By Richard J. Rosenfeld RPh, MBA

Controlling Drug Costs in Difficult Financial Times

In these tough financials times, directors of pharmacy are being asked to control pharmacy expenses and do more with less. One area where pharmacy can impact the hospital's bottom line is through drug spending cost control measures. While patient safety is the number one factor in any decision to control costs, there are many ways to reduce drug costs while also improving or maintaining patient safety.

Inventory Management

Managing inventory is one way to curb drug costs in the pharmacy. Start by taking a critical look at your current inventory turns. Carrying excess inventory results in higher carrying costs. Simply put, carrying costs are those costs incurred from having and maintaining excess inventory. A big component of carrying costs is the opportunity cost of the capital: when money is tied up in excess inventory rather than being invested by the hospital in financial markets or capital equipment that would generate revenue, there is a net loss to the facility. Carrying costs generally range from 6% to 10%, depending on the organization.

Improving cash flow is the second factor to address. To decrease inventory, the excess inventory is used while purchasing decreases, thereby putting more cash back into the facility. This also means that your drug budget for the next year will reflect the lower inventory costs. Remember when budgeting the following year that part of your costs were covered by reducing the inventory.

Common Drug Cost Control Measures

- Inventory management
- Purchase monitoring
- GPO management
- Market share letters of commitment
- Auto-substitution programs
- Investment purchasing
- Buy against claims
- Rebate tracking
- Borrow/loan programs

One note of caution: When decreasing inventory, make sure to keep the finance department apprised of your plan. They will need to move the dollars from inventory to your cost of goods (COG). (This is called a burn.) If you wait until your inventory is taken at the end of the year, you will have a high adjustment to your COG, which could then have a negative effect on your overall budget performance. You do not want to be on budget for the year while decreasing inventory without a burn taking place. If you are, finance will then need to write off your inventory into your COG—a time-consuming task that will not make you popular with the finance department. However, if a pharmacy reduces inventory and takes the appropriate actions with finance, the end result will be increased turns and decreased COG (that is less cash outlay since excess inventory is being used instead of purchasing product) with the COG on your financials reflecting both the inventory burn and purchases.

	Cost of Goods	Inventory	Turns
Year 0	$1,000,000 (On Budget)	$100,000	10
Year 1	$1,000,000 (On Budget)	$90,000	11.1

After the inventory is taken for Year 1 and a decrease is noted, this decrease is added to your cost of goods, which will take you off budget. While turns did increase, the $10,000 burn off inventory should have been taken care of before the year's end.

Monitoring Purchases

Too often directors do not take the time to monitor purchases throughout the month. A simple way to control over ordering is to review your budgeted cost per patient day or cost per adjusted patient day at the beginning of the month. Based on these calculations, take the census from the day before and calculate what the purchases should be for the following day. Tell your buyer what this number is and then have them compare the actual figure against the projected one. If the buyer is over budget, review the purchases with that person to assess the cause of the variance. Some variances may be unavoidable, such as those caused by outlier patients or a change in patient mix, but it is

Tips for Decreasing Inventory

Review the 80/20 list as these are your top targets

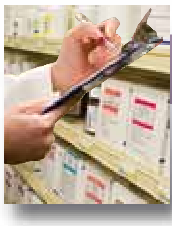
Assess the quantities in the pharmacy as well as in the automated dispensing cabinets (ADC) and floor stock

Set three-day minimums and seven-day maximums (min/max) based on the total quantities in the entire hospital (Carrying the min/max in the pharmacy only will result in excessive quantities)

Label the shelf tags with min/max or OP/OQ (order points/order quantities)

Educate staff on the process

Keep in mind that inventory levels are not static and need attention on a regular basis



For health systems, instituting regular buyers meetings can help increase the success of many pharmacy-based financial initiatives. The meetings can be a good opportunity for buyers to toss around ideas and **discuss concerns and purchasing practices of the individual hospitals**.

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helpful to have this data prior to the end of the month. If there is a change that will affect the adjusted budget at the end of the month, keep the buyer and the finance department apprised of this. Calculating the amount the buyer should be spending on a daily basis will help set clear expectations. Of course, there are times when an overage cannot be avoided. However, by being actively involved with the buyer, you can help reduce the risk of over ordering and increasing your inventory unnecessarily.

GPO Management

Ensuring that you are ordering the most cost effective product in your GPO catalogue is a sure way to control costs. Often, buyers continue to purchase the same product out of habit rather than seeking out a more cost effective alternative. Most wholesaler's purchasing software will highlight the least expensive alternative, but this feature needs to be used to be effective. Of course, the least expensive product is not always the best choice. Some common reasons for not switching to an equivalent product include:

- Product is not bar code readable
- Look-alike/sound-alike issue
- Packaging issue
- Does not fit in ADC
- Does not fit needleless system
- Not individually wrapped (e.g., inhalant solutions)
- Wrong size for hospital
- Contains preservatives
- Does not meet non-PVC packaging requirements
- Manufacturer backorder issues

Market Share Letters of Commitment

Market share letters of commitment can help ensure that you are getting the discount drug pricing that you are entitled to. First, make sure that your GPO provides you with a list of all the companies who offer market share commitments that will decrease the price of primary branded products. Remember, market shares are calculated differently based on the manufacturer's requirements: Some have a market basket based strictly on percentage of dollars, while others are based on grams of product. After you decide on a particular market share agreement, a signed letter of this commitment should be kept on file with the manufacturer. This market share commitment needs to be tracked to ensure appropriate pricing.

Auto-substitution Programs

For those classes of drugs with equivalent, efficacious products at different price points, establish a single product as your formulary product that can be substituted for other, more expensive products in the same class. Implementing an auto-substitution program with a single product can help decrease drug costs. Proton pump inhibitors and nasal steroids are two classes of drugs that should be on your hit list. Beyond cost savings, this type of program can improve patient safety by limiting choices, thus decreasing the chance of dispensing the wrong product.

It is important to get the support of the appropriate physician experts and then pre-sell it to the pharmacy & therapeutics committee. By addressing questions and concerns before presenting the program, you increase your chances of having it approved in a painless fashion.

Investment Purchasing

Because pricing is constantly changing, your buyer should keep abreast of any potential significant price increases. This information can help you decide when you can save money by purchasing a large volume (e.g., six months to a year) of product in advance of a price increase. You should have a percentage savings amount in mind to make this decision: If the savings is 3% to 5%, it may not be cost effective to purchase extra product. If the savings is 10% or greater it may be worth looking into. Keep in mind that carrying costs must be figured into this decision.

If you decide to invest in a large order, consider having the costs associated with this purchase spread over the period in which the product will be used. Ask your CFO to credit the purchase to your inventory (inventory build) and add the COG each month removed from inventory (inventory burn) to your profit and loss statement. This way you avoid being hit with a huge COG in the month that you purchased the product.

Buy Against Claims

The director of pharmacy and/or the buyer should be familiar with the contracts that include a "failure to supply" clause. When a manufacturer cannot supply the contracted product and a more expensive alternative product must be pur-

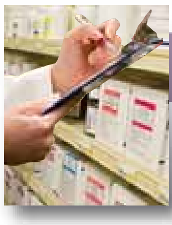

Photo courtesy of AmerisourceBergen

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chased, a "buy against claim" should be filed with the original manufacturer. Your buyer should be familiar with each manufacturer's requirements as the forms and processes are often manufacturer-specific. The key to success is to continually track the claim and communicate with the manufacturer throughout the process. It is also important to keep in mind that oftentimes it can take up to six months to get your money.

Rebate Tracking

As a director of pharmacy, you should know whether all the rebates that you are eligible for are actually received. Keep a spreadsheet that lists all of the companies that you receive rebates from, the drugs, and associated rebate percentages. In addition, record the frequency of the rebates, so any missing rebate checks can be researched. Sometimes, rebates show up at accounts receivable and are placed in a general account rather than credited to the pharmacy COG.

When rebate checks are received, reconcile them against your calculated amount. Any difference should be brought to the attention of the local sales representative and rectified.

Borrow/Loan vs. Transfer Programs

For independent (non-system) hospitals, a solid record-keeping program for borrowed and loaned drug products should be in place. While a variety of systems can be used to track these products, it is imperative to document every transaction whether it is a borrow or a loan. All transactions should be reconciled at the end of the month. Develop standardized forms for your facility and educate the staff on the process. With a borrow/loan program, you can potentially increase inventory every time an item is sent to a borrowing facility (i.e., you reorder the product to replace the loan and then the loan is returned to you, thus increasing inventory on that product).

For health systems, I recommend establishing a transfer program for moving drugs within the system, not a borrow/loan program. This way drugs are transferred, not loaned, to the facility in need. You will need to have invoice forms that accompany the order to the borrowing facility, a tracking spreadsheet of the transfers, and the ability to transfer those costs at the end of the month. Some systems have developed software to automatically transfer the costs at the end of the month, thus eliminating all the paperwork.

The key to success with this type of program is to have a process in place that everyone follows.

General Ledger Reconciliation

Every month most directors receive a large pile of green bar paper from the finance department. These general financial reports are usually piled in the corner of the office, never to be looked at again. (Of course, some hospitals do have this information online.) However, there is some useful information in these reports, namely the general ledger. This is where all your monthly expenses are listed with detail about the vendor and product, and these are the expenses that drive your monthly profit and loss statement.

Reviewing this data may seem tedious, but it is to your advantage as it only takes one misplaced digit to end up with another department's expenses. It is not uncommon for surgical equipment, arm boards, radiology supplies, and other inappropriate expenses to be assigned to the pharmacy cost center. Once reported to the finance department, these errors are easily remedied.

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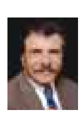
Conclusion

In many ways, running a pharmacy is similar to running your own small business. And like any good business owner, it is imperative to pay attention to the financial details that will improve cash flow and decrease costs. Of course, in health care, we also have to keep in mind that every good cost control program has patient safety as its centerpiece. Using the tools outlined above, you can ensure safe and efficacious therapies for your patients, while also helping your hospital meet or exceed its financial goals. ■



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