ADDENDUM A

Palomar Pomerado Health

FINANCE COMMITTEE

(BOARD MEETING WITH RESPECT TO BOARD MEMBERS ON THE COMMITTEE)

Pomerado Hospital, 15615 Pomerado Road, Poway, CA

Meeting Room E

Tuesday, August 29, 2006, Meeting Minutes

AGENDA ITEM	DISCUSSION	CONCLUSION/ACTION	FOLLOW UP
NOTICE OF MEETING	The notice of meeting was mailed before close of business on Thursday, August 24, 2006, which is consistent with legal requirements		
MEETING CALLED TO ORDER	6:00 p.m. by Chairman Ted Kleiter		
ESTABLISHMENT OF QUORUM	By roll call. Present: Directors Nancy Bassett, R.N., Linda Greer, R.N., Ted Kleiter and Marcelo Rivera, M.D. Finance Committee Members Michael Covert, Paul Tornambe, M.D. and Robert Trifunovic, M.D.		
ATTENDANCE	Gerald Bracht, Jim Flinn, Bob Hemker and Assistant Tanya Howell. Director Gary Powers also attended as a guest.		
PUBLIC COMMENTS	There were no public comments.		
INFORMATION ITEMS	• Bob Hemker acknowledged today as the first anniversary of Hurricane Katrina, commenting on the impacts and lessons learned in our industry and on the personal losses of those impacted • Bob Hemker reported that Tim Cass, our investments banker with Morgan Stanley for approximately the past 10 years, has accepted a position in the high wealth, private banking division of Merrill Lynch. Mr. Hemker has already calendared a call with the team at Morgan Stanley who will replace Mr. Cass, and indicated that he will use this event to evaluate the benefits of an RFP/RFI process to ensure we are getting the best services available.		
MINUTES **AUGUST 1, 2006**	No discussion.	**MOTION:** By Director Bassett, seconded by Director Greer and carried, to approve the Minutes from the August 1, 2006, Finance Committee meeting. Dr. Rivera abstained based on his absence from that meeting.	
STATUS REPORT ON THE 2006 REVENUE BOND ISSUANCE	Bob Hemker reported that this will be a regular item on the agenda, often with action requested. No action was requested for this update. • He distributed a copy of the current schedule *(calendar attached)* o Revenue Bonds to price on October 23rd and issue on October 24th o Attorneys on Financing Team on-site next week reviewing documents ▪ Ensuring that everything being disclosed in the Preliminary Offering Statement (POS) is factual ▪ Audited Financial Statements for FY2006 will be included as a part of the POS	**INFORMATION ONLY**	Forwarded to the September 11, 2006, Board of Directors meeting as information

AGENDA ITEM	DISCUSSION	CONCLUSION/ACTION	FOLLOW UP A2
	• Bond insurer interviews w/MBIA, FGIC & FSA o We have a commitment letter from FSA and are finalizing language/covenants for the Agreement ▪ FSA has agreed to insure the new money as well as a refunding of the 1993 and 1999 Series, up to $239 million ▪ Based upon the questions and follow-up interview with FSA, it was obvious they knew our business and wanted to insure our issue o Still weighing refunding of 1999 Series – will be based upon economics and current covenant issues o Funded Debt Reserve Fund (FDRF) ▪ One year's worth of payments into a cash account for both the 1993 and 1999 Series bonds is already funded ▪ Negotiating a "springer" covenant that requires a FDRF for new money only if certain conditions aren't met		
JULY 2006 & YTD FY2007 FINANCIAL REPORT	Utilizing the presentation included in Addendum B of the agenda packet, Bob Hemker discussed the financial statements. He also introduced a new Key Variance Explanations that will become a regular part of the presentation going forward *(attached)*: • Admissions are down 56 at PMC and up 3 at POM year-on-year • Acute Patient Days are down 195 at PMC and up 3 at POM • Weighted Patient Days are slightly below budget and down about 6% year on year • The outpatient book of business approximates budget • ER and trauma continues to see about a 4% growth at PMC (up 138) but is flat at POM o ER visit to inpatient admissions are at about 19.7% at PMC and 13.9% at POM o Administration is reviewing trauma volumes and outcomes • Surgeries are down against budget and year on year at PMC, but up at POM o Jim Flinn stated that all the major surgical service lines at POM appear to be trending upward ▪ Discussion of lower volumes in bariatric cases, evaluation of performing the new lapband procedure ▪ Kaiser is not utilizing POM for budgeted orthopedic surgeries at this time o Linda Greer requested information on the status of the Rehab Program o Gerald Bracht reported on lower surgical volume at PMC and capacity opportunities ▪ He is working with Kaiser to get orthopedic surgical patients up to PMC, subject to post-operative capacity ▪ One physician was down 20 cases from average, and one was ill for a period of time ▪ Orthopedic surgeries were down by 13 cases • Net capitation has a negative variance against both budget and year on year o Lagging indicators, with July as the mid-point of the plan year, have resulted in a trailing performance of recent actions and plans to restore financial viability—next several months will be key to understanding the sustainability of the improvements o The mechanics of the capitation process are to annually terminate the risk pool valuation	**MOTION:** By Director Rivera, seconded by Director Greer and carried to recommend approval of the July 2006 & YTD FY2007 Financial Report as presented.	Forwarded to the September 11, 2006, Board of Directors meeting with a recommendation for approval. • **Gerald Bracht & Lorie Shoemaker will report back to the Finance Committee on the outcome of their review of trauma outcomes** • **A report on the Rehab Program is due at the January 2007 meeting** • **Director Rivera instructed that the issue causing a complaint in the ER at POM be corrected**

AGENDA ITEM	DISCUSSION	CONCLUSION/ACTION	FOLLOW UP A3
	rates and renegotiate, which should not be construed by the groups as canceling a capitation arrangement and is consistent with previous procedure ■ By November 2006, those plans with a deficit side must develop a plan to recapture the deficit or risk losing plan • Productivity is being reviewed on a daily basis, with a new tool that provides a snapshot of the midnight census by both email and a retrievable phone message the next morning o Benchmark for Acute is 320 ADC o First three pay periods were at 101% productivity, but we need to determine how paid hours are tying to volumes ■ How much premium pay and overtime is being allowed? • The union contracts were negotiated in June o Some carryover for retro pay (@$30K) and longevity pay (@$350K) from last fiscal year – should not be a trend going forward o PTO accrual true-up was also affected due to new salaries, with about $400K expensed in July • Salaries & wages are up almost $500K against budget o If non-trending items were removed, salaries & wages would be on target for July • Supplies will always be cyclical as to physician preference items and technology drugs o No Factor VII was used in July, but there has already been one usage in August, which will use up the positive variance from July • The more we capitalize, the more depreciation goes up, but it does not hurt OEBITDA o Operating income for July compared to the same period last year shows a 50% improvement when depreciation is added back in • Investment income was about budget Leadership is aware that day-to-day costs need to be kept in check as there is no room in the Plan of Finance if we don't maintain profitability. Michael Covert stated that proactively managing productivity for a drop in census would be key to that effort.		
PERINATOLOGY PROFESSIONAL SERVICES & MEDICAL DIRECTOR AGREEMENT **UCSD SCHOOL OF MEDICINE, DEPT OF REPRODUCTIVE MEDICINE**	No discussion.	**MOTION:** By Director Rivera, seconded by Director Kleiter and carried to recommend approval of the Perinatology Professional Services & Medical Director Agreement with the UCSD School of Medicine, Dept of Reproductive Medicine	Forwarded to the September 11, 2006, Board of Directors meeting with a recommendation for approval.
PHYSICIAN RECRUITMENT AGREEMENT – ORTHOPEDIC SURGERY **PHILIP BALIKIAN, M.D. & CENTRE FOR HEALTHCARE**	No discussion.	**MOTION:** By Director Kleiter, seconded by Director Bassett and carried to recommend approval of the Physician Recruitment Agreement for Orthopedic Surgery with Philip Balikian, M.D., and Centre for Healthcare	Forwarded to the September 11, 2006, Board of Directors meeting with a recommendation for approval.

AGENDA ITEM	DISCUSSION	CONCLUSION/ACTION	FOLLOW UP A4
UPDATE ON RAMONA PROPERTY	Bob Hemker reported that this Thursday, August 31st, was the original closing date for the Ramona property. Both parties agreed to continue due diligence at this time. • Certain due diligence matters continue to be reviewed • New closing date is October 13th plus 21 days – will likely close the first week of November • We had originally agreed to allow Ramona's Oktoberfest and Christmas tree lot to use the property as long as insurance permitted it, consistent with past practices. As the property remains in the seller's possession, Oktoberfest is no longer an issue; and the Christmas tree lot will be addressed if necessary at a later date	**INFORMATION ONLY**	Forwarded to the September 11, 2006, Board of Directors meeting as information
COMMITTEE COMMENTS	• Director Kleiter requested a schedule for items regularly reviewed by the Finance Committee and the months they could be expected o Bob Hemker reported that the EMT Business Matters meetings will now include updates from the SLAs and will be the conduit through which new business *pro formas* are brought to the Finance Committee • The attached report from Moody's on Supply Chain Management was distributed to the members of the Committee		
ADJOURNMENT	There being no further business, the meeting was adjourned at 7:40 p.m.	**MOTION:** By Director Rivera, seconded by Director Bassett and carried for adjournment.	
SIGNATURES: • **COMMITTEE CHAIR** _____ T.E. Kleiter • **COMMITTEE SECRETARY** _____ Tanya Howell			

PALOMAR POMERADO HEALTH

Palomar Pomerado Health
Series 2006 Revenue Bonds
Time and Responsibility Schedule
(as of August 21, 2006)

May						
S	M	T	W	T	F	S
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

June						
S	M	T	W	T	F	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	

July						
S	M	T	W	T	F	S
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

August						
S	M	T	W	T	F	S
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

September						
S	M	T	W	T	F	S
					1	2
3	**4**	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30

October						
S	M	T	W	T	F	S
1	2	3	4	5	6	7
8	**9**	10	11	12	13	14
15	16	17	18	19	20	21
22	**23**	**24**	25	26	27	28
29	30	31				

Transaction Team:

PPH:	**Palomar Pomerado Health**	**DC:**	**Latham & Watkins LLP**
BC:	**Orrick Herrington & Sutcliffe**	**County:**	**San Diego County**
UW:	**Citigroup Global Markets, Inc.**	**FA:**	**Kaufman, Hall & Associates**
UC:	**Squire, Sanders & Dempsey**	**DT:**	**Deloitte & Touche**

Month of	Event	Responsible Party(ies)
June	➢ **Begin Drafting Appendix A and Document Drafting**	UC, PPH, BC, DC
	➢ *June 8th – Conference Call @ 9:00am PDT Regarding Swap* *Call in - (866) 445-7018* *Conference Code: 6825413*	ALL
	➢ **Negotiate Insurance Commitment(s)**	PPH, UW, FA
	➢ **Finalize Plan of Finance and Timeline**	PPH, UW, FA
	➢ *June 12th - Receive rating update from Moody's*	PPH, FA, UW
	➢ *June 12th – PPH Board Meeting*	PPH
	➢ *June 20th – Circulation of Draft Appendix A Outline*	UC
	➢ *June 22nd – Conference Call @ 4:30pm PDT to Discuss Appendix A* *Call in - (866) 445-7018* *Conference Code: 6825413*	ALL
	➢ *June 27th – PPH Finance Committee Meeting* o ***Update on Insurance and Covenant Package*** o ***Update on Swap / Hedging strategy*** o ***Update on Bond Financing***	PPH, UW, FA
	➢ *June 28th – PPH to Send Draft Appendix A to Underwriter's Counsel*	PPH

Month of	Event	Responsible Party(ies)
July	➢ *July 4th – HOLIDAY*	ALL
	➢ *July 5th – Circulation of First Draft of Appendix A*	UC
	➢ *July 7th – Meeting @ Orrick in Orange County @ 10:00am PDT to Discuss Appendix A* *Call in - (866) 445-7018* *Conference Code: 6825413*	ALL
	➢ *July 17th – PPH Board Meeting*	PPH, UW, FA
	➢ *July 21st to July 24th – Appendix A information due to Underwriter's Counsel*	PPH, UW, FA, BC, DC, DT, UC
	➢ *July 25th – PPH Finance Committee Meeting*	PPH, UW, FA
	➢ *July 26th – Circulation of draft Appendix A*	UC
	➢ *July 28th – Conference Call @ 9:30am to Review Appendix A* *Call in - (866) 445-7018* *Conference Code: 6825413*	PPH, UW, FA, BC, DC, DT, UC
	➢ **Circulate Agreed Upon Procedures Letter Requirements**	UC
August	➢ **Continue Appendix A and Document Drafting**	BC, UC, DC
	➢ **Working Group Call/Meeting to Review Documents**	ALL
	➢ *August 14th – PPH Board Meeting*	PPH, UW, FA
	➢ *August 29th – PPH Finance Committee Meeting*	PPH, UW, FA
	➢ *August 31st - Available Due Diligence Information to be Sent to Lawyers*	PPH
	➢ **Circulate Draft Agreed Upon Procedures Letter**	DT, PPH
	➢ **Lock in Interest Rates (if applicable)**	PPH, UW, FA
September	➢ **Continue Appendix A and Document Drafting**	BC, UC, DC
	➢ **Working Group Call/Meeting to Review Documents**	ALL
	➢ *September 4th – HOLIDAY*	ALL
	➢ *September 6th to 8th – Due Diligence @ PPH*	PPH, BC, UC, DC
	➢ *September 11th to 15th - Follow-up Due Diligence @ PPH (If needed)*	PPH, BC, UC, DC
	➢ *September 11th – PPH Board Meeting*	PPH, UW, FA
	➢ *September 26th – PPH Finance Committee Meeting*	PPH, UW, FA

Month of	Event	Responsible Party(ies)
October	➢ **Circulate Final Agreed Upon Procedures Letter** ➢ *October 9th – HOLIDAY* ➢ *October 9th – PPH Board Meeting* o ***Approve Final Bond Documents*** o ***Approve Final Financing Structure*** o ***Approve Audits*** o ***Approve Official Statement*** ➢ *October 10th – Meeting with JPA to Approve Financing* ➢ *October 12th - Print and Mail Official Statement* ➢ *October 13th to 23rd - Marketing of Bonds* ➢ *October 23rd - Price Series 2006 Revenue Bonds* ➢ *October 23rd - Pre-Close Series 2006 Revenue Bonds* ➢ *October 24th - Close Series 2006 Revenue Bonds*	DT, PPH ALL PPH, UW, FA, DT PPH, BC UC, UW UW UW, FA, PPH ALL ALL

PALOMAR POMERADO HEALTH
Key Variance Explanations for July 2006

	Actual	Budget	Variance
Weighted Patient Days	**12,517**	**13,331**	**(814)**
Gross Patient Revenue:	**99,141,914**	**106,335,415**	**(7,193,501)**
Primarily due to volume.			
Contractuals:	**67,634,009**	**73,812,302**	**6,178,293**
Due to lower than budgeted volume in gross revenue and favorable chartiy and undocumented write-offs.			
Net Capitation:	**(212,120)**	**63,928**	**(276,048)**
Based on estimate from last six months.			
Other Operating Revenue:	**872,091**	**1,007,597**	**(135,506)**
Foundation			(52,496)
PPNC Health Development			(38,967)

PALOMAR POMERADO HEALTH
Key Variance Explanations for July 2006

Salaries & Wages:	**14,762,338**	**15,256,595**	**494,257**
Due to volume; however, rate variance is still at $437K over budget.			
Benefits:	**3,850,733**	**3,774,533**	**(76,200)**
Due to Worker's Comp higher than last year's average.			
Contract Labor:	**741,109**	**678,883**	**(62,226)**
Information Systems			(10,000)
PAL Surgery			(17,000)
PAL Food Services			(22,000)

PALOMAR POMERADO HEALTH
Key Variance Explanations for July 2006

Professional Fees:	**1,877,179**	**1,815,681**	**(61,498)**
Excess over-budget legal fees.			(75,000)
Supplies:	**5,052,484**	**5,503,090**	**450,606**
Lower than budget primarily in pharmaceuticals and other nonmedical general supplies.			
Purchased Services:	**2,085,188**	**2,164,495**	**79,307**
Favorable overall in purchased services such as repairs and maintenance and general.			
Depreciation:	**1,647,189**	**1,568,084**	**(79,105)**
Due to higher than estimated depreciation.			
Other Direct Expenses:	**1,689,103**	**1,949,209**	**260,106**
Utilities under budget			50,000
Other misc expenses under budget including outside training, marketing, recruitment, etc.			213,000

August 2006

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Rising Costs Sharpen Focus on Supply Chain Management at Not-For-Profit Hospitals

Moody's Survey of Supplies Expense Indicates Manageable Credit Impacts

Summary Opinion

Driven largely by rapid advances in medical technology, hospital supply expenses are increasingly difficult to manage in the face of the constant influx of new products, pharmaceuticals, and medical devices. Rising costs are also fueled by increased energy costs related to freight and distribution channels for supplies, as well as increased usage rates of various supplies. The results of our survey of not-for-profit hospitals indicate that supply expenses are expected to increase again in 2006, but not to the extent of causing significant near-term credit risk for most hospitals.

Primary hospital strategies for managing supply expense include better management of information technology (IT) to achieve a more efficient supply chain and improved coordination of supply ordering with physicians. For most hospitals that have made prior investments in supply chain technology and physician coordination strategies, we do not expect rising supply expenses to become a credit concern. However, institutions which have deferred maintenance, postponed investment in IT, or failed to engage physicians may face greater difficulty that could lead to competitive and credit challenges.

Survey Design

The voluntary survey was comprised of five questions (responses are in **bold** and discussed further in the text):

- What percentage of the operating expenses did supply expenses comprise in FY 2004 and FY 2005? **18.05% and 18.25%**
- What increases do you expect in supply expenses in FY 2006? **5.1%**
- What is the percentage of supply expenses for Drugs/ Pharmaceuticals, Medical Devices, and other? **22.9%, 27.1% and 50%, respectively**
- Is the organization a part of a purchasing cooperative? **97.5% responded affirmatively**
- What are the savings from participating in this arrangement? **$1.5 million in savings, or 4.5%**
- What budget adjustments or strategic initiatives has the organization taken to accommodate rising supply costs? **See text below**

Survey Response

Out of 543 organizations surveyed, 82 responded, or 15.1% of the credits in the not-for-profit hospitals and health care system portfolio. The sample size of the survey response allows us to observe overall supplies expense trends in the industry.

Supply expense management requires a delicate balancing of bottom line goals and patient safety and quality. As hospitals endeavor to control their supply costs they must also satisfy physicians and patient needs with the latest technologies. We believe that maintaining cutting-edge technology and administering the most effective drug therapies can be a distinguishing factor for hospitals when recruiting physicians, attracting patients and negotiating managed care contracts.

Medical Devices and Pharmaceutical Costs Driving Increase in Medical Supplies

Figure 1

Supply Expenses on the Rise

(Sample size includes 543 rated hospitals)

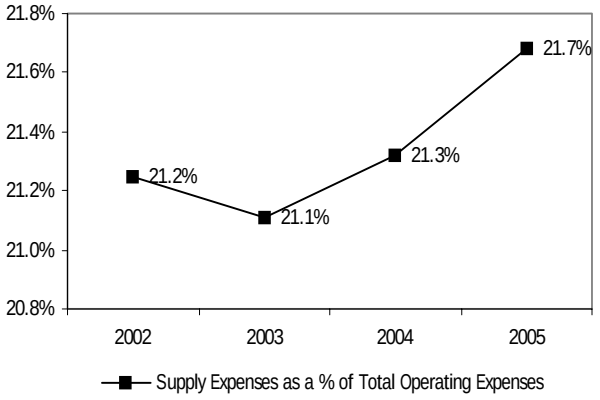
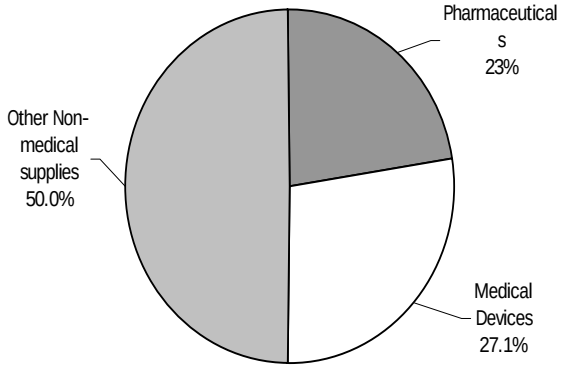


Figure 2

Composition of Supply Expenses

(Sample size includes 82 survey respondents)

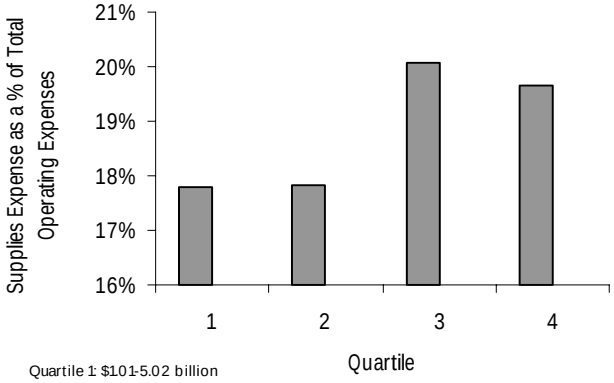


According to *Healthcare Financial Management*, medical supplies expense was one of the fastest rising hospital costs in 2005. As illustrated in figure 1, among Moody's 543 rated not-for-profit hospitals, general supplies expense comprised 21.7% of total operating expenses in FY 2005 and represents the second largest line item after labor expense. Supply expense as a percentage of total operating expenses is accelerating, growing 1.0% in 2004 over 2003 and increasing by 1.9% in 2005 over 2004.

The survey responses mirrored the national growth trend but at a lower rate. Of the 82 organizations who participated, the median for supplies expense comprised 18.25% of total operating expenses in FY 2005, an increase of 1.1% from 18.05% in FY 2004 and lower than the national growth rate of 1.9%. The lower growth rate is attributable to 44% of the respondents reporting that supply expenses as a percentage of total operating expenses either remained constant between 2004 and 2005 or declined as increased focus on supply chain yielded greater efficiencies. Notwithstanding, in absolute terms, survey respondents expect supplies expense to increase 5.1% in FY 2006. As illustrated in figure 2, the median composition of supplies expense revealed that 23% was pharmaceuticals/drug related, 27% was represented by medical devices, and 50% by other non-medical supplies.

Figure 3

Supplies Expense a Smaller Share of Operating Expenses for Larger Hospitals



Quartile 1: $1.01-5.02 billion
Quartile 2: $543.3-929.2 million
Quartile 3: $251.6-518.9 million
Quartile 4: $84.9-242.6 million

Size and Scale Fundamental to Containing Supplies Expense Pressures

As illustrated in figure 3, although the overall median supply expense as a percent of total operating expenses is increasing, several trends emerge when we divide the respondents by size and rating category. Dividing survey respon-

dents into four quartiles, with the first quartile representing the largest hospitals as measured by total operating revenues, supplies expense comprised 17.8% of total operating expenses for the first two quartiles, compared to 20.1% and 19.7% for the third and fourth quartile, respectively. This association suggests that the size and scope of an organization lends greater ability to manage costs and reduce the outstanding share of operating expenses that supplies expense represents. According to survey results, supply expenses were 19.4% for stand alone hospitals and 18.8% for single state systems. We believe that larger organizations likely benefit from greater economies of scale, with greater leverage vis-à-vis payers and vendors alike, translating into negotiated discounts and preferential pricing. Larger systems can also devote greater resources to supply chain management and invest in IT that delivers efficiencies and savings.

Likewise, a negative association between credit quality and supplies expense as a percent of total operating expenses is also observed, with supplies expense constituting a higher percentage of total operating expenses as we move down the rating scale as illustrated in figure 4.

Figure 4

Supplies Expense Smaller Portion of Total Operating Expenses for Higher Rated Issuers

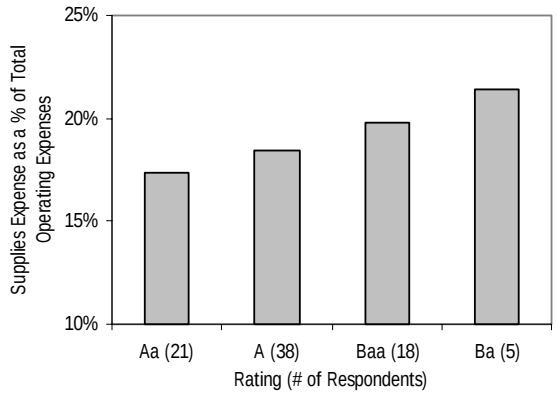
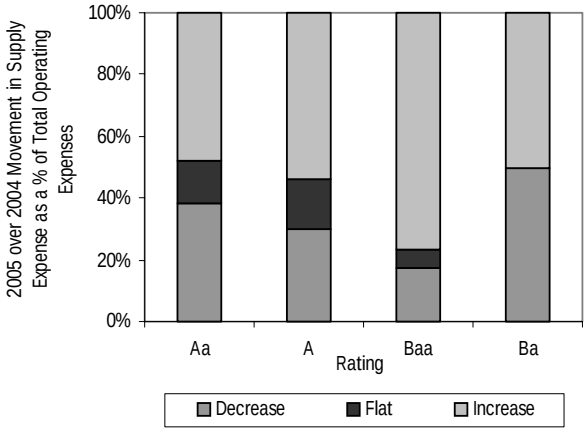


Figure 5

Higher Rated Credits Manage Rising Supply Expenses More Effectively



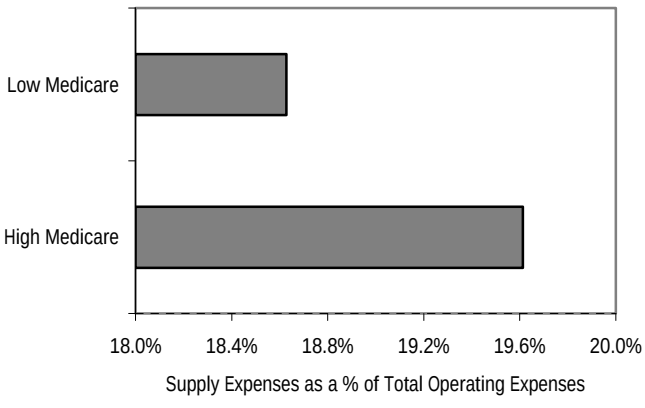
In addition, as we observe in figure 5, only 48% of Aa rated respondents reported an increase in the share of total operating expense represented by supply expenses in 2005 over 2004, and 38% even reported a decrease, whereas 77% of Baa rated respondents experienced an increase over the same period.

Hospital Payer Mix and Demographics Impact the Magnitude of Supply Expense Pressures

The share of operating expenses represented by supply expenses also varies by other characteristics, including hospital payer mix and demographics. The Moody's 2005 national median for Medicare as a percentage of payer mix is 42%. Figure 6 illustrates the difference in supply expense as a percentage of total operating expenses for respondents that have high and low Medicare payer mix, defined by being above or below the median. Hospitals with higher Medicare payer mix incur greater supplies expense due to the higher acuity and complexity of procedures often associated with Medicare patients.

Figure 6

Higher Medicare Payer Mix Associated with Higher Supply Expense



Finally, our findings show that demographics also play a role in supplies expense. For hospitals in the five fastest growing states from 2000-2005, (Nevada, Arizona, Florida, Georgia, and Utah), supplies expense represented 19.2% of total operating expenses, versus 18.5% for the respondents in the remaining states. The supplies expense pressures could be a function of a higher Medicare payer mix in retirement states such as Arizona and Florida, in addition to difficulties in supply chain management in response to rapid volume growth and demand.

Hospitals Adopt Various Strategies to Address the Rise in Supply Expense

In recent years, not-for-profit hospitals and health systems have been adjusting to rising supplies expense with a renewed focus on pricing, information technology, utilization management, standardization of supplies, and optimization of physician preference on various devices and strong physician participation to address this challenge. These strategies are expanded upon below.

Group Purchasing Organization Membership the Norm; Hospitals Increasingly Consider Direct Contracting

Organizations have long relied on group purchasing organizations (GPO) for discounts and as a source of market pricing data, allowing hospitals to benefit from the leverage attained by GPOs and forego the cost of building an in-house purchasing department. GPO discounts are usually tiered, with maximum discounts correlated with volume and market share. Therefore, members who consolidate and concentrate procurement through a single GPO extract the largest savings possible. Virtually all hospitals (97.5% of respondents) affirmed membership in a GPO or purchasing cooperative, reporting an average of $1.5 million in savings, or 4.5% annual reduction in costs. However, survey respondents are often members of several GPO's because not all GPO's have uniform product offerings or respondents may feel the need to secure a backup GPO in case of shortage.

Even with these savings, several respondents reported strong consideration to supplement or even abandon GPO membership and build in-house purchasing teams to extract even more savings. For larger systems that drive larger volumes and can afford the initial overhead costs of establishing an in-house supply chain organization, the savings can be significant. In order to retain members, manufacturers often offer larger discounts to larger systems that are willing to commit to volume guarantees, with savings delivered in the form of waived administrative, wholesale, and distribution fees that are associated with GPOs. Overall, respondents were committed to establishing broader channels, with a willingness to shop between both GPO's and directly with vendors in order to achieve the greatest cost savings.

Leveraging Information Technology the Key

Many respondents cited that the key to successful implementation of the aforementioned initiatives is (IT). Hospitals are increasingly reporting increased automation and technological advancement, which serves as the backbone for a more efficient and effective supply chain. Due to the non-profit and patient safety mission orientation of the industry, healthcare has historically lagged behind other sectors in the use of supply chain technologies and software. Some of the newer software technologies promise to deliver substantial financial savings via improved inventory management, standardized product coding, accurate tracking of utilization, and increased efficiencies in delivery and distribution.

Hospitals Step Up Focus on Physician Preference and Physician Participation

Successful containment of supplies expense requires buy-in from management and physicians and involves a delicate balance between the bottom line and patient safety. Physician preference items often times account for more than half of the total supply spend. In response to the constant influx of new products, devices, and new technology, hospitals have responded by establishing value analysis committees, supply chain task forces, or standardization and utilization committees. These committees and task forces are made up of physicians and management staff that review and agree upon the most effective and appropriate standardized usage, while prioritizing patient safety and cost.

Utilization Management Cited as the Next Frontier in Supply Chain Management

With most of the gains on price already achieved via GPO mechanisms, management of supply utilization is often cited as the next frontier in controlling supply expense. Hospitals commonly reported waste and over-use of basic supplies, leading to greater efforts to eliminate supply waste and agreement with physicians to standardize the choice of vendors.

Related Research

Industry Outlook:

Not-For-Profit Healthcare Sector: 2006 Industry Outlook, January 2006 (96269)

Special Comment:

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