evidence that in some sectors, rising profit levels are associated

with rising dividends (and, conversely, falling wages and salaries) rather than rising R&D spending.

In combination with compelling evidence of rising market concentration in many sectors, this implies healthcare leaders need to take account of trends in supply market competitiveness, profit levels and value appropriation when looking at the (un)affordability of healthcare in the long term.

These factors are not just matters for regulators, but also for healthcare providers collectively, as the buyers in the market. It is in buyers’ common interest to act today in ways which promote healthy markets in the future – that is, markets in which sufficient suppliers compete effectively and consistently to reliably deliver high-quality products at a reasonable cost with fair profits and with an acceptable rate of innovation. Suppliers’ market barriers to entry and exit, and buyers’ switching costs, should be low enough to sustain market diversity and dynamism without leading to chaotic churn.

Buying Together at the Individual Member Level		
Advantages <ul style="list-style-type: none"> Reduction of purchasing-related costs (namely, acquisition, transaction and administrative costs). Human resources savings, since some purchasing effort is transferred to the group. Increased information on supply markets. Increased focus on core operational activities. 	Disadvantages <ul style="list-style-type: none"> Standardisation decreases the ability to fulfil the needs of decentralised users. Lower innovation capabilities (at contract and product/service levels) due to compromise, standardisation, and reduction of direct contacts with suppliers. Lower responsiveness, e.g., in case of a small-scale emergency situation. 	Doubts/ Concerns <ul style="list-style-type: none"> Prices negotiated by purchasing groups may be higher than those negotiated directly with vendors.
Buying Together at the Group/ Supply Chain Level		
Advantages <ul style="list-style-type: none"> Consolidation of purchase volumes enables the negotiation of more favourable terms with suppliers. Reduction of duplicated purchasing efforts, namely, through reduction of the number of transactions. Development of purchasing expertise. Rationalised choice through better-informed selection and standardisation. Standardisation and consolidation of purchasing volumes increase economies of scale (e.g., at the supplier level), lowering unit costs for the whole supply chain. Improved ability to respond to large-scale emergency situations due to increased flexibility of inventories, coordination and resource pooling. 	Disadvantages <ul style="list-style-type: none"> Coordination costs, mainly when GPO size increases. 	
Buying Together at the Macro/Political Level		
Advantages <ul style="list-style-type: none"> Reduction of overall supply chain costs, which, in the public sector, implies that the amount paid by taxpayers decreases in the public sector, prevention/reduction of corruption. 	Disadvantages <ul style="list-style-type: none"> Consolidation of sales volumes may inhibit SMEs from participating in the tenders and may be a barrier to innovation because GPOs tend to favour suppliers with broad product lines rather than a single innovative product. 	Doubts/Concerns <ul style="list-style-type: none"> Risk of a negative effect on market dynamics due to excessive buyer concentration. Risk of a negative effect on market dynamics due to the introduction of an additional intermediary in the case of third-party GPOs. Depending on the market at stake, an increase in the concentration of the buyers (demand side) may counterbalance the excess concentration on the supply side, improving competition conditions.

Table 1: Group purchasing advantages and disadvantages. Source: Rego N, Claro J & de Sousa J P (2014)

A key role for procurement could be what we call ‘market stewarding’ by buyers: first, recognising that today’s (individual) buying decisions create tomorrow’s markets and then actively anticipating how buying decisions and practices may shape those markets in the longer term. Only then is it possible to identify options for action which can influence the development trajectory of the market towards a more competitive, healthy, and dynamic ecosystem for the long-term advantage of all buyers in the market (and most suppliers, though not those which would seek to unfairly exploit their

sectors, including – and some would say especially – in healthcare. For example, recent media has highlighted excessive profits, particularly concerning vaccines (Buchholz 2021) and energy (King 2023).

A study focusing on leading pharmaceutical companies revealed that their earnings as a fraction of revenue were almost double those of other S&P 500 Index companies (Buchholz 2021). Additionally, the largest MedTech firms enjoy profit margins ranging from 20-30% and impose widely varying prices for identical products in different countries. And yet, discussions

We cannot talk about affordability and profitability in healthcare without also paying close attention to the suppliers of products and services, and procurement effectiveness

market dominance). Joint market consultations to promote innovation would be one such option, though market stewarding is also relevant to many other supply situations. Market stewarding is very much future-focused and concerned with promoting positive developments. It also relates to tackling problems in the market, as outlined next.

Tackling Excessive Profits and Unacceptable Practices

Procurement also has a role to play in directly addressing market failures, unfair value distribution and questionable practices. These are rife in many

about the impact of profit levels in markets and value distribution in supply chains on healthcare affordability and environmental impact are not common. In contrast, the need to protect companies’ margins to incentivise R&D and secure innovation is often emphasised (see example in Figure 3).

During the pandemic, extensive media coverage highlighted corruption and incompetence in healthcare PSCM, both on the buying and supplying side. When facing supply challenges such as personal protective equipment, chips, vaccines, and energy, governments often intervene, leveraging their political influence

Purpose of Action	Domain of Action	
	Internal	External
Improve Resource Access	Internal Resource Enhancement <ul style="list-style-type: none"> • Monitor stocks and predict stock coverage. • Consult daily. • Shorten the purchasing process. • Reassemble (existing) products. 	Crafting the Resource Environment <ul style="list-style-type: none"> • Collaborate with suppliers from different industries. • Change specifications, search for alternative products. • Retrieve second-hand products. • Prevent price gouging. • Beware of the ‘cowboy’ market.
Reduce Resource Importance	Internal Resource Replacement <ul style="list-style-type: none"> • Change the specification or purpose of products. • Sterilise and reuse products. • Use older products. • Use products longer/change quality requirements. 	Managing Resource Demands <ul style="list-style-type: none"> • Anticipate changing healthcare demands by society. • Facilitate the potential of new technologies & digitisation.

Figure 2 – Hospital “crisis strategies” to manage scarce resources during the COVID pandemic. Based on: Tip B, Vos F G S, Peters E, & Delke V (2022)

and economies of scale to manage turbulent markets. Excessive prices and supply (in)security motivate these reactive measures. While there is plenty of advice on recognising and addressing anti-competitive practices (e.g. from the OECD [OECD]), they mostly remain an undiscussed theme when developing procurement or debating healthcare affordability. To name a few examples of questionable practices (Knight 2023):

- Prioritising wealth creation over health creation and care quality.
- Gaining price advantage by reducing costs through tax avoidance facilitated by complex ownership arrangements.
- Management strategies and financial practices which jeopardise basic services such as social care and core government services.

Healthcare leaders need to take account of trends in supply market competitiveness, profit levels and value appropriation when looking at the (un)affordability of healthcare in the long term

- Insisting buyers sign non-disclosure agreements, which prevents price benchmarking and facilitates price gouging.
- Buying up and then closing down innovative market entrants.
- Forcing customers to prematurely buy system upgrades and expensive staff training.
- Shielding profit increases behind talk of inflation.
- Realising increased profit through unethical marketing practices generates an ‘artificial’ demand for healthcare.
- Bid rigging.

Procurement experts have a significant role to play in taking collective action to identify, assess, and tackle these harmful strategies. This is not instead of regulation but rather complementing it to promote genuine competition among suppliers. Procurement experts are well-placed to identify procurement policies and contracting strategies for addressing market entry barriers and barriers to switching and establishing appropriate and aligned incentives. The challenge for health executives and procurement leaders lies in ensuring that the essential resources within the buying functions are available, motivated, and skilled for additional, novel roles.

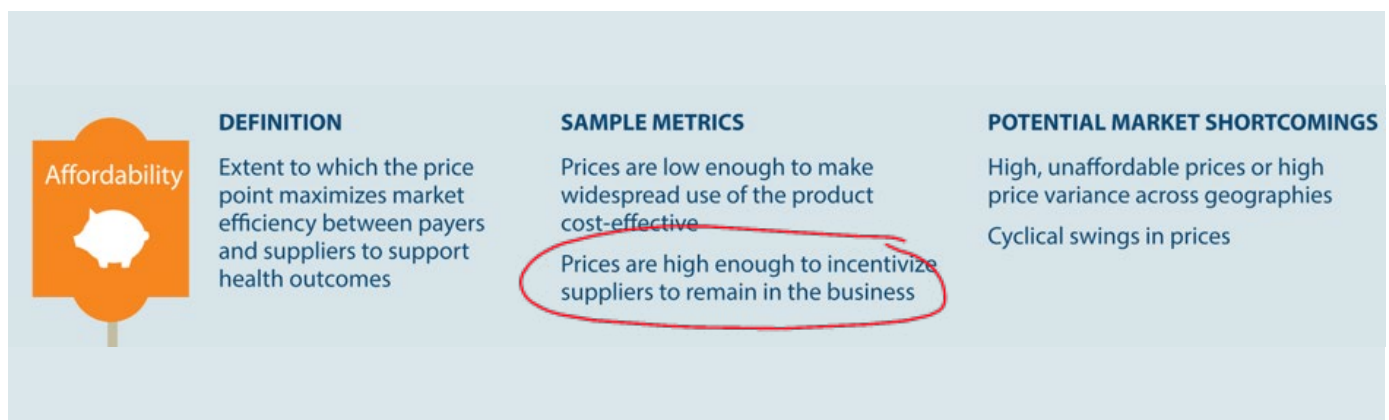


Figure 3: Example of protecting companies' margins. Source: Healthy markets for global health: a market-shaping primer (2014), p21.

Conclusion

With ever-rising healthcare costs, we cannot talk about affordability and profitability in healthcare without talking about procurement and supply chain management. Recent crises have exposed multiple points of system failure, indicating the urgent need to rethink and reorganise how we manage (in) the system.

Based on government reviews and research, we argue that healthcare institutions can and should do more as buying organisations working together. Responsible procurement in healthcare can encompass more than improving social and environmental performance. It can also be about proactively addressing market-level issues, where these affect resource and value distribution, affordability, quality, sustainability, innovativeness, and, ultimately, healthcare outcomes.

Healthcare providers cannot combat the ever-rising healthcare expenditures by acting alone. By fostering an understanding of the challenges and aligning their efforts on strategic and structural solutions, they can more vigorously and effectively mobilise suppliers to adapt and develop to meet rising expectations, promote healthy markets, avoid the unchecked rivalry between buyers and tackle questionable practices by suppliers.

Post-script: At the European Lab for Innovative Purchasing and Supply (EL-IPS) at the University of Twente (NL), we are pursuing several lines of research

in healthcare procurement to better frame and develop these ‘business-not-as-usual’ roles for procurement and evaluate their potential impact. The link below takes you to an overview of our current projects and recent findings and recommended reading/sources we have drawn on in preparing this article. The quality and value of management research depend on excellent dialogues with policymakers and managers – we would be very pleased to hear from readers! See the link or scan the QR code for our contact details.



[The Power of Healthcare Procurement](#)

Conflict of Interest

None. ■

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