

# Total supply chain cost



What is your evaluation of the Total Supply Chain Cost (TSCC) program developed by Owens & Minor and Virginia Mason? \* Virginia Mason Medical Center (VM) hired Owens & Minor (O&M) as its alpha vendor for medical/surgical supplies in 2004. At that time O&M was performing JIT and low unit measure services for VM. Together VM and O&M worked together to create a new supply chain process called the Total Supply Chain Cost (TSCC) pricing program. \* TSCC was is an activity-based model that assigned all the cost drivers of distribution and inventory handling to VM, while also guaranteed O&M a profit. TSCC uses the Alpha system which created exclusive relationships with a few key vendors that acted a partnership in the supply chain, which offered on average the lowest costs of both goods and services. \* Since the costs of distribution activities directly impacted VM's fees, the TSCC encouraged VM to streamline its supply chain. \* This resulted in overall savings for both VM and O&M. \* After testing the TSCC for one year, VM's Daniel Borunda and O; M's Michael Stefanic felt that TSCC was a better and more cost-effective pricing model. In 2007, one of VM's buyers received an offer from a specialty distribution company that offered a very low cost-plus fee for suture orders. \* A comparison was run between the new distributor's costs and O&M's fees under TSCC (see exhibit 7) \* Clearly the analysis shows the cost savings of staying with TSCC (Alpha Cost). \* Under the Alpha System the total cost of ordering sutures is \$769, 800. The client is charged a fee of \$. 30 per line item plus the Alpha Fee. In this case the Alpha Fee is \$350 a month; this monthly fee provides the client the right to order sutures from O&M.

There is no % of sales markup with the TSCC model. \* Under the cost-plus method of the competitor the client is charges a 1. 5% of sales markup by the distributor. In the Suture Vendor analysis this results in a charge of \$11, 430 just to place the order with the new distributor. On top of that fee, there is a \$36, 000 internal cost to VM to process the purchase order outside of the TSCC system. \* In this example it would cost an additional \$42, 630 to go outside of the Alpha System with a new distributor. Suture activity through O&M does not generate additional purchase orders which allow the cost to remain low to O&M. Even with the added line number fees and Alpha Fee, the savings to the client and O&M are obvious. Exhibit 7| Suture Vendor Change Analysis| Description| Variables| Non-Alpha Cost| Alpha Cost|

Description	Variables	Non-Alpha Cost	Alpha Cost
Estimated Purchase Orders 2008	400	762, 000	762, 000
Estimated Purchases 2008	762, 000	762, 000	762, 000
Non-Alpha Purchase Order Costa	90	36, 000	36, 000
Alpha Line Cost (at \$0. 0/line) b	12, 000 lines	\$ 3, 600	\$ 3, 600
Non-Alpha Mark up (Cost-plus % of sales)	1. 50%	\$ 11, 430	\$ 11, 430
Alpha Fee c		\$ 4, 200	\$ 4, 200
Non-Alpha Shipping	\$7. 50 per order	\$ 3, 000	\$ 3, 000
Alpha Shipping		-	-
Product Cost		\$ 812, 430	\$ 769, 800
Total Annual Cost of Change		\$ 42, 630	\$ 42, 630

What are the advantages and disadvantages of cost-plus pricing relative to the TSCC pricing program? Cost-plus pricing is easy to calculate and requires little information.

The fees are easy to explain and understandable. There is simply a % of sales markup, and a purchase order cost for all orders. With the TSCC pricing program there more of a commitment needs to be made between client and distributor. Clients must pay an Alpha line fee for each line item on a order, plus a Alpha fee every month for the right to purchase sutures from the TSCC

system. The benefit of this is that TSCC motivates client and distributor to work together and increase efficiency for both.

The client will work to lower the number of line items per order in order to reduce the total cost of Alpha Line Cost. By doing this the client is also lowering the distributors cost, since the less line items order will mean a lower number of different items they will have to keep in inventory. If the client is only ordering one type of latex glove, then the distributor will not incur expenses to order multiple different kinds of latex gloves, process them, store them, and deliver them. Therefore TSCC results in a cost savings to the distributor which flows down to the client. Even though TSCC provides savings overall it is difficult to explain to clients that are used to a simple Cost-Plus system. Also, clients may be reluctant to make such a commitment to a distributor. How does Virginia Mason's lean philosophy affect the partnership? \* VM's "Everyday lean idea" philosophy focused on the concept that all employees should continually attempt to reduce waste and add value in every facet of their jobs.

This philosophy allows them to be open and willing to implementing TSCC and reduce unnecessary expenses in the distribution system. \* VM's stated vision is "to be the quality leader and transform healthcare" providing the "best outcomes available anywhere." This allows VM to be open to new money saving processes, which will make the partnership with O&M to work so well because they are willing to take the time and effort to streamline the supply chain. \* VM had been implementing since 2002 the Virginia Mason Production System (VMPS), which continuously strived for a zero defect rate. Value-stream mapping was a main component of VMPS; it defined a process

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by visually mapping (creating a flow chart) of information, materials, workflow, and other medical-center metrics involved in a process. \* By looking at the larger picture, they will see that there are many unnecessary expenses in the distribution process that can be eliminated. This will encourage them to work with O&M to streamline the distribution process, and work together to reduce the distributor cost so that they can reduce waste and flow the savings to VM.

What changes to the TSCC contract would you propose? \* Don't know that anything can be done to simplify the process; perhaps they can try and show forecasted cost of purchases to clients. To show them to total annual savings with the TSCC system as opposed to the cost-plus system. \* Focus on showing customer's how by reducing line orders and SKU they can reduce cost to distributor which results in lower costs to client. \* Focus on establishing relationship with distributor so that client has more control over variable costs that flow down to them.