

# Distribution Channel Considerations For Medical Products Manufacturers



# Channel Strategy Should Be Based On Maximizing Value, Not Just Minimizing Costs.

Manufacturers should:

- Begin with understanding **customer needs** and expectations
- Consider the nature of their own **products and markets**



Manufacturers with a wide array of products may find that different channels fit for different products.

# Why Do *Customers* Use Distribution?

## Service Levels



- 98%+ fill rates
- Same or next-day delivery
- No/low minimum order quantities

## Space And Budget



- Inventory buffers without need to tie up cash or space

## Special Programs



- Low unit of measure delivery programs
- Procedure kits
- Pricing optimization

**Most manufacturers' distribution model decisions are driven by *customer* requirements.**

# Why Do *Manufacturers* Use Distribution?

## Service Levels



- Meet customer expectations for fill rates and lead times
- Provide inventory buffers for customers

## Target Markets



- Reach fragmented markets including non-acute and post-acute

## Investment



- Deal directly with a few distributors rather than many end customers
- Reduce investments in warehouse management, A/R, and other functions

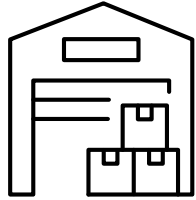
## Focus



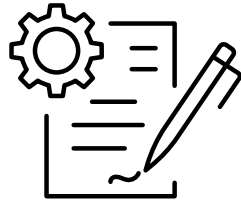
- Maintain focus on product quality and sales growth rather than logistics

**Again: Most distribution decisions are driven by *customer* requirements.**

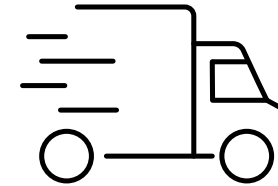
# Functions To Consider When Evaluating Channels



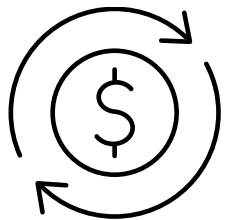
Receiving and storage



Order processing and fulfillment



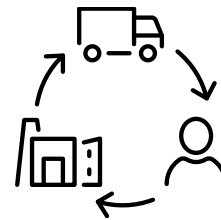
Outbound transportation and delivery



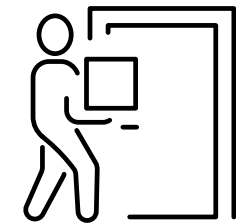
Bill and credit management



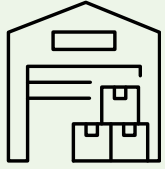
Information and data services



Returns and customer service



Prospecting and demand generation



*Meeting the ups and downs of customer demand for products requires having inventory on hand in the supply chain*

# Receiving And Storage

## Costs Of This Function Include

Warehouse • Equipment and technology • Inventory carrying costs • Warehouse labor

## Customer Expectations

- Customers want short lead times and high fill rates
- Back orders or shortages can directly impact patient care
- Many providers want frequent, smaller deliveries due to limited storage space

## Manufacturer Considerations

- Customer service level requirements: Difficult for most manufacturers to provide the fill rates providers expect
- Opportunity costs: Holding inventory ties up capital that could be invested elsewhere
- Control: Direct model allows control over inventory storage, levels, and allocations
- Risk: Distributed model transfers cost and risk to distributor

### Commercial Medical Distribution Estimates (U.S.)

- 500 distribution centers
- 76 million square feet of warehouse space
- 5500 manufacturers served
- Average inventory levels of ~30 days (varies by product)

# Order Processing And Fulfillment



*Manufacturers must engage in order fulfillment activities regardless of the distribution channel they choose, but the level of effort and investment differs greatly between models.*

## Costs Of This Function Include

Equipment and technology • Warehouse and order processing labor

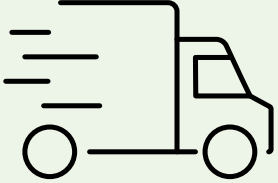
## Customer Expectations

- Preference for fewer, larger shipments
- Complete orders in a single shipment
- Low/no order minimums
- Often, low unit of measure or just in time services

## Manufacturer Considerations

- Number of transactions: Direct channel involves exponentially more order/fulfillment transactions
- Customer contact: Direct channel can provide closer connection with end customer
- Kits: Many products are sold to healthcare providers as part of kits. Kitting makes it less feasible for a manufacturer to sell certain products directly to customers

# Outbound Transportation And Delivery



*Once product is manufactured, it must be delivered either to a distribution center or directly to a healthcare facility.*

## Costs Of This Function Include

Shipping • Vehicle costs • Driver/delivery/shipping personnel • Equipment and technology

## Customer Expectations

- Providers generally prefer to receive fewer shipments, to reduce receiving labor costs
- Some facilities, especially those in urban areas, are space-constrained and can't accommodate tractor-trailer deliveries

## Manufacturer Considerations

- Number of transactions: Distributed channel involves fewer, larger deliveries
- Customer contact: Direct channel can provide full control over delivery and installation
- Environmental advantages: Consolidation of shipments reduces emissions



# Billing And Credit Management



*Credit management includes assessing creditworthiness, invoicing and collections, and importantly, assuming bad debt risk.*

## Costs Of This Function Include

A/R carrying costs • Credit and contract administration labor • Technology • Bad debt

## Customer Expectations

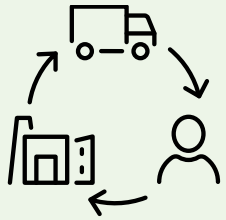
- Customers generally prefer to reduce their total number of invoices, reducing the staff time necessary to manage payables
- Customers experience slow reimbursement from insurers and are therefore often slow payers themselves
- Providers expect suppliers to invoice them using the most favorable appropriate GPO pricing tiers

## Manufacturer Considerations

- A/R days outstanding: Distributors tend to pay more quickly than healthcare providers
- Risk: Bad debt is typically lower when selling to distributors than to end customers
- GPO contract pricing:
  - Distributors are adept at optimizing contract pricing for the customer
  - However, the direct channel eliminates the need for the manufacturer to deal with chargebacks

Group purchasing organization (GPO) contracts make billing management more complex.

# Returns And Customer Service



*Support before and after the sale is critical for healthcare customers. Products need to be exchanged or returned, product recalls are sometimes required, and questions have to be answered promptly and correctly.*

## Costs Of This Function Include

Customer service staff • Technology and software • Return shipping

## Customer Expectations

- Customers expect prompt service and ability to efficiently return products

## Manufacturer Considerations

- Direct channel gives the manufacturer control over service levels and return policies; reduces steps in the returns processes
- Distributed channel saves the manufacturer from dealing with smaller customers and low-dollar issues; can improve sales force effectiveness
  - Manufacturer reps focus on growth while distributor manages service issues

# Sales And Marketing Support

Manufacturers who self-distribute are more often those with high-dollar physician preference devices who want maximum customer control. Manufacturers that use distributors benefit from making their products more widely accessible to customers, and may receive some level of sales and marketing support as well.

## Costs Of This Function Include

Sales staff • Marketing staff • Advertising and marketing • Website costs • Technology

## Customer Expectations

- Customers expect easy access to customer information when they need it
- They may prefer not to see sales reps otherwise

## Manufacturer Considerations

- Control: Direct channel often maximizes the manufacturer's influence over customer buying decisions
- Customer intelligence: Distributed channel can give the manufacturer access to market data across a wide base of customers
- Lead and/or demand generation: The distributor's sales force can complement the sales and marketing activity of manufacturers' representatives and provide more frequent customer contact
- Target markets: The value of distributor sales support is often strongest for manufacturers serving non-hospital providers, because the markets are so fragmented

**A manufacturer's channel strategy should complement its sales and marketing strategy.**

# What Kind Of Channel Partner Is Needed?



## **Logistics:**

Product storage, order management, delivery, billing and credit management



## **Sales and marketing support:**

Prospecting/lead identification and/or demand generation

- Most distributors can provide either or both
- Other resources can provide one or the other (3PLs, independent manufacturer reps, etc.)
- Margins and fees depend on specific expectations

# What Products Belong In A Distributor Warehouse?

	High Purchase Frequency	Low Purchase Frequency	Notes
<b>Consumable Products</b> <i>(low clinical preference, less expensive, more commoditized products)</i>	Yes	Maybe	<ul style="list-style-type: none"> <li>• Most customers prefer to buy high-turnover items through distribution</li> <li>• Full-line distributors may not want to carry low-turn items</li> <li>• Some distributors specialize in certain product categories or hard-to-find items</li> </ul>
<b>Complex Or High-Dollar Devices</b> <i>(physician preference items, expensive equipment, new technologies, etc.)</i>	Yes	No	<ul style="list-style-type: none"> <li>• The decision on whether to use distributors for logistics is impacted by the product's size and weight, value, and sales frequency</li> <li>• Some providers prefer to buy high-frequency items from a distributor, including PPI, surgical devices, and other clinically complex products</li> </ul>

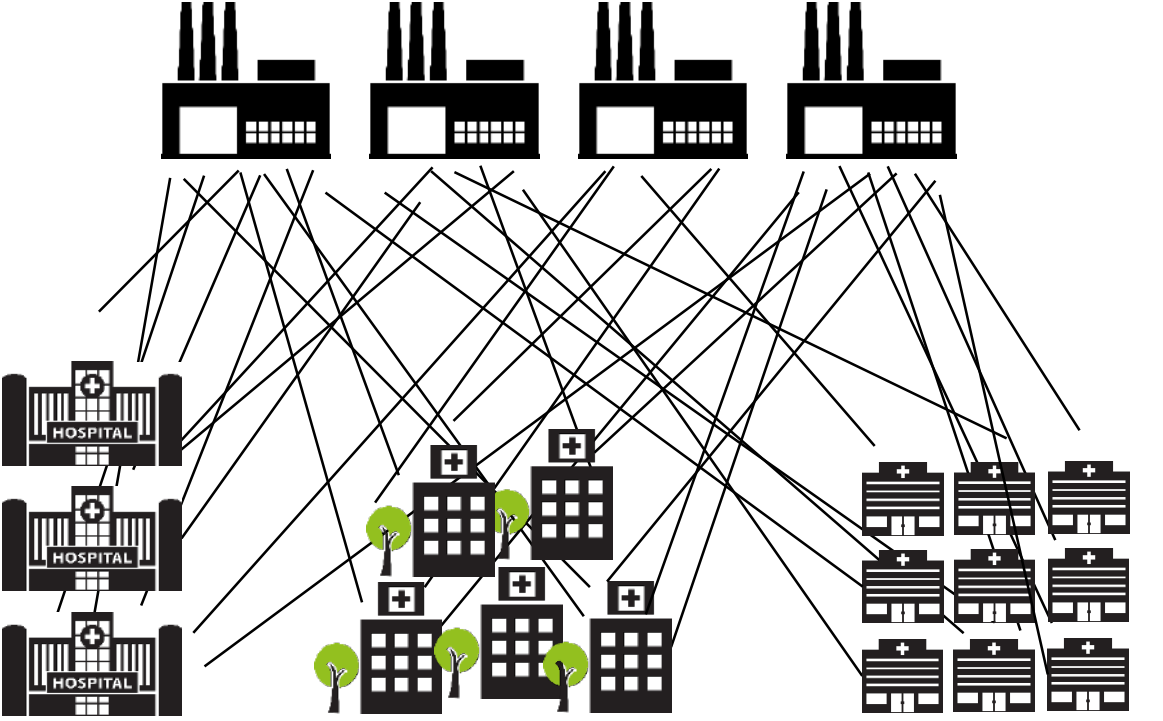
# Will The Product Benefit From Distributors' Sales And Marketing Support?

	<b>Fragmented Target Market</b> <i>(many potential customers and call points, such as non-acute markets)</i>	<b>Consolidated Target Market</b> <i>(narrow range/ small number of potential customers)</i>	<b>Notes</b>
<b>Consumable Products</b>	Yes	Maybe	<ul style="list-style-type: none"> <li>• Distributors offer a variety of sales and marketing programs for manufacturers</li> <li>• The level of support must be negotiated in the distribution agreement</li> <li>• Distributors often have large sales teams with high call frequency, allowing manufacturers to reach a larger number of customers</li> <li>• Distributors are less likely to focus significant sales time on low-dollar commodity items</li> </ul>
<b>Complex Or High-Dollar Devices</b>	Probably	Maybe	<ul style="list-style-type: none"> <li>• Distributors sometimes help manufacturers find prospects from among the many thousands of potential customers in a fragmented market</li> <li>• The manufacturer's sales force (or specialty distributors) may be most appropriate for customer contact and demand creation</li> <li>• Capital products with high-dollar values, financing options, and installation may be challenging to sell through distribution</li> </ul>

# Distributors Aggregate Customer Demand

## Manufacturer Direct

15,000+ manufacturers



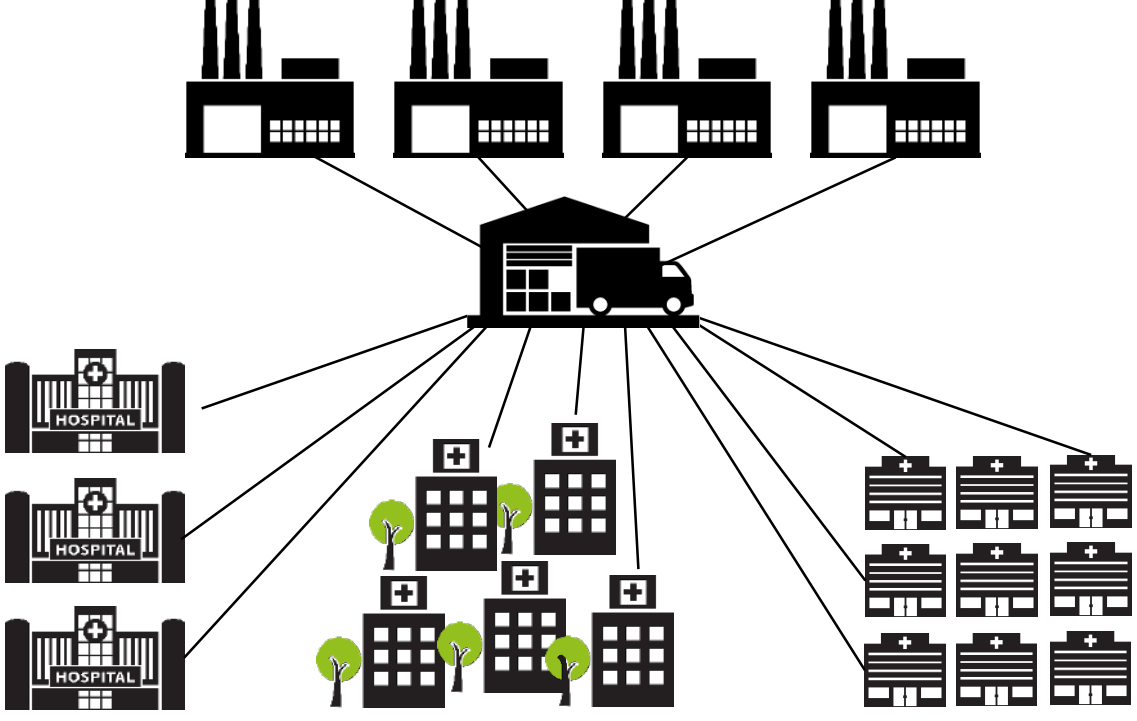
5,000+ hospitals

20,000+ post-acute facilities

250,000+ non-acute locations

## With Distribution

15,000+ manufacturers



5,000+ hospitals

20,000+ post-acute facilities

250,000+ non-acute locations

# Fewer Transactions = Reduced Overhead For Manufacturers And Providers

## Manufacturer Direct: Many Transactions, Big Infrastructure Investment



**Logistics transactions:**  
product storage,  
order picking,  
deliveries, returns



**Financial transactions:**  
purchase orders,  
invoices, credit,  
collections



**Service transactions:**  
product  
questions, order  
status, returns



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hospitals

20,000+  
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250,000+  
non-acute locations

## With Distribution: Fewer Transactions, Less Investment



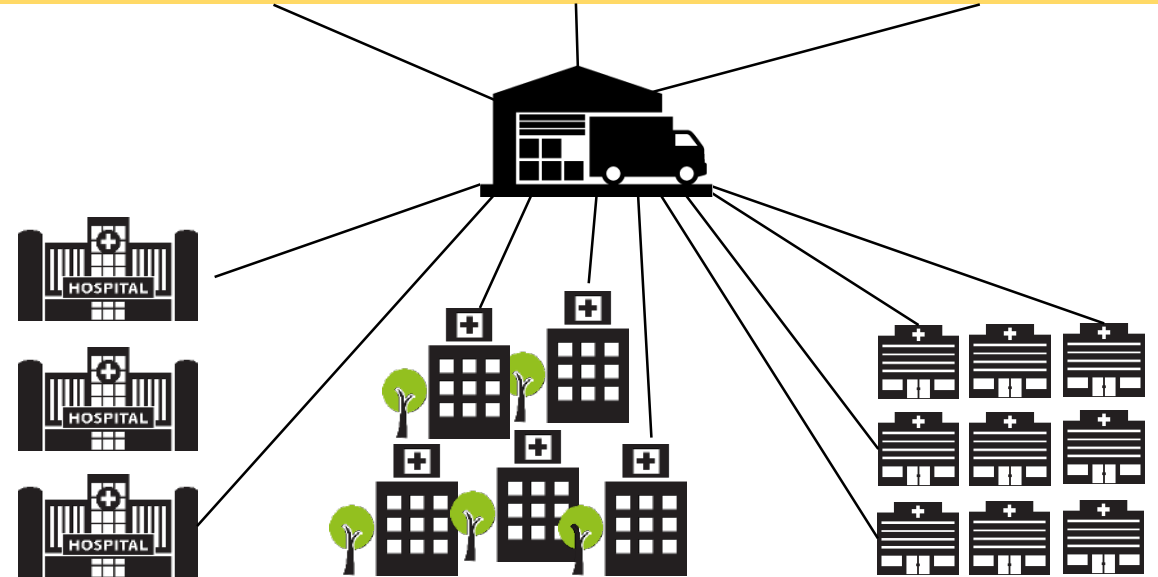
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# Is This Product A Fit For Healthcare Distribution?

