OPTIMIZING MULTI-ITEM INVENTORY MANAGEMENT DECISIONS IN HEALTHCARE FACILITIES

by

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Healthcare costs in the United States continue to grow at a significant rate. In many healthcare settings material supply and inventory management represent significant areas of opportunity for managing healthcare costs more effectively. In this dissertation, we explore three topics related to these areas.

In the first chapter, we propose methodologies to help clinicians store medications and medical supplies optimally in space-constrained, decentralized Automated Dispensing Cabinets (ADCs) located on hospital patient floors. This is significant for many reasons: first, locating and storing medical supplies and pharmaceutical products within automated dispensing devices on patient floors is often not done efficiently and these devices are not utilized optimally. The primary purpose of an ADC is to ensure ready access of pharmaceuticals and medical supplies at floor locations within a hospital. However, the allocation of the limited space within an ADC to these items is typically not planned systematically and this often results in wasted staff effort as clinical personnel must expend effort in locating and retrieving them from a hospital’s central pharmacy/storage location. A second major issue in using these devices is human error associated with the selection of pharmaceuticals from floor storage. These problems are addressed via two different mixed integer programming (MIP) models. In the first model, we only focus on the tradeoff between storing many of a few items and storing smaller quantities of many items and in the second model we also consider how to reduce medication dispensing errors by designing appropriate storage layouts.
We also propose valid inequalities and continuous relaxations to facilitate solving instances of a scale that represents real-world applications. Based on computational tests using actual data, these refinements can reduce the run time to well under 10% of the time of the base model and thereby allow for large, real-world instances to be readily solved. Our results indicate that using simplistic space allocation and inventory management policies, rather than our modeling approach, could result in about twice as much work for medical staff while still leaving unused space in the ADC. The second (position-based) model decreases risks associated with medication errors by at least 38% over simpler methods.

In the next chapter, we investigate a class of inventory control systems which are used in inventory management systems at points of use (POUs) in hospitals. This class of inventory control systems is characterized by stochastic demand, periodic reviews with fractional (or very small) lead time, expedited delivery when stockouts occur, limited storage capacity, and service level requirements. We develop discrete time Markov chain models of different inventory control systems that deal with all of these characteristics while minimizing the total expected replenishment effort at POUs. We have derived closed form solutions and propose an exact algorithm to calculate the limiting probability distribution by locally decomposing the state space. We investigate the structural results and based on our approach we propose an algorithm that is much easier to use in practical applications compared to solving the steady state equations in Markov models, and the computational effort required for finding the replenishment policy parameters is reduced.

In the final chapter, we address the management of inventory for multiple non-perishable medical supplies in floor storage by selecting the optimal inventory policy for each item along with its corresponding operating parameters. In practice, hospitals tend to assign the same overall inventory control policy to all or the majority of the items. This simplistic approach often leads to wasted staff effort and ineffective policies. The objective of our research is to minimize the average labor effort required to count and replenish all of the items, while providing an acceptably high level of service (avoiding stock outs) and taking into account constraints on available space. We consider four policies: PAR, \((R, s, S)\), \((R, s, Q)\), and a two-bin Kanban system. We illustrate the model with actual data from a healthcare setting.
and propose some practical insights and guidelines on how to choose a hybrid inventory system based on demand and system characteristics.

**Keywords:** Mixed integer programming, computational optimization, two-staged two dimensional knapsack problem, valid inequalities, healthcare operations, automated dispensing cabinets (ADCs), discrete time Markov chains, local decomposition, closed form solutions hybrid inventory control system, periodic inventory policies, expedited deliveries, point of use locations
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1.0 INTRODUCTION

Providing high quality and affordable health care is one of the greatest challenges facing the nations of the world (Hall 2012). Since the 90s, the health care sector has changed rapidly. Due to increased competition, and a stronger necessity to deliver health services in a more efficient and effective way, many health care organizations have started projects in the area of service quality, clinical pathways, information systems and logistics [Stock et al. (2007)]. Nevertheless hospitals carry large amounts of a great variety of items, and health care organizations have paid little attention to the management of inventories [Nicholson et al. (2004)]. Studies performed in the past as well as more recent research suggest that inventory costs in the health care sector are substantial and are estimated to be between 10% and 18% of net revenues (De Vries 2011). At the same time, hospitals are trying to increase their internal service performance and this is another reason why a strong focus on inventory management has become vital in many hospitals. It comes as no surprise, therefore, that a large number of hospitals have initiated projects in the area of inventory management in order to reduce costs and improve service levels. In short, logistics in health care is important, including the specification of appropriate stock levels for medicines or other clinical items.

Some of the reasons for health care organizations, especially hospitals, to effectively manage their inventory include efficient use of space, providing protection against stock outs and reduction of inventory control related staff effort. The advantages of having an effective means to control inventory typically outweigh the costs associated with implementing an inventory control system. An effective inventory management system allows the health care
organization to track the use and availability of these inventories and consequently reduces the opportunity for loss and theft.

Despite the existence of well-documented evidence on the benefits of the introduction of supply chain management practices and the resulting significant competitive advantage and cost reduction, the health care sector has been extremely slow to embrace these practices (McKone-Sweet et al. 2005). Although a multitude of publications in the field of hospital inventory policy exists, this area remains promising for future research (Volland et al. 2015).

Only a few studies have addressed the question of how the design and implementation of inventory systems in a health service setting takes place. This dissertation is dedicated to improving the efficiency of health care by optimizing space allocation, choosing the best inventory control system for every item, optimally selecting the associated inventory management parameters, and improving the allocation of health care resources to reduce medication errors. All of the chapters demonstrate the importance of providing resources in accordance with anticipated needs and making adjustments as needs change. In particular, we demonstrate how mathematical modeling and optimization methods can improve health care processes such as the space allocation in automated dispensing cabinets, inventory control with space limitations, and others. It is our hope that the knowledge and techniques presented in this dissertation will help make quality health care accessible to more people.

The remainder of this dissertation is organized as follows. In the next chapter, we propose shelf-space optimization models in decentralized automated dispensing devices. In chapter 3, we investigate closed-form solutions for periodic inventory systems with fractional lead time, lost sales and service level restrictions; two different periodic review inventory control systems are analyzed and we propose algorithms for computing system parameters. In chapter 4, we study the optimal selection of inventory policies in a healthcare setting with space constraints. Finally, in the last chapter, we summarize our findings.
2.0 SHELF-SPACE OPTIMIZATION MODELS IN DECENTRALIZED AUTOMATED DISPENSING DEVICES

2.1 INTRODUCTION

In this chapter, we propose a mixed integer programming (MIP) model to help clinicians store medications and medical supplies optimally in space-constrained, decentralized Automated Dispensing Cabinets (ADCs) located on hospital patient floors. We also propose a second MIP model that addresses human errors associated with the selection of pharmaceuticals from floor storage, and not only selects the best set of medications for storage but also determines their optimal layout within the cabinet. To improve the computational performance of these MIP models, we investigate several valid inequalities and relaxations that allow us to solve large, real-world instances in reasonable times. These models are applicable to very general ADC. The models are illustrated using real-world data from ADCs at hospitals. Our results indicate that using these models can significantly reduce the time spent by clinical staff on routine logistical functions, while making efficient use of limited space and decreasing risks associated with errors in the selection of medication.

The efficient storage and management of medical supplies and pharmaceutical products is an important prerequisite for the smooth operation of a hospital system and for providing high quality patient care. Typically, 30% to 40% of hospital expenses accrue from logistics related activities, and inventory costs are estimated at between 10% and 18% of total revenues (Nachtmann and Pohl 2009). Hospitals are generally structured around patient care units (PCUs), which must have on-hand medical supplies and pharmaceutical products in storage.
at these units in order to support patient care. To do so, hospitals use decentralized inventory systems where the main inventory is stored in a central pharmacy/storage location that orders products from distributors/manufacturers, while the floor storage units (located in the PCUs) place their orders with this central location.

Landry and Beaulieu (2013) claim that inefficient or unnecessary logistics activities at the various PCUs in a hospital tend to inflate the costs associated with hospital operations and also have an adverse effect on patient care; e.g., nurses and other providers are often interrupted in their work because medicines or supplies are not readily available. By some estimates, clinical personnel spend more than 10% of their time on logistics tasks (Ferenc 2010). Moreover, clinical staff members typically have neither the expertise nor the resources to manage logistics activities. Therefore, maintaining a high level of service and effective inventory control and storage policies are essential objectives for health care systems seeking to reduce administrative costs and provide good patient care.

Despite the importance of managing medical supplies and pharmaceutical products, healthcare organizations have paid relatively little attention to this area and many health systems and hospitals have not systematically addressed how these items are managed, supplied, and used (Uthayakumar and Priyan 2013). In this chapter, we investigate the problem of locating and storing such items within decentralized automated dispensing devices on patient floors. The goal is to ensure that items are available when needed and to minimize the clinical staff (typically, nurses) effort if the PCU is out of stock. A second important issue that we address is that of minimizing human errors associated with the selection of pharmaceuticals from floor storage.

Automated dispensing devices or automated dispensing cabinets (ADCs) were introduced in hospitals in the late 1980s. These decentralized medication distribution systems provide storage, dispensing, and tracking of most unit-dose and many bulk medications, as well as medical supplies at the point of care. Although adoption of the technology began slowly, as of 2011, more than 89% of hospitals were moving to replace manual floor stock systems or medication carts with ADC systems (Grissinger 2012).
ADC systems are designed for maximizing flexibility and space efficiency. Generally, they are available in two main module types: drawer and tower. A drawer module is suitable for unit doses while a tower module is commonly used for bulk medications and medical and surgical supplies that will not fit within the drawer modules. Using adjustable dividers, drawers and shelves are typically reconfigurable based on the sizes of the items being stored. A capacity of up to 96 unique compartments might be possible for drawer modules although typically, they tend to contain up to 24 compartments. The drawers can be open or can have a locking mechanism (commonly used for controlled substances). The tower module features both sliding and fixed shelves with solid bottoms that stop spills and reduce the likelihood of supplies tipping. The slide-out shelves can be easily divided into many flexible compartments (typically up to about 18). There is also a controller, often referred to as the “brain.” This might be external to the ADC unit (or more likely) within the tower module, in which case items cannot be stored in the space occupied by it. ADCs are also available in mixed configurations of shelves and drawers. The models proposed in this chapter can be applied to any type of ADC.

A major issue with an ADC is that it increases medication inventory in a PCU and may increase the burden of medication delivery on the nurse or medical professionals who work there (Holdford and Brown 2010). While ADCs offer advantages such as potentially reducing labor costs by optimizing where inventory is located to facilitate servicing patients, many hospitals unfortunately fail to accrue the full potential advantages of ADCs and may actually incur a reduction in nurse productivity due to poor system design (Handfield 2007). The reason for this is that to maximize the quality of patient care, medications and supplies must be available whenever they are needed; otherwise expensive staff resources are wasted in locating and retrieving the item from elsewhere, typically a central storage location or other PCUs (Bijvank and Vis 2012b). Also, these cabinets are expensive and there is often only enough physical space to have a limited number of them within each PCU. Therefore, in addition to deciding on what items to store and in what quantities, they must also be organized such that space is used efficiently and to allow for easy and quick retrievals in response to item or medication requests. Finally, there are situations where we must also
address possible medication dispensing errors by designing an appropriate medication layout within the ADC. This can be a major issue and we elaborate further on this below.

It is well known that storage of medication without careful planning can lead to errors at the point of use, and ADCs are not immune to this challenge. To ensure patient safety and reduce medication selection errors, the storage and operation of an ADC must be carefully planned and implemented (Holdford and Brown 2010). Based on an the Institute for Safe Medication Practices (ISMP) ADC survey in 2007, only 18% of hospitals verify medication stock after stocking the ADC and only 29% double check when a nurse chooses to manually override the ADC’s automatic features (Horsham (PA): Institute for Safe Medication Practices 2009). The Pennsylvania Patient Safety Reporting System (PA-PSRS) has received a number of medication error reports that cite an ADC as the source of the medication, such as wrong drug concentrations, wrong location (shelf/bin), errors in restocking or return to inventory, item levels being too high, and bin overflow (PA-PSRS (2005)). Based on this report, nearly 15% of all medication error reports cite ADCs as the source of the medication, and 23% of these reports involve high-alert medications. Many of these reports describe cases in which the design or use of an ADC has contributed to the errors. Unfortunately, these errors are often not caught until the patient receives the incorrect medication.

The ISMP interdisciplinary guidelines (see (ISMP 2008)) note that decisions about types and quantities of medications stocked and their placement are key considerations in the operation of an ADC system. The ISMP also conducted a survey of more than 1,000 nurses across the US in 2007 (Horsham (PA): Institute for Safe Medication Practices 2009, Grissinger 2012) and the results of this survey reveal that 97% of nurses are concerned about medication errors. They also believed that the design and/or use of ADCs have contributed to errors and 60% of these errors are caused by similar drug names or appearance.

In general, storing medications with look-alike names and/or packaging next to each other on the same drawer or shelf can contribute to stocking and retrieval errors (Oh et al. 2014), particularly when accessing medications in non-profiled ADCs, or when an override function is invoked by a nurse in pharmacy-profiled ADCs (a system that needs pharmacy
permission for direct access to medications). Of those hospitals that used pharmacy-profiled ADCs, it is estimated that 12% of medications are dispensed as overrides (Pedersen et al. (2012)). In addition, medication dispensing errors also occur when ADCs with open drawers and shelving are used, as they allow uncontrolled access to multiple medications (Holdford and Brown 2010). 38% of hospitals use open (matrix) drawer configurations as the predominant ADC type (Pedersen et al. (2012)). A focus of this chapter is on open drawers since their compartment layouts are reconfigurable and they have a large potential for errors. Although overall rates of dispensing errors are generally low, further improvements in pharmacy distribution systems are still important because pharmacies dispense such high volumes of medications that even a low error rate can translate into a large number of errors (Cheung et al. 2009).

Numerous studies have proposed guidelines for the design and use of ADCs for medical supplies and pharmaceutical products. The principal guidelines are (1) assigning medications to devices based on the needs of the patient care unit, (2) taking advantage of flexible drawer configurations to better use available space, (3) carefully considering both the selection and placement quantity of medications, and (4) separating sound-alike and look-alike medications (ISMP 2008, Hyland et al. 2007, Holdford and Brown 2010). Currently, these actions follow a manual process and are typically performed by a pharmacist or pharmacy technician (Pazour and Meller 2012).

In this chapter we first propose a model, which we refer to as a position-free model, that determines optimal allocations for an ADC by determining item types, quantities and shelf/drawer configurations. This model addresses the first three guidelines mentioned above. We then propose a second position-based model that explicitly addresses the last guideline regarding item positions based on the use of an error coefficient between each medication pair that measures the degree of undesirability associated with storing two items next to each other.

The remainder of this chapter is organized as follows. Section 2.2 reviews the relevant literature. Section 2.3 formulates the position-free and the position-based paradigms. Sec-
tion 2.4 presents model enhancements to improve computational performance, including the use of valid inequalities and relaxations. Section 2.5 presents results from various computational tests for instances motivated by real world problems. Finally, Section 2.6 provides concluding remarks and ideas for future research.

2.2 LITERATURE REVIEW

Researchers have used process improvement, lean principles and inventory management techniques to address the challenges associated with the usage of ADCs in healthcare settings (e.g., Opolon (2010), Arpit and Laura (2015), Uthayakumar and Priyan (2013)). However to the best of our knowledge, there are very few technical papers that address shelf space or layout optimization and item allocation for ADCs. One such paper is by Pazour and Meller (2012) that addresses the layout of medications in ADCs with matrix drawer configurations, where the drawer is divided into fixed, equal sized compartments. The assignment of medications to drawers is done so as to minimize the risk of selection errors based on the closeness of similar medication pairs using a quadratic assignment model. Our proposed models differ from (Pazour and Meller 2012) in several aspects. First, we determine not only which items to store from a pool of items but also how many units of each item to store, instead of the item type and amount being set a priori. Second, the size of the storage location needed for each item varies based on the size, demand and quantity stored of the item and therefore our models do not have the structure of a quadratic assignment problem. Third, we also address the issue of reducing replenishment and retrieval times by storing items which are more commonly used, while considering potential errors due to item similarities as model constraints. Finally, we solve our models optimally rather than heuristically for realistically sized problems.

A few publications in the literature address ADC item allocation based on minimizing staff efforts. Kelle et al. (2012) determine the reorder point and order up to level (i.e., $s$ and $S$ in an $(s, S)$ inventory control system) that control an automated ordering system. These
parameters are based on a near-optimal allocation policy of cycle stock and safety stock under a storage space constraint. They consider the ADC as a single large knapsack and do not consider compartments or shelving. Rosales et al. (2014) optimize single item inventory parameters to minimize both nurse time and inventory management staff for only medical supplies while Rosales et al. (2015) minimize the amount of time nurses spend requesting and getting items, to reduce nurse dissatisfaction and disruptions in patient care. However, none of these papers consider shelf space restrictions.

Although our problem is three dimensional in nature, if we assume that we store only one item type in each lane, the problem may be viewed as a 2-stage two dimensional guillotine cutting problem. In the context of our problem the first dimension with guillotine cuts corresponds to the width of the cabinet and creates a set of “shelves” of different heights. The second dimension corresponds to the individual compartments created by cuts along an axis perpendicular to the first one. Many variants of two dimensional guillotine cutting problem have been studied (Wäscher et al. 2007). If there is a limit to the number of items of each type that can be cut out of the sheet, the problem is said to be constrained, and it is said to be unweighted if the profits of all items are not directly proportional to their areas. For some limited cases, our problem could be considered as a constrained, unweighted, 2-stage two dimensional guillotine cutting problem, where we wish to maximize the sum of the profits obtained from small rectangular pieces cut from several large rectangular plates, where the number of each type that is cut cannot exceed a prescribed quantity. The 2-stage two-dimensional guillotine constrained cutting problem has been also called a 2-stage two-dimensional knapsack (2TDK) problem (Furini and Malaguti 2013). Lodi and Monaci (2003) introduce models for 2TDK that are considered the best polynomial size formulations in the literature (Furini and Malaguti (2013)). Our first model bears some resemblance to the model of Lodi and Monaci, but in the setting addressed by this chapter our model has fewer decision variables and constraints, which permits it to be solved more efficiently. It should be noted that the ADC generally cannot be considered as a single large rectangular sheet because of the brain and possibly, drawers between shelves. These aspects make our problem similar to having multiple different sized rectangular sheets rather than a single one.
Unfortunately, if we attempt to adapt the 2TDK approaches to multiple sheets to solve our problem, the number of integer and binary variables increase exponentially and the model becomes very inefficient.

Another related line of research is the shelf space allocation problem (SSAP). In fact, the SSAP is similar to a knapsack problem that incorporates some additional policy constraints regarding shelving. The most well-known application of this class of problem is in retail stores. The reader is referred to Hansen and Heinsbroek (1979) for more on this topic. Recently, Geismar et al. (2015) used an MIP approach to maximize the revenue of retail stores through two-dimensional shelf-space allocation. In general, the SSAP deals with how to optimally allocate available shelf space to each item in order to maximize profit, minimize inventory cost, or minimize wasted space. We generalize this with a model for the simultaneous optimal selection of a subset of items from among a given set of items and the allocation of shelf space to these items.

Our models also have some similarity to the forward-reserve problem found in warehousing and distribution centers. To reduce labor-intensive and costly order picking activities, many distribution centers are subdivided into a forward area and a reserve (or bulk) area; in our problem the floor storage might be considered as the forward area, while the central storage would be the reserve area. For example, Walter et al. (2013) consider the discrete forward-reserve problem by allocating space, selecting products, and area sizing in forward order picking. Subramanian (2013) improves the efficiency of warehouses that store small items such as pharmaceuticals or cosmetic supplies by creating forward pick areas in which many popular products are stored in a small area that is replenished from reserve storage.

Finally, picking errors due to item similarity has attracted attention in the human factors literature. Storage assignment policies can be developed that consider the restriction that similar items (e.g. in shape, color, weight or name) not be stored close to each other in order to avoid confusing the order picker and thus reducing the chance of picking errors. McCoy (2005) investigates confusion resulting from look-alike and sound-alike drug names and shows how look-alike product packaging can result in potentially harmful medication
errors. In summary, while different aspects of our problem bear resemblance to classical problems in the literature from optimization, planning and logistics, there is no prior work that addresses the particular combinations of issues that we consider in our models.

2.3 MODEL DEVELOPMENT

ADCs come with a wide range of design options including flexible shelving, different-sized drawers, and specialty storage options. For any configuration, the ADC has a rectangular shape with dimensions characterized by height \( H \), width \( W \), and depth \( D \). Drawers can be single-deep or double deep and are usually divided into smaller rectangular compartments, while shelves can be of different heights with each shelf being divided into several compartments running along the width of the shelf. Shelves are typically used to stock medium/large items or items that tend to have large demand, while smaller items are typically stored in drawer modules henceforth we refer to both medications and medical supplies stored in an ADC as items). We assume that items can be stored in either shelves or drawers but not both.

We first describe shelf storage since drawer storage (which is more common with pharmaceuticals) can be viewed as a special case of this. When using shelves, items are stored either individually or in plastic bins in dedicated compartments or “lanes” along the shelf. While the depth of a lane is equal to that of the ADC, we assume that each lane could have a different width. Each shelf could have a different height; however, we define a minimum shelf height \( \tilde{h} \) and any shelf is restricted to a height from the set \( (\tilde{h}, 2\tilde{h}, 3\tilde{h}, \cdots) \) and this corresponds to physical locations where a shelf can be placed; a typical value for \( \tilde{h} \) might be between 3.5 and 4.5 inches. Possible shelf positions are (vertically) numbered with position \( s = 1 \) corresponding to the bottom of the cabinet, position \( s = 2 \) to a location \( \tilde{h} \) units above the bottom, position \( s = 3 \) to a location \( 2\tilde{h} \) units above the bottom, etc. For example, consider Figure 1 (a), which shows an ADC that is a combination of drawer and shelf units. If we focus on the lowest shelf unit, it spans 5 positions. Thus it could accommodate as few
as one shelf with height $5\tilde{h}$ or as many as five shelves where every shelf has its minimum height of $\tilde{h}$; the current configuration shows two shelves of heights $2\tilde{h}$ and $3\tilde{h}$.

Figure 1: (a) Tower module ADC (OmniRx one cell, courtesy of Omnicell company) (b) Schematic figure of OmniRx (c) MIP model display.

Hospitals only store one item in each lane since they want every item to be completely visible to someone standing in front of the unit; therefore we assume that each lane is comprised of multiple units of the same item. Dividers between lanes create a clear separation between two different items. Note that items that can be stored without using bins permit more efficient use of the available space since the lane widths are not limited to the widths of the bins that are available. However, using bins for some small items (e.g., needles) is unavoidable.

Without loss of generality, we assume that the thicknesses of the dividers and the shelves are negligible and that we can use as many dividers as we need on each shelf. A drawer module can be viewed as a shelf unit with multiple shelves if we imagine the drawer being removed and stood up vertically as in Figure 2: the depth of the drawer would correspond to the height of the unit and the height of the drawer would correspond to its depth.
Finally we look at general ADC configurations such as the one shown in Figure 1 (a) that could be comprised of multiple drawer, shelf or specialty sections/units. We handle such systems by sequentially inserting a storage unit corresponding to each shelf section and a storage unit for each drawer. A dummy position with a single shelf of height $\tilde{h}$ is inserted between different storage units. Our model ensures that nothing can be stored in the dummy positions, which keeps each unit within the ADC distinct. When the “brain” is an integral part of the cabinet or there are positions where items cannot be stored, these are dropped altogether from the cabinet, and a dummy position is used to separate the storage units above and below. We assume without loss of generality that each shelf unit and each drawer “shelf” have the same minimum shelf height of $\tilde{h}$. Figure 1 (c) shows the schematic representation of the cabinet shown in Figure 1 (a). Note that this cabinet has 2 shelf units of heights $4\tilde{h}$ and $5\tilde{h}$, and 3 drawer units each of “height” $6\tilde{h}$. There are 5 dummy positions, one at the top of each of the 5 storage units (we insert the dummy position at the top of the upper-most unit for consistency and in case we have multiple cabinets). The overall height of this cabinet is redefined to be $(5+1+6+1+6+1+6+1+4+1)\tilde{h} = 32\tilde{h}$ units. Given an ADC with $K$ distinct storage sections (units) where unit $c$ has height $H_c$, note that the maximum possible number of shelf positions is $M = \sum_{c=1}^{C} \left( \frac{H_c}{\tilde{h}} \right) + C$. In the remainder of this chapter we will refer to all shelf heights in units of $\tilde{h}$.

We now provide the definition of a lane of item $i$ on a shelf as follows:

**Definition 1.** A lane of item $i$ is defined as a compartment on a shelf filled with at most $n_i$ units of item $i$ and has width $w_i$, height $h_i$, and depth $D$, where the height $h_i$ is the height
of item $i$ in units of $\bar{h}$, the width $w_i$ is either the width of item $i$ or the width of the bin in which it is stored, and $D$ is the depth of the shelf. Units of an item are not stacked on top of each other to fill the shelf space and the last lane of an item could be only partially filled since filling it fully might cause the number of units of that item to exceed its upper bound.

Desired inventory values are commonly called “PAR levels” in hospital inventory management (Kelle et al. 2012); here PAR stands for Periodic Automatic Replenishment. A common approach is to periodically review stock levels and reorder up to the PAR level for each item. In the context of an ADC it is common to specify both a minimum and a maximum PAR level (say, $l_i$ and $u_i$, respectively for an item $i$). We assume that an $(s, S)$ policy is used to manage ADC inventory, where $s$ for an item $i$ is set to the minimum PAR level $l_i$ and $S$ can be freely chosen as long as it does not exceed the maximum PAR level $u_i$.

The formulary is another important factor in pharmaceutical management on a patient floor. A formulary refers to product variety and is a list of all medicines that might be prescribed by physicians on a patient floor. Medication types and their max/min levels within an ADC often require modifications over time due to changes in the composition of the formulary level and dynamic demand characteristics (e.g., flu season, changes in drug popularity). Given the limits on an ADC’s storage capacity, it cannot always contain all patient care items, and regular assessments and periodic adjustments in its layout are needed. In summary, we assume that at any given time there is a pool of items to choose from (the formulary) along with a maximum and minimum PAR level for each. If an item is chosen for storage in the ADC, the number of units stored must be at least its minimum PAR level. However, we can choose the order-up-to level $S$ based on the desirability of stocking the item and to make efficient use of the limited storage space available, as long as this order-up-to level $S$ does not exceed the maximum PAR level.

Demand for items at the unit level differs by item, and item demands ($D_i$) are independent random variables. Let the cumulative distribution function of $D_i$ be given by $F_i(d) = Pr(D_i \leq d)$. Our main goal is to pack a set of items into an ADC such that we maximize the “value” of the set of items. The value of an item is defined in terms of the
benefit from stocking it in the ADC and thus saving staff effort to retrieve it from a central storage location. In general, we would like to store minimal amounts of slow-moving items, while storing more of fast-moving ones. However, there is no benefit to overstocking the ADC with the fastest moving items in an ADC, because we assume diminishing returns from storing additional units of an item and define the marginal value accruing from the $t^{th}$ unit of item $i$ as

$$v_{it} = Pr(D_i \geq t). \quad (2.1)$$

The reasoning behind (2.1) follows if we first note that a trip to central storage is required any time an item that is required is unavailable in the ADC. For the sake of simplicity, let us temporarily ignore the subscript $i$ and let the demand distribution be given by $p_j = Pr(D = j)$ and let the capacity of each lane be $n$. If we did not stock the item then we would make 1 trip if $D = 1$, 2 trips if $D = 2$, etc. So the expected number of trips $= p_1 + 2p_2 + 3p_3 + \cdots$. If we have one unit of the item in stock we would make 0 trips if $D \leq 1$, 1 trip if $D = 2$, 2 trips if $D = 3$, etc. So the expected number of trips $= p_2 + 2p_3 + 3p_4 + \cdots$. So the “value” of the first unit in terms of the expected number of trips saved $= (p_1 + 2p_2 + 3p_3 + \cdots) - (p_2 + 2p_3 + 3p_4 + \cdots) = p_1 + p_2 + p_3 + \cdots = Pr(D \geq 1)$. Similar reasoning can be applied to determine the value of the second, third and other stored items. Since $Pr(D_i \geq j)$ is non-increasing in $j$, it follows that $v_{i,t+1} \leq v_{it}$. We can use empirical distributions to calculate the above probabilities based on the historical item demand data that is available.

### 2.3.1 A Position-Free Paradigm

The effective decisions to be made in our model are the positions of the shelves (which also determine the heights of the shelves) and the items to have on each shelf along with their quantities. As each lane of each item has a different value based upon the demand distribution and individual characteristics of the item, we also need to define variables corresponding to the number of each item type. The parameter sets, indices, and decision variables used are as follows:
Parameters

$N$: number of item types to store in the ADC

$C$: number of separate storage units in the ADC

$H_c$: height of section $c \in \{1, \cdots, C\}$

$M$: maximum number of shelves possible in the ADC (i.e., $M = \sum_{c=1}^{C} \left\lfloor \frac{H_c}{\tilde{h}} \right\rfloor + C$)

$W$: width of the ADC

$v_{it}$: the marginal value of the $t^{th}$ unit of item $i$ (as determined by equation (2.1))

$n_i$: maximum number of item $i$ that can be stored in one lane

$l_i$: minimum required number of item $i$ if it is stored in the ADC

$u_i$: maximum number of item $i$ allowed to be stored in the ADC

$w_i$: width of one lane of item $i$

$h_i$: height of item $i$ (in units of $\tilde{h}$)

$\eta_c$: maximum number of shelves possible in section $c \in \{1, \cdots, C\}$ i.e., $\left\lfloor \frac{H_c}{\tilde{h}} \right\rfloor$

$m_i$: maximum number of lanes of item $i$ on one shelf, $m_i = \min\left\{ \left\lfloor \frac{W}{w_i} \right\rfloor, \left\lceil \frac{u_i}{n_i} \right\rceil \right\}$

Sets and Indices

$I$: index set of item types, i.e., $I = \{1, \cdots, N\}$

$H$: index set of possible (vertical) shelf positions, i.e., $H = \{1, \cdots, M\}$

$H_c$: index set of possible (vertical) shelf positions in section $c$

$H'$: index set of dummy (vertical) shelf positions

$S_i$: index set of possible shelf positions along the height of the ADC for (a lane of) item $i$

$T_s$: index set of possible items that can be stored on a shelf in vertical position $s$

$L_i$: the index set $\{1, \cdots, u_i\}$

Decision Variables

$x_{is}$: number of lanes of item $i$ located on shelf $s$ (integer)

$q_i$: = 1 if item $i$ is stored in the ADC; 0 otherwise (binary)

$z_{it}$: = 1 if there are at least $t$ units of item $i$ stored in the ADC; 0 otherwise (binary)

$y_s$: = 1 if a shelf is located at position $s$; 0 otherwise (binary)

Note that there is a dummy position above each storage section so that $H' = [\eta_1 + 1, (\eta_1 + \eta_2) + 2, \cdots, \sum_{j=1}^{c} \eta_c + c]$, and the index sets for shelves in the various sections are
given by \( \tilde{H}_1 = \{1, \cdots, \eta_1\} \), \( \tilde{H}_2 = \{\eta_1 + 2, \cdots, \eta_1 + 1 + \eta_2\} \), etc. Also note that \( S_i = \bigcup_{c=1}^C \{c + (\sum_{j=1}^{c-1} \eta_c), c + (\sum_{j=1}^{c-1} \eta_c) + 1, \cdots, c + (\sum_{j=1}^c \eta_c) - h_i\} \) and we ensure that the top most shelf location possible for item \( i \) in each section is such that there is sufficient height to store it, while \( T_s \) (i.e., \( T_s = \{i \in I : s \in S_i\} \), where \( T_s \subset I \)) is the set of all items that are not too tall for a shelf in position \( s \). The idea behind defining these sets \( S_i \) and \( T_s \) is to reduce the number of integer and binary variables used in the formulations.

Model MIP1

\[
\max \sum_{i \in I} \sum_{t \in L_i} v_{it} z_{it},
\]

subject to:

\[
\sum_{i \in T_s} w_i x_{is} \leq W y_s \quad \forall s \in H \setminus H',
\]

\[
\sum_{t \in L_i} z_{it} \leq \sum_{s \in S_i} n_i x_{is} \quad \forall i \in I,
\]

\[
l_i q_i \leq \sum_{t \in L_i} z_{it} \quad \forall i \in I,
\]

\[
m_i y_s + x_{ir} \leq m_i \quad \forall s \in H \setminus \{1\} \cup H', \forall i \in T_s, \forall r \in \{\max\{1, s - h_i + 1\}, \cdots, s - 1\},
\]

\[
0 \leq x_{is} \leq m_i q_i, \quad x_{is} \in \mathbb{Z}^+ \quad \forall i \in I, s \in S_i,
\]

\[
y_s = 0, \quad s \in H', \quad y_s \in \{0, 1\}, \quad s \in H,
\]

\[
z_{it} \in \{0, 1\}, \quad i \in I, t \in L_i, \quad q_i \in \{0, 1\}, \quad i \in I.
\]

The objective function (2.2) represents the total value across all lanes in the cabinet and is the expected number of trips saved by a clinician not having to go to a central storage location to retrieve a required item. Constraint set (2.3) ensures that the width constraint for each shelf is satisfied. Constraint set (2.4) ensures that enough lanes are allocated for the number of units of an item in the ADC and constraint set (2.5) ensures that if item \( i \) is stored in the ADC then we store at least the minimum required number of that item. Constraint set (2.6) ensures that no item on any lower shelf is tall enough to cause it to intrude into the space occupied by the current shelf. Constraint set (2.7) ensures that if choose not to
stock an item in the ADC, no lanes are allocated for it and (2.8) ensures that we do not use dummy shelves for storage.

Note that even though there might appear to be a large number of \( z_{it} \) binary variables in this formulation, we will prove (Proposition 1 in Section 2.4) that we can relax the integrality of \( z_{it} \) to simple lower and upper bounds of 0 and 1. Also, if the storage sections within an ADC are not similar to each other (so that \( \tilde{h} \) varies by section), we can readily extend the formulation by providing an additional subscript corresponding to each section \( c \) for \( \tilde{h} \) and \( h_i \) and slightly redefining \( \eta_c \) and \( S_i \) as follows:

\( \tilde{h}_c \): minimum shelf height for section \( c \)

\( h_{is} \): height of item \( i \) on shelf \( s \in \tilde{H}_c \) in units of \( \tilde{h}_c \)

\( \eta_c \): maximum number of shelves possible in section \( c \in \{1, \cdots, C\} \) i.e., \( \left\lfloor \frac{h_c}{\tilde{h}_c} \right\rfloor \)

\( S_i = \bigcup_{c=1}^{C} \{ c + (\sum_{j=1}^{c-1} \eta_c), c + (\sum_{j=1}^{c-1} \eta_c) + 1, \cdots, c + (\sum_{j=1}^{c-1} \eta_c) + (\eta_c - h_{is}) \} \)

### 2.3.2 A Position-Based Paradigm

We now propose a position-based model that addresses dispensing errors by selecting and maintaining proper ADC inventory and also selecting appropriate ADC layouts. The term LASA (look-alike, sound-alike) is used to refer to medications that have names that have spelling similarities and/or similar phonetics. The ISMP recommends that LASA items should not be stored next to each other. In addition, the FDA has published guidelines for safety considerations with container labels and carton labeling designed to minimize medication errors. We integrate the ISMP and FDA information to determine potential interactions between each pair of medications. Based on the literature and our data characteristics, we define error coefficients based on medication categorical data, which may include LASA or same medication names, package size and types (i.e., bottle, vial, box, ampule, etc), strength and strength unit (mg, ml, gm, unit-dose, packet), form (tablet, capsule, liquid, powder, suppository, patch, etc), and demand frequency (low, medium, high).

The error coefficient, \( e_{ij} \), is defined for medication pair \((i,j)\) based on the number of factors in common relative to the maximum number of factors that are considered. A coef-
ficient value of 0 indicates that the medication pair has extremely dissimilar characteristics, whereas a value closer to 1 indicates that the medication pair has very similar characteristics and the items should not be located near one another. We define two thresholds for error coefficients. We assume that if the error coefficient of a medication pair is greater than or equal to $\epsilon$ ($0 \leq \epsilon \leq 1$), they should not be stored next to each other on the same shelf and at least one other item should be between them. If the error coefficient is greater than or equal to $\epsilon'$ ($\epsilon \leq \epsilon' \leq 1$), they should not be stored on two consecutive shelves. The values of $\epsilon$ and $\epsilon'$ are decided by clinicians or other key hospital stakeholders.

It is important to note that each of the factors affecting the similarity of two items does not have the same effect on the likelihood of inducing a picking error. For example, if a pair of medications has LASA names then the chance of error is more than having just similar package types or form. Therefore, in calculating an error coefficient between items $i$ and $j$, we assign a weight $\omega_k$ to factor $k$, where the values of the weights are assigned by an appropriately qualified individual. Suppose that there is a set $K$ of factors that are relevant when contrasting two items $i$ and $j$. Suppose also that two items $i$ and $j$ are similar with respect to some subset $K'$ of these factors. Then the error coefficient between items $i$ and $j$ can be computed as

$$e_{ij} = \frac{\sum_{k \in K'} \omega_k}{\sum_{k \in K} \omega_k},$$

(2.10)

To solve this second model more efficiently, we do some preprocessing to reduce the number of binary variables required. We start by estimating the maximum number of lanes we could have on a shelf, given that a single lane with some item $i \in I$ has been assigned to it. Let us denote this number by $\gamma_{i}^{\text{max}}$ for item $i$. To compute this value for a given $i$ we first sort all of the items in increasing order of their lane widths (with ties being broken arbitrarily), along with corresponding estimates of the maximum number of lanes possible in the cabinet for each item ($= \left\lceil \frac{u_j}{n_j} \right\rceil$ for item $j$). To the existing lane of item $i$ we then start adding additional lanes starting at the top of this list (i.e., with the item having the smallest lane width) one at a time, until we reach the upper limit on its number of lanes (at which point, we move on to the next item on the list), or until adding the next lane would cause us to exceed the width of the cabinet ($W$); the corresponding number of lanes at that
point gives us the value of $\gamma_i^{\text{max}}$. The sets, indices, parameters and decision variables that are needed in addition to the ones already defined in Section 2.3.1 are as follows:

**Parameters**

$e_{ij}$: error coefficient between item $i$ and $j$, $0 \leq e_{ij} \leq 1$

$\epsilon$: the maximum allowable error coefficient between two items stored next to each other on the same shelf

$\epsilon'$: the maximum allowable error coefficient between two items stored on two adjacent shelves

**Sets and Indices**

$\gamma_i$: index set of possible positions along a shelf for item $i$ starting at the left, i.e., $\{1, \cdots, \gamma_i^{\text{max}}\}$

$\Lambda$: the index set $\{1, \cdots, \max_i \gamma_i^{\text{max}}\}$

$\Delta_l$: set of possible items for horizontal position $l$, $\Delta_l = \{i \in I : l \in \gamma_i\}$, where $\Delta_l \subset I$

**Decision Variables**

$x_{isl}$: $= 1$ if a lane of item $i$ is located on shelf $s$ in horizontal position $l$; 0 otherwise (binary)

Note that we number horizontal positions consecutively starting from the left end of the shelf. How many such positions exist depends upon what items we store on the shelf; the set $\gamma_i$ indexes these positions (up to a maximum of $\gamma_i^{\text{max}}$) when we are given that one of those positions is occupied by item $i$. The set $\Delta_l$ ensures that we do not consider item $i$ for a position $l$ if that position is not feasible for item $i$ on the shelf. In general, the set $\Delta_l$ will only be limited for larger values of $l$, i.e., on the right side of the ADC.
Model MIP2

\[
\max \sum_{i} \sum_{t} v_{it} \ z_{it}, \quad (2.11)
\]

subject to:

\[
\sum_{t} \sum_{i} w_{i} x_{isl} \leq W \quad \forall s \in H \setminus H', \quad (2.12)
\]

\[
\sum_{i \in (T \cap \Delta)} x_{isl} \leq 1 \quad \forall s \in H \setminus H', l \in \Lambda, \quad (2.13)
\]

\[
x_{isl} + x_{jrk} \leq 1 \quad \forall i, \forall s \in S, \forall l \in \gamma_i, \forall r \in \{s + 1, \ldots, s + h_i - 1\}, \forall j \in T, \forall k \in \gamma_j, \quad (2.14)
\]

\[
x_{isl} + x_{jsk} - \sum_{i' \neq i, j} \sum_{l' = l+1}^{k-1} x_{i's' l'} \leq 1 \quad \forall s, \forall i, j \in T \ni i \neq j, e_{ij} \geq \epsilon, \forall l \in \gamma_i, k \in \gamma_j, \quad (2.15)
\]

\[
x_{isl} + x_{js+h_i k} \leq 1 \quad \forall r \ni s, s + h_k \in \tilde{H}, \forall i \in T, \forall j \in T_{s+h_i}, \quad (2.16)
\]

\[
\ni \neq j, e_{ij} \geq \epsilon', \forall l \in \gamma_i, k \in \gamma_j \quad (2.17)
\]

\[
\sum_{t} z_{it} \leq \sum_{s} \sum_{l \in \gamma_i} n_{i} x_{isl} \quad \forall i \in I, \quad (2.18)
\]

\[
l_i q_i \leq \sum_{t} z_{it} \quad \forall i \in I, \quad (2.19)
\]

\[
x_{isl} \leq q_i \quad i \in I, s \in S, l \in \gamma_i, \quad x_{isl} \in \{0, 1\} \quad i \in I, s \in S, l \in \gamma_i, \quad (2.20)
\]

\[
z_{it} \in \{0, 1\}, \quad i \in I, t \in L, \quad q_i \in \{0, 1\}, \quad i \in I. \quad (2.21)
\]

The objective function (2.11) and constraint set (2.12) are similar to (2.2) and (2.3), respectively. Constraint set (2.13) ensures that every horizontal position along a shelf is assigned to a lane for at most one item. Constraint set (2.14) ensures that the height of a shelf is determined by the height of the tallest item by ensuring that there is no shelf that would be “running through” an item on the current shelf. Constraint set (2.15) prevents two items \(i\) and \(j\) with an error coefficient more than \(\epsilon\) from being next to each other on the same shelf by ensuring that there is at least one other item in between these two items, while (2.17) prevents two items with an error coefficient more than \(\epsilon'\) from being stored on adjacent shelves unless there is intervening empty space above the item in the lower shelf that
separates the two items. Constraint sets (2.18), (2.19) and (2.20) are similar to (2.4), (2.5) and (2.7), respectively.

2.4 TIGHTENING AND ENHANCING THE MIP FORMULATIONS

In this section, we present several enhancements in the form of valid inequalities and relaxations for the models in Section 2.3 in order to improve their computational performance. Later, in Section 2.5 we will discuss the efficacy of these enhancements using several test instances.

Symmetries constitute one of the main problems when dealing with exact methods for discrete optimization. Numerous authors have noted the importance of resolving this issue when solving MIPs for combinatorial problems (e.g., Sherali and Smith (2001)). Formulations of packing and layout problems in particular can result in considerable degeneracy due to symmetry and redundant sequences. Removing such alternatives from a model can lead to a dramatic reduction in computational effort because considerable effort is expended in evaluating each of these. We address this issue through the addition of valid inequalities using the theorems of this section.

In our first model, some symmetries are avoided since we do not need to explicitly distinguish the position of an item on a shelf. However, the model does decide where a shelf is positioned within the cabinet, and therefore, one of the symmetries to be resolved arises from the permutations of shelves. We propose a class of valid inequalities in Theorem 1 that sorts the shelves from the tallest to the shortest, starting at the bottom. These valid inequalities are defined separately for each storage section $c$ of an ADC.

**Theorem 1.** Linear inequalities

$$y_s + y_{s'} + y_{s''} - \sum_{r=s+1, r \neq s'}^{s''-1} y_r \leq 2, \quad \forall c, \forall s, s', s'' \in \tilde{H}_c \ni s < s' < s'', s' - s < s'' - s', \quad (2.22)$$

are valid for MIP1.
Proof. Suppose that an optimal solution of MIP1 violates one of the inequalities in (2.22), say for \( s = a, \ s' = b, \ s'' = c \). This implies that there are three consecutive shelves at positions \( a, b \) and \( c \) and the shelf at a higher location \( b \) is taller \((s'' - s')\) than the shelf below it at location \( a \) \((s' - s)\). However, it is always possible to swap the order of shelves at locations \( a \) and \( b \) by moving the shelf at position \( b \) (along with its contents) to position \( a \), and moving the shelf at position \( a \) (along with its contents) to position \( a + (c - b) \) without altering any other aspect of the optimal solution. Therefore these inequalities are valid for MIP1.

Another issue that is unique to the problem that we consider is the fact that several items that are stored in ADCs have very similar size and demand, and therefore contribute the same or similar amounts to the objective for the first model while consuming the same or similar amounts of space. For example, based on actual data, we have observed that different concentrations of the same medication often have the same size and similar demand. This can cause our model to expend considerable effort in choosing between items that are the same or very similar when limited space is to be assigned to one (or a subset) of such items.

To address this we first introduce the following definition.

Definition 2.  \( \psi_{ik} = \sum_{t=(k-1)n_i+1}^{\min\{kn_i,u_i\}} v_{it} \)

To interpret this definition, the quantity \( kn_i \) represents the total number of units of item \( i \) in the ADC if we fill \( k \) lanes with units of this item. Note that once we decide to store an item, there is no reason to not fill the last lane entirely, unless doing so exceeds the upper bound \( (u_i) \) on the number of units allowed. This is true because by doing so the objective function can be improved while none of the constraints are affected. Then \( \psi_{ik} \) represents the value of the total number of units of item \( i \) that we can store in lane \( k \).

In a preprocessing step, we first index our items in decreasing order of their heights, breaking ties arbitrarily. The following theorem proposes a class of valid inequalities that removes dominated cases by choosing one item over another when it takes up less space while also adding more value. These inequalities also breaks ties in those cases where two items
require the same amount of space and have the same demand, based on our indexing scheme. Also, for notational convenience, let us refer to \( \lceil \frac{n_i}{n_i} \rceil \) and \( \lceil \frac{w_i}{n_i} \rceil \) as \( L_i \) and \( U_i \), respectively. Note that \( L_i \) and \( U_i \) represent the number of lanes needed to store the minimum required and maximum allowable amounts (\( l_i \) and \( u_i \), respectively) of an item \( i \) selected for storage.

**Theorem 2.** Linear inequalities

\[
q_i \geq q_j \quad \forall i, j \ni i > j \ni w_i \leq w_j, L_i w_i \leq L_j w_j, U_i - L_i \geq U_j - L_j,
\]

(2.23)

\[
\sum_{k=1}^{L_i} \psi_{ik} \geq \sum_{k=1}^{L_j} \psi_{jk}, \forall k \in \{L_j + 1, \cdots, U_j\} \ni \psi_{ik} \geq \psi_{jk}
\]

are valid for MIP1.

**Proof.** First, note that if \( i > j \) then \( h_i \leq h_j \), and if \( L_i w_i \leq L_j w_j \) the total space in the ADC used to store \( l_i \) units of item \( i \) is no more than the total space used to store \( l_j \) units of item \( j \). Also, if \( \sum_{k=1}^{L_i} \psi_{ik} \geq \sum_{k=1}^{L_j} \psi_{jk} \) then the value derived from \( L_i \) lanes of item \( i \) is at least as much as that derived from \( L_j \) lanes of item \( j \). Therefore, item \( j \) is dominated by item \( i \) if we want to store these two items at their minimum levels. Second, suppose that after adding \( L_i \) lanes of item \( i \) or \( L_j \) lanes of item \( j \) we have room for additional lanes of either item. Because \( w_i \leq w_j \) and \( \psi_{ik} \geq \psi_{jk} \forall k \in \{L_j + 1, \cdots, U_j\} \) it again follows that item \( i \) dominates item \( j \) and \( U_i - L_i \geq U_j - L_j \) ensures that we cannot add more lanes of item \( j \) than item \( i \). Given these two facts, item \( j \) is dominated by item \( i \) and there is never any reason to store the former in preference to the latter, and the result follows.

The third set of valid inequalities apply to the position-based model (MIP2) and addresses degeneracies related to empty positions along a shelf. It eliminates alternative solutions with different horizontal positions for empty lanes by moving all empty lanes to the right and eliminating other permutations. As we will see in Section 2.5.1, this set of valid inequalities is particularly effective.

**Theorem 3.** Linear inequalities

\[
\sum_{i \in T \cap \Delta_l} x_{isl} \geq \sum_{i \in T \cap \Delta_k} x_{isk} \quad \forall s, \forall l, \ni k > l,
\]

(2.24)

are valid for formulation MIP2.
Proof. Suppose that in an optimal solution of MIP2, an inequality in (2.24) is violated for some particular $l, k$. This implies that position $l$ is empty but a position $k$ to its right is occupied. However, we can shift all items in positions $l + 1$ through $k$ one position to the left and move the empty space to position $k$ to obtain an equivalent optimal solution such that all inequalities (2.24) are satisfied. The result follows.

When we use inequality set (2.24), we can replace (2.15) with the following constraint set, because all of the empty shelves has been pushed to the right side of the shelf; this results in a smaller number of constraints as well as a sparser coefficient matrix:

$$x_{isl} + x_{js, l+1} \leq 1 \quad \forall s, \forall i, j \in T_s \ni i \neq j, e_{ij} \geq \epsilon, \forall l \in \gamma_i, l + 1 \in \gamma_j$$

(2.25)

Another way to enhance computational performance is to relax the integrality restriction on binary variables that are guaranteed to be either 0 or 1 at the optimum. In our formulations, a critical result is that we can replace the binary restrictions for $z_{it}$ with $0 \leq z_{it} \leq 1$. The following proposition shows that this relaxation is valid as long as $v_{it}$ is strictly positive.

**Proposition 1.** There exist optimal solutions $(x^*, y^*, q^*, z^*)$ to model MIP1 and $(x^*, q^*, z^*)$ of model MIP2 with the relaxations $0 \leq z \leq 1$, with all elements of the vector $z^*$ having binary values.

**Proof.** Suppose we have an optimal solution $(x^*, y^*, q^*, \tilde{z})$ with fractional values for elements of $\tilde{z}$ in model MIP1 with the $z$ variables relaxed. The two constraints that are relevant are (2.4) and (2.5). Note that the LHS of (2.4) and (2.5) are both integers. For notational ease, let us use $Q_i$ to denote the integer $\sum_{s \in S_i} n_i x^*_{isa}$, so that (2.4) and (2.5) reduce to

$$l_i q_i \leq \sum_{t \in L_i} z_{it} \leq Q_i$$

(2.26)
Case 1: $Q_i \geq u_i$

Define $z^*_{it} = 1$ for all $t \in L_i$, i.e., $t = 1, \cdots, u_i$. This satisfies (2.26) since $\sum_{t \in L_i} z^*_{it} = u_i$. Also, since $\tilde{z}_{it} \leq z^*_{it}$ for all $t$ it follows that $\sum_{t \in L_i} v_{it} \tilde{z}_{it} \leq \sum_{t \in L_i} v_{it} z^*_{it} = \sum_{t \in L_i} v_{it}$ and since $\tilde{z}$ is optimal it follows that it cannot have any fractional components.

Case 2: $l_i \leq Q_i < u_i$

Define $z^*_{it} = 1$ for $t = 1, 2, \cdots, Q_i$, and $z^*_{it} = 0$ for $t = Q_i + 1, Q_i + 2, \cdots, u_i$. Again, it is clear that $z^*$ satisfies (2.26) and item $i$ contributes $\sum_{t=1}^{Q_i} v_{it} z^*_{it} = \sum_{t=1}^{Q_i} v_{it}$ to the objective function. So this is a lower bound to the contribution from item $i$ to the objective with the vector $\tilde{z}$. Now, with the vector $\tilde{z}$, item $i$ contributes $\sum_{t=1}^{Q_i} v_{it} \tilde{z}_{it} + \sum_{t=Q_i+1}^{u_i} v_{it} \tilde{z}_{it}$ to the objective. Consider $\tilde{z}_{it}$ for $t \leq Q_i$; if all these values are 1 then we cannot have $\tilde{z}_{it}$ positive for any $t > Q_i$ (otherwise (2.26) would be violated). So $\tilde{z}_{it}$ for some $t \leq Q_i$ has to be fractional. Consequently, at least one $\tilde{z}_{it} > 0$ for some $t > Q_i$ because otherwise the contribution of item $i$ to the objective would be smaller than the lower bound of $\sum_{t=1}^{Q_i} v_{it}$ and thus the vector $\tilde{z}$ could not be optimal. We could then reduce $\tilde{z}_{it}$ for one or more of these values of $t > Q_i$ and increase the (fractional) value for $t \leq Q_i$ by the same amount and obtain a solution that is at least as good, since $v_{it}$ is non-increasing in $t$. Since the most that we could increase any value of $\tilde{z}_{it}$ for each $t \leq Q_i$ is to the point where each of them is equal to 1 (at which point every $\tilde{z}_{it}$ for $t > Q_i$ must be zero) the upper bound on the contribution we can get from item $i$ in the optimal objective is $\sum_{t=1}^{Q_i} v_{it}$. Thus the vector with $z^*_{it}$ as defined above must be optimal.

The proof for Model MIP2 is similar and is omitted. In general, this proposition tells us that we can solve the relaxation and we will either obtain a binary solution (case 1) or if we obtain a fractional $z$ vector we can use the $x$ vector to redefine a new binary $z$ vector that yields the same optimum value. \qed
In this section, we illustrate our models using numerical examples based on real data derived from drawer module ADC transactions at ten ADC stations across multiple hospitals within a healthcare system in Pennsylvania, each with several hundred beds. We name these data sets PA1, · · · , PA10. Table 1 displays some information for each of the ten data sets: the upper section shows statistical information about items, and the lower section displays the number of unique medication pairs that are similar with respect to the pertinent factor corresponding to that row.

The computations are all done using a standard solver (CPLEX 12.4) with up to eight threads on three machines using the same hardware specifications (Intel Xeon Processor E5−2690). We set the symmetry breaking parameter in CPLEX at the “extremely aggressive” level since our model has many symmetries. In general, we impose a 10 hour run time limit for the numerical examples, but for some of the harder problems thus increases this to 24 hours (all CPU times given in seconds).

We report results from three types of numerical studies. In Section 2.5.1, we evaluate the relative effectiveness of the valid inequalities introduced in Section 2.4. In Section 2.5.2, we do some benchmarking. First, we compare the performance of our approach with heuristic techniques described in the literature that can be adapted to our problem and that represent what might be commonly done in practice. We then also compare our simpler model (MIP1) with one of the best MIP models in the literature for some limited cases where the latter model can be adapted to our problem. Finally, in Section 2.5.3, we compare and contrast MIP1 and MIP2.

2.5.1 Analysis of Valid Inequalities

While we can eliminate many of the redundancies resulting from symmetry by using the valid inequalities presented in Sections 2.4, we have to balance this against the increase in
Table 1: ADC transaction data set characteristics and number of medication pairs based on different similarity factors

<table>
<thead>
<tr>
<th>Factors</th>
<th>PA1</th>
<th>PA2</th>
<th>PA3</th>
<th>PA4</th>
<th>PA5</th>
<th>PA6</th>
<th>PA7</th>
<th>PA8</th>
<th>PA9</th>
<th>PA10</th>
</tr>
</thead>
<tbody>
<tr>
<td>no. of item types</td>
<td>105</td>
<td>98</td>
<td>97</td>
<td>127</td>
<td>111</td>
<td>104</td>
<td>125</td>
<td>86</td>
<td>93</td>
<td>90</td>
</tr>
<tr>
<td>max. no. of items</td>
<td>1333</td>
<td>1483</td>
<td>887</td>
<td>1100</td>
<td>975</td>
<td>915</td>
<td>1101</td>
<td>902</td>
<td>954</td>
<td>834</td>
</tr>
<tr>
<td>mean demand</td>
<td>11.6</td>
<td>13.2</td>
<td>7.57</td>
<td>8.90</td>
<td>8.91</td>
<td>7.27</td>
<td>9.43</td>
<td>8.83</td>
<td>9.03</td>
<td>9.31</td>
</tr>
<tr>
<td>mean size (in $^3$)</td>
<td>60.1</td>
<td>60.7</td>
<td>104.0</td>
<td>91.8</td>
<td>90.0</td>
<td>97.3</td>
<td>84.9</td>
<td>48.9</td>
<td>69.2</td>
<td>67.4</td>
</tr>
<tr>
<td>name</td>
<td>86</td>
<td>83</td>
<td>51</td>
<td>59</td>
<td>52</td>
<td>54</td>
<td>43</td>
<td>71</td>
<td>60</td>
<td>41</td>
</tr>
<tr>
<td>unit</td>
<td>2170</td>
<td>2266</td>
<td>1950</td>
<td>2405</td>
<td>1881</td>
<td>2380</td>
<td>1659</td>
<td>2294</td>
<td>1882</td>
<td>1627</td>
</tr>
<tr>
<td>dosage</td>
<td>850</td>
<td>535</td>
<td>1002</td>
<td>890</td>
<td>800</td>
<td>1270</td>
<td>863</td>
<td>942</td>
<td>722</td>
<td>580</td>
</tr>
<tr>
<td>package</td>
<td>371</td>
<td>221</td>
<td>436</td>
<td>382</td>
<td>298</td>
<td>563</td>
<td>308</td>
<td>407</td>
<td>296</td>
<td>227</td>
</tr>
<tr>
<td>strength &amp; unit</td>
<td>142</td>
<td>159</td>
<td>132</td>
<td>188</td>
<td>112</td>
<td>162</td>
<td>149</td>
<td>148</td>
<td>148</td>
<td>98</td>
</tr>
</tbody>
</table>

the number of constraints, which in general can cause the run time to increase. We consider a single and double column tower module ADC (Pyxis Medstation ES) where each column has size $79.5 \times 31.0 \times 28.0$ in $^3$ (i.e., $H \times W \times D$) with at most 18 shelves of height 4.4 in. We compare the base version of model MIP1 with versions that have different combinations of the valid inequalities defined by (2.22) and (2.23) for both column configurations of the ADC.

The charts in Figures 3 and 4 provide a graphical view of the results for the single and double column configurations, respectively. The three bars on each chart for a given problem correspond to the cases with (a) inequality set (2.22), (b) inequality set (2.23) and (c) both sets of valid inequalities. When the problem could be solved using the base model we plot the value of $\frac{\text{time for version}}{\text{time for base model}}$, i.e., the version’s run time as a fraction of the base model’s run time. In cases where the problem could not be solved by the base model we plot the value of $\frac{\text{time for version}}{\text{allowed time limit}}$ if the version in question could solve the problem, and 1.0 otherwise.
For the problems where the version with both (2.22) and (2.23) took more than 5 hours, we allowed the other versions to run for a maximum of 24 hours instead of 10 hours (e.g., PA3, PA4, PA5 and PA7 with the double column ADC). For instances where the base model (without any valid inequalities) took under one minute, there is clearly no need for valid inequalities and we do not study these further (e.g., PA8 and PA10 with the double column ADC).

Figures 3 shows that for the single module ADC the reductions in run time from the base model by using (2.22) and (2.23) are more than 90% in most cases. We also see that inequality set (2.22) is more effective when the average size of items in our list is smaller (PA1, PA8, PA9); inequality set (2.23) tends to be more effective when the average size of items on our list is smaller and the demand is also higher (PA1, PA2); and using both inequality sets (2.22) and (2.23) has the most effect when the number of item types increases (PA4, PA6). Figure 4 indicates that problems with the double column ADC are harder to solve because of the increased search space (larger feasible region), except when there is enough room to store all items at their upper limit (e.g., PA8, PA9 and PA10), and that it is not possible to solve our problems without having both sets of valid inequalities.
In summary, adding both classes of valid inequalities allows us to solve all of our problem instances and also produces a significant reduction in run time. Of the eighteen instances analyzed there were five that could be solved by the base version and across these five instances, the average CPU time for the version with both valid inequalities is around 16\% of the base model’s time. For the remaining thirteen instances, the CPU time is at most 22\% of the base model’s time; the actual values are likely to be lower. The results from using the valid inequalities defined by (2.24) along with MIP2 are similar. We tested the effectiveness of these inequalities using instance PA1 with different combinations of $\epsilon$ and $\epsilon'$ for different ADC sizes. We choose $\epsilon$ and $\epsilon'$ in such a way that $a\%$ of the item pairs are precluded from being stored next to each other and $b\%$ of the pairs are precluded from being stored on adjacent shelves, resulting in three combinations: $(a, b) = \{(0\%, 0\%), (25\%, 0), (25\%, 8\%)\}$. We also define the different ADC sizes as a function of the number of drawers, $p$, and the number of compartments in each drawer, $q$, and explore combinations of $p \in \{1, 2, 3, 4, 5\}$ and $q \in \{6, 12, 24, 48\}$. Across all of the different ADC size combinations, the average reductions in CPU time by using (2.24) for MIP2 for the (25\%, 0) and (25\%, 8\%) cases are 94\% and 76\%, respectively. Recall that this set of valid inequalities is related to permutations of items on shelves, and therefore, when we have restrictions only on the shelves (i.e., case (25\%, 0%)),
the effectiveness of this set of valid inequalities is more evident. Detailed results are shown in Table 2. For larger instances with 12 or more compartments per drawer, the base MIP2 model was not able to obtain solutions within the ten hour limit when at least one of either $\epsilon$ and $\epsilon'$ is not zero, while using the valid inequalities enabled all problems to be solved.

### 2.5.2 Benchmarking

In this section, we compare the results from our model with those obtained by adapting some common heuristic procedures that might be plausibly implemented in practice, and also with an efficient 2TDK IP model from the literature. Note that there are sophisticated heuristics for shelf-space allocation that could be adapted to our problem, but due to the complexity of their implementation these could take just as much (or more) effort than using our model. In order to estimate the likely real benefits of our approach, we therefore chose to compare it with the heuristics in Jylänki (2010) that are similar to the simple rules used in practice. Each method represents a combination of a sequencing rule to determine which item to select next, and a greedy heuristic to determine how to allocate items to shelves. The general approach is as follows:

1. **Sequencing:** Choose one of the following ranking rules to obtain a sorted list of items (in all cases, ties are broken arbitrarily).
   - R1: non-increasing order of item value of the first unit of the item, i.e., $v_{i1}$
   - R2: non-increasing order of the value of the first lane of an item, i.e., $\sum_{t \in \{1, \ldots, n_i\}} v_{it}$
   - R3: non-increasing order of the value of the first unit of its lane surface area, i.e., $\frac{v_{i1}}{h_i w_i}$
   - R4: non-decreasing order of lane height, i.e., $h_i$
   - R5: non-decreasing order of lane volume, i.e., $h_i \times w_i \times d_i$

2. **Heuristic selection:** Choose a space allocation heuristic from the following:
   - Shelf First Fit (SFF): store items in the first feasible location starting from the first shelf
   - Shelf Best Width Fit (SBWF): store items to minimize unused width
   - Shelf Best Height Fit (SBHF): store items to minimize unused height
Table 2: Summary of valid inequalities effects for Model MIP2 considering different percentages of nonadjacent medication pairs on and between shelves

<table>
<thead>
<tr>
<th>#</th>
<th>p(q)</th>
<th>CPU seconds</th>
<th>CPU seconds</th>
<th>CPU seconds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>MIP2</td>
<td>MIP2+VI</td>
<td>MIP2</td>
</tr>
<tr>
<td>1</td>
<td>1(6)</td>
<td>2.529</td>
<td>1.763</td>
<td>10.34</td>
</tr>
<tr>
<td>2</td>
<td>2(6)</td>
<td>3.480</td>
<td>2.512</td>
<td>49.51</td>
</tr>
<tr>
<td>3</td>
<td>3(6)</td>
<td>4.512</td>
<td>3.198</td>
<td>67.02</td>
</tr>
<tr>
<td>4</td>
<td>4(6)</td>
<td>4.791</td>
<td>3.869</td>
<td>313.5</td>
</tr>
<tr>
<td>5</td>
<td>5(6)</td>
<td>6.165</td>
<td>5.507</td>
<td>590.7</td>
</tr>
<tr>
<td>6</td>
<td>1(12)</td>
<td>3.151</td>
<td>3.026</td>
<td>597.5</td>
</tr>
<tr>
<td>7</td>
<td>2(12)</td>
<td>4.181</td>
<td>4.134</td>
<td>*</td>
</tr>
<tr>
<td>8</td>
<td>3(12)</td>
<td>9.422</td>
<td>5.990</td>
<td>*</td>
</tr>
<tr>
<td>9</td>
<td>4(12)</td>
<td>10.45</td>
<td>7.847</td>
<td>*</td>
</tr>
<tr>
<td>10</td>
<td>5(12)</td>
<td>15.10</td>
<td>9.656</td>
<td>*</td>
</tr>
<tr>
<td>11</td>
<td>1(24)</td>
<td>4.087</td>
<td>3.931</td>
<td>*</td>
</tr>
<tr>
<td>12</td>
<td>2(24)</td>
<td>10.14</td>
<td>9.188</td>
<td>*</td>
</tr>
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<td>13</td>
<td>3(24)</td>
<td>17.74</td>
<td>16.49</td>
<td>*</td>
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<tr>
<td>14</td>
<td>4(24)</td>
<td>25.59</td>
<td>23.24</td>
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</tr>
<tr>
<td>15</td>
<td>5(24)</td>
<td>15.77</td>
<td>14.20</td>
<td>3557.65</td>
</tr>
<tr>
<td>16</td>
<td>1(48)</td>
<td>34.43</td>
<td>11.70</td>
<td>*</td>
</tr>
<tr>
<td>17</td>
<td>2(48)</td>
<td>114.9</td>
<td>32.00</td>
<td>*</td>
</tr>
<tr>
<td>18</td>
<td>3(48)</td>
<td>189.4</td>
<td>56.49</td>
<td>*</td>
</tr>
<tr>
<td>19</td>
<td>4(48)</td>
<td>158.0</td>
<td>48.20</td>
<td>*</td>
</tr>
<tr>
<td>20</td>
<td>5(48)</td>
<td>115.5</td>
<td>41.50</td>
<td>*</td>
</tr>
</tbody>
</table>

*: after 10 hours, the code was still running
Shelf Best Area Fit (SBAF): store items to minimize unused surface area

3. Initial allocation: Allocate items to their minimum levels starting with the first item on the list; if there is not enough space to store an item at its minimum level, then don’t store that item at all and go to the next item. Continue until the end of the list is reached.

4. Final allocation: If there is space still available on one or more shelves, choose sequentially from items already stored (at their minimum levels) and try to store additional units up to the item’s maximum level using the heuristic selected in step 2. If there is not enough space available to store the item to its upper limit, store as much as possible and go on to the next item.

We ran all combinations of sequencing rules and heuristics for all ten data sets. For all problems we computed the ratio of the solution obtained and the optimum solution. These were then averaged across all ten test problems and the results are shown in the left half of Table 3. The right half of Table 3 shows the ratio of the space utilization for the heuristic versus that of the optimal solution (again, averaged across the ten test problems). It is clear that none of the heuristics are particularly efficient. In general, the combination of SFF and R5 appear to the best. On average, across all cases considered and across all ten data sets (200 instances), the objective value and space utilization with the heuristics are 50% and 82% of the corresponding optimum values, which suggests that simplistic methods could result in about twice as much work for medical staff while still leaving unused space in the ADC.

We also contrast model MIP1 with that of Lodi and Monaci (2003), which is considered to be the best polynomial size model in the 2TDK literature (Furini and Malaguti (2013)); henceforth, we will refer to their model as the LM Model. The LM model is directly adaptable to our problem only for the specific case where we have a single, continuous storage section in the ADC (an example might be the the tower module Pyxis MedStation ES). In such instances, the section might be viewed as a single “sheet” from which pieces are to be cut out using guillotine cuts. The corresponding adaptation to our problem may be found in the Appendix. We perform the comparison for various sizes of the tower module ADC considered, resulting in 28 different test instances. To benchmark the performance of MIP1
Table 3: Comparison of heuristic versus optimal methods for MIP1

<table>
<thead>
<tr>
<th></th>
<th>SFF</th>
<th>SBWF</th>
<th>SBHF</th>
<th>SBAF</th>
<th></th>
<th>SFF</th>
<th>SBWF</th>
<th>SBHF</th>
<th>SBAF</th>
</tr>
</thead>
<tbody>
<tr>
<td>R1</td>
<td>0.57</td>
<td>0.56</td>
<td>0.55</td>
<td>0.55</td>
<td></td>
<td>0.94</td>
<td>0.88</td>
<td>0.88</td>
<td>0.88</td>
</tr>
<tr>
<td>R2</td>
<td>0.44</td>
<td>0.41</td>
<td>0.42</td>
<td>0.41</td>
<td></td>
<td>0.95</td>
<td>0.88</td>
<td>0.88</td>
<td>0.88</td>
</tr>
<tr>
<td>R3</td>
<td>0.56</td>
<td>0.46</td>
<td>0.46</td>
<td>0.46</td>
<td></td>
<td>0.80</td>
<td>0.55</td>
<td>0.56</td>
<td>0.55</td>
</tr>
<tr>
<td>R4</td>
<td>0.54</td>
<td>0.43</td>
<td>0.43</td>
<td>0.42</td>
<td></td>
<td>0.98</td>
<td>0.93</td>
<td>0.94</td>
<td>0.93</td>
</tr>
<tr>
<td>R5</td>
<td>0.65</td>
<td>0.59</td>
<td>0.59</td>
<td>0.59</td>
<td></td>
<td>0.89</td>
<td>0.72</td>
<td>0.73</td>
<td>0.73</td>
</tr>
</tbody>
</table>

against the LM adaptation, we consider three metrics: the number of integer variables, the number of binary variables and the solution times. In Figure 5, we use the approach of Dolan and More (2002) to depict the results in the form of three separate performance profiles. For each of these three metrics the horizontal axis is used to represent the value of the metric for MIP1 as a percentage ($\tau$) of the corresponding value for the LM adaptation, and the vertical axis represents the cumulative percentage of instances where the metric is at or below this value. Across all of the test instances, the solution times, the number of integer variables, and the number of binary variables with MIP1 were never more than 29.6%, 7.7% and 14.6%, respectively, of the LM model, this indicating the efficiency of the former.

2.5.3 Contrasting MIP1 and MIP2

Finally, we contrast models MIP1 and MIP2. First, note that if there are no layout restrictions we could set the values of $\epsilon$ and $\epsilon'$ to 1 so that there are no constraints on where items can be placed and the solution of MIP2 will be the same as the optimal solution to MIP1. The question therefore arises as to why we need MIP1 at all when MIP2 is more general and can solve the same problem. The answer is that solving MIP2 is in general, much more difficult than solving MIP1 and when we have an option (e.g., the storage of
hospital supplies where picking errors are not serious) it is definitely preferable to use the simpler model. To compare the ease of solving the same problem via MIP1 and MIP2 (with $\epsilon$ and $\epsilon'$ set to 1), we consider two data sets (PA1 and PA10) and test both models along with their valid inequalities for different ADC sizes such as $p \in \{1, 2, 3, 4, 5\}$ drawers and $q \in \{6, 12, 24, 48, 96\}$ compartments per drawer. In all cases the run times for MIP1 are lower than those for MIP2, with the average reduction in run time from MIP2 to MIP1 being 73% and 81% for PA1 and PA10, respectively. More importantly, the relative effort required for MIP2 starts to grow as the problems become larger (more storage compartments). For 9 of the 50 instances tested the run time with MIP2 hits the ten-hour threshold. These results indicate that if items being stored are not similar or if item-picking errors do not constitute a significant issue, it is much more efficient to use the simpler MIP1 model.

 Conversely, when the layout is critical we require MIP2. A question that might arise is whether one could just use MIP1 for a problem while ignoring layout restrictions to easily obtain the optimal value, and then manually find a layout that is feasible with respect to the
layout restrictions. Unfortunately, this is generally not a viable approach, and we do require MIP2 for problems requiring layout consideration. We use a simple example to illustrate this point. Consider the 10 different medications shown in Table 4 that have various degrees of similarity; e.g., medication pairs (1,3), (2,3), (4,9), (4,10) and (7,8) are LASA pairs based on the ISMP and FDA lists. We choose $K = 8$ using factors such as name, dosage, package type, strength, unit, demand, size, and the combination of strength and unit with corresponding $\omega_k$ values of 1.0, 0.2, 0.3, 0.2, 0.1, 0.1, 0.2, and 0.3 based on expert opinion.

Consider the relatively easy case where $\epsilon = 0.04$ and $\epsilon' = 1$. We chose $\epsilon = 0.04$ because this is the smallest value for which MIP1 and MIP2 both yield the same optimal value. Suppose that we attempt to manually configure the layout after solving MIP1. Figure 6 illustrates (a) a layout that is randomly generated from the set of optimal solutions to MIP1, (b) an improved layout obtained by manually rearranging items within the same shelf (shelves 1 and 4), (c) a further improvement obtained by exchanging items between shelves (shelves 1 and 3), and (d) the layout obtained from MIP2 (note that all have the same value for the objective). The value of the sum of the error coefficients $e_{ij}$ (which we call the layout total error, LTE) for these four cases are 3.5, 2.37, 1.17 and 0.04, respectively. Note that the changes in going from (a) to (b) are what one might typically expect from clinical staff, while going from (b) to (c) would be far more difficult. Yet, even this is not satisfactory compared to the layout from MIP2. This reinforces why MIP2 is essential in many cases.

To study the effectiveness of MIP2 in reducing LTE versus MIP1, we run numerical results for all ten data sets, i.e., PA1, PA2, ···, PA10, and for ten ADC sizes, i.e., $p \in \{1, \cdots, 5\}$, and $q \in \{6, 12\}$. We chose $\epsilon$ in a way that an average of approximately 18% of the item pairs are prohibited from being stored next to each other and the optimal objective function value remains the same in both MIP1 and MIP2. When compared to a layout randomly selected from the set of optimal solutions of MIP1, the average reduction in the LTE value from MIP2 across the 100 problems tested was approximately 38%. Thus MIP2 can be used to significantly reduce the likelihood of picking errors.
Table 4: Medication categorical data: an example

<table>
<thead>
<tr>
<th>instance</th>
<th>Medications</th>
<th>Dosage</th>
<th>Package</th>
<th>Strength</th>
<th>Unit</th>
<th>Demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DOPamine</td>
<td>liquid</td>
<td>bag</td>
<td>500</td>
<td>ml</td>
<td>Low</td>
</tr>
<tr>
<td>2</td>
<td>DOPamine</td>
<td>liquid</td>
<td>bag</td>
<td>250</td>
<td>ml</td>
<td>Low</td>
</tr>
<tr>
<td>3</td>
<td>DOBUTamine</td>
<td>liquid</td>
<td>bag</td>
<td>100</td>
<td>ml</td>
<td>low</td>
</tr>
<tr>
<td>4</td>
<td>EPINEPHrine</td>
<td>liquid</td>
<td>vial</td>
<td>10</td>
<td>ml</td>
<td>high</td>
</tr>
<tr>
<td>5</td>
<td>hydrOXYzine</td>
<td>tab</td>
<td>kit</td>
<td>50</td>
<td>mg</td>
<td>medium</td>
</tr>
<tr>
<td>6</td>
<td>HYDROmorphone</td>
<td>tab</td>
<td>unit dose</td>
<td>20</td>
<td>mg</td>
<td>medium</td>
</tr>
<tr>
<td>7</td>
<td>LORazepam</td>
<td>tab</td>
<td>unit dose</td>
<td>5</td>
<td>mg</td>
<td>low</td>
</tr>
<tr>
<td>8</td>
<td>clonazePAM</td>
<td>tab</td>
<td>unit dose</td>
<td>5</td>
<td>mg</td>
<td>low</td>
</tr>
<tr>
<td>9</td>
<td>ePHEDrine</td>
<td>tab</td>
<td>kit</td>
<td>25</td>
<td>mg</td>
<td>high</td>
</tr>
<tr>
<td>10</td>
<td>ePHEDrine</td>
<td>tab</td>
<td>kit</td>
<td>50</td>
<td>mg</td>
<td>high</td>
</tr>
</tbody>
</table>

2.6 CONCLUSIONS

An important issue that hospitals face is the proper selection of a set of medical supplies and/or pharmaceutical products and their corresponding storage quantities in automated dispensing devices on patient floors. Unlike traditional inventory control problems, the tradeoffs here are somewhat different, e.g., holding costs are not as important and lead times are negligible. The key issue here is wasted medical staff effort. Typically, most hospitals manage routine inventory replenishment using dedicated logistics personnel who work on these tasks according to some fixed routine. However, demand for medications or supply items occurs continuously, and when items are unavailable when required, it often necessitates medical staff (nurses, medical assistants or even physicians) having to go to a central storage location to retrieve the required item. This is a highly inefficient use of a hospital’s most expensive resources. Maximizing the number of different items stored in an ADC on a patient floor will minimize staff effort required to retrieve items from a central
pharmacy/storage location when they are unavailable. However, the total storage space in an ADC is constrained and units of different items take up different amounts of the available space. In addition, the demand characteristics of items are different and also vary by location within the hospital. One must consider all of these factors when selecting the right set of items for storage. A related issue that is often just as important is the layout of the selected items within storage, given that there is flexibility in how an ADC is configured. This is especially true with storage of pharmaceutical supplies when picking errors can have very serious consequences. In this case one must also determine how items are actually distributed among the shelves or compartments of a cabinet. It is also worth mentioning that hospitals update the items stored on patient floors approximately once every three months and thus these questions might need to be answered on an ongoing basis.

We address all these issues with two different MIP models. In both models the objective is to minimize the expected staff effort to retrieve items that are unavailable when required. The first model uses what we refer to as a position-free paradigm. It is simpler and easier to solve and can be used when the layout of items within the ADC is not critical (e.g., with routine medical supplies). This model determines what items to store and how many units of each, along with the overall shelf configuration of the ADC. However, it does not specifically address how items selected for a shelf are stored on it, and it also does not
consider any restrictions on what items can be stored alongside or close to another. The second (and more complex) model, uses what we refer to as a position-based paradigm to address these issues, and can be used when we have constraints on how items are stored within an ADC because of the possibility of item selection errors (e.g., with medications or pharmaceutical supplies). This model simultaneously selects the best set of items, the optimal ADC configuration and the optimal layout of items within the ADC. Comparisons between the two models show that when either one could be used the first model (MIP1) is generally preferable. However, when layout is important, solutions from this model cannot be adapted in a straightforward fashion to meet the additional constraints, and a simplistic shelf layout selection could result in unacceptably high error coefficients. In these cases we must use MIP2. For both models, we propose valid inequalities and relaxations to facilitate solving large instances. Based on computational tests using actual data, these refinements can reduce the run time to well under 10% of the time for the base model and thereby allow for large, real-world instances to be readily solved.

We also compare our approach with simple heuristics or rules of thumb representative of those that tend to be common in practice, and our analysis shows that these simplistic approaches lead to poor solutions and very inefficient utilization of available space. There is no prior model in the literature that directly addresses the general problem that we examine; however, in certain limited cases we could consider our problem to be a two dimensional cutting stock problem with guillotine cuts. For these limited instances we compare our approach with the best MIP formulation reported in the literature (with respect to run times, and the number of binary and integer variables), and show that for the data characteristics associated with the specific types of problems that we address herein, our formulation is more efficient along all these dimensions.
3.0 CLOSED-FORM SOLUTIONS FOR PERIODIC INVENTORY SYSTEMS WITH FRACTIONAL LEAD TIME, LOST SALES AND SERVICE LEVEL RESTRICTIONS

3.1 INTRODUCTION

In this chapter we consider a class of inventory systems characterized by stochastic demand, periodic review with fractional replenishment lead times (i.e., lead times that are smaller than the review interval), limited storage capacity, and pre-specified service level requirements. This type of system has several applications, and this work in particular, is motivated by an application in inventory management systems at points-of-use (POUs) in hospitals, which are served by a central warehouse that has sufficient capacity to meet the demand at the POUs. Our system of interest is shown in Figure 7 and we will emphasize the inventory management that occurs at the local storage locations and their interaction with the central storage location. If a required item is not available in the right quantity at a specific POU the original demand for the item is considered to be lost; in practice, a substitute product is used or an emergency delivery is performed (e.g., from another POU location or central warehouse).

Frequent expedited deliveries are extremely undesirable because they imply reduced clinician time with patients as clinical staff have to attend to logistics-related activities and this can result in compromised patient care. Moreover, such situations are also costly because time associated with clinical professionals is expensive and using this time for non-clinical activities is very inefficient. Therefore, we define the service level as the fraction of demand...
Figure 7: The healthcare supply chain system of interest

to be satisfied directly from stock on hand (i.e., item fill rate). Note that this definition does not include the fraction of demand that is satisfied due to a substitution or an emergency delivery in case of a stock out such as in Bijvank and Vis (2012a).

In an effort to make the presentation very general, from this point forward, we explain our model in an abstract setting, and then discuss the connection and relevance to the medical applications motivating our work in the numerical results and future work sections. The material here applies broadly to logistics, supply chains, and inventory management, and in particular is very relevant to hospital operations. The structure of this chapter is as follows: We start with a review of the literature in the next section. We describe the model in Section 3.3 and then investigate the structural results from this model in Section 3.4. We present numerical analysis in Section 3.4 and finally we discuss conclusions in Section 3.6.

### 3.2 LITERATURE REVIEW

Lost sales inventory control systems are more challenging computationally to analyze when compared to backorder inventory control systems because the on-hand inventory level cannot be negative in this class of inventory systems (Bijvank and Vis 2012b). The challenging structure of lost sales inventory control systems has attracted significant interest over the
last few decades. Nonetheless, a well-performing heuristic doesn’t exist even for the simplest setting of this class of inventory systems (Levi et al. 2008). Lost sales inventory control systems have numerous applications including inventory management systems at POUs in hospitals, retail stores, and forward pick areas in warehouses. From the application standpoint, lost sales systems are similar to an inventory control system with expedited delivery or emergency orders in the event of a stockout.

Recently, lost sales models with lead time greater than the length of the review interval have received significant attention (i.e., Goldberg et al. (2016)) in the literature, while fractional lead time models have not been as extensively studied (Bijvank and Vis 2012b). In this paper, we assume that lead time is strictly less than the length of the review interval; this is commonly the case at POUs within a hospital. For more information on lost sales inventory control systems theory and its different settings the reader is referred to the survey paper by Bijvank and Vis (2012b).

Lost sales models are studied in two main different settings that differ in how they address the lost demand. In the first setting, it is assumed that there is a penalty associated with lost sales, and as a result, an expedited delivery is needed. In this setting, the number of these expedited deliveries should be minimized (Bijvank and Vis 2012a). In the second setting, the objective function is some other measure of performance (not minimizing expedited delivery), and an upper bound is imposed for the lost sales (Bijvank and Vis 2012b). In this setting, the customer has a required service level criterion which the supplier needs to meet.

In this chapter, we consider a periodic review inventory control system in the context of this second setting under stochastic demand, fractional lead times, and limited storage capacity. The same setting is investigated in other papers such as Kapalka et al. (1999), Janakiraman and Muckstadt (2004), Bijvank and Vis (2012b), Bijvank and Johansen (2012), and the main modeling approaches in the literature use discrete time Markov chains (DTMC) or constrained dynamic programming (CDP). The reader is referred to Kapalka et al. (1999) for the first approach and to Bijvank and Vis (2012b) for the second one. We choose to use a DTMC to model this problem, similar to Kapalka et al. (1999), to both avoid issues related
to Lagrangian relaxation approximation that arise from having a service level criterion and to avoid the curse of dimensionality. Kapalka et al. (1999) also explain in detail why a DTMC is a better modeling approach than a CDP. Utilizing heuristics and approximation procedures or using asymmetric approximations of lost demand and considering an upper bound on the optimal order size are the main methods used in the literature to deal with the complexity of the structure of this class of inventory systems (see Bijvank and Vis (2012b), Bijvank and Johansen (2012), Kapalka et al. (1999)). To the best of our knowledge, no closed form solutions for the limiting probabilities are proposed even for the simplest problem variations.

The mathematical details of the basis of our model are very similar to Kapalka et al. (1999) with the difference that our model is more general because we consider both \((R, s, S)\) and \((R, s, Q)\) periodic review inventory control policies. In order to solve the problem optimally, they propose a search procedure to locate an optimal policy. This search procedure heuristically examines different policies for optimality and in every step updates transition probabilities and then solves the balance equations to derive the limiting probability distribution. This means that at every step, not only does one need to calculate a part of the transition matrix, but one also needs to solve a system of equations in \(S\) unknowns to get the new limiting probability distribution. The computational effort to solve such a system grows exponentially with \(S\).

In this paper, we investigate the structure of the transition probabilities for all settings for periodic review inventory systems, and we show that for a given item with a stochastic demand we never need to explicitly compute the transition matrix at all to find the limiting probability distribution. Rather, we just need a one-time computation of \(S+1\) simple discrete probabilities. As opposed to Kapalka et al. (1999) we also propose closed form solutions for the limiting probabilities and an exact recursive algorithm for some problem classes to calculate the limiting probability distribution directly without the need to update the transition probability matrix. Therefore, there is no need to solve a system of simultaneous equations. To the best of our knowledge, no prior work creates closed form expressions for the limiting probability distribution. In the following paragraphs, we review the literature associated with the method that we use to derive these.
In order to derive the limiting probability distribution, prior research has studied the structure of the transition probabilities so as to simplify the solution of what could potentially be a very large system of balance equations. Reducing the number of these equations or finding closed form solutions have been the main goal in these studies. Finding closed form solutions for limiting probability distributions has been studied in the queueing literature when the transition probability matrix has multiple rows with the same values. The most well-known queueing system with this property is the $M/G/1$ queue Zhao and Li (1997). For the case where the transition probabilities $p_{ij}$ are zero for all $i > j + 1$, a closed form is derived by Zhao and Li (1997). A square matrix with these characteristics is called upper Hessenberg.

A second important structural feature of a transition probability matrix is the ability to decompose the matrix into two independent parts and solve each part locally to derive product form solutions. Although a lot of probability theorists mention this method as a solution approach (see Bolch et al. (2006)) it is not precisely defined and is still considered as a part of bag of tricks for probability theorists Harchol-Balter (2013). In fact, the author indicates that there is no general algorithm in the literature to decompose the transition probability matrix into independent parts and derive product form solutions; therefore, she refers to this method as an art form that can be derived by trial and error. A major contribution of this chapter is that we derive exact closed form solutions for the $(R, s, S)$ policy and we reduce the number of equations at least in half for the $(R, s, Q)$ policy by locally decomposing the state space under a specific setting of the class of inventory systems considered herein. We will discuss our methodology in Section 3.4 after describing the model in the next section.

### 3.3 MARKOV CHAIN MODEL FORMULATION

In this section, we determine the optimal inventory control policy for each item in a set of items along with the corresponding parameters in a periodic review setting, i.e., order
up-to-levels \((S)\) or order quantities \((Q)\), and reorder points \((s)\), such that they satisfy certain capacity and service level constraints. We introduce the notation to model a general periodic review inventory control system for a single item as a Markov chain. Subsequently, we adapt our general model to policies that are commonly used in healthcare settings which provided the motivation for our work (i.e., \((R,s,S)\), \((R,s,Q)\), PAR and 2-BK). Readers interested in the mathematical details of the basis of our model are referred to Kapalka et al. (1999) and references therein.

We consider an infinite horizon, discrete time, periodic review, single item, and single echelon inventory control system. On-hand inventory level is reviewed at discrete periodic points that are exactly \(R\) units of time apart (e.g., one day, one week). We refer to the time between two consecutive review points as the review period (of length \(R\)) and the on-hand inventory level at review point \(t\) (equivalently, at the end of the previous review period from \(t-1\) through \(t\)) as \(X_t\). It is assumed that the review takes place at the beginning of a review period and an order can then be placed with an external supplier with infinite capacity at each review point and is delivered after exactly \(L\) units of time (the lead time). We refer to the time when an order is delivered as the order delivery point. We assume that \(L < R\), so that \(L\) is a fraction of the review interval \(R\); this is referred to as fractional lead time in the literature (Duclos 1993, Kapalka et al. 1999, Bijvank and Vis 2012a). Thus, the number of outstanding orders at any point in time is either one or zero.

We assume that any demand that cannot be satisfied from on-hand inventory is lost with no penalty. This assumption is valid for systems where unmet demand is satisfied from an alternative source at no extra cost. For example, in a hospital environment, demand that cannot be met from a clinical or floor-level storage unit is satisfied via expedited/special deliveries from a central store. Thus, there are no backorders and the inventory position does not decrease if the system is out of stock. As a result, the on-hand inventory level at the order delivery point does not simply equal the on-hand inventory level at review minus the demand during the lead time, and unlike with backorder models, the on-hand inventory level cannot be used as the main indicator of the inventory status when excess demand is lost. Similar to traditional lost-sales models, our model has to keep track of the available
inventory on hand and whether an order was placed at the previous review point. Figure 8 shows a sample path followed by on-hand inventory in this system. Our objective is to minimize the long run average expected cost (e.g., time, effort, salary, etc.) of performing inventory review and order placement by staff at each review point, subject to capacity and service level constraints. These costs include a fixed ordering processing effort at those review points where an order is placed, and counting effort proportional to on-hand inventory at every review point for each item. It is assumed that these efforts take significantly less time than the lead time ($\ll L$).

We assume that capacity is limited because (1) available storage space might be limited, and (2) there might be lower and upper bounds for the desirable quantity of an item. Therefore, these capacity constraints determine the maximum on-hand inventory-level possible with the type of policy selected. We refer to this value as $C$; note that it is equal to $S$ for the $(R, s, S)$ policy, and $s + Q$ for the $(R, s, Q)$ policy, respectively. A second constraint in our model is on the desired service level. We define the service level as the probability of not stocking out during a review period. This is often referred to as the $\alpha$-service level in the
literature (Schneider 1978). The service level is assumed to be specified at a suitably high value ($\bar{\alpha}$) and $\bar{\alpha}$ determines the reorder point, $s$ for a given $C$. We also define the fill rate or $\beta$-service level as the long-run fraction of demand satisfied directly from inventory on-hand.

We assume that demand is stochastic, with the demand over the lead time $L$ being described by a random variable $D_L$ and the demand over the remainder of the review period $R-L$ being described by another random variable $D_{R-L}$, and also assume that $D_L$ and $D_{R-L}$ are independent. The sum of these two random variables constitutes the total demand over the review period $R$ and is denoted by $D_R$ (of course, when $L=0$ we have $D_R=D_{R-L}$.) We assume that $D_L$ and $D_{R-L}$ could have their own probability distributions and are independent of each other. Let $X_n$ be the on-hand inventory level at a review point $n$; therefore $\{X_n\}$ is a discrete-time stochastic process on state-space $S = \{0, 1, 2, \cdots, C\}$. The following equation shows the relationship between the values of the random variable $X_n$ at two successive points of this process.

$$X_{n+1} = \begin{cases} 
((X_n - D_L)^+ + Q_n - D_{R-L})^+, & X_n \leq s, \\
(X_n - D_R)^+, & X_n > s,
\end{cases} \quad (3.1)$$

Here $Q_n$ is the order quantity at review point $n$ and depends on the policy type and its associated parameters. Assuming $C$ is specified, $Q_n$ is equal to $C-s$ or $C-X_n$ for $(R,s,Q)$ and $(R,s,S)$ policies, respectively. In addition to the type of policy selected, the random variable $X_{n+1}$ only depends upon $X_n$ and the demand during review period $n$.

Let us use $l$ as an identifier for the two policies considered, so that $l$ is one of $(R,s,Q)$ or $(R,s,S)$. Then the transition matrix $P(l)$ for a policy $l$ is defined by the stationary one-step transition probabilities, where $p_{i,j}(l)$ is the probability of having $j$ units at the next review point given that there were $i$ units at the current review point. For the case where $i \leq s$, we
have:

\[
p_{i,j}(l) = \begin{cases} 
\sum_{k=0}^{i-1} \Pr(D_{R-L} \geq i + q_i(l) - k) \Pr(D_L = k) \\
+ \Pr(D_{R-L} \geq q_i(l)) \Pr(D_L \geq i), & j = 0, \\
\sum_{k=0}^{i-1} \Pr(D_{R-L} = i + q_i(l) - (j + k)) \Pr(D_L = k) \\
+ \Pr(D_{R-L} = q_i(l) - j) \Pr(D_L \geq i), & 0 < j \leq q_i(l), \\
\sum_{k=0}^{q_i(l)-(j-i)} \Pr(D_{R-L} = i + q_i(l) - (j + k)) \Pr(D_L = k), & q_i(l) < j \leq q_i(l) + i, \\
0, & \text{otherwise,} 
\end{cases}
\]

(3.2)

where, \(q_i(l)\) is the order quantity for policy \(l\) when we have an on-hand amount of \(i\) at the review point.

\[
q_i(l) = \begin{cases} 
C - i, & i \leq s, \ l = (R, s, S), \\
C - s, & i \leq s, \ l = (R, s, Q), \\
0, & \text{otherwise.} 
\end{cases}
\]

(3.3)

Note that (3.2) is for values of \(i\) that require us to place an order. The first equation covers the case where the total demand over \(R = L + (R - L)\) is equal to \(i + q_i(l)\) or more (so that we are left with zero units). The second and third equations cover the case where this demand is exactly equal to \(i + q_i(l) - j\) (so that we are left with exactly \(j\) units): the second equation applies when what we are left with at the end of the period (= \(j\)) is less than or equal to the order quantity (i.e., the total demand in the period is at least \(i\)), while the third applies when \(j\) is more than the order quantity (i.e., the total demand in the period is less than \(i\)). Finally, \(j\) can never exceed \(i + q_i(l)\) and this corresponds to the value of 0 above.

For the case where \(i > s\) (so that \(q_i(l) = 0\)), we have a simpler relationship:

\[
p_{i,j}(l) = \begin{cases} 
\Pr(D_R \geq i), & j = 0, \\
\Pr(D_R = i - j), & 0 < j \leq i, \\
0, & i < j \leq C. 
\end{cases}
\]

(3.4)

Corresponding to the transition matrix above let the limiting probability distribution be defined via the probability \(\pi_i\) that we are in state \(i\). We next define several performance measures to derive structural results and compare different policies later in the chapter. Note
that \( q_l, p_{ij}(l) \) and all of the following performance measures are a function of the policy type \( l \) that is selected. However, for ease of exposition, we drop the policy identifier \( l \) below; we will add these later when we want to compare two policies.

**Lost sales** \( B_i \) is the probability of being out-of-stock during a review period, given that there were \( i \) units at the beginning of the period; note that this could happen during the first interval of length \( L \) or during the second interval of length \( R - L \).

\[
B_i = \begin{cases} 
\Pr(D_R > i), & i > s, \\
\Pr(D_L > i) + \sum_{k=0}^{i} \Pr(D_{R-L} > q_i + i - k) \Pr(D_L = k), & 0 \leq i \leq s.
\end{cases}
\tag{3.5}
\]

**\( \alpha \) service level** is the probability of not being out-of-stock during a review period.

\[
\alpha = 1 - \sum_i B_i \pi_i
\tag{3.6}
\]

**\( \beta \) service level** is the long-run proportion of total demand that is satisfied.

\[
\beta = \frac{\text{expected demand satisfied per review period}}{\text{expected demand per review period}}
\tag{3.7}
\]

**Expected counting effort** \( E[H] \) is the expected number of units counted per review period.

\[
E[H] = \sum_i i \pi_i
\tag{3.8}
\]

**Expected reorder effort** \( E[R] \) is the expected number of reorders per review period.

\[
E[R] = \sum_{i=0}^{s} \pi_i
\tag{3.9}
\]

**Total expected replenishment effort** \( E[C] \) is the total expected effort to control the inventory at each review point,

\[
E[C] = hE[H] + rE[R],
\tag{3.10}
\]

where \( h \) and \( r \) are total effort required to count an item and to place an order for a batch of the item respectively.
3.4 STRUCTURAL RESULTS

We define the following row vector \( a \) of order \( C \), which will be used to develop the results in this section.

\[
a_j = \Pr(D_R = j), \quad \forall j \in \{0, 1, \cdots, C - 1\}.
\]

(3.11)

For ease of notation, besides \( a \), we also define the row vector \( \hat{a} \) of order \( C \) and the column vector \( b \) of order \( C \) via

\[
\hat{a} = [a_{C-1}, a_{C-2}, \cdots, a_1, a_0].
\]

(3.12)

\[
b_i = \Pr(D_R \geq C - i) = 1 - \sum_{j=0}^{C-(i+1)} a_j, \quad \forall i \in \{0, 1, \cdots, C - 1\}.
\]

(3.13)

In order to compare the same measures for different policy types, we now add the policy identifier \( l \), where \( l \in \{(R, s, S), (R, s, Q)\} \) to all measures. Now consider this transition matrix given by

\[
P(l) = \begin{bmatrix}
p_{0,0} & p_{0,1} & \cdots & p_{0,s} & p_{0,s+1} & \cdots & p_{0,C-1} & p_{0,C} \\
p_{1,0} & p_{1,1} & \cdots & p_{1,s} & p_{1,s+1} & \cdots & p_{1,C-1} & p_{1,C} \\
\vdots & \vdots & \ddots & \vdots & \vdots & \ddots & \vdots & \vdots \\
p_{s,0} & p_{s,1} & \cdots & p_{s,s} & p_{s,s+1} & \cdots & p_{s,C-1} & p_{s,C} \\
p_{s+1,0} & p_{s+1,1} & \cdots & p_{s+1,s} & p_{s+1,s+1} & \cdots & p_{s+1,C-1} & p_{s+1,C} \\
\vdots & \vdots & \ddots & \vdots & \vdots & \ddots & \vdots & \vdots \\
p_{C-1,0} & p_{C-1,1} & \cdots & p_{C-1,s} & p_{C-1,s+1} & \cdots & p_{C-1,C-1} & p_{C-1,C} \\
p_{C,0} & p_{C,1} & \cdots & p_{C,s} & p_{C,s+1} & \cdots & p_{C,C-1} & p_{C,C}
\end{bmatrix}
\]

(3.14)

**Proposition 2.** The transition matrix \( P(l) \) when the lead time is zero (i.e., \( L = 0 \)) can be written using just the vector \( a \) as given by (3.11).
Proof. Consider each of the two cases indexed by \( l \).

CASE 1: When \( l = (R, s, S) \), and \( i \leq s \) then \( q_i(l) = C - i \) and so the counterpart of equation (3.2) is given by

\[
p_{i,j}(R, s, S) = \begin{cases} 
\Pr(D_R \geq C), & j = 0, \\
\Pr(D_R = C - j), & 0 < j \leq C, \\
0, & \text{otherwise},
\end{cases}
\]

(3.15)

\[
= \begin{cases} 
b_0(= 1 - \sum_{j=0}^{C-1} a_j), & j = 0, \\
a_{C-j}, & 0 < j \leq C, \\
0, & \text{otherwise},
\end{cases}
\]

(3.16)

where (3.16) follows from (3.11) and (3.13).

For the case where \( i > s \), the counterpart of equation (3.4) is given by

\[
p_{i,j}(R, s, S) = \begin{cases} 
b_{C-i}(= 1 - \sum_{j=0}^{i-1} a_j), & j = 0, \\
a_{i-j}, & 0 < j \leq i, \\
0, & i < j \leq C.
\end{cases}
\]

(3.17)

Using (3.16) and (3.17) we can rewrite \( P(l = (R, s, S)) \) as follows in terms of just the \( a_i \) and \( b_i \) (recall that the \( b_i \) are completely determined by the \( a_i \) and are defined only as a matter of convenience)

\[
P(R, s, S) = \begin{bmatrix} 
b_0 & a_{C-1} & \ldots & a_{C-s} & a_{C-(s+1)} & \ldots & a_1 & a_0 \\
b_0 & a_{C-1} & \ldots & a_{C-s} & a_{C-(s+1)} & \ldots & a_1 & a_0 \\
\vdots & \vdots & \ddots & \vdots & \vdots & \ddots & \vdots & \vdots \\
b_0 & a_{C-1} & \ldots & a_{C-s} & a_{C-(s+1)} & \ldots & a_1 & a_0 \\
b_{C-(s+1)} & a_s & \ldots & a_1 & a_0 & \ldots & 0 & 0 \\
\vdots & \vdots & \ddots & \vdots & \vdots & \ddots & \vdots & \vdots \\
b_1 & a_{C-2} & \ldots & a_{C-(s+1)} & a_{C-(s+2)} & \ldots & a_0 & 0 \\
b_0 & a_{C-1} & \ldots & a_{C-s} & a_{C-(s+1)} & \ldots & a_1 & a_0 \\
\end{bmatrix}
\]

(3.18)
CASE 2: When \( l = (R, s, Q) \), and \( i \leq s \) then \( q_i(l) = C - s \) and so the counterpart of equation (3.2) is given by

\[
p_{i,j}(R, s, Q) = \begin{cases} 
\Pr(D_R \geq i + C - s), & j = 0, \\
\Pr(D_R = i + C - s - j), & 0 < j \leq i + C - s, \\
0, & \text{otherwise},
\end{cases}
\]

(3.19)

\[
(3.20)
\]

(3.20) follows from (3.11) and (3.13).

For the case where \( i > s \), the counterpart of equation (3.4) is given by

\[
p_{i,j}(R, s, Q) = \begin{cases} 
\mathrm{b}_{C-i}(= 1 - \sum_{j=0}^{i-1} a_j), & j = 0, \\
a_{i-J-C-s-j}, & 0 < j \leq C - s + i, \\
0, & \text{otherwise},
\end{cases}
\]

(3.21)

Similar to the first case, using (3.20) and (3.21) we can rewrite \( P(l = (R, s, Q)) \) in terms of just the \( a_i \) and \( b_i \):

\[
P(R, s, Q) = \begin{bmatrix}
\mathrm{b}_s & a_{C-(s+1)} & \ldots & a_{C-2s} & a_{C-2s-1} & \ldots & 0 & 0 \\
\mathrm{b}_{s-1} & a_{C-s} & \ldots & a_{C-2s+1} & a_{C-2s} & \ldots & 0 & 0 \\
\vdots & \vdots & \ddots & \vdots & \vdots & \ddots & \vdots & \vdots \\
\mathrm{b}_0 & a_{C-1} & \ldots & a_{C-s} & a_{C-(s+1)} & \ldots & a_1 & a_0 \\
\mathrm{b}_{C-(s+1)} & a_s & \ldots & a_1 & a_0 & \ldots & 0 & 0 \\
\vdots & \vdots & \ddots & \vdots & \vdots & \ddots & \vdots & \vdots \\
\mathrm{b}_1 & a_{C-2} & \ldots & a_{C-(s+1)} & a_{C-(s+2)} & \ldots & a_0 & 0 \\
\mathrm{b}_0 & a_{C-1} & \ldots & a_{C-s} & a_{C-(s+1)} & \ldots & a_1 & a_0
\end{bmatrix}
\]

(3.22)

Note that because (3.17) and (3.21) are identical, the sub-matrix in rows \( s + 1 \) and higher is the same for either policy. This should be intuitively clear because if we are not placing an order at the current review point then the state of the process at the next review point will only depend on the total demand during the current review period and not on the policy in use or the lead time.
Matrices for \((R, s = 4, S = 12)\) and \((R, s = 4, Q = 8)\) are added to the appendix B as an example.

**Corollary 1.** The transition probability matrix \(P\) has the following characteristics:

1. The last row of the transition matrix for any policy with any lead time is always \(\hat{a}\).
2. When \(s = 0\), all rows of \(P\) except for the first row (corresponding to \(i = 0\)) are identical across all policies.
3. When \(L = 0\) and we are using an \((R, s, S)\) policy, the transition probabilities for all states less than or equal to the reorder point \(s\) are identical and given by \(\hat{a}\).
4. When \(s = C - 1\) in the \((R, s, S)\) policy, all rows of the transition matrix are identical and given by \(\hat{a}\); therefore, we can conclude that its limiting probability distribution is also given by \(\hat{a}\).
5. With the \((R, s, S)\) policy, all elements of \(b\) only appear once for \(s = 0\).

**Proof.**
1. The entry in column \(j\) of the last row is \(p_{Cj}\). If \(i = C\) then regardless of the policy in use we will not place an order at the current review point and so the probability of being in state \(j\) at the next review point depends only on the total demand in the current review period as given by \(a_j\) and is independent of the policy or the lead time.
2. If \(s = 0\), then for all \(i > 0\), the identical equations (3.17) and (3.21) are used to calculate transition probabilities, and this does not depend on \(L\), \(s\) or the policy type.
3. All transition probabilities in \(P(R, s, S)\) when \(i \leq s\) are derived from equation (3.16), which is identical for every \(i\).
4. Follows from clauses (1) and (3); note that this is the so-called PAR policy that is commonly used in many hospital settings.
5. Follows from clause (3).

In order to exactly compute the limiting probability distribution, we need to show that our DTMC is ergodic. In the following lemma, we prove that this is true for both policies considered.
Lemma 1. Assuming that $0 < \Pr(D = i) < 1$ for all $i \in (0, 1, \cdots, C)$, the DTMC with transition matrix $P$ is ergodic.

Proof. First note that a DTMC is said to be ergodic when it is irreducible, positive recurrent and aperiodic. Second, an irreducible finite-state Markov chain is always positive recurrent. As a result, it is enough to only show that the DTMC is irreducible and aperiodic to prove that the it is ergodic. To show that our DTMC is irreducible, we need to show that it is possible to go from every state to every other state (not necessarily in one step). First, note that if the process is in state $i = s$ then it is possible for it to be in any of the states $(0, 1, \cdots, C)$ at the next step, since we will place an order of $C - s$ in the current period and by our assumption on the demand distribution there is a non-zero probability that the total demand $D_R$ in this period can be any value between 0 and $C$. Thus we can reach any state from state $s$ in the next step. But clearly, state $s$ is reachable from every state $i$ in one step: for $s < i \leq C$ it is possible for the demand in the period to be $i - s$; and for $0 \leq i \leq s$ we will place an order for $Q = C - i$ units (with the $(R, s, S)$ policy) or $Q = C - s$ units (for the $(R, s, Q)$ policy) and it is possible for the demand in the period to be $i + Q - s$. Thus every state is reachable from every other state and our DTMC is irreducible. Now, consider any state $i \in \{s + 1, s + 2, \cdots, C\}$. Because of our assumption that $0 < \Pr(D = 0) < 1$ it follows that $p_{ii} > 0$ and thus state $i$ is aperiodic. Because the DTMC is irreducible, it follows then that every other state is also aperiodic. Therefore our DTMC is ergodic.

Note that the assumption that $0 < \Pr(D = i) < 1$ for all $i \in (0, 1, \cdots, C)$ is a mild one and quite realistic in practice since $C$ is specified based on the actual characteristics of an item’s demand and available storage space.

3.4.1 Structural Results for the $(R, s, S)$ Policy

In this section, we investigate the structural results of $(R, s, S)$ policy when lead time is insignificant. We now proceed to derive the limiting probability distribution for all states based on the balance equations corresponding to our transition matrix. Referring to this ma-
trix (18), the corresponding equation for \( j = 0 \) and for each \( j \in \{0, 1, \cdots s\} \) are respectively given by

\[
\pi_0 = b_0 \left( \sum_{i=0}^{s} \pi_i \right) + \sum_{i=s+1}^{C} b_{C-i} \pi_i \quad (3.23)
\]

\[
\pi_j = \sum_{i} \pi_i P_{ij}, \\
= \sum_{i \leq s} P_{ij} \pi_i + \sum_{i > s} P_{ij} \pi_i, \\
= a_{C-j} \left( \sum_{i=0}^{s} \pi_i \right) + \sum_{i=s+1}^{C} a_{i-j} \pi_i \quad (3.24)
\]

Now consider the balance equations corresponding to a state \( j \in \{s + 1, s + 2, \cdots C\} \). This is given by

\[
\pi_j = P_{jj} \pi_j + \sum_{i \neq j} \pi_i P_{ij}, \\
= P_{jj} \pi_j + \sum_{i \leq s} P_{ij} \pi_i + \sum_{i > s, i \neq j} P_{ij} \pi_i, \\
= a_0 \pi_j + a_{C-j} \left( \sum_{i=0}^{s} \pi_i \right) + \sum_{i=j+1}^{C} a_{i-j} \pi_i \quad (3.25)
\]

Note that (3.25) follows from the fact that for \( i > s \), the value of \( P_{ij} \) is equal to 0 for \( i < j \), and equal to \( a_0 \) for \( i = j \). It now follows that

\[
(1 - a_0) \pi_j = a_{C-j} \left( \sum_{i=0}^{s} \pi_i \right) + \sum_{i=j+1}^{C} a_{i-j} \pi_i, \quad (3.26)
\]

\[
\Rightarrow \frac{\pi_j}{\sum_{i \leq s} \pi_i} = \frac{a_{C-j}}{1 - a_0} + \sum_{i=j+1}^{C} \frac{a_{i-j}}{1 - a_0} \left( \frac{\pi_i}{\sum_{i \leq s} \pi_i} \right) \quad (3.27)
\]

As a matter of notational convenience, let us define the following:

**Definition 3.**

\[
\gamma_j = \frac{\pi_j}{\sum_{i \leq s} \pi_i}, j \in \{s + 1, \cdots, C\} \quad (3.28)
\]

\[
\rho_i = \frac{a_i}{1 - a_0}, i \in \{0, \cdots, C\} \quad (3.29)
\]
Thus, equations (3.27) for \( j \in \{ s + 1, s + 2, \ldots, C \} \) can be rewritten as

\[
\gamma_j = \rho_{C-j} + \sum_{i=j+1}^{C} \rho_{i-j} \gamma_i
\]  

(3.30)

We now state and prove the main proposition in this section, which provides a closed-form for the values of \( \gamma_{s+1}, \gamma_{s+2}, \ldots, \gamma_C \) that uses just the vector \( \mathbf{a} \) as given by (3.11) (as we will show subsequently, these values can in turn be used to determine a closed-form for the limiting probability vector \( \mathbf{\pi} \)). The approach is based on decomposing the set of states into two mutually exclusive subsets: (1) \( j \in \{0, 1, \ldots, s\} \), and (2) \( j \in \{s + 1, \ldots, C\} \), i.e., values smaller than or equal to the reorder point and values larger than the reorder point. We will focus initially on the second subset.

To motivate the development of this proposition, consider the application of (3.30) for values of \( j = C, C - 1, \ldots \).

\[
\gamma_C = \rho_0
\]

\[
= \frac{a_0}{1 - a_0}
\]

\[
\gamma_{C-1} = \rho_1 + \rho_1 \gamma_C
\]

\[
= \rho_1 (1 + \gamma_C)
\]

\[
= \rho_1 \left( \frac{1}{1 - a_0} \right)
\]

\[
= \frac{1}{(1 - a_0)} \left( \frac{1!}{1!} \right) \rho_1
\]

\[
\gamma_{C-2} = \rho_2 (1 + \gamma_C) + \rho_1 \gamma_{C-1}
\]

\[
= \rho_2 \left( \frac{1}{1 - a_0} \right) + \rho_1 \left( \frac{1}{1 - a_0} \right)
\]

\[
= \frac{1}{(1 - a_0)} \left( \frac{1!}{1!} \rho_2 + \left( \frac{2!}{2!} \right) \rho_1^2 \right)
\]

\[
= \frac{1}{(1 - a_0)} \left( \frac{1!}{1!} \rho_1^0 \rho_2^1 + \left( \frac{2!}{2!} \right) \rho_1^2 \rho_2^0 \right)
\]

\[
= \frac{1}{(1 - a_0)} \left( \sum_{n \in \mathbb{Z}^+ \mid n_1 + 2n_2 = 2} \frac{(n_1 + n_2)!}{n_1! n_2!} \rho_1^{n_1} \rho_2^{n_2} \right)
\]
\[ \gamma_{c-3} = \rho_3(1 + \gamma_C) + \rho_1\gamma_{c-2} + \rho_2\gamma_{c-1} \]
\[ = \frac{\rho_3}{1-a_0} + \rho_1\frac{(\rho_2 + \rho_1^2)}{1-a_0} + \rho_2\frac{\rho_1}{1-a_0} \]
\[ = \frac{1}{(1-a_0)}(\rho_3 + 2\rho_1\rho_2 + \rho_1^3) \]
\[ = \frac{1}{(1-a_0)}\left((\frac{1!}{1!})\rho_3 + (\frac{2!}{1!1!})\rho_1\rho_2 + (\frac{3!}{3!})\rho_1^3\right) \]
\[ = \frac{1}{(1-a_0)}\left((\frac{1!}{1!})\rho_1^0\rho_2^0\rho_3^0 + (\frac{2!}{1!1!})\rho_1^1\rho_2^1\rho_3^0 + (\frac{3!}{3!})\rho_1^0\rho_2^0\rho_3^0\right) \]
\[ = \frac{1}{(1-a_0)}\left(\sum_{n\in\mathbb{Z}_+^{d} | \sum_{k=1}^{d} n_k = 3} \frac{(n_1+n_2+n_3)!}{n_1!n_2!n_3!} \rho_1^{n_1}\rho_2^{n_2}\rho_3^{n_3}\right) \]

\[ \gamma_{c-4} = \rho_4(1 + \gamma_C) + \rho_1\gamma_{c-3} + \rho_2\gamma_{c-2} + \rho_3\gamma_{c-1} \]
\[ = \frac{\rho_4}{1-a_0} + \rho_1\frac{(\rho_3 + 2\rho_1\rho_2 + \rho_1^3)}{1-a_0} + \rho_2\frac{(\rho_2 + \rho_1^2)}{1-a_0} + \rho_3\frac{\rho_1}{1-a_0} \]
\[ = \frac{1}{(1-a_0)}(\rho_4 + 2\rho_1\rho_3 + \rho_2^2 + 3\rho_1^2\rho_2 + \rho_1^4) \]
\[ = \frac{1}{(1-a_0)}\left((\frac{1!}{1!})\rho_4 + (\frac{2!}{1!1!})\rho_1\rho_3 + (\frac{2!}{2!})\rho_2^2 + (\frac{3!}{3!})\rho_1^2\rho_2 + (\frac{4!}{4!})\rho_1^4\right) \]
\[ = \frac{1}{(1-a_0)}\left((\frac{1!}{1!})\rho_1^0\rho_2^0\rho_3^0\rho_4^0 + ((\frac{2!}{1!1!})\rho_1^1\rho_2^1\rho_3^0\rho_4^0 + (\frac{2!}{2!})\rho_1^0\rho_2^0\rho_3^0\rho_4^0) + (\frac{3!}{3!})\rho_1^0\rho_2^1\rho_3^0\rho_4^0 + (\frac{4!}{4!})\rho_1^0\rho_2^0\rho_3^0\rho_4^0\right) \]
\[ = \frac{1}{(1-a_0)}\left(\sum_{n\in\mathbb{Z}_+^{d} | \sum_{k=1}^{d} n_k = 4} \frac{(\sum_{k=1}^{d} n_k)!}{\prod_{k=1}^{d} n_k!} \rho_k^{n_k}\right) \]

Observing the pattern above, we may now generalize this to the following proposition.

**Proposition 3.** The values of \( \gamma_{c-d} = \frac{\pi_{c-d}}{\sum_{i\leq s} \pi_i} \) are given by

\[ \gamma_C = \frac{a_0}{1-a_0}; \quad d \in \{0\} \quad (3.31) \]

and

\[ \gamma_{c-d} = \frac{1}{(1-a_0)}\left(\sum_{n\in\mathbb{Z}_+^{d} | \sum_{k=1}^{d} n_k = d} \frac{((\sum_{k=1}^{d} n_k)!}{\prod_{k=1}^{d} n_k!} \rho_k^{n_k}\right); \quad d \in \{1,2,\ldots,C-(s+1)\} \quad (3.32) \]
Proof. Our focus is on states \( j \in \{s+1, \ldots, C\} \), i.e., we consider values of \( d = 0, 1, \ldots, C - (s + 1) \) to find \( \gamma_{C-d} \). First, note that (3.31) corresponding to \( d = 0 \) follows trivially from (3.30) and (3.29). For \( d = 1, 2, \ldots, C - (s + 1) \) we will prove (3.32) using strong induction on \( d \). Consider the base case with \( d = 1 \). Using (3.30) we have

\[
\gamma_{C-1} = \rho_1 + \rho_1 \gamma_C
\]

\[
= \rho_1 (1 + \gamma_C)
\]

\[
= \rho_1 \frac{1}{1 - a_0}
\]

\[
= \frac{1}{(1 - a_0)} \left( \frac{1!}{1!} \right) \rho_1
\]

This shows that equation (3.32) holds for \( d = 1 \). Now consider some arbitrary \( m \in \{2, 3, \ldots, C - (s + 2)\} \), and for the strong induction step, suppose that ((3.32)) holds for \( d = 1, 2, \ldots, m \). It suffices to prove that (3.32) also holds for \( d = m + 1 \). Note that based on its definition in (3.28), \( \gamma_j \) is not defined for values of \( j < s + 1 \) or equivalently \( \gamma_{C-d} \) is not defined for values of \( d > C - (s + 1) \). Corresponding to \( m \) we have

\[
\gamma_{C-m} = \frac{1}{(1 - a_0)} \left( \sum_{n \in Z_+^m | \sum_k n_k = m} \frac{(\sum_{k=1}^m n_k)!}{\prod_{k=1}^m n_k!} \prod_{k=1}^m \rho_k^{n_k} \right) \tag{3.33}
\]

Now consider equation (3.30) for \( j = C - (m + 1) \)

\[
\gamma_{C-(m+1)} = \rho_{m+1} + \sum_{i=C-m}^{C} \rho_{i-C+m+1} \gamma_i \tag{3.34}
\]

It is easily seen that this may be re-indexed and rewritten as

\[
\gamma_{C-(m+1)} = \rho_{m+1} + \sum_{i=0}^{m} \rho_{m+1-i} \gamma_{C-i} \tag{3.35}
\]

Based on the strong induction assumption let us substitute the values for \( \gamma_{C-d} \); \( d \in \{1, 2, \ldots, C - m\} \) obtained from equation (3.32) and for \( \gamma_C \) from ((3.31)), into equation (3.35). This yields

\[
\gamma_{C-(m+1)} = \rho_{m+1} + \rho_{m+1} \frac{a_0}{1 - a_0} + \frac{1}{(1 - a_0)} \sum_{i=1}^{m} \rho_{m+1-i} \left( \sum_{n \in Z_+^i | \sum_k n_k = i} \frac{(\sum_{k=1}^i n_k)!}{\prod_{k=1}^i n_k!} \prod_{k=1}^i \rho_k^{n_k} \right)
\]

\[
= \frac{1}{1 - a_0} \rho_{m+1} + \frac{1}{(1 - a_0)} \sum_{i=1}^{m} \rho_{m+1-i} \left( \sum_{n \in Z_+^i | \sum_k n_k = i} \frac{(\sum_{k=1}^i n_k)!}{\prod_{k=1}^i n_k!} \prod_{k=1}^i \rho_k^{n_k} \right) \tag{3.36}
\]
Now consider the vectors $\mathbf{n} \in \mathbb{Z}^i_+ | \sum_{k=1}^i kn_k = i$ that determine the domain for the inner summation in (3.36) above. Noting that $i \leq m$, we can instead write this domain as $\mathbf{n} \in \mathbb{Z}^m_+ | \sum_{k=1}^m kn_k = i$, because any $\mathbf{n} \in \mathbb{Z}^m_+$ that satisfies $n_1 + 2n_2 + \ldots + n_i + \ldots m n_m = i$ must have $n_{i+1} = n_{i+2} = \ldots = n_m = 0$. The quantity within the summation is of course unaffected by this because $\rho_0^k = 1$ and $0! = 1$. This allows us to rewrite (3.36) as

$$\gamma_{C-(m+1)} = \frac{1}{1 - a_0} \rho_{m+1} + \frac{1}{(1 - a_0)} \sum_{i=1}^m \rho_{m+1-i} \left( \sum_{\mathbf{n} \in \mathbb{Z}^m_+ | \sum_{k=1}^m kn_k = i} \frac{(\sum_{k=1}^m n_k)!}{\prod_{k=1}^m n_k!} \prod_{k=1}^m \rho_k^{n_k} \right)$$

(3.37)

Now consider the expression within the outer summation:

$$\rho_{m+1-i} \left( \sum_{\mathbf{n} \in \mathbb{Z}^m_+ | \sum_{k=1}^m kn_k = i} \frac{(\sum_{k=1}^m n_k)!}{\prod_{k=1}^m n_k!} \prod_{k=1}^m \rho_k^{n_k} \right) = \sum_{\mathbf{n} \in \mathbb{Z}^m_+ | \sum_{k=1}^m kn_k = i} \frac{(\sum_{k=1}^m n_k)!}{\prod_{k=1}^m n_k!} \rho_{m+1-i} \prod_{k=1}^m \rho_k^{n_k}$$

(3.38)

Since $1 \leq i \leq m$ in this summation, we also have $1 \leq (m+1-i) \leq m$. In other words $\rho_{m+1-i}$ also appears in the product $\prod_{k=1}^m \rho_k^{n_k}$, and if $\rho_{(m+1-i)}$ were to be pulled into the product it would have an exponent of $1 + n_{m+1-i}$. For ease of notation let us define

$$\tilde{n}_{m+1-i} = 1 + n_{m+1-i}; \tilde{n}_k = n_k, k \neq (m + 1 - i)$$

(3.38)

This allows us to rewrite

$$\rho_{m+1-i} \prod_{k=1}^m \rho_k^{n_k} = \prod_{k=1}^m \rho_k^{\tilde{n}_k}$$

(3.39)

In order to also restate the $\frac{(\sum_{k=1}^m n_k)!}{\prod_{k=1}^m n_k!}$ portion (so that the summation can now be all in terms of $\tilde{n}$) we will use some basic algebra. If

$$\sum_{k=1}^m kn_k = i$$
then

$$(m + 1 - i) + \sum_{k=1}^{m} kn_k = i + (m + 1 - i)$$

$$(m + 1 - i) + (m + 1 - i)n_{m+1-i} + \sum_{k=1, k \neq m+1-i}^{m} kn_k = m + 1$$

$$(m + 1 - i)(1 + n_{m+1-i}) + \sum_{k=1, k \neq m+1-i}^{m} kn_k = m + 1$$

$$\sum_{k=1}^{m} k\tilde{n}_k = m + 1 \quad (3.40)$$

Also, using some simple algebra

$$\frac{(\sum_{k=1}^{m} n_k)!}{\prod_{k=1}^{m} n_k!} = \frac{(n_1 + \cdots + n_{m+1-i} + \cdots + n_m)!}{n_1! \cdots n_{m+1-i}! \cdots n_m!} \quad (3.41)$$

$$= \frac{(n_1 + \cdots + (n_{m+1-i} + 1) + \cdots + n_m)!}{1 + \sum_{k=1}^{m} n_k} \frac{n_1! \cdots (n_{m+1-i} + 1)! \cdots n_m!}{n_1! \cdots n_{m+1-i}! \cdots n_m!}$$

$$= \frac{\tilde{n}(m+1-i)}{\sum_{k=1}^{m} \tilde{n}_k!} \frac{(\sum_{k=1}^{m} \tilde{n}_k)!}{\prod_{k=1}^{m} \tilde{n}_k!} \quad (3.42)$$

Using (3.39), (3.40) and (3.42) in equation (3.37), we have

$$\gamma_{C-(m+1)} = \frac{1}{1 - a_0} \rho_{m+1} + \frac{1}{(1 - a_0)} \sum_{i=1}^{m} \left( \sum_{\tilde{n} \in Z^m_+ | \sum_{k=1}^{m} \tilde{n}_k = m+1} \frac{\tilde{n}(m+1-i)!}{\prod_{k=1}^{m} \tilde{n}_k!} \prod_{k=1}^{m} \rho_{\tilde{n}_k} \right)$$

Changing the order of the summation in the RHS this yields

$$\gamma_{C-(m+1)} = \frac{1}{1 - a_0} \rho_{m+1} + \frac{1}{(1 - a_0)} \left( \sum_{\tilde{n} \in Z^m_+ | \sum_{k=1}^{m} \tilde{n}_k = m+1} \left( \sum_{i=1}^{m} \frac{\tilde{n}(m+1-i)!}{\prod_{k=1}^{m} \tilde{n}_k!} \prod_{k=1}^{m} \rho_{\tilde{n}_k} \right) \right)$$

$$= \frac{1}{1 - a_0} \rho_{m+1} + \frac{1}{(1 - a_0)} \left( \sum_{\tilde{n} \in Z^m_+ | \sum_{k=1}^{m} \tilde{n}_k = m+1} \left( \sum_{i=1}^{m} \frac{\tilde{n}(m+1-i)!}{\prod_{k=1}^{m} \tilde{n}_k!} \prod_{k=1}^{m} \rho_{\tilde{n}_k} \right) \right)$$

$$= \frac{1}{1 - a_0} \left( \sum_{\tilde{n} \in Z^m_+ | \sum_{k=1}^{m} \tilde{n}_k = m+1} \left( \sum_{i=1}^{m} \frac{\tilde{n}(m+1-i)!}{\prod_{k=1}^{m} \tilde{n}_k!} \prod_{k=1}^{m} \rho_{\tilde{n}_k} \right) \right) \quad (3.43)$$

This completes the proof.
Note that the coefficient for $\prod_k \rho_k$ is the so-called multinomial coefficient and using the notation that is common for the latter, could be denoted as follows:

$$\frac{(\sum_{k=1}^{m+1} n_k)!}{\prod_{k=1}^{m+1} n_k!} = \left( \sum_{k=1}^{m+1} n_k \right)_{n_1, n_2, \cdots, n_{m+1}}$$ (3.44)

Let us use Proposition 3 to compute $\gamma_j$ for all $j \in \{s+1, s+2, \cdots, C\}$, and in particular, the sum of these values. Then we can directly compute the exact value of the limiting probability $\pi_j$ for $j \in \{0, 1, \cdots, C\}$ using the very simple formulas in the following two propositions; the first computes values of $\pi_j$ for $j \in \{s+1, s+2, \cdots, C\}$ and the second uses these to compute values of $\pi_j$ for $j \in \{0, 1, \cdots, s\}$.

**Proposition 4.** The values of the limiting probability $\pi_j$ for $j \in \{s+1, s+2, \cdots, C\}$ are given by

$$\pi_j = \frac{\gamma_j}{1 + \sum_{i=s+1}^{C} \gamma_i}$$ (3.45)

**Proof.** First note that we can rewrite $\sum_{j=0}^{C} \pi_j = 1$ as

$$\sum_{j=0}^{s} \pi_j + \sum_{j=s+1}^{C} \pi_j = 1$$

$$\sum_{j=0}^{s} \pi_j + \sum_{j=s+1}^{C} \pi_j = \frac{1}{\sum_{j=0}^{s} \pi_j}$$

$$1 + \sum_{j=s+1}^{C} \frac{\pi_j}{\sum_{i=0}^{s} \pi_i} = \frac{1}{\sum_{j=0}^{s} \pi_j}$$

$$1 + \sum_{j=s+1}^{C} \gamma_j = \frac{1}{\sum_{j=0}^{s} \pi_j}$$

$$\sum_{i=0}^{s} \pi_i = \frac{1}{1 + \sum_{j=s+1}^{C} \gamma_j}$$ (3.46)

But from (3.28) in Definition 3 we had $\pi_j = \gamma_j \sum_{i=0}^{s} \pi_i$. Then it follows that

$$\pi_j = \frac{\gamma_j}{1 + \sum_{i=s+1}^{C} \gamma_i}$$ (3.47)

This completes the proof. □
Proposition 5. The values of the limiting probability $\pi_j$ for $j = 0$ and $j \in \{1, \cdots, s\}$ are given respectively, by

$$\pi_0 = b_0 \left( \frac{1}{1 + \sum_{i=s+1}^{C} \gamma_i} \right) + \sum_{i=s+1}^{C} b_{C-j} \pi_i$$

(3.48)

and

$$\pi_j = a_{C-j} \left( \frac{1}{1 + \sum_{i=s+1}^{C} \gamma_i} \right) + \sum_{i=s+1}^{C} a_{i-j} \pi_i$$

(3.49)

Proof. Follows directly from (3.46), (3.23) and (3.24).

Before proceeding to develop an efficient algorithm for computing the exact limiting probability distribution for various values of $s$, let us use $\pi_j(s)$ to denote the limiting probability corresponding to state $j$, given that we are using an $(R, s, S)$ policy with $s$ as its reorder point. Let us also use $\gamma_j(s)$ in a similar fashion to denote the value of $\gamma_j$ corresponding to a given $s$. We introduce two new lemmas now. The first establishes the fact that we can re-use values of $\gamma_j$ computed for some reorder point when we need these values for smaller reorder points.

Lemma 2. Suppose $s_1$ and $s_2$, where $s_1 > s_2$, correspond to two different reorder points for the same $(R, s, S = C)$ system. The the following equation holds for all $j \in \{s_1 + 1, \cdots, C\}$,

$$\gamma_j(s_1) = \gamma_j(s_2)$$

(3.50)

Proof. The results follow directly from Proposition 3; (3.31) and (3.32) are identically defined for both $s_1$ and $s_2$ when $d \in \{0, 1, \cdots, C - (s_1 + 1)\}$.

The second lemma establishes a relationship between the limiting distributions for adjacent values of the reorder point that can be exploited in a recursive algorithm.

Lemma 3. In an $(R, s, S)$ system with zero lead time, the following equation holds:

$$\frac{\sum_{i=0}^{s-1} \pi_i(s - 1)}{\sum_{i=0}^{s} \pi_i(s)} = 1 - \pi_s(s - 1)$$

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Proof. Using Lemma 2 with \( s_1 = s \) and \( s_2 = s - 1 \) and (3.28) we have for all \( j \in \{s + 1, s + 2, \ldots, C\} \)

\[
\frac{\pi_j(s - 1)}{\sum_{i=0}^{s-1} \pi_i(s - 1)} = \frac{\pi_j(s)}{\sum_{i=0}^{s} \pi_i(s)},
\]

(3.51)

Therefore

\[
\sum_{j=s+1}^{C} \frac{\pi_j(s - 1)}{\sum_{i=0}^{s-1} \pi_i(s - 1)} = \sum_{j=s+1}^{C} \frac{\pi_j(s)}{\sum_{i=0}^{s} \pi_i(s)},
\]

(3.52)

\[
\sum_{i=0}^{C} \pi_i(s - 1) = 1,
\]

\[
\sum_{i=0}^{s-1} \pi_i(s - 1) + \sum_{i=s+1}^{C} \pi_i(s - 1) = 1 - \pi_s(s - 1),
\]

\[
\sum_{i=0}^{s-1} \pi_i(s - 1) \left( 1 + \frac{\sum_{i=s+1}^{C} \pi_i(s - 1)}{\sum_{i=0}^{s-1} \pi_i(s - 1)} \right) = 1 - \pi_s(s - 1),
\]

(3.53)

Substituting from (3.52) in equation (3.53) we obtain

\[
\sum_{i=0}^{s-1} \pi_i(s - 1) \left( 1 + \frac{\sum_{i=s+1}^{C} \pi_i(s)}{\sum_{i=0}^{s} \pi_i(s)} \right) = 1 - \pi_s(s - 1),
\]

(3.54)

\[
\sum_{i=0}^{s-1} \pi_i(s - 1) \left( \frac{\sum_{i=0}^{s} \pi_i(s) + \sum_{i=s+1}^{C} \pi_i(s)}{\sum_{i=0}^{s} \pi_i(s)} \right) = 1 - \pi_s(s - 1),
\]

\[
\sum_{i=0}^{s-1} \pi_i(s - 1) \left( \frac{\sum_{i=0}^{s} \pi_i(s)}{\sum_{i=0}^{s} \pi_i(s)} \right) = 1 - \pi_s(s - 1),
\]

where the last equation follows from the fact that the sum in the numerator of the fraction in the penultimate equation is \( \sum_{i=0}^{C} \pi_i(s) = 1 \).

We now derive the following theorem using Lemmas 2 and 3; this theorem forms the basis for an efficient recursive algorithm that starts with the limiting distribution for \( s = C - 1 \) and proceeds to compute the limiting distributions for \( s = C - 2, C - 3, \ldots, 0 \).
Theorem 4. Given an \((R, s, S)\) system with \(L = 0\) and the limiting probability distribution \(\pi(s)\) corresponding to some \(s\), the limiting probability distribution \(\pi(s - 1)\) corresponding to \(s - 1\) may be computed as follows:

For \(j \in \{s, \cdots, C\}\)

\[
\pi_j(s - 1) = \left\{ \begin{array}{ll}
\frac{\pi_s(s)}{1 - a_0 + \pi_s(s)} & \text{if } j = s, \\
\frac{(1 - a_0)\pi_j(s)}{1 - a_0 + \pi_s(s)} & \text{if } s < j \leq C,
\end{array} \right.
\]

(3.55)

For \(j \in \{1, \cdots, s - 1\}\)

\[
\pi_j(s - 1) = a_{C-j} + \sum_{k=s}^{C} (a_{k-j} - a_{C-j})\pi_k(s-1)
\]

(3.56)

Proof. We start with \(j \in \{s, \cdots, C\}\). Consider the balance equation for \(\pi_s(s - 1)\) (when \(j = s\)) in the form given by equation (3.27) and then apply equation (3.51) to obtain

\[
\frac{\pi_s(s - 1)}{\sum_{i \leq s-1} \pi_i(s - 1)} = \frac{a_{C-s}}{1 - a_0} + \sum_{i=s+1}^{C} \frac{a_{i-s}}{1 - a_0} \left( \frac{\pi_i(s - 1)}{\sum_{i \leq s-1} \pi_i(s - 1)} \right)
\]

(3.57)

Now consider (3.24) corresponding to \(j = s\) for the \((R, s, S = C)\) system. If we divide both sides of (3.24) by \(\sum_{i=0}^{s} \pi_i(s)\) the RHS is identical to the RHS of (3.57) above. Thus we may rewrite (3.57) as

\[
(1 - a_0)\frac{\pi_s(s - 1)}{\sum_{i=0}^{s-1} \pi_i(s - 1)} = \frac{\pi_s(s)}{\sum_{i=0}^{s} \pi_i(s)}
\]

(3.58)
Applying Lemma 3 to equation (3.58) then yields

\[(1 - a_0)\pi_s(s - 1) = \pi_s(s) \left(1 - \pi_s(s - 1)\right),\]

\[\pi_s(s - 1) = \frac{\pi_s(s)}{1 - a_0 + \pi_s(s)} \tag{3.59}\]

This completes the proof for \(j = s\). Now consider some \(j > s\). We start by using Lemma 2 and (3.28) to obtain

\[\frac{\pi_j(s - 1)}{\sum_{i=0}^{s-1} \pi_i(s - 1)} = \frac{\pi_j(s)}{\sum_{i=0}^{s} \pi_i(s)} ;\]

\[\pi_j(s - 1) = \pi_j(s) \left(\frac{\sum_{i=0}^{s-1} \pi_i(s - 1)}{\sum_{i=0}^{s} \pi_i(s)}\right)\]

Now, first applying Lemma 3 to the expression within parentheses in the RHS, and then applying (3.59) for the value of \(\pi_s(s - 1)\) we obtain

\[\pi_j(s - 1) = \pi_i(s) \left(1 - \pi_s(s - 1)\right)\]

\[\pi_j(s - 1) = \frac{(1 - a_0)\pi_j(s)}{1 - a_0 + \pi_s(s)} \tag{3.60}\]

This completes the proof for \(j \in \{s + 1, s + 2, \cdots, C\}\). To compute the limiting probabilities for \(j \in \{1, 2, \cdots, s - 1\}\) consider the balance equation for \(\pi_j\) as given by (3.24).

\[\pi_j(s - 1) = a_{C-j} \left(\sum_{i=0}^{s-1} \pi_i(s - 1)\right) + \sum_{i=s}^{C} a_{i-j} \pi_i(s - 1)\]

\[= a_{C-j} \left(1 - \sum_{i=s}^{C} \pi_i(s - 1)\right) + \sum_{i=s}^{C} a_{i-j} \pi_i(s - 1)\]

\[= a_{C-j} + \sum_{i=s}^{C} (a_{i-j} - a_{C-j}) \pi_i(s - 1)\]
The limiting probabilities corresponding to any given \( s \) may be computed by using Propositions 4 and 5. However, these require the computation of the closed-form for \( \gamma_j \) as given by Proposition 3. While this is easy to do when values of \( s \) are close to \( C \) it becomes increasingly difficult for values of \( s \) that are significantly smaller than \( C \). Note that enumerating all vectors \( \mathbf{n} \in \mathbb{Z}_+^k \) that satisfy \( n_1 + 2n_2 + \cdots + kn_k = k \) is a combinatorial problem, and as \( C - s \) increases, the value of \( k \) also increases and makes this task more difficult. We therefore take an alternative approach and propose an algorithm that starts by computing \( \pi(C - 1) \), which is trivial to do, and then uses Theorem 4 to recursively compute \( \pi(C - 2), \pi(C - 3), \cdots \).

This algorithm is very efficient and only requires the values of the vectors \( \mathbf{a} \) and \( \mathbf{b} \) as given by (3.11) and (3.13) respectively, which is a simple one-time calculation. Moreover, the algorithm provides us with the limiting probability distribution corresponding to every value of \( s \) between 0 and \( C - 1 \).

**Algorithm 1.** The following steps may be used to find the limiting probability distributions \( \pi(s) \) for \( s \in \{C - 1, C - 2, \cdots, 0\} \):

1. Set \( s = C - 1 \), and compute \( \pi_j(C - 1) = a_{C-j}, \forall j \in \{1, \cdots, C\} \) and \( \pi_0(C - 1) = 1 - \sum_{i=0}^{C-1} a_i = b_0 \); this yields \( \pi(C - 1) \).
2. Find \( \pi_j(s - 1) \), for all \( j \in \{s, \cdots, S\} \) using the previously computed values of \( \pi(s) \) and equation (3.55) from Theorem 4.
3. Using the results of the previous step, find \( \pi_j(s - 1) \) for \( 1 \leq j < s - 1 \) using equation (3.56) from Theorem 4 and then \( \pi_0(s - 1) = 1 - \sum_{j=1}^{C} \pi_j \); the end of this step yields \( \pi(s - 1) \).
4. If \( s = 0 \), exit the algorithm; otherwise, if \( s = C - 1 \) set \( s = s - 2 \), else set \( s = s - 1 \) and return to step 2.

In Step 1 we use Propositions 4 and 5 with the value of \( \gamma_{C-1} \) computed via Proposition 3. In steps 2 and 3 we use Theorem 4 to recursively compute the values of \( \pi(C - 2), \pi(C - 3) \cdots \) using \( \pi(C - 1), \pi(C - 2) \cdots \), respectively. Also, note that the first time we execute Step 4, \( s = C - 1 \) and we already have the value of \( \pi(s - 1 = C - 2) \) so we decrement \( s \) by 2 to next find \( \pi(C - 3) \); at subsequent iterations we decrement it by 1.
3.4.2 Structural Results for the \((R, s, Q)\) Policy

We now turn to the \((R, s, Q)\) system. With a maximum limit on the amount of inventory \((C)\) we can have at any one time the order quantity we will use is determined by the reorder point \(s\) via \(Q = C - s\). In this system, having a large value for \(s\) along with a small order quantity can result in poor service. For example, consider an extreme case where \(s = C - 1\) so that \(Q = 1\). In this instance orders will be placed in almost every cycle. However, since the order quantity is equal to 1, there will be many cycles where we start with much fewer than \(C\) items and eventually there will be many cycles where we stock out. Given that service levels are specified as fairly high values, we therefore make the assumption that the reorder point is smaller than \(\frac{C}{2}\), so that the order quantity \(Q\) is larger than \(\frac{C}{2}\). Other researchers have also set similar limits for \(s\) with an \((R, s, Q)\) policy (e.g., Bijvank and Vis (2012b) and Bijvank and Vis (2012a)). In order for this policy to be stable, one approach is to set the difference between the reorder point and \(C\) to be greater than reorder point. So this requirement that \(C - s > s\) leads to \(s < \frac{C}{2}\).

We now proceed to derive the limiting probability distribution for all states based on the balance equations corresponding to our transition matrix for \((R, s, Q)\) as given by (3.22), starting with \(s < j \leq C\). Referring to the structure of this matrix and given our assumption that \(s < \frac{C}{2}\), the corresponding equations will be described separately for values of \(j\) such that \(s < j < C - s\) and \(j\) such that \(C - s \leq j \leq C\).

We consider the latter case first, i.e., \(C - s \leq j \leq C\). Note that for such \(j\), as a result of our assumption that \(s < \frac{C}{2}\) it follows that \(j > s\). The corresponding steady-state equation is given by

\[
\pi_j = \sum_i \pi_i P_{ij},
\]

\[
= \sum_{i=0}^{s} P_{ij} \pi_i + \sum_{i=s+1}^{C} P_{ij} \pi_i,
\]

Note that in the first summation, where \(i \leq s\) (3.20) applies and \(P_{ij} = 0\) if \(j > i + C - s\), i.e., when \(i < s - (C - j)\). So this summation ranges from \(s - (C - j)\) to \(s\). Similarly, in the
second summation where (3.21) applies, \( P_{ij} = 0 \) when \( i < j \), so that this summation ranges from \( j \) to \( C \). Therefore we may rewrite the above equation as

\[
\pi_j = \sum_{i=s-(C-j)}^{s} P_{ij} \pi_i + \sum_{i=j}^{C} P_{ij} \pi_i,
\]

\( (3.61) \)

\[
= \sum_{i=s-(C-j)}^{s} a_{(C-j)-(s-i)} \pi_i + \sum_{i=j}^{C} a_{i-j} \pi_i,
\]

We now make a change in the index for the first summation from \( i \) to \( i - (C - s) \); therefore for the lower and upper bounds of the summation we have:

\[
s - (C - j) \leq i \leq s,
\]

\[
s - (C - j) + (C - s) \leq i + (C - s) \leq s + (C - s),
\]

\[
j \leq i + (C - s) \leq C
\]

It follows then that

\[
\pi_j = \sum_{i=j}^{C} a_{i-j} \pi_{s-(C-i)} + \sum_{i=j}^{C} a_{i-j} \pi_i,
\]

\( (3.62) \)

\[
= \sum_{i=j}^{i-(C-j)} a_{i-j}(\pi_{s-(C-i)} + \pi_i),
\]

\( (3.63) \)

\[
= a_0(\pi_{s-(C-j)} + \pi_j) + \sum_{i=j+1}^{C} a_{i-j}(\pi_{s-(C-i)} + \pi_i)
\]

Rearranging this we obtain

\[
(1 - a_0)\pi_j = a_0(\pi_{s-(C-j)}) + \sum_{i=j+1}^{C} a_{i-j}(\pi_{s-(C-i)} + \pi_i),
\]

\( (3.64) \)

\[
\pi_j = \frac{a_0}{1 - a_0}(\pi_{s-(C-j)}) + \sum_{i=j+1}^{C} \frac{a_{i-j}}{1 - a_0}(\pi_{s-(C-i)} + \pi_i),
\]

\( (3.65) \)
Now consider the equation for $j$ such that $s + 1 \leq j < C - s$.

\[
\pi_j = \sum_i \pi_i P_{ij},
\]
\[
= \sum_{i=0}^s P_{ij} \pi_i + \sum_{i=s+1}^C P_{ij} \pi_i,
\]

Once again, note that in the second summation where (3.21) applies, $P_{ij} = 0$ when $i < j$, so that it only ranges from $j$ to $C$; we further break this up into two parts: from $j$ to $C - (s+1)$ and from $(C - s)$ to $C$, and apply an index change as with the previous case. Thus

\[
\pi_j = \sum_{i=0}^s P_{ij} \pi_i + \sum_{i=s+1}^{C-(s+1)} P_{ij} \pi_i + \sum_{i=C-s}^C P_{ij} \pi_i,
\]

\[
= \sum_{i=0}^s a_{(C-j)-(s-i)} \pi_i + \sum_{i=j}^{C-(s+1)} a_{i-j} \pi_i + \sum_{i=C-s}^C a_{i-j} \pi_i,
\]

\[
= \sum_{i=C-s}^{C-(s+1)} a_{i-j} \pi_i + \sum_{i=C-s}^C a_{i-j} \pi_i + \sum_{i=C-s}^C a_{i-j} \pi_i,
\]

\[
= \sum_{i=j}^{C-(s+1)} a_{i-j} \pi_i + \sum_{i=C-s}^C a_{i-j} \left(\pi_{s-(C-i)} + \pi_i\right),
\]  

\[
(1 - a_0)\pi_j = \sum_{i=j+1}^{C-(s+1)} a_{i-j} \pi_i + \sum_{i=C-s}^C a_{i-j} \left(\pi_{s-(C-i)} + \pi_i\right),
\]

\[
\pi_j = \sum_{i=j+1}^{C-(s+1)} \frac{a_{i-j}}{1 - a_0} \pi_i + \sum_{i=C-s}^C \frac{a_{i-j}}{1 - a_0} \left(\pi_{s-(C-i)} + \pi_i\right),
\]

\[
= \sum_{i=j+1}^{C-(s+1)} \rho_{i-j} \pi_i + \sum_{i=C-s}^C \rho_{i-j} \left(\pi_{s-(C-i)} + \pi_i\right),
\]

Before introducing the next proposition we revisit $\gamma_j, j \in \{s + 1, s + 2, \cdots, C\}$ as defined by (3.28) in Definition 3 for which we derived the closed-forms given by (3.31) and (3.32) in Proposition 3 when discussing the $(R, s, S)$ system. For the rest of the discussion in this section we will use these same values of $\gamma_j$. Note that the values computed using (3.31) and
also satisfy (3.28) for the \((R, s, S)\) system. However, these closed form expressions themselves are independent of \(s\), \(S\) and \(Q\) and are functions only of the \(a_j\) values (recall that the \(\rho_j\) in the closed form are functions of only the \(a_j\) and are given by (3.29)). While these values were derived for the \((R, s, S)\) system we will also use them for deriving limiting probabilities in the \((R, s, Q)\) system. In effect, for the remainder of this section we may view these values derived for the \((R, s, S)\) system (and that follow all the relationships in the prior section) as constants.

We now state and prove the following proposition.

**Proposition 6.** Assuming that \(s < \frac{C}{2}\), we can compute the values of \(\pi_{C}, \pi_{C-1}, \cdots, \pi_{s+1}\) via

\[
\pi_{C-d} = \sum_{i=0}^{\min\{s,d\}} \gamma_{C-(d-i)} \pi_{s-i}; \quad d \in \{0, 1, \cdots, C - (s + 1)\}
\]  

(3.70)

**Proof.** Let us think of \(d\) as the distance of \(j\) from \(C\), i.e., \(d = C - j\). We divide the proof into two parts: (i) for all \(j\) such that \(C - s \leq j \leq C\) (i.e., \(0 \leq d \leq s\)) and (ii), for all \(j\) such that \(s + 1 \leq j \leq C - (s + 1)\) (i.e., \(s + 1 \leq d \leq C - (s + 1)\).

**Part 1:** Here we consider states \(j \in \{C - s, \cdots, C\}\), i.e., values of \(d = 0, 1, \cdots, s\). We will find each \(\pi_{C-d}\) as a function of \(\pi_s, \pi_{s-1}, \cdots, \pi_{s-d}\). The proof will use strong induction on \(d\). Consider the base case with \(d = 0\). Using (3.65), 3.29 and 3.31 it then follows that

\[
\pi_C = \rho_0 \pi_s = \frac{a_0}{1 - a_0} \pi_s = \gamma_C \pi_s,
\]  

(3.71) (3.72)

Thus equation (3.70) holds for \(d = 0\). Now consider some arbitrary \(m \in \{1, 2, \cdots, s - 1\}\), and for the strong induction step, suppose that (3.70) also holds for \(d = 1, 2, \cdots, m\). It suffices for the first part to prove that (3.70) also holds for \(d = m + 1\). Corresponding to \(i \in \{1, 2, \cdots, m\}\) we have

\[
\pi_{C-i} = \sum_{k=0}^{i} \gamma_{C-(i-k)} \pi_{s-k}
\]  

(3.73)
Now consider equation (3.65) for \( j = C - (m + 1) \)

\[
\pi_{C-(m+1)} = \rho_0(\pi_{s-(m+1)}) + \sum_{i=C-m}^{C} \rho_{i-(C-(m+1))}(\pi_{s-(C-i)} + \pi_{i}) \tag{3.74}
\]

Noting that \( \rho_0 = \gamma_C \) and re-indexing the summation we can rewrite this as

\[
\pi_{C-(m+1)} = \gamma_C(\pi_{s-(m+1)}) + \sum_{i=0}^{m} \rho_{m+1-i}(\pi_{s-i} + \pi_{C-i}) \tag{3.75}
\]

Based on the strong induction assumption let us substitute the values for \( \pi_{C-i}; i \in \{1, \ldots, m\} \) obtained from equation (3.73) and for \( \pi_C \) from ((3.72)), into equation (3.75). This yields

\[
\pi_{C-(m+1)} = \gamma_C(\pi_{s-(m+1)}) + \sum_{i=0}^{m} \rho_{m+1-i}(\pi_{s-i} + \pi_{C-i}) \tag{3.76}
\]

\[
= \gamma_C(\pi_{s-(m+1)}) + \sum_{i=0}^{m} \rho_{m+1-i}\pi_{s-i} + \sum_{i=0}^{m} \sum_{k=0}^{m-i} (\rho_{m+1-i} \gamma_{C-(i-k)}) \pi_{s-k}, \tag{3.77}
\]

\[
= \gamma_C(\pi_{s-(m+1)}) + \sum_{i=0}^{m} \rho_{m+1-i}\pi_{s-i} + \sum_{i=0}^{m} \left( \sum_{k=0}^{m-i} (\rho_{m+1-(k+i)} \gamma_{C-k}) \pi_{s-i} \right), \tag{3.78}
\]

\[
= \gamma_C(\pi_{s-(m+1)}) + \sum_{i=0}^{m} \left( \rho_{m+1-i} + \sum_{k=0}^{m-i} (\rho_{m+1-(k+i)} \gamma_{C-k}) \right) \pi_{s-i} \tag{3.79}
\]

where equation (3.78) is re-indexed and rewritten from equation (3.77) in a way that the \( \pi \)'s do not depend on \( k \) and only depend on \( i \). We may rewrite equation (3.30) as the following,

\[
\gamma_{C-d} = \rho_d + \sum_{k=0}^{d-1} \rho_{d-k} \gamma_{C-k} \tag{3.80}
\]

If we write equation (3.80) for \( d = (m + 1 - i) \), so we will have:

\[
\gamma_{C-(m+1-i)} = \rho_{m+1-i} + \sum_{i=0}^{m-i} \rho_{m+1-(k+i)} \gamma_{C-k} \tag{3.81}
\]

Now by using equations (3.78) and (3.81), we have

\[
\pi_{C-(m+1)} = \gamma_C(\pi_{s-(m+1)}) + \sum_{i=0}^{m} \gamma_{C-(m+1-i)} \pi_{s-i}, \tag{3.82}
\]

\[
\pi_{C-(m+1)} = \sum_{i=0}^{m+1} \gamma_{C-(m+1-i)} \pi_{s-i} \tag{3.83}
\]
and (3.83) completes the Part 1 of the proof.

**Part 2:** We next look at states \( j \in \{s + 1, \cdots, C - (s + 1)\} \), i.e., we consider values of \( d = s + 1, \cdots, C - (s + 1) \). We will find each \( \pi_{C-d} \) as a function of \( \pi_0, \pi_1, \cdots, \pi_s \). Note that \( \min\{s, d\} = s \) in equation (3.70). Again, the proof will use strong induction on \( d \). Consider the base case with \( d = s + 1 \). Using (3.69), we have

\[
\pi_{C-(s+1)} = \sum_{i=C-s}^{C} \gamma_{i-(C-(s+1))} \left( \pi_{s-(C-i)} + \pi_i \right),
\]

(3.84)

\[
= \sum_{i=0}^{s} \gamma_{s+1-i} (\pi_{s-i} + \pi_{C-i}),
\]

(3.85)

\[
= \sum_{i=0}^{s} \gamma_{s+1-i} (\pi_{s-i} + \sum_{k=0}^{i} \gamma_{C-(i-k)} \pi_{s-k}),
\]

(3.86)

where, equation (3.85) is derived by re-indexing equation (3.84) and equation (3.86) follows from the results of the first part of the proof. Now, by using the same approach that we used to derive the summation in equation (3.82) from the summation in (3.76), we can reduce equation (3.86) to the following:

\[
\pi_{C-(s+1)} = \sum_{i=0}^{s} \gamma_{(s+1-i)} \pi_{s-i}.
\]

(3.87)

Thus (3.70) holds for the base case of \( d = s + 1 \). Now consider some arbitrary \( m \in \{s + 2, \cdots, C - (s + 2)\} \), and for the strong induction step, suppose that (3.70) also holds for \( d \in \{s + 2, \cdots, m - 1, m\} \), i.e., corresponding to \( i \in \{s + 2, \cdots, m\} \) we have

\[
\pi_{C-i} = \sum_{k=0}^{s} \gamma_{C-(i-k)} \pi_{s-k}.
\]

(3.88)

It suffices to prove that equation (3.70) also holds for \( d = m + 1 \). We first re-index and rewrite equation (3.69) as follows:

\[
\pi_{C-d} = \sum_{k=s+1}^{d-1} \rho_{d-k} \pi_{C-k} + \sum_{k=0}^{s} \rho_{d-k} \left( \pi_{s-k} + \pi_{C-k} \right)
\]

(3.89)

Now consider equation (3.89) for \( d = (m + 1) \):

\[
\pi_{C-(m+1)} = \sum_{k=s+1}^{m} \rho_{m+1-k} \pi_{C-k} + \sum_{k=0}^{s} \rho_{m+1-k} \left( \pi_{s-k} + \pi_{C-k} \right)
\]

(3.90)
Now by using the strong induction assumption, we substitute the values for $\pi_{C-k}$; $i \in \{s + 2, \ldots, m\}$ obtained from equation (3.88) and for $\pi_{C-(s+1)}$ from (3.87), into the first summation in the above equation. Similarly, in the second summation, we substitute the values of $\pi_{C-k}, k = 0, 1, \ldots, s$ obtained in the first part of the proof. This yields the following:

\[
\pi_{C-(m+1)} = \sum_{k=s+1}^{m} \rho_{m+1-k} \sum_{i=0}^{s} \gamma_{C-(k-i)} \pi_{s-i} + \sum_{k=0}^{s} \rho_{m+1-k} \left( \pi_{s-k} + \sum_{i=0}^{k} \gamma_{C-(k-i)} \pi_{s-i} \right)
\]

\[
= \sum_{k=0}^{s} \rho_{m+1-k} \pi_{s-k} + \sum_{k=0}^{s} \sum_{i=0}^{k} \rho_{m+1-k} \gamma_{C-(k-i)} \pi_{s-i} + \sum_{k=0}^{s} \sum_{i=0}^{k} \rho_{m+1-k} \gamma_{C-(k-i)} \pi_{s-i} + \sum_{k=0}^{m} \rho_{m+1-k} \gamma_{C-(i-k)} \pi_{s-k}
\]

\[
= \sum_{k=0}^{s} \left( \rho_{m+1-k} + \sum_{i=0}^{s-k} \rho_{m+1-(i+k)} \gamma_{C-i} + \sum_{i=s+1}^{m} \rho_{m+1-k} \gamma_{C-(i-k)} \right) \pi_{s-k}
\]

\[
= \sum_{k=0}^{s} \left( \rho_{m+1-k} + \sum_{i=0}^{s-k} \rho_{m+1-(i+k)} \gamma_{C-i} + \sum_{i=s-k+1}^{m} \rho_{m+1-(i+k)} \gamma_{C-i} \right) \pi_{s-k}
\]

\[
= \sum_{k=0}^{s} \left( \rho_{m+1-k} + \sum_{i=0}^{s-k} \rho_{m+1-(i+k)} \gamma_{C-i} \right) \pi_{s-k}
\]  

(3.91)

Now using equation (3.80) with $d = m + 1 - k$ for the expression within parentheses above we obtain

\[
= \sum_{k=0}^{s} \gamma_{C-(m+1-k)} \pi_{s-k}
\]  

(3.92)

This completes the proof. \(\square\)

Next, let us first re-index equation (3.24) as follows:

\[
\pi_{C-d} = a_{d} \left( \sum_{i=0}^{s} \pi_{i} \right) + \sum_{i=0}^{C-(s+1)} a_{d-i} \pi_{C-i}
\]  

(3.93)

As a matter of notational convenience, let us extend the definition for $\gamma$ in Definition 3 to all $j \in \{0, \ldots, s\}$. We may thus rewrite (3.93) as

\[
\gamma_{C-d} = a_{d} + \sum_{i=0}^{C-(s+1)} a_{d-i} \gamma_{C-i}
\]  

(3.94)
Also, let us define the following:

**Definition 4.**
\[ \zeta_j = \frac{\pi_j}{\pi_0}, j \in \{0, \cdots, C\} \] (3.95)

Thus \( \zeta_0 = 1 \) and let us correspondingly redefine equation (3.70) using this new definition as follows:
\[ \zeta_{C-d} = \min\{s,d\} \sum_{i=0}^{C-s} \zeta_{C-(d-i)} \pi_{s-i}; \quad d \in \{0, 1, \cdots, C - (s + 1)\} \] (3.96)

Recall that from our assumption, \( s < \frac{C}{2} \). Therefore, the number of equations is no more than half the total number of states when deriving the limiting probability distribution for values of \( j \) between 0 and \( s \). In the following, we will provide the final theorem for this section which specifies the balance equations to be solved.

**Proposition 7.** Assuming that \( s < \frac{C}{2} \), we can compute the values of \( \zeta_1, \zeta_2, \cdots, \zeta_s \) by solving the following set of \( s \) equations:
\[ \zeta_{C-d} = \gamma_{C-(d-s)} + \sum_{i=0}^{s-1} \gamma_{C-(d-i)} \zeta_{s-i}; \quad d \in \{C - s, \cdots, C - 1\}. \] (3.97)

**Proof.** We will use Proposition 6 to prove this theorem. We start by writing balance equations for all \( C-d \) where \( d \in \{C - s, \cdots, C - 1\} \) based on the corresponding matrix that we defined at the beginning of the section.

\[
\begin{align*}
\pi_{C-d} &= \sum_{k=0}^{s} a_{d-k} \pi_{s-k} + \sum_{k=s+1}^{C-(s+1)} a_{d-k} \pi_{C-k} + \sum_{k=0}^{s} a_{d-k} \pi_{C-k}, \\
&= \sum_{k=0}^{s} a_{d-k} \pi_{s-k} + \sum_{k=s+1}^{C-(s+1)} a_{d-k} \left( \sum_{i=0}^{s} \gamma_{C-(k-i)} \pi_{s-i} \right) + \sum_{k=0}^{s} a_{d-k} \left( \sum_{i=0}^{k} \gamma_{C-(k-i)} \pi_{s-i} \right), \\
&= \sum_{k=0}^{s} a_{d-k} \pi_{s-k} + \sum_{k=0}^{s} \left( \sum_{i=s+1}^{C-(s+1)} a_{d-i} \gamma_{C-(i-k)} \pi_{s-k} \right) + \sum_{k=0}^{s} \left( \sum_{i=0}^{s} a_{d-k} \gamma_{C-(k-i)} \pi_{s-i} \right), \\
&= \sum_{k=0}^{s} a_{d-k} \pi_{s-k} + \sum_{k=0}^{s} \left( \sum_{i=s+1}^{C-(s+1)} a_{d-i} \gamma_{C-(i-k)} \pi_{s-k} \right) + \sum_{k=0}^{s} \left( \sum_{i=0}^{s} a_{d-(i+k)} \gamma_{C-i} \pi_{s-k} \right),
\end{align*}
\] (3.98)
Re-indexing the inner summations, we get

\[
\pi_{C-d} = \sum_{k=0}^{s} a_{d-k} \pi_{s-k} + \sum_{k=0}^{s} \left( \sum_{i=s-k+1}^{C-(s+k)-1} a_{d-(i+k)} \gamma_{C-i} \right) \pi_{s-k} + \sum_{k=0}^{s} \left( \sum_{i=0}^{s-k} a_{d-(i+k)} \gamma_{C-i} \right) \pi_{s-k},
\]

where the final equation is obtained by applying equation (3.94). If we now divide equation (3.100) by \( \pi_0 \) we obtain \( \zeta_{C-d} \) as the following:

\[
\zeta_{C-d} = \sum_{k=0}^{s} \gamma_{C-(d-k)} \zeta_{s-k},
\]

\[
= \gamma_{C-(d-s)} + \sum_{k=0}^{s-1} \gamma_{C-(d-k)} \zeta_{s-k}. \tag{3.101}
\]

\[\square\]

**Theorem 5.** The values of the limiting probability \( \pi_j \) for \( j = 0 \) and \( j \in \{1, \ldots, C\} \) are given respectively, by

\[
\pi_0 = \frac{1}{1 + \sum_{i=1}^{C} \zeta_i} \tag{3.102}
\]

and

\[
\pi_j = \pi_0 \zeta_j \tag{3.103}
\]
Proof. First note that we can rewrite \( \sum_{j=0}^{C} \pi_j = 1 \) as

\[
\pi_0 + \sum_{j=1}^{C} \pi_j = 1
\]

\[
\frac{\pi_0}{\pi_0} + \frac{\sum_{j=1}^{C} \pi_j}{\pi_0} = \frac{1}{\pi_0}
\]

\[
1 + \sum_{j=1}^{C} \frac{\pi_j}{\pi_0} = \frac{1}{\pi_0}
\]

\[
1 + \sum_{j=1}^{C} \zeta_j = \frac{1}{\pi_0}
\]

\[
\pi_0 = \frac{1}{1 + \sum_{j=1}^{C} \zeta_j}
\] (3.104)

The values of \( \zeta_{C-d} \) for all \( d \in \{C - s, \cdots, C - 1\} \) where \( d = C - j \) such as \( j \in \{1, \cdots, s\} \) are derived by Proposition 7. By substituting these values into equation (3.96), we can derive values of \( \zeta_{C-d} \) for all \( d \in \{0, \cdots, C - (s + 1)\} \) where \( d = C - j \) such as \( j \in \{s + 1, \cdots, C\} \). By substituting these values into equation (3.104), \( \pi_0 \) is derived. From definition 4 we had \( \pi_j = \zeta_j \pi_0 \) and this completes the proof.

3.5 Numerical Analysis

In this section, we have five different subsections. First, we illustrate the intuitive fact that when lead time is high, service level will be low and that when lead times are small the performance of a policy is very close to the performance of a policy with \( L = 0 \). This holds with both \((R, s, S)\) and \((R, s, Q)\) policies. Next, we illustrate the fact that determining whether \((R, s, S)\) or \((R, s, Q)\) is better in a particular setting is not a trivial task and depends on the relative magnitudes of the costs associated with replenishment and counting. Third, we illustrate that for the \((R, s, Q)\) policy, when the reorder point is high the service level is low (recall that we discussed this when deriving structural results for this policy). Fourth, we show how our structural results enable us to reduce the computational effort required
to evaluate an \((R, s, Q)\) policy. Finally, we illustrate the Algorithm 1 introduced in the last section with a numerical example.

### 3.5.1 Analyzing the Relationship Between Lead Time and Service Level

It is intuitively clear that a high lead time will lead to low \(\alpha\)-service levels. This would be unacceptable in the healthcare environment that motivated this work, where we typically need very high \(\alpha\)-service levels. Figure 9 (a) shows the service level for various values of the reorder point for the case where the lead time \(L = 0\) and the expected value of demand over the review interval \((D_R)\) is 10. Figures 9 (b) and (c) present similar results for the same setting but with non-zero lead times. Figure 9 (b) refers to the case where the expected value of lead time demand \((D_L)\) is 1 and Figure 9 (c) refers to the case where this value is 7 (if the demand is stationary, these might represent the case with short and long lead times that are respectively, 10\% and 70\% of the review interval). Looking at the first two figures, when the lead times are zero or relatively small the \((R, s, C = S)\) policy performs well when \(s\) is relatively large, but the \((R, s, Q)\) policy does not do well and the service levels start to fall off drastically once \(s\) is more than roughly half of the maximum inventory level. However, when the lead time is relatively large (Figure 9 (c)), neither policy is able to provide acceptable service for any value of the reorder point \(s\).

Our analysis with other rates of demand illustrated similar results. The main takeaways are that when lead times are relatively large it is not possible to meet the required high levels of service, but if lead times are small (even up to 10\% of the review period) we can find a policy that meets the service criterion and the performance of both types of policies are very similar to a policy with \(L = 0\). For the problem that motivated this work the lead times tend to be very small fractions of the review interval because floor inventory is replenished immediately following a count and is typically from an internal hospital location. Thus, the fraction of the total demand over the review interval constituted by the lead-time demand is typically very small. This works in our favor when the \(\alpha\)-service level is also set at a high value (as is typical in a hospital environment), because we can use the efficient algorithm of
Figure 9: Comparison of \((R, s, S)\) and \((R, s, Q)\) policies service level when \(D \sim \text{Poisson}(\mu = 10)\), and \(C = 15\) and (a) \(L=0\), (b) \(E[D_L] = 1\) (c) \(E[D_L] = 7\) in increasing order of reorder points

the previous section for the case where lead time is zero, when \(L > 0\) as long as \(L\) is small.

For an \((R, s, S)\) policy we can examine a range of values for \(s\) while for an \((R, s, Q)\) policy we must restrict ourselves to relatively small values of \(s\) (say less than \(\frac{C}{2}\) as assumed in the previous section).

In summary, in order to calculate the limiting probability of an inventory policy with small lead times relative to the review interval and the \(\alpha\) service level criterion, Propositions 4 and 5 and Algorithm 1 in the previous section can be used for the \((R, s, S)\) policy and Theorem 5 can be used for the \((R, s, Q)\) policy.
3.5.2 Trade-offs Between Replenishment Effort and Service Level for \((R, s, S)\) and \((R, s, Q)\) Policies

The fundamental takeaway from this section is that determining whether an \((R, s, S)\) or an \((R, s, Q)\) policy is better for a given setting is not trivial. To illustrate the main takeaways from this section consider the simple example of an inventory system with \(D \sim \text{Poisson}(\mu = 5)\), \(C = 15\), and \(L = 0\).

![Figure 10: Inventory policy performance for \(L = 0\), \(D \sim \text{Poisson}(\mu = 5)\), and \(C = 15\) in increasing order of reorder points](image)

In Figure 10, we illustrate the replenishment effort for various values of the reorder point \(s\). This has two components plotted as the two bars: counting effort (expected number of items counted in each review cycle, shown in the black bars) and reordering effort (the expected number of reorders per cycle, shown as the white bar). Note that the latter is a number between 0 and 1. Also plotted is the associated \(\alpha\)-service level attained. The plot on the left is for the \((R, s, S)\) policy and the one on the right is for the \((R, s, Q)\) policy. Assume that the required \(\alpha\)-service level is sufficiently high, as represented by the horizontal line close to a value of 1. In both cases it is clear that the optimal reorder point is given by \(s = 5\) because for each policy the counting and replenishment efforts are both the least at this value of \(s\) when compared to other values of \(s\) that satisfy the service criterion for that policy type. However, the actual total expected cost, and consequently, the choice between
an \((R, s, S)\) and \((R, s, Q)\) policy will depend on the specific values of the cost parameters \(h\) and \(r\) which we defined in section 3.3 and which translate expected effort into expected cost. Note that for the \((R, s, Q)\) policy, as before we do not consider values of \(s\) greater than \(\frac{C}{2}\) because these do not provide satisfactory service. In fact, as Figure 11 shows, it is possible that even with the assumption that \(s < \frac{C}{2}\), the \((R, s, Q)\) policy might be infeasible.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure11.png}
\caption{Inventory policy performance for \(L = 0, D \sim \text{Poisson}(\mu = 10)\), and \(C = 15\) in increasing order of reorder points}
\end{figure}

In summary, there is no obvious way of picking one policy over the other in this case and we need to study this system further to determine specific settings where one policy might dominate the other. We will investigate some of this further in the next chapter of this dissertation. Moreover, it is also possible that for a different value of the \(\alpha\)-service level the optimal values of \(s\) for the two policies might also be different from each other. In summary, determining whether \((R, s, S)\) or \((R, s, Q)\) is better in the same setting is in general not trivial and depends on the \(\alpha\)-service level, and the values of \(h\) and \(r\).

### 3.5.3 Reorder Points and Service Levels in the \((R, s, Q)\) Policy

In this section, we focus specifically on the \((R, s, Q)\) policy and turn our attention to the behavior of the \(\alpha\) service level when the reorder point increases. As Figure 9 indicates, the
α service level from an \((R, s, Q)\) policy does not follow a monotonic pattern, but one thing that appears to be consistent between these graphs and the graphs for other values of mean demand that we studied is that with zero or small lead times, the service level reaches its maximum around approximately \(\frac{C}{2}\). The reason for this is that when we have a maximum limit on what the inventory level can be, the order quantity (i.e., \(Q\)) for the \((R, s, Q)\) policy is not independent of \(s\) and is always fixed at \(Q = C - s\); the closer \(s\) is to \(C\), the smaller the order quantity. For example, consider two cases with the same problem settings where \(s\) equals \(\frac{C}{4}\) in one and \(s\) equals \(\frac{3C}{4}\) in the other (so that the corresponding order quantities \(Q\) are given by \(\frac{3C}{4}\) and \(\frac{C}{4}\), respectively). The second policy orders more frequently but in small quantities and the inventory level at the beginning of a cycle will most often be well below its maximum value, while in the first policy the order quantities are larger and the average inventory level at the beginning of a cycle will be closer to \(C\). In a given problem setting, this will lead to the first policy having better service than the second, especially when the expected value of demand increases. The following figures show the values of the limiting probability for each possible state (inventory level at the beginning of a cycle) corresponding to various reorder points between 0 and \(C - 1\). The problem setting corresponds to when \(C = 15\), \(L = 0\), and we consider two cases for the mean demand: (a) \(\mu = 5\) and (b) \(\mu = 10\).

Focusing on the case where \(j = 0\) (which corresponds to the case where at the end of the previous cycle there was no inventory and probably resulted in a shortage), the probability of being in this state is quite high at higher values of \(s\), indicating that in steady state, many cycles will experience a stock-out. In both cases this value reaches its minimum in the vicinity of \(\frac{C}{2}\) and for the case where \(\mu = 5\) we can still meet the service requirements, with \(\mu = 10\) we cannot. Concomitantly, it can be seen that the probabilities of finishing a cycle with large amounts on the shelf (i.e., for larger values of \(j\)) are almost zero. In summary, when the reorder point is high with an \((R, s, Q)\) policy the service level drops off rapidly. As discussed in the previous section this point has been made previously in the literature associated with the \((R, s, Q)\) policy in settings similar to ours, and the reorder point is often assigned a suitable upper bound (e.g., \(S - \mu\)).
Figure 12: Inventory position analysis for $L = 0$, $D \sim \text{Poisson}(\mu = 5)$, and $C = 15$. 
Figure 13: Inventory position analysis for $L = 0$, $D \sim \text{Poisson}(\mu = 10)$, and $C = 15$
3.5.4 Computational Effort and Problem Size

In Section 3.4, we demonstrated that with \( L = 0 \) and an \((R, s, S)\) policy we can use Algorithm 1 to calculate the limiting probability distribution very efficiently by using a recursive procedure starting with \( s = C \) and successively finding the probabilities for each smaller value of \( s \), without ever having to use the closed-form solution which involves the computation of the \( \gamma \) values with many factorial coefficients. The procedure is easily implemented within a spreadsheet and the limiting probability distribution can be calculated in less than a second for any practical size of \( C \). This is significant because as \( C \) increases, the computational time for the traditional approach of solving the balance equations will increase significantly as the size of the transition probability matrix increases. Moreover, by using Algorithm 1, and then using Propositions 4 and 5 for the \((R, s, S)\) policy, we are able to calculate the \( \gamma \) values and use them in any setting, including with an \((R, s, Q)\) policy (recall that the closed forms for \( \gamma \) show that these values are independent of the policy and its associated policy parameters).

![Figure 14: Percentage reduction in matrix size by applying Theorem 5](image)

Turning to the \((R, s, Q)\) policy, via Theorem 5 we can reduce the size of the coefficient matrix for the system of linear equations that needs to be solved to derive the limiting
probability distribution by at least 75% as illustrated in the following figure, where the percentage reduction in size is plotted against values of \( s \in \{0, 1, \cdots, C - 1\} \) for several different values of \( C \).

Without Theorem 5, if we want to calculate the limiting probability distribution for the entire state space, we would need to solve a set of \( C \) equations simultaneously for the \((R, s, Q)\) policy. However, we are now able to solve only \( s \) equations simultaneously and because by our assumption \( s \) is at most \( \frac{C}{2} - 1 \), our reduction in matrix size will be \( \frac{C^2 s^2}{C^2} \).

3.5.5 Illustration of Algorithm 1

We illustrate the application of Algorithm 1 described at the end of Section 3.4 when \( S = C = 15 \) and \( \mu = 5 \) with Poisson demands. The table below shows the first few iterations of the algorithms where the limiting probabilities are computed and shown for values of \( s = 14, 13, 12 \) and 11. Initially the values of \( a_i \) for \( i \in \{0, 1, \cdots, 14\} \) are computed (second column). Then we start with \( s = C - 1 = 14 \).

- In Step 1 we find the values of \( \pi_j = a_{C-j} \) for \( j = 1, 2, \cdots, 15 \) and finally the value of \( \pi_0 = 0.00023 \) by subtracting the sum of these values from 1. This yields the column of values for \( s = 14 \).
- Next, in Step 2 we move on to the column for \( s = 13 \) and find the values of \( \pi_j \) for \( j = 14, 15 \) (the last two entries in the column) using equation (80). Thus \( \pi_{14} = (0.03369)/(1 - 0.00674+0.03369) = 0.03281 \), and \( \pi_{15} = (1-0.03369)*(0.00674)/(1-0.00674+0.03369) = 0.00652 \).
- Then in Step 3, we find the values of \( \pi_j \) for \( j = 1, 2, \cdots, 13 \) using equation (81), e.g., \( \pi_1 = a_{14} + (a_{13} - a_{14})(\pi_{14} = 0.00047 + (0.00132 - 0.00047) = 0.00050 \). Finally we subtract the sum of the \( \pi_j \) values just found from 1 to obtain \( \pi_0 = 0.00024 \).

Steps 2 and 3 are repeated to obtain \( \pi(s) \) for \( s = 12, 11, \cdots, 0 \). With \( s = 12 \) we first find \( \pi_{13}, \pi_{14}, \pi_{15}, \) then \( \pi_1, \cdots, \pi_{12}, \) and then \( \pi_0 \); with \( s = 11 \) we first find \( \pi_{12}, \pi_{13}, \pi_{14}, \pi_{15}, \) then
\[ \pi_1, \ldots, \pi_{11}, \text{ and then } \pi_0, \text{ etc. The results from the first two iterations are shown in the last two columns.} \]

### Table 5: Example of algorithm iterations

<table>
<thead>
<tr>
<th>i</th>
<th>(a_i)</th>
<th>(s = 14)</th>
<th>(s = 13)</th>
<th>(s = 12)</th>
<th>(s = 11)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0.00674</td>
<td>0.00023</td>
<td>0.00024</td>
<td>0.00038</td>
<td>0.00097</td>
</tr>
<tr>
<td>1</td>
<td>0.03369</td>
<td>0.00047</td>
<td>0.0005</td>
<td>0.00072</td>
<td>0.0016</td>
</tr>
<tr>
<td>2</td>
<td>0.08422</td>
<td>0.00132</td>
<td>0.00139</td>
<td>0.00192</td>
<td>0.0038</td>
</tr>
<tr>
<td>3</td>
<td>0.14037</td>
<td>0.00343</td>
<td>0.00359</td>
<td>0.00471</td>
<td>0.00837</td>
</tr>
<tr>
<td>4</td>
<td>0.17547</td>
<td>0.00824</td>
<td>0.00857</td>
<td>0.01069</td>
<td>0.01703</td>
</tr>
<tr>
<td>5</td>
<td>0.17547</td>
<td>0.01813</td>
<td>0.01873</td>
<td>0.0223</td>
<td>0.03184</td>
</tr>
<tr>
<td>6</td>
<td>0.14622</td>
<td>0.03627</td>
<td>0.03722</td>
<td>0.04238</td>
<td>0.05444</td>
</tr>
<tr>
<td>7</td>
<td>0.10445</td>
<td>0.06528</td>
<td>0.06656</td>
<td>0.07268</td>
<td>0.08461</td>
</tr>
<tr>
<td>8</td>
<td>0.06528</td>
<td>0.10445</td>
<td>0.10582</td>
<td>0.11116</td>
<td>0.11863</td>
</tr>
<tr>
<td>9</td>
<td>0.03627</td>
<td>0.14622</td>
<td>0.14718</td>
<td>0.14935</td>
<td>0.14831</td>
</tr>
<tr>
<td>10</td>
<td>0.01813</td>
<td>0.17547</td>
<td>0.17547</td>
<td>0.17277</td>
<td>0.16249</td>
</tr>
<tr>
<td>11</td>
<td>0.00824</td>
<td>0.17547</td>
<td>0.17432</td>
<td>0.1674</td>
<td>0.15188</td>
</tr>
<tr>
<td>12</td>
<td>0.00343</td>
<td>0.14037</td>
<td>0.13853</td>
<td>0.13049</td>
<td>0.11612</td>
</tr>
<tr>
<td>13</td>
<td>0.00132</td>
<td>0.08422</td>
<td>0.08257</td>
<td>0.07675</td>
<td>0.06784</td>
</tr>
<tr>
<td>14</td>
<td>0.00047</td>
<td>0.03369</td>
<td>0.03281</td>
<td>0.03029</td>
<td>0.02677</td>
</tr>
<tr>
<td>15</td>
<td>0.00674</td>
<td>0.00652</td>
<td>0.00602</td>
<td>0.00532</td>
<td>0.00532</td>
</tr>
</tbody>
</table>

Figure 15 provides a schematic view of the transition matrix for some of the values of \(s\) corresponding to the problem.
Figure 15: Schematic view of the transition matrix of the algorithm. Each color represents a different value.
3.6 CONCLUSIONS

In this chapter, we develop comprehensive discrete time Markov chain models for the two most common periodic review systems, namely \((R, s, S)\) and \((R, s, Q)\) systems, that deal with all of the aforementioned characteristics while minimizing the total expected replenishment effort. We investigate the structural results and point out the tradeoffs of performance measures of interest for different periodic review policies. We develop the transition probabilities for different systems and propose an approach that only needs to calculate these transition probabilities one time for any system regardless of its parameters; there is no need to update these transition probabilities when changing inventory policy parameters in order to optimize the performance measure of interest while comparing different systems. In fact, our algorithm does not even directly use the transition probability matrix; rather, it only needs a one-time computation of a set of simple probabilities.

We also derive closed form solutions for the limiting probability distribution of on-hand inventory at the beginning of a review interval for several settings of interest, by using nontrivial and novel methods. For such settings, we also propose an exact algorithm to calculate the limiting probability distribution by locally decomposing the state space. In this method, there is no need to explicitly solve the balance equations to find the limiting probability distribution for any state. The derived closed form expressions and the proposed algorithm are much easier to implement in practical applications compared to traditional methods of solving Markov models, and the computational effort required for finding the replenishment policy parameters is reduced tremendously. Our approach is new and has never been used in the literature for design and analysis of the types of inventory control systems considered here.
4.0 OPTIMAL SELECTION OF INVENTORY POLICIES IN A HEALTHCARE SETTING WITH SERVICE LEVEL AND SPACE CONSTRAINTS

4.1 INTRODUCTION

Up to 45% of a hospital’s operating budget could be tied up in materials management, which indicates that hospitals may face industry-specific inventory-related problems not experienced elsewhere (Kowalski (1991), De Vries (2011)). Higher than both the manufacturing and distribution industries, it has been estimated that 48% of materials management costs could be avoided with better logistical processes (Landry and Philippe 2004).

Since investment in a continuous review framework is not always cost effective, inventory is generally reviewed at set periodic intervals (Bijvank and Vis 2012a). In practice, hospitals tend to assign the same overall periodic inventory control policy to all or the majority of items. This simplistic approach often leads to wasted staff effort, ineffective use of storage space and other inefficiencies. Furthermore, the inventory policy at points of use (POU) may cause central storage to incorrectly interpret demand consumption and interfere with the performance of the entire supply chain.

In this chapter, we address the management of inventory for multiple non-perishable routine use items in a healthcare setting. A PAR level approach (this was defined and discussed in Chapter 2.3) is often used as the primary inventory control system, and this results in operational procedures that are often inefficient and time consuming. We propose
a model that allows for exploration of a range of alternatives and chooses the best solution, given space and inventory control policy constraints. The objective is to minimize the average labor effort required to count and replenish all of the items, while providing an acceptably high level of service (avoiding stock outs) and taking into account the available space. We present a mixed-integer programming model for selecting the best periodic review inventory control system for each item and the best associated storage option considering space and item size constraints. Parameters including the dimensions of items and bins, available inventory policies, width and depth of the shelves, and the order-up-to amount of each item, are assumed to be given as inputs to the model. We optimize the order-up-to amount of each item for each inventory policy separately as a preprocessing step to the model using the results of the previous chapter. The objective is to minimize the total average effort to replenish items over a suitable interval of time, subject to limits on the storage space available. We consider \((R, s, S)\), \((R, s, Q)\), PAR level (i.e., \((R, S)\)) and two-bin Kanban policies (these are described further in the Section 4.3), and we jointly optimize space and policy allocation for multiple items and optimally allocate medical items to shelves in a storage area within a hospital by selecting the optimal inventory policy for each item along with its corresponding operating parameters. We illustrate the model with actual data from a Veteran’s Administration hospital in the Pittsburgh area.

The remainder of this chapter is organized as follows: Section 4.2 reviews the related literature, Section 4.3 reviews different inventory policies considered here and their tradeoffs while section 4.4 describes the model. Section 4.5 proposes a mixed integer programming model while Section 4.6 presents computational test results motivated by an actual setting. Finally, Section 4.7 provides concluding remarks.

### 4.2 LITERATURE REVIEW

Although most hospitals currently employ a periodic review inventory system as their primary approach to managing inventories, seeking effective inventory management policies
and approaches to ensure the availability of medical and surgical supplies at the lowest inventory control cost has consistently been a critical objective for hospital materials management and applications of operations research in health care (Little and Coughlan 2008). Presently, in most hospital internal supply inventory management practices, nurses and staff members use personal experience or heuristic rules to determine the timing and quantity when replenishing inventory stock (Nicholson et al. 2004).

Multi-item inventory control gives rise to many challenging problems, and a number of contributions have been made in the design of multi-item inventory control systems since 1960. Many of the papers in this area consider joint replenishment since ordering multiple items independently results in a large number of small orders. Such an approach is suitable for many systems, e.g., when we have a very large number of items, when fixed ordering costs are very high, or when group discounts might be available. Much of the prior research emphasizes quantitative fundamentals of inventory control systems. A huge body of literature exists on determining how to group items in such a way that all items from the same group have the same order cycle. However, this approach is not suitable for the hospital context since group discounts are not available and a fixed order cost is not applied to the items considered for this study due to the fact that hospitals usually use a local warehouse. Our main objective is to minimize the expected time that inventory staff spend to count and replenish the items when placing orders with the hospital’s internal central warehouse during every review period.

Other researchers have investigated multi-item inventory models incorporating other costs or constraints. Typically, these constraints are on the budget and/or space available. Space-constrained inventory models occur naturally in the retail domain. However, the primary retail objective is maximizing profit, which is not the case in hospitals. Much work has also been done on optimizing a specific inventory control policy’s parameters. For example, Golany and Lev-Er (1992) construct a multi-item, multi-period fixed quantity inventory policy considering items with variable demand and determine the optimal order quantity ($Q$) and reorder point ($s$) for each item to maximize the profit for a pharmaceutical distributor while considering several constraints. Additionally, a wide range of optimization
methodologies have been used to model these problems, and due to the complexity of multi-item inventory systems, different types of heuristic methods have also been utilized in the literature (Kelle et al. (2012), and Bijvank and Vis (2012a)). Much of the literature on multi-item inventory control systems cannot easily translate to healthcare settings because these are more focused on either very large numbers of items or very high fixed ordering costs (Downs et al. (2001)).

Table 6: Characteristics of the relevant literature in periodic review inventory system in hospitals

<table>
<thead>
<tr>
<th>Study</th>
<th>Demand process</th>
<th>Excess demand</th>
<th>L</th>
<th>Policy</th>
<th>No. of items</th>
<th>SL</th>
<th>Cap.</th>
<th>Obj.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kelle et al. (2012)</td>
<td>stoch</td>
<td>lost</td>
<td>int</td>
<td>(R, s, S)</td>
<td>multi</td>
<td>yes</td>
<td>yes</td>
<td>cost</td>
</tr>
<tr>
<td>Bijvank and Vis (2012a)</td>
<td>stoch</td>
<td>lost</td>
<td>frac</td>
<td>(R, s, Q)</td>
<td>multi</td>
<td>yes</td>
<td>no</td>
<td>service</td>
</tr>
<tr>
<td>Little and Coughlan (2008)</td>
<td>stoch</td>
<td>back</td>
<td>0</td>
<td>(R, S)</td>
<td>multi</td>
<td>yes</td>
<td>no</td>
<td>service</td>
</tr>
<tr>
<td>Lapierre and Ruiz (2007)</td>
<td>det</td>
<td>back</td>
<td>int</td>
<td>(R, s, Q)</td>
<td>single</td>
<td>no</td>
<td>no</td>
<td>cost</td>
</tr>
<tr>
<td>Nicholson et al. (2004)</td>
<td>stcoh</td>
<td>back</td>
<td>0</td>
<td>(R, S)</td>
<td>single</td>
<td>no</td>
<td>no</td>
<td>cost</td>
</tr>
<tr>
<td>Dellaert and van de Poel (1996)</td>
<td>stoch</td>
<td>back</td>
<td>0</td>
<td>(R, s, Q)</td>
<td>multi</td>
<td>no</td>
<td>no</td>
<td>cost</td>
</tr>
<tr>
<td>Vincent and Ranton (1984)</td>
<td>det</td>
<td>back</td>
<td>int</td>
<td>(R, s, Q)</td>
<td>single</td>
<td>yes</td>
<td>no</td>
<td>cost</td>
</tr>
<tr>
<td>This chapter</td>
<td>stoch</td>
<td>lost</td>
<td>frac</td>
<td>(R, s, S)</td>
<td>multi</td>
<td>yes</td>
<td>yes</td>
<td>cost</td>
</tr>
</tbody>
</table>

Table 6 presents a summary of several important studies in the hospital inventory management literature. This is an expanded version of the table in Bijvank and Vis (2012a) with additional rows and columns. The key characteristics addressed in the table include whether the demand process is deterministic (det) or stochastic (stoch); whether excess demand is back-ordered (back) or lost; whether the lead time (L) is integral (int), fractional (frac) or zero (0); whether the replenishment policy (Policy) is (R, s, S), (R, S), (R, s, Q), Kanban, or (s, Q); whether there are multiple items (multi) or a single item; whether capacity limitation...
(Cap) exist (yes) or not (no); service level limitations (SL), and the objective function (cost or service).

In this chapter, we study a multi-item inventory control system. The inventory control policies that we consider are the PAR level or \((R, S)\), \((R, s, S)\), \((R, s, Q)\), and two-bin Kanban systems, and we do so while imposing shelf-space constraints. To our knowledge, no prior research has considered comparing these four inventory control policies on the aforementioned problem.

4.3 COMPARISON OF DIFFERENT INVENTORY POLICIES IN HOSPITALS

In its most basic form, inventory management is control over the flow of entities into and out of a stock of different items. The tradeoffs associated with holding inventories in a hospital are clear. More inventory means that more demand can be met and consequently, the hospital provides better service to its patients and reduces expediting time, energy and costs. On the other hand, holding a large volume of items means that a large amount of space is required to store inventory. Storage space in hospitals is scattered around many locations and usually tends to be limited; it is not uncommon to see all manner of \textit{ad hoc} storage arrangements in place. Moreover, hospital storage systems require hospital staff to categorize, organize, count, and replenish items; these handling and administrative costs are the most important economic factors considered in this chapter. Another problem with holding large amounts of inventory in hospitals is that some items can have a limited shelf-life or deteriorate over time; in this chapter we do not consider these situations. We consider only disposable, non-perishable items within a storage area where there are typically less than one hundred different items.

To have a good inventory control system, it is necessary to have a clear understanding of how different inventory control policies work and are influenced by hospital characteristics.
There are two broad types of inventory review policies, continuous and periodic. Because the setup cost of a monitoring system for a continuous review policy is relatively high, it is usually utilized in hospitals mostly for critical or expensive items. In a periodic review system, the inventory position is monitored at fixed points in time and if necessary, an order is placed only at these times. In a hospital setting this tends to be the system of choice for a large number of items. In particular, for the items we consider in this chapter that are not expensive or critical, periodic review is typically used. In hospitals, the review interval (i.e., the amount of time that elapses between two consecutive reviews of inventory in the stockroom) is usually one day, but for some locations it could be longer and up one week for the types of items that we consider.

The inventory policy used by most health systems defines the stocking quantity (within a minimum and maximum value for the PAR levels) for each item based on average usage and the desired number of days supply, e.g., an overall average of 14 days of supply for items, and a desired fill rate of at least 98.5%. Wang et al. (2015) use a fixed order inventory control policy model for health inventory system which uses these PAR levels as parameters for this policy. Also, clinics sometimes set their inventory levels at a days worth of demand with minimal safety stock (Wilson et al. (2015)).

Stressing hospitals’ need for simplicity and ease of usage is an important potential future research area. As staff dealing with logistics activities in hospitals often do not have the same technical background and knowledge as their counterparts in manufacturing, implementation of sophisticated inventory systems may be difficult in hospitals. The PAR inventory method involves a supply staff member scanning all the supplies with a hand-held scanning device or manually counting them and entering data onto a piece of paper attached to a clip board and possibly transcribing these into a computer system later on. The supply clerk notes any nursing supplies that need to be replenished, or “brought up to PAR”, and then refills the bins on a separate trip, usually later the same day. If the supply for some item runs out during the day because of a higher usage rate than expected, the material management department is notified in order to have an expedited delivery of the item. In a worse scenario that is not uncommon, a clinical staff member might have to go to the central storage location and pick
up the item. Our model is based on ensuring that this happens with very low probability and for very few items.

The two-bin Kanban policy has also become popular in healthcare. Here inventory is stored in two identical bins and when the first bin is exhausted, it signals the need to reorder a full bin. Consistent with the service level requirement of the PAR level system we set bin capacity to $s$. In a continuous review context, the second bin may be viewed as reserve stock for use during the lead-time interval, so the capacity of each bin is such that there is enough to meet expected demand over the lead time plus some safety stock. In our periodic review context with short lead times the capacity of each bin should be enough to meet demand until the next review point with very high probability and thus we set this capacity to $s$ once again. There are numerous benefits to using the two-bin Kanban supply system over a PAR system, including a decrease in the number of resupply trips, eliminating daily inventory counts, and a reduction in supply shortages. A PAR system requires significant effort for counting and replenishment and also leads to staff members taking shortcuts in the process, which in turn leads to inaccuracies and poor service, and replenishment during almost every review period requires significant labor. On the other hand, a Kanban system doesn’t necessitate daily counting, eliminates “guesstimating” of supply quantities, creates a standardized supply replenishment process, and allows for more frequent replenishment cycles without increasing material handling costs. As a two-bin Kanban policy is much easier to use from an operational perspective, it has been widely used for material supply in manufacturing, and more recently the healthcare industry has been increasingly considering the Kanban approach as an alternative to the PAR policy on the basis of efficiency, accuracy, compliance levels, and cost savings. A recent article by Landry and Beaulieu (2013) provides a very good chronicle of inventory systems in healthcare.

Many studies like Rosales et al. (2015) show that changing from a PAR system to a two-bin Kanban system is an excellent move for hospitals in terms of reducing the total cost of counting and replenishment per review cycle. However, none of these emphasize the fact that although a two-bin Kanban system is simpler and reduces operational costs, it also has several limitations. First, unless we can use a card separator within a single bin, we are
restricted to using two separate bins. With the other policies it might be possible to store
everything needed in a single bin. Thus we generally need more shelf space. Moreover, we
need to consider both bins as one item since the bins should be stored together. With this
restriction, we are less flexible when optimizing the allocation of space. Second, we generally
have more inventory; e.g., with the PAR system we have a maximum inventory of \( s + 1 \) but
here we could have as many as \( 2s \) units (with the other two systems it would depend on the
values of \( S \) and \( Q \)). Third, this policy may not be suitable for all items. For example, \( s_i \)
units of a larger item \( i \) may not fit in any of the available bins. Also, we can only store \( 2s_i \) of
an item \( i \) with a two-bin Kanban system, and sometimes this might not be optimal because
we might want to store more of an item.

As mentioned earlier, a PAR system could result in orders for an item being placed in
every review cycle (especially items with high usage levels). Therefore in the context of
medical inventory, an alternative and more general approach is to use a system that allows a
range of desired inventory values. Here the inventory level of an item \( i \) is never allowed to fall
below some minimum value (\( LB_i \)) or exceed some maximum value (\( UB_i \)). The value of \( LB_i \)
is based on some minimum level of service (fill-rate or probability of not stocking out) that
is to be provided over the review interval (although, based on our experience in numerous
hospital settings, this is done based on clinician experience as opposed to any rigorous
statistical methodology). The value of \( UB_i \) is set based on some conservative estimate of
the maximum possible demand for the item over the review period, or possibly, based on
space considerations. When these values are specified and a PAR system is in use, the PAR
level must be chosen to be within this desired range. It is common in some hospital settings
to use the terms minimum PAR and maximum PAR to denote these desired minimum and
maximum levels, even when the actual system in use is not a PAR system. We adopt the
more general notation of \( LB_i \) and \( UB_i \) since the terms minimum PAR and maximum PAR
are not meaningful when used with inventory control strategies that do not follow a PAR
system. Moreover, all four policies we consider can be implemented within the constraints
of \( LB_i \) and \( UB_i \). Specifically, we consider
• \((R, s, S \mid S = C)\) policy: \(LB_i \leq s < C \leq UB_i\)
• \((R, s, Q \mid Q = C - s)\) policy: \(LB_i \leq s < C \leq UB_i\)
• \((R, S \mid S = C)\) policy: \(LB_i \leq C - 1 < C \leq UB_i\)
• \((R, s, Q \mid s = Q = \lfloor C/2 \rfloor)\) policy: \(LB_i \leq \frac{C}{2} < C \leq UB_i\)

Note that in order to be stable and have a reasonable service level, the reorder point should satisfy the following two conditions, \(s < C - \mu\) and \(s < \frac{C}{2}\), for an \((R, s, Q)\) policy where \(\mu\) is the expected value of the stochastic demand for all policies. Consequently, \((R, s, S)\) or Kanban policies might not be even feasible for an item because of this condition regardless of the desired service level. In the following section, we describe the model for choosing which inventory control policy to use for an item and compare some of the structural properties of the different policies.

### 4.4 MODEL AND ALGORITHM DEVELOPMENTS

We begin with several modeling assumptions. First, we assume the items are stored on standard steel shelving units and the dimension of each shelving unit is \(H \times W \times D\). There are a total of \(N\) items, where item \(i\) is a rectangular solid of dimensions \(\tilde{h}_i \times \tilde{w}_i \times \tilde{d}_i\) and there are \(B\) different bin types where bin type \(l\) can store \(n_{il}\) units of item \(i\). We assume that the amount of time to count an item \((h)\) is the same for all items, as are the amounts of time to replenish each item \((r)\). We summarize our assumptions as follows:

• space in patient-unit storage rooms is limited
• shelving units have standard rectangular shapes
• all items are stored in bins
• there is a limited set of bin sizes
• a single bin size is used for any item
• only one item type is allowed to be stored in a lane of bins
• there is no bin stacking
• two equal-sized bins (or card-separated bin sections) are used if a Kanban policy is used
• the summation of the widths of all the bins used for a given item is less than the width of a shelving unit

Note that, in this chapter we use the same inventory control settings and notation as in the previous chapter. For ease of notation, we will henceforth index and refer to the \((R,s,S)\), \((R,s,Q)\), PAR, and Kanban policies as Policies 1, 2, 3, and 4, respectively. We summarize the sets and indices that we use in the following table.

<table>
<thead>
<tr>
<th>Set/Index</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>index for item type, (i \in I), where (I = {1, 2, \ldots, N})</td>
</tr>
<tr>
<td>(j)</td>
<td>index for policy type, (j \in J_i) where (J_i \subseteq {1, 2, 3, 4})</td>
</tr>
<tr>
<td>(l)</td>
<td>index for bin type, (l \in {1, 2, \ldots, B})</td>
</tr>
<tr>
<td>(K^j_i)</td>
<td>set of possible values for the maximum inventory level associated with item (i) when it uses policy (j), i.e., (K^j_i = {LB_i, \ldots, UB_i})</td>
</tr>
<tr>
<td>(k)</td>
<td>the value of the maximum inventory level considered for a policy (j) to use with item (i); (k \in K^j_i),</td>
</tr>
</tbody>
</table>

Next, we redefine equations (3.8), (3.9), and (3.10) from the previous chapter in order to make them be a function of the policy, and its related parameters. In general there are two parameters: \(s\), which represents the reorder point as before and \(k\), which is the value of \(C \in \{LB_i, \ldots, UB_i\}\)
Table 8: Parameters for deriving objective function coefficients

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>$H_j^i(s,k)$</td>
<td>expected counting effort: the expected number of units counted per review</td>
</tr>
<tr>
<td></td>
<td>period for item $i$ with policy $j$ and corresponding parameters $s$ and $k$</td>
</tr>
<tr>
<td>$R_j^i(s,k)$</td>
<td>expected reorder effort: the expected number of reorders per review period</td>
</tr>
<tr>
<td></td>
<td>for item $i$ with policy $j$ and corresponding parameters $s$ and $k$</td>
</tr>
<tr>
<td>$T_j^i(s,k)$</td>
<td>total expected replenishment effort: the total expected effort to control</td>
</tr>
<tr>
<td></td>
<td>the inventory at each review point for item $i$ with policy $j$ and</td>
</tr>
<tr>
<td></td>
<td>corresponding parameters $s$ and $k$</td>
</tr>
<tr>
<td>$\alpha_j^i(s,k)$</td>
<td>service level: the probability of not being out-of-stock during a review</td>
</tr>
<tr>
<td></td>
<td>period for item $i$ with policy $j$ and corresponding parameters $s$ and $k$</td>
</tr>
<tr>
<td>$\Delta_j^i(k)$</td>
<td>feasible reorder point set: a set of all feasible reorder points for item $i$</td>
</tr>
<tr>
<td></td>
<td>with policy $j$ and corresponding parameter $k$ where the system is stable</td>
</tr>
<tr>
<td></td>
<td>and meets the service criterion</td>
</tr>
<tr>
<td>$\varphi$</td>
<td>service level threshold: the lower bound for the $\alpha$-service level</td>
</tr>
</tbody>
</table>

We define $T_j^i(s,k)$ as

$$T_j^i(s,k) = hH_j^i(s,k) + rR_j^i(s,k), \quad (4.1)$$

and $\Delta_j^i(k)$ for $\forall j \in \{1, 2, 3, 4\}$ separately as,

$$\Delta_1^i(k) = \{ s \mid 0 \leq s < k - 1, \alpha_1^i(s,k) \geq \varphi \}, \quad \forall i, \quad (4.2)$$

$$\Delta_2^i(k) = \{ s \mid 0 \leq s < \min\{k - \mu, \frac{k}{2}\}, \alpha_2^i(s,k) \geq \varphi \}, \quad \forall i, \quad (4.3)$$

$$\Delta_3^i(k) = \{ s \mid s = k - 1, \alpha_3^i(k - 1, k) \geq \varphi \}, \quad \forall i, \quad (4.4)$$

$$\Delta_4^i(k) = \{ s \mid s = \frac{k}{2}, \alpha_4^i(\frac{k}{2}, k) \geq \varphi \}, \quad \forall i. \quad (4.5)$$

If $\Delta_j^i(k) = \emptyset$, then the corresponding policy $j$ is infeasible for item $i$ and will not be contained in $J_i$. For a given item $i$ we consider each policy $j \in J_i$ and each value of parameter $k \in K_i^j$ for the maximum inventory level, and find the optimal value of the reorder point
(s∗) that minimizes total expected replenishment cost. We denote the corresponding total expected cost in one review period by \( f^j_i(k) \), i.e., this is the cost if item \( i \) uses policy \( j \) with maximum inventory level \( C = k \). Thus

\[
f^j_i(k) = \min\{T^j_i(s, k) \mid s \in \Delta^j_i(k)\},
\]

(4.6)

It is obvious that the reorder point for the PAR and Kanban policies are fixed once \( k \) is specified; therefore, we do not need (4.6) to optimize the reorder point. As a result, assuming that \( s = k - 1 \in \Delta^3_i(k) \) and \( s = \frac{k}{2} \in \Delta^4_i(k) \) are feasible for the PAR and Kanban policies respectively, we will have,

\[
f^3_i(k) = T^3_i(k - 1, k), \quad \forall i
\]

(4.7)

\[
f^4_i(k) = T^4_i(\lfloor \frac{k}{2} \rfloor, k), \quad \forall i
\]

(4.8)

Finally, we also select the best policy \( j^* \) for a given item \( i \) and a given maximum inventory level \( C = k \) and specify the corresponding cost via

\[
j^* \in \arg\min_j \{f^j_i(k)\}
\]

(4.9)

\[
f_i(k) = f^{j^*}_i(k)
\]

(4.10)

Let us define \( s^*_i(j, k) \) as the optimal reorder point for item \( i \) with policy \( j \) when we use parameter value \( k \) for the maximum inventory level permitted \( (C) \). In the following corollary, we investigate the behavior of parameters of interest in the \((R, s, S)\) policy (i.e., with \( j = 1 \))

**Corollary 2.** The following statements are true for the \((R, s, S)\) policy with item \( i \),

1. For any \( k \), \( R^1_i(k) \), \( H^1_i(k) \), and \( \alpha^1_i(k) \), are increasing in \( s \),
2. \( s^*_i(1, k) = \arg\min \{s \mid \alpha^1_i(k) > \phi\} \).
Proof. Consider an item \( i \) and two \((R,s,S)\) policies with different reorder points \( s_i(1,k) \) and \( s'_i(1,k) \) for a given value of \( S = k \), where \( s_i(1,k) < s'_i(1,k) \). Let us denote by \( X \) and \( Y \) (respectively) the on-hand inventory levels at the beginning of some arbitrary review cycle for these two policies. If \( X \) and \( Y \) are both less than \( s_i(1,k) \), or greater than \( s'_i(1,k) \) then the decision is the same for both cases, and the inventory levels at the beginning of the next cycle will differ by the same amount as they currently do. However, when \( s_i(1,k) < X, Y \leq s'_i(1,k) \) then we need to reorder for the system that has reorder point \( s'_i(1,k) \) but not for the one that has \( s_i(1,k) \). In particular, we are adding an amount \( k - Y \) > 0, which makes the on-hand inventory level higher for the second system at the beginning of the next review cycle. In addition, we are also reordering more frequently because of the reorder point being higher. So, the counting and replenishment efforts are both higher with reorder point \( s'_i(1,k) \) and this proves clause (1). Clause (2) follows directly from the results of clause (1). □

The following corollary indicates that for the same value \( k \) for the maximum inventory level allowed, the PAR system has higher counting and replenishment effort but provides better service.

**Corollary 3.** The following statements are true when comparing the \((R,s,S)\) and PAR policies,

1. \( H^1_i(s,k) \leq H^3_i(k-1,k) \),
2. \( R^1_i(s,k) \leq R^3_i(k-1,k) \),
3. \( \alpha^1_i(s,k) \leq \alpha^3_i(k-1,k) \).

Proof. Recognizing that the PAR policy is equivalent to the \((R,s,S = k)\) policy with \( s = k - 1 \), the result follows directly from Corollary 2. □

Using the results of Corollary 2 and after running several examples and observing the behavior of the optimal reorder point for high service levels, we propose the following two algorithms (one for each of the \((R,s,S)\), and \((R,s,Q)\) policies) to calculate the optimal reorder point with a service constraint. This is more efficient for finding \( f^j_i(k) \) than calculating
$T^j_i(s,k)$ for all $s \in \Delta^j_i(k)$ for the $(R,s,S)$ and $(R,s,Q)$ policies. The algorithms are simple search methods that begin with an initial guess of $E[D]$ for the value of $s$. We then search among successively higher values if this is not feasible, and if it is not feasible, then we search among successively lower values for the smallest feasible value.

**Algorithm 2.** For an item $i$ and parameter value $k$, the optimal reorder point, $s^*_i(1,k)$ for an $(R,s,S)$ policy may be found as follows.

1. We start with $s = E[D]$, and calculate the $\alpha$-service level; if $\alpha^1_i(s,k) \geq \varphi$, then go to the next step, otherwise go to step 3.
2. If $s = 0$, then $s^*_i(1,k) = 0$ and go to step 5, otherwise reduce $s$ by 1, and calculate the $\alpha$-service level. If $\alpha^1_i(s,k) \geq \varphi$, repeat this step, otherwise $s^*_i(1,k) = s + 1$ and go to step 5.
3. If $s = k$, then go to the next step; otherwise, increase $s$ by 1, and calculate the $\alpha$-service level; If $\alpha^1_i(s,k) \geq \varphi$, $s^*_i(1,k) = s$ and go to step 5, otherwise, repeat this step.
4. Report that the problem is infeasible with the current $\alpha$-service level and go to the next step.
5. Terminate the algorithm.

**Algorithm 3.** For an item $i$ and parameter value $k$, the optimal reorder point, $s^*_i(2,k)$ for an $(R,s,Q)$ policy may be found as follows:

1. We start with $s = E[D]$, and calculate the $\alpha$-service level; if $\alpha^2_i(s,k) \geq \varphi$, then go to the next step, otherwise go to step 3.
2. If $s = 0$, then $s^*_i(2,k) = 0$ and go to step 5, otherwise reduce $s$ by 1, and calculate the $\alpha$-service level; If $\alpha^2_i(s,k) \geq \varphi$, repeat this step, otherwise $s^*_i(2,k) = s + 1$ and go to step 5.
3. If $s \geq \min\{k - E[X], \lfloor \frac{k}{2} \rfloor\}$ go to step 4, otherwise, increase $s$ by 1, and calculate the $\alpha$-service level; If $\alpha^2_i(s,k) \geq \varphi$, $s^*_i(2,k) = s$ and go to step 5, otherwise, repeat this step.
4. Report that the problem is infeasible with the current $\alpha$-service level and go to the next step.
5. **Terminate the algorithm.**

We tested 100 different instances for these two algorithms and also enumerated across all possible values of $s$. In all of the instances, these two algorithms are able to either find the optimal $s$ or determine if the problems is infeasible.

The following table contains a summary of the notation that we have either already used or wish to use in order to derive the parameters of interest for our mathematical programming model, which will choose the best combination of policies across our set of items. Up until this point, we have focused on deriving the objective function coefficients and now, we discuss how to assign the optimal bin size to item $i$ and policy $j$ with corresponding parameter value $k$.

### Table 9: Summary of parameters needed for the models

<table>
<thead>
<tr>
<th>Parameters</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>$N$</td>
<td>number of item types</td>
</tr>
<tr>
<td>$B$</td>
<td>number of bin types</td>
</tr>
<tr>
<td>$A$</td>
<td>number of shelving units</td>
</tr>
<tr>
<td>$n_i$</td>
<td>capacity of bin $l$ to store item $i$</td>
</tr>
<tr>
<td>$\tilde{h}_l \times \tilde{w}_l \times \tilde{d}_l$</td>
<td>dimensions of bin $l$</td>
</tr>
<tr>
<td>$H \times W \times D$</td>
<td>dimensions of available shelf space (all shelving units) with corresponding volume $V$</td>
</tr>
<tr>
<td>$v^j_i(k)$</td>
<td>required volume to store item $i$ using policy $j$ with its associated parameter value $k$</td>
</tr>
<tr>
<td>$w^j_i(k)$</td>
<td>required width to store item $i$ using policy $j$ with its associated parameter value $k$</td>
</tr>
<tr>
<td>$h^j_i(k)$</td>
<td>required height to store item $i$ using policy $j$ with its associated parameter value $k$</td>
</tr>
</tbody>
</table>
Now for every item and its corresponding feasible policy set (i.e., \( J_i \)), we iteratively check different numbers of possible bins in this set for every bin type, i.e., \( \{ \lfloor \frac{LB_i}{n_{il}} \rfloor, \ldots, \lceil \frac{UB_i}{n_{il}} \rceil \} \). For different permutations of bin type and possible numbers of that bin, we test for each item and policy to see at first whether it is feasible and second, to determine the optimal \( k \) for each permutation of bin type and number. We update \( K^j_i \) accordingly and remove those parameter values for the maximum storage level that are not optimal for a given bin size and possible bin number. Then, we review the results for each bin size and compare the results across different policies for that size with dominated policies being removed. Therefore, for each bin size and value of \( k \) only one policy can be assigned: the space requirement is the same and the policy with the least cost will be assigned to that specific item for that specific bin type and associated number of bins. Next, we review the different bin sizes and if a larger bin results in higher cost, then the corresponding parameter value associated with that bin is also removed from \( K^j_i \) because it is dominated. Finally, based on the components of \( K^j_i \), we update \( w_i^j(k) \), \( h_i^j(k) \), and \( v_i^j(k) \).

Now, let \( \Gamma^i_k = j^* \) from (4.9) denote the optimal policy for item \( i \) when we use corresponding parameter value \( k \). In the next section, we will use this definition to create the shelf space allocation model. Because we don’t need the index \( j \) (we can find the optimal \( j \) via (4.9) if we know its corresponding parameter value \( k \)), we drop the index \( j \) and for ease of notation, we redefine \( v_i(k) = v_i^\Gamma(k) \), \( h_i(k) = h_i^\Gamma(k) \), and \( w_i(k) = w_i^\Gamma(k) \).

Note that in the worst case scenario, we end up with a maximum value of \( \lceil \frac{UB_i}{n_{il}} \rceil - \lfloor \frac{LB_i}{n_{il}} \rfloor + 1 \) for the size of the parameter value set \( K^j_i \) for each combination of item and policy. As this process is very straightforward, we do not write a formal algorithm for it and treat it as a preprocessing procedure. In the next section, we define the space allocation models based on the derivation within this section.
4.5 OPTIMAL ALLOCATION MODELS BASED ON REPLENISHMENT EFFORT

In this section we define a two-dimensional level bin packing (2LBP) model. We formulate a model that minimizes the total expected counting and replenishment time subject to constraints on storage area, item and bin dimensions and available inventory control policies. The objective of the model is to select exactly one candidate for each item $i$ along with its associated value of $k$, as well as to decide on how the item should be assigned to the available shelf space. We assume that all required units of an item are on a single shelf in order to facilitate easy access to the item when it is needed. Shelves in shelving units at POU can only have discrete height values as the number of bin sizes is limited. We assume that each shelf can have a different height but that it is a multiple of some base unit height $h$ (i.e., the possible heights are $h, 2h, 3h, \cdots$). Using this idea we divide a shelving unit into a set of shelves that are arranged vertically with a height that is a multiple of $h$. We also update the values of $h_i(k)$ and $H$ correspondingly. Let us define the index $l \in \{1, \cdots, H\}$.

In the next page, we redefine MIP1 for this problem, and call it the 2LBP model. The objective function (4.11) represents the total expected cost of counting and replenishment. Constraint set (4.12) ensures that the width constraint for each shelf is not violated. Constraint set (4.13) ensures that the relationships between the $x$ and $z$ variables are correct, and constraint set (4.14) ensures that each item is stored with exactly one policy with one associated parameter value. Constraint set (4.15) ensures that no item on any lower shelf is tall enough to cause it to intrude into the space occupied by a higher shelf.

**Decision Variables**

$x_{ik}^l$: = 1 if item $i$ with parameter $k$ is located on a shelf at height position $l$; 0 otherwise (binary)

$y_l$: = 1 if a shelf is located at position $l$; 0 otherwise (binary)
Model 2LBP

\[
\min \sum_i \sum_k f_i(k) z_{ik},
\]

subject to:

\[
\sum_i \sum_k w_i(k)x_{ik}^l \leq W_y l \quad \forall l,
\]

\[
z_{ik} \leq \sum_l x_{ik}^l \quad \forall i, k
\]

\[
\sum_k z_{ik} = 1 \quad \forall i,
\]

\[
y_l + x_{ik}^r \leq 1 \quad \forall l, i, k, \forall r \in \{\max\{1, l - h_i(k) + 1\}, \cdots, l - 1\},
\]

\[
z_{ik} \in \{0, 1\}, \quad \forall i, k, \quad x_{ik}^l \in \{0, 1\}, \quad \forall i, k, l.
\]

4.6 COMPUTATIONAL ANALYSIS

In this section, we have four different subsections. First, we compare \((R, s, S)\) and \((R, s, Q)\) policies and examine their tradeoffs which leads to a conjecture and discussion about that conjecture. Second, we perform sensitivity analysis for the service level across all four policies and show how the optimal reorder point changes when we change the service level. Then, using real data from a healthcare setting we illustrate the behavior of a hybrid inventory control policy when we change the available storage space. We also provide some guidelines and insights based on this real example. Finally, we generate data to test the performance of our model and to consider the tradeoffs between different policies across different inventory policy parameter settings.

4.6.1 Trade-offs Between \((R, s, S)\) and \((R, s, Q)\)

In this section, we compare different policies regarding their expected counting or ordering efforts, and the service level. In Conjecture 1, we compare \((R, s, S)\) and \((R, s, Q)\) policies
based on the computational results from the inventory system that we consider.

**Conjecture 1.** Given \( i, s \) and \( k \), the following statements are true for comparing \((R, s, S)\) and \((R, s, Q)\) policies when lead time is insignificant,

1. \( H_1^1(s, k) \geq H_1^2(s, k) \),
2. \( R_1^1(s, k) \leq R_1^2(s, k) \),
3. \( \alpha_1^1(s, k) \geq \alpha_1^2(s, k) \).

The order quantity (i.e., \( Q \)) for an \((R, s, Q)\) policy is fixed (i.e., \( Q(j = 2) = k - s \)), regardless of the on-hand inventory level (i.e., equation (3.1)) at the reorder point. Therefore only when inventory on-hand equals \( s \) will our order quantity be \( k - s \) and we might be at our maximum capacity, \( k \), when the order arrives. But in an \((R, s, S)\) policy, \( Q(j = 1) = k - i \), and no matter how much inventory is on-hand at the reorder point, there is a chance that we will order and hence that we will be at our maximum capacity, \( k \), when the order arrives. As we noted while proving Corollary 2, in an \((R, s, S)\) policy the expected inventory on-hand at the beginning of any review interval is more than in an \((R, s, Q)\) policy. We will demonstrate our conjecture above with several examples.

The first four sets of figures below compare for a single item the counting and reordering effort associated with the two policies for two different demand rates of \( \mu = 5 \) and \( \mu = 10 \), with (a) zero lead time and (b) a positive but relatively small lead time where the mean lead time demand is either 10% \( (\mu = 10) \) or 20% \( (\mu = 5) \) of the mean demand over the review interval. There are several takeaways. First, as per our conjecture, the counting effort for the \((R, s, S)\) policy is always higher while the reorder effect is always lower when compared to the \((R, s, Q)\) policy when we have a constraint on the maximum inventory allowed. Second, the behavior of the cost elements in the presence of a positive but small lead time is quite similar to that with zero lead time. Third, the \((R, s, Q)\) policy is often unable to provide the required service level when demand rates are high.
Figure 16: Comparison of $(R, s, S)$ and $(R, s, Q)$ policies (a) expected counting effort, (b) expected reordering effort, and (c) $\alpha$-service level when $D \sim \text{Poisson}(\mu = 5)$, $L = 0$, and $C = 15$ in increasing order of reorder points.

Figure 17: Comparison of $(R, s, S)$ and $(R, s, Q)$ policies (a) expected counting effort, (b) expected reordering effort, and (c) service level when $D \sim \text{Poisson}(\mu = 10)$, $L = 0$, and $C = 15$ in increasing order of reorder points.
Figure 18: Comparison of \((R, s, S)\) and \((R, s, Q)\) policies (a) expected counting effort, (b) expected reordering effort, and (c) service level when \(D \sim \text{Poisson}(\mu = 5), E[D_L] = 1,\) and \(C = 15\) in increasing order of reorder points.

Figure 19: Comparison of \((R, s, S)\) and \((R, s, Q)\) policies (a) expected counting effort, (b) expected reordering effort, and (c) service level when \(D \sim \text{Poisson}(\mu = 10), E[D_L] = 1,\) and \(C = 15\) in increasing order of reorder points.
In order to further clarify the logic behind our conjecture, consider the limiting probability of being in a particular state $j$, where $0 \leq j \leq C = 15$ for a given value of $s$. Suppose we compute this probability for every possible value of $s$ and then sum these values up. While this sum has no physical interpretation, larger values for a particular $j$ would imply that across all possible reorder points, that value of $j$ is more likely for the state of the system (the inventory level at the beginning of a review interval). In the figures below we plot these values as a stacked sum for $(R, s, S)$ and $(R, s, Q)$ for various values of $j$. Figures 20 and 21 correspond to two different values of the expected demand of 5 and 10, respectively. As both figures show, when we consider larger values of $j$, the sum of the limiting probabilities across all reorder points with the $(R, s, S)$ policy is generally higher when compared to the sum for the $(R, s, Q)$ policy. This implies that an $(R, s, S)$ policy will generally have higher inventory levels when counting is done and this results in higher counting effort. However, it will also provide better service because of the higher inventory level. We also notice a pattern with the $(R, s, S)$ policy. The sum of these limiting probabilities for a given $j$ appears to be directly related to $Pr(D = C - j)$, the probability that the demand is equal to $C - j$. We also plot this probability for each $j$ for the $(R, s, S)$ policy in the figures below. In this policy, the highest limiting probabilities are close to values of $C - E[D]$ corresponding to which $Pr(D = C - j)$ is at a maximum as well.

![Figure 20: Limiting probabilities for different on-hand inventory levels; $D \sim$ Poisson($\mu = 5$)](image)
4.6.2 Sensitivity Analysis for Service Level Across All Policies

In this section, we change the threshold for the service level and investigate the effect of this change on the optimal reorder point. In Figures 22 \((R, s, S)\) and 23 \((R, s, Q)\), we study the behavior of the reorder point as the threshold for the service level increases, for two different values of expected demand and three different values of the maximum inventory level allowed. Note that if the policy is infeasible based on the threshold, we remove the point for that value of the threshold from the graph. We did not perform this particular analysis for PAR and Kanban policies because the reorder point is fixed with these two policies. We may summarize our takeaways from these plots as follows:

- the optimal reorder point with the \((R, s, S)\) policy is non-decreasing in the service threshold, as long as it is not infeasible
- the behavior of the optimal reorder point depends on the expected demand as well as the maximum allowable inventory level
- our algorithm to determine the value of \(s\) has better performance for the \((R, s, S)\) policy but in both, it is able to find the optimal value
- the behavior of the optimal value for the \((R, s, Q)\) policy is inconsistent because it depends on \(r\) and \(h\)
• for the setting where $E[D] = 10$ and $C = 15$, there is no feasible $(R, s, Q)$ policy when the service threshold is greater than 0.8.

Figure 22: Optimal reorder point for an $(R, s, S)$ policy over different $\alpha$ service level thresholds

Figure 23: Optimal reorder point for an $(R, s, Q)$ policy over different $\alpha$ service level thresholds
For the PAR policy and Kanban policy the service level results are as follows for the aforementioned settings:

Table 10: Summary of service level for PAR and Kanban policy

<table>
<thead>
<tr>
<th>Setting</th>
<th>PAR</th>
<th>Kanban</th>
</tr>
</thead>
<tbody>
<tr>
<td>$E[D] = 5, C = 14$</td>
<td>0.9998</td>
<td>0.9763</td>
</tr>
<tr>
<td>$E[D] = 5, C = 20$</td>
<td>1.0000</td>
<td>0.9991</td>
</tr>
<tr>
<td>$E[D] = 5, C = 30$</td>
<td>1.0000</td>
<td>1.0000</td>
</tr>
<tr>
<td>$E[D] = 10, C = 14$</td>
<td>0.9165</td>
<td>infeasible</td>
</tr>
<tr>
<td>$E[D] = 10, C = 20$</td>
<td>0.9984</td>
<td>0.8068</td>
</tr>
<tr>
<td>$E[D] = 10, C = 30$</td>
<td>1.0000</td>
<td>0.9960</td>
</tr>
</tbody>
</table>

instead of $C = 15$, we consider $C = 14$ for the Kanban policy.

4.6.3 Optimal Allocation Based on Changing Available Storage Space

In this section, we illustrate the proposed IP formulation using actual data from a hospital. We select a subset of 100 items with diverse characteristics, stored in a stockroom with multiple standard steel shelving units each with height 70 in., width 30 in. and depth 21 in. There are 8 different bin types corresponding to all combinations of height = 4 or 8 inches, depth = 6 or 12 inches and width = 12 or 24 inches. The review interval is one week long and the optimal reorder point is computed for each item $i$ using a 99th percentile service level.

In Table 11, we report the optimal value for the proposed IP model across several instances. We use the maximum number of shelves as a key problem size factor for all instances to see what happens when we limit space, assuming that the fixed cost per replenishment is fifty times the unit counting cost ($r = 50, h = 1$). The average daily replenishment and counting effort for each item is obtained by using the limiting probabilities derived by the
methods described in the last chapter and the optimal reorder point is calculated by the algorithms described in this chapter. Table 11 shows that when the number of shelves is greater than or equal to 24, it is optimal (in terms of total costs) to use a two-bin Kanban system for every item where it is feasible to do so and an \((R, s, S)\) policy is chosen for the others. Since PAR has the lowest average inventory on hand compared with the other policies it has lower counting cost, but it also has the highest replenishment costs because unlike the other policies, there is an order placed in virtually every cycle. The \((R, s, Q)\) system has lower counting costs than the \((R, s, S)\) system but on the other hand it has more replenishment cost. For the selected cost structure that we chose (i.e., \(r/h = 50\)), the \((R, s, S)\) policy has lower cost than the \((R, s, Q)\) or PAR systems.

For \(H \leq 8\) (8 or fewer shelves), the problem is infeasible, meaning that at least 9 shelves are required to store all items with the PAR policy which takes up the least amount of space. But note that for \(k = 9\), policies other than the PAR policy are assigned to some items. The first reason for this is that there is some empty space available if the model assigns PAR to all items; second, for some items the space required for the PAR policy is equal to that of another policy, but the total expected cost of the PAR policy is greater so that the PAR policy is dominated. In this particular example, the \((R, s, S)\) and \((R, s, Q)\) policies take the same amount of space, but based on the objective function’s parameters, one of them is always dominated by the other.

When the number of shelves is between 9 and 24, items being assigned the \((R, s, S)\) or \((R, s, Q)\) policies means that the replenishment costs are high enough to dominate the counting costs; otherwise PAR, with its lower counting costs, would dominate these two. When space is restricted, we see the trade-off between decreasing space usage and increasing costs. As space decreases the model chooses items to change to the more costly PAR policy to conserve space.
Table 11: Optimal values from Model 2LBP

<table>
<thead>
<tr>
<th>H</th>
<th>objective function</th>
<th>policy for 20 selected items</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\geq 24$</td>
<td>414</td>
<td><strong>Policy 1</strong>: 2, 4, 5, 12, 15, 17, 18, 19, 20; <strong>Policy 4</strong>: 1, 3, 6, 7, 8, 9, 10, 11, 13, 14, 16</td>
</tr>
<tr>
<td>23, 22, 21</td>
<td>461</td>
<td><strong>Policy 1</strong>: 2, 5, 12, 15, 17, 18, 19, 20; <strong>Policy 3</strong>: 4; <strong>Policy 4</strong>: 1, 3, 6, 7, 8, 9, 10, 11, 13, 14, 16</td>
</tr>
<tr>
<td>20</td>
<td>462</td>
<td><strong>Policy 1</strong>: 2, 5, 7, 12, 15, 17, 18, 19, 20; <strong>Policy 3</strong>: 4; <strong>Policy 4</strong>: 1, 3, 6, 8, 9, 10, 11, 13, 14, 16</td>
</tr>
<tr>
<td>19</td>
<td>491</td>
<td><strong>Policy 1</strong>: 5, 12, 15, 17, 18, 19, 20; <strong>Policy 3</strong>: 2, 4; <strong>Policy 4</strong>: 1, 3, 6, 7, 8, 9, 10, 11, 13, 14, 16</td>
</tr>
<tr>
<td>18</td>
<td>500</td>
<td><strong>Policy 1</strong>: 2, 5, 12, 15, 17, 18, 20; <strong>Policy 3</strong>: 4, 19; <strong>Policy 4</strong>: 1, 3, 6, 7, 8, 9, 10, 11, 13, 14, 16</td>
</tr>
<tr>
<td>17</td>
<td>504</td>
<td><strong>Policy 1</strong>: 2, 5, 7, 12, 15, 17, 18, 20; <strong>Policy 3</strong>: 4, 19; <strong>Policy 4</strong>: 1, 3, 6, 7, 8, 9, 10, 11, 13, 14, 16</td>
</tr>
<tr>
<td>16</td>
<td>509</td>
<td><strong>Policy 1</strong>: 5, 12, 15, 17, 18, 20; <strong>Policy 3</strong>: 2, 4, 19; <strong>Policy 4</strong>: 1, 3, 6, 7, 8, 9, 10, 11, 13, 14, 16</td>
</tr>
<tr>
<td>15</td>
<td>512</td>
<td><strong>Policy 1</strong>: 5, 15, 17, 18, 20; <strong>Policy 3</strong>: 2, 4, 12, 19; <strong>Policy 4</strong>: 1, 3, 6, 7, 8, 9, 10, 11, 13, 14, 16</td>
</tr>
<tr>
<td>12</td>
<td>579</td>
<td><strong>Policy 1</strong>: 5, 7, 15, 20; <strong>Policy 2</strong>: 13, 18; <strong>Policy 3</strong>: 2, 4, 12, 17, 19; <strong>Policy 4</strong>: 1, 3, 6, 8, 9, 10, 11, 14, 16</td>
</tr>
<tr>
<td>10</td>
<td>674</td>
<td><strong>Policy 1</strong>: 7, 15, 20; <strong>Policy 2</strong>: 3, 5, 8, 9, 13, 14, 16, 18; <strong>Policy 3</strong>: 2, 4, 12, 17, 19; <strong>Policy 4</strong>: 1, 6, 10, 11</td>
</tr>
<tr>
<td>9</td>
<td>754</td>
<td><strong>Policy 1</strong>: 15, 20; <strong>Policy 2</strong>: 3, 5, 6, 8, 9, 11, 13, 14, 16, 18; <strong>Policy 3</strong>: 2, 4, 7, 12, 17, 19; <strong>Policy 4</strong>: 1, 2, 4</td>
</tr>
<tr>
<td>$\leq 8$</td>
<td>Infeasible</td>
<td>Infeasible</td>
</tr>
</tbody>
</table>
Figure 24: Optimal policy based on the number of shelves and item characteristics for a sample of 20 items

In figure 24, we show the characteristics of sample items from a prosthetics POU for a VA hospital in Pittsburgh. We multiply demand for an item by the volume of that item and then order the items in decreasing order of this measure. In the following, we discuss some general guidelines and rules of thumb for hospitals by considering the results of this section and based on studying the transition between different policies for items with different characteristics and in different settings. By different characteristics, we mean demand (low, high), size (small, large) and by different settings, we mean replenishment and reordering effort and required service level. We summarize our findings as follows:

- $(R, s, S)$ policy
  - when item is small and demand is high
  - when replenishment cost is high
  - when service level is high
• (\(R, s, Q\)) policy
  – when item is small and demand is low
  – when counting cost is high
  – when service level is not extremely high

• PAR policy
  – when item is large and demand is high
  – when replenishment cost is low
  – when service level is extremely high

• Kanban policy
  – when item is small and demand is low
  – when counting cost is very high
  – when service level is not extremely high

Note that guidelines stated above are very general and not universally true; for a particular combination of items that need to be stored, a hospital would need to run our model to arrive at the best set of policies and the associated storage scheme.

4.6.4 Tradeoffs Between Different Policies Considering Different Inventory Control Parameter Settings

In this section we investigate the tradeoffs between the different inventory policies and test the performance of our model. To do this, we randomly generated expected item demand and associated bin size data for a set of 185 items. The data is depicted in Figure 25, with expected demands ranging between 1 and 50 as displayed along the x-axis, and the corresponding width of the bin (which can contain an amount equal to the expected demand) as displayed along the y-axis. We assume that the height of each bin is the same and that we have 20 different bin widths ranging between 1 and 20 units. This set of items was then used with our model in three different settings with the following combinations of the required \(\alpha\) service level and values for the costs of counting \(r\) and replenishment \(h\):
1. \( \alpha = 0.95, r = 50, h = 1 \) 
2. \( \alpha = 0.95, r = 1, h = 1 \) 
3. \( \alpha = 0.9, r = 1, h = 1 \) 

For each setting we ran our algorithm with different numbers of available shelves, up to a maximum of 30 shelves.

![Randomly generated item bin size and demand data](image)

Figure 25: Randomly generated item bin size and demand data

The run time varies from a few seconds to one minute. Figures 26 (a), (b), and (c) display for the above settings (respectively), the number of items (out of 185) that are assigned a particular policy for each given value of the number of shelves available for storage. With fewer than 10 shelves, the problem is infeasible and the optimal value remains unchanged when we go beyond 23 shelves. Figures 27 (a), (b) and (c) that follow provide for the three settings (respectively) a display of how the maximum inventory of the 185 items in storage with the optimum policy is distributed among the items for different numbers of available shelves. The items are divided into groups having maximum inventory levels equal to 2, 3, 4, 5 or 6 times the expected demand rate at the optimum, and the number of items in each group is depicted. Finally, Figures 28 (a), (b) and (c) display for the three settings (respectively), the total cost across all 185 items when we select the best policy for each item, plotted as a function of the number of shelves available for storage.
Figure 26: Distribution of inventory systems when the number of shelves increases for (a) setting 1 (b) setting 2 (c) setting 3
Figure 27: Distribution of the maximum inventory on-hand when the number of shelves increases for (a) setting 1 (b) setting 2 (c) setting 3
Figure 28: Total cost when the number of shelves increases for (a) setting 1 (b) setting 2 (c) setting 3
We summarize takeaways as the following:

- In the first setting, only the Kanban and \((R, s, S)\) policies are chosen and when we decrease the reorder costs relative to counting cost (in setting 1 it is 50 times the counting cost and in settings 2 and 3 it is equal to the counting cost), the PAR policy is also chosen for a few items. This is because the frequent ordering with the PAR policy does not add as much to the cost any more. The \((R, s, Q)\) policy is very rarely selected for an item.

- Sometimes, even when sufficient space is available for an item with the Kanban policy (using the bin size that was assigned to the item), the \((R, s, S)\) policy is chosen. This happens because an \((R, s, S)\) policy can have less frequent ordering than a Kanban policy and if the reorder costs are relatively high, the former policy can be more attractive than the latter one.

- As the optimal policy differs for items with different bin widths it is not trivial to determine how the final policy for an item is changed when we change the ratio \(\frac{r}{h}\).

- The change in total cost when we increase the number of shelves is monotone non-increasing.

- The change in total cost when we change the ratio \(\frac{r}{h}\) is not linear.

- In general, Kanban and \((R, s, S)\) are dominating the other policies.

- We observe in setting 3 that when the required \(\alpha\) service level decreases, the \((R, s, Q)\) policy is used instead of the Kanban policy. Recall that we assume that the optimal reorder point in the \((R, s, Q)\) policy is less than \(\frac{C}{2}\) which reduces both the counting effort and the reordering effort compared to when the reorder point equals \(\frac{C}{2}\). Therefore, we can conclude that in those cases when the \((R, s, Q)\) policy is selected instead of a Kanban policy, these reduction are large enough that the reordering cost with the Kanban policy is greater than the sum of the counting and reordering costs with the \((R, s, Q)\) policy.

- Because the counting cost is considered to be zero in the Kanban policy, the Kanban policy dominates the \((R, s, Q)\) policy most of the time.

- Generally, the total cost decreases when the ratio \(\frac{r}{h}\) decreases (Figure 28 (a) vs. Figures 28 (b) and (c)). However, the behavior of the cost curve is somewhat different for the two cases. In both cases attaining the minimum possible cost for each of the settings
requires 23 shelves. However, with the lower \( \frac{r}{h} \) value the cost drops quite rapidly as we start increasing the number of shelves from the minimum required value of 10, and we are able get quite close to this minimum cost with relatively few shelves (around 14). When \( \frac{r}{h} \) is high the decrease in costs as the number of shelves increases is much more gradual. This is because when \( \frac{r}{h} = 1 \) the counting cost is very high relative to the reordering cost, so that the Kanban policy quickly becomes very attractive (this is also validated by Figures 26 (b) and (c)) and so as soon as there is shelf space available the items choose the Kanban policy and quickly approach the minimum cost policy. Generally, the total cost decreases when the \( \alpha \) service level decreases (Figure 28 (b) vs. Figure 28 (c)).

- Generally, the maximum inventory on-hand decreases when the \( \alpha \) service level decreases (Figures 27 (b) vs. (c)).
- Generally, the maximum inventory on-hand decreases when the reordering cost decreases (Figure 27 (a) vs. Figures 27 (b) and (c)).

### 4.7 SUMMARY AND CONCLUSIONS

In this chapter, we consider a specific storage area or stockroom at a POU location that is restocked from a central location within the hospital. The major cost drivers are the effort to monitor and replenish inventory for the items in the storage location as opposed to the holding cost, which is incurred irrespective of where in the system the item is stored. We study a multi-item system with shelf space constraints, where any of several different inventory policies such as \((R, s, S)\), \((R, s, Q)\), PAR, and Kanban can be used for an item. We assume a fractional lead time, stochastic demand, and a service level constraint as well as space restrictions. We propose a shelf space allocation approach using a 2LBP approach. The results indicate that the more shelves we have the more we tend to use a Kanban policy and the less shelving space we have we utilize an \((R, s, S)\) policy and perhaps the PAR system.
5.0 CONCLUSIONS AND FUTURE WORK

This dissertation addresses inventory control and logistics challenges related to pharmaceuticals as well as medical and surgical supplies within a hospital and how to optimally solve these problems to minimize hospital staff effort. Despite the existence of well-documented evidence on the benefits of the introduction of good supply chain management practices and the resulting cost reduction, the health care sector has been extremely slow to embrace these practices. Regardless of having some rather unique characteristics, only a few studies have addressed the question of how the design and implementation of inventory systems in a health service setting takes place. This dissertation is dedicated to improving the efficiency of health care by optimizing space allocation in healthcare facilities that are typically very space constrained, choosing the best inventory control system for different items and improving the allocation of health care resources to reduce medication errors and staff effort needed to manage inventory. All of the chapters of this dissertation demonstrate the importance of providing resources by anticipating needs and making adjustments as needs change.

Decentralized ADCs can be an integral component of distribution systems within pharmacy departments across the hospital. There are significant challenges associated with managing ADC inventory optimally while minimizing labor and capital resources. The role of enhanced inventory control functionality is not fully defined for these devices. The aim of one chapter of this dissertation is to improve ADC inventory management by leveraging dynamic inventory parameters. To do so, we optimally determine what items and how many of each should be stored in decentralized ADCs within a patient unit, while simultaneously determining the storage layout within the ADC. The approach considers each item’s demand...
and inventory control parameters, as well as its size. There are two main goals associated with our approach. First, when supplies are not immediately available, it typically means that a nurse, medical assistant or other clinician needs to retrieve out-of-stock items from central storage. This is expensive and disruptive, and our goal is to minimize such occurrences. Second, we also aim to minimize possible errors that might arise from storing look-alike and/or sound-alike (LASA) medications next to each other. We use a novel MIP approach to maximize the benefits from stocking items in decentralized ADCs located at POU, as measured by expected reductions in time spent by clinical personnel in managing expedited deliveries. We investigate both position-free and position-based paradigms to allocate shelf space optimally and design appropriate layouts that reduce the likelihood of potentially serious human errors from selecting the wrong medication.

In the first model, we focus on only assigning items to an ADC in an efficient way with regard to the space required. We also propose valid inequalities, upper-bounds, and continuous relaxations to facilitate solving large, practically sized instances. Based on computational tests using actual data, these refinements can reduce the run time to well under 10% of the time for the base model and thereby allow for large, real-world instances to be readily solved. We show that our approach is better than other methods from the literature with regard to computational time.

In the second model, we also aim to minimize possible errors that might arise from storing similar medications next to each other. To do so, we present a grid-based position paradigm to control errors due to storing medications with similar names and/or packaging next to each other. The model reduces selection errors by designing a layout that assigns medications with high similarity ratings to storage locations that are sufficiently nonadjacent within an ADC. Our results indicate that simplistic space allocation and inventory management could result in about twice as much work for medical staff while still leaving unused space in the ADC, while the second (position-based) model decreases risks associated with medication errors by at least 38% for the data set we considered.
Next, we develop discrete time Markov chain models of inventory control systems which are used at POUs. These systems are characterized by limited storage capacity, stochastic demand, periodic reviews with fractional lead times, expedited delivery when stocking out, and very high service level requirements. We have derived closed form solutions and propose an exact algorithm to calculate the limiting probability distribution by locally decomposing the state space. We decompose the transition probabilities into independent parts, and then we solve each part locally to derive product form solutions. As there is no precise algorithm in the literature to derive such closed form solutions, probability theorists still refer to this approach as a "bag of tricks" and note that the application of this method is an art form that is derived by trial and error. A major contribution of this chapter is that we derive exact closed-form solutions for an \((R, s, S)\) policy and we reduce the number of equations at least in half for an \((R, s, Q)\) policy by locally decomposing the state space for the specific class of inventory systems considered herein.

Also for the \((R, s, S)\) policy, by using the derived closed form structure, we propose an algorithm which recursively solves the problem from \(s = C - 1\) to get the limiting probability distribution for every possible value of the reorder point. This algorithm is very easy to implement and can even be implemented in a spreadsheet. By using this algorithm, not only do we not need to update the transition probability matrix required to calculate the inventory control policy each time we consider a new reorder point, but we also don’t need to solve a set of simultaneous linear equations to get the results for the limiting probability distribution. In fact, using this method, there is no need to even calculate coefficients in the form of factorials (product-form) and the computational time is negligible for a problem of any realistic size. For an \((R, s, Q)\) policy, we reduce the number of equations that need to be solved simultaneously to a maximum of \(s < \frac{C}{2}\) equations. This contribution leads to a reduction in the number of equations of at least 50% and the size of the transition matrix reduces by at least 75%. In the numerical results, we also show that even when lead time is greater than zero the results from when the lead time equals zero are a very good approximation, as long as the lead time is small. In summary, the main contribution of this section of the dissertation the derivation of closed-form expressions for the limiting
distribution, and an algorithm that is very easy to implement in practical applications and entails far less effort than solving steady-state equations for Markov models. The overall computational effort required for finding the optimal replenishment policy parameters is thus significantly reduced.

Finally, in the last chapter we investigate the tradeoffs between standard inventory control policies used at POUs such as PAR, (R,s, S), (R,s, Q), and two-bin Kanban systems. We optimally allocate medical and surgical items to shelves in a storage area within a hospital by selecting the optimal inventory policy for each item along with its corresponding operating parameters. In practice, hospitals tend to assign the same overall inventory control policy to all or the majority of the items. This simplistic approach often leads to wasted staff effort and ineffective policies. Our objective is to pick policies for items that reduce replenishment and counting effort by hospital staff.

To do so, by using the results of the previous chapter, we propose two algorithms to find the optimal reorder point for the different items. We show that the optimal reorder point for an \((R, s, S)\) policy doesn’t depend on the counting and reordering unit effort. Using this result, we propose an efficient algorithm that can find the optimal reorder point for an item in a few steps. By solving several instances for the \((R, s, Q)\) policy and looking at the patterns in those instances, we propose another algorithm to find the \((R, s, Q)\) optimal reorder point. The algorithm for \((R, s, Q)\) can also find the reorder point in a reasonable number of steps. Finally, by using a 2-dimensional level bin packing approach, we simultaneously select the inventory policy for each item along with its corresponding operating parameters as well as assign those items to shelving units at POU locations. We illustrate the model with actual data from a healthcare setting and offer some practical insights and guidelines on how to choose a hybrid inventory system based on demand and system characteristics.

Also, there are several directions for future research in this area. We now explain potential future work and extensions for the material in Chapters 2, 3 and 4. For the first chapter, an initial thought is to examine further ways to reduce the computation times for our formulations. It may be possible to insert additional valid inequalities or to reformulate portions
of the model. Second, one could explore creating heuristics that can be easily applied. The effectiveness of the heuristics can be compared with the results from the optimization model. Third, one could also consider analyzing the problem for various performance metrics while explicitly considering different inventory policies that might be used for the items (e.g., \((R, s, S)\), \((R, s, Q)\) or two-bin Kanban). Fourth, one could also extend this to develop a joint location-allocation formulation that examines the issue of how to optimally locate a given set of ADCs within different patient units or floors of a hospital, along with the storage and configuration of each, so as to minimize overall staff effort. A fifth idea relates to the formulation of MIP1, where one possible extension might be reformulating the model as a robust optimization model. Finally, for MIP2 one can consider other approaches for defining the error coefficient and then comparing the results for this new definition with respect to the optimal values found using the original and new definitions.

For the work in Chapter 3, the first set of extensions would continue to address the zero lead time case described in this work but focus on the \((R, s, Q)\) system. One extension would entail finding an algorithm to reduce the number of balance equations when \(s \geq \frac{C}{2}\) for this policy. This in turn could lead to the development of a more efficient algorithm, similar to the one used for the \((R, s, S)\) policy, for determining the corresponding policy parameters. A second and more challenging set of extensions would consider non-zero lead times. Corresponding transition matrices would need to be defined for these cases (for both \((R, s, S)\) and \((R, s, Q)\) policies) and these would then be used to develop structural results for both classes of inventory systems along the lines of what was done in for zero lead times in this work. These results could then be used to develop suitable algorithms for the case with non-zero lead times as well, similar to what we did in Chapter 4. Finally, further study is required to determine the threshold values of non-zero lead time, up to which we can still reasonably approximate the results by using the results for the case where lead time equals zero.

For the last chapter, the first possible extension is to investigate finding closed form solutions for the optimal reorder point for both the \((R, s, S)\) and \((R, s, Q)\) policies. A second extension would be to conduct extensive numerical data analyses using different data sets
form different hospitals to compare different policies with different item sizes and reorder and counting coefficients in order to draw more general conclusions regarding when to use which type of inventory management policy.
APPENDIX A

LM MODEL ADOPTION TO MIP1

We describe an adaptation of the LM Model for our problem. In a preprocessing step, items are first arranged based on decreasing order of their heights (with ties being broken arbitrarily). Then, each lane of an item is considered as a possible shelf position (i.e., there are $\bar{M} = \sum_{i \in I} u_i$ possible shelf positions). Item $i$ can be located on shelves 1 to $\bar{A}_i = \sum_{s=1}^{u_i} u_s$, while shelf $s$ can store items with indices in the range $\bar{B}_s$ to $N$, where $\bar{\beta}_s = \{\min k : 1 \leq k \leq N, \alpha_k \geq s, \forall s \in (1, \cdots, \bar{M})\}$. Instead of $x$ and $y$, we define two sets of new decision variables ($\bar{x}$, $\bar{y}$). Other decision variables and all parameters remain the same.

Decision Variables

$\bar{x}_{is}$: number of (additional) lanes of item $i$ located on shelf $s$ (integer)

$\bar{y}_s$: = 1 if shelf $s$ is used (binary)
Adaptation of Model LM to MIP1

\[
\max \sum_{i \in I} \sum_{t \in L_i} v_{it} z_{it}, \quad (A.1)
\]

subject to:

\[
\sum_{i=\beta_s}^{N} w_i \bar{x}_{is} \leq (W - w_{\beta_s}) \bar{y}_{s} \quad \forall s \in \{1, \ldots, M\}, \quad (A.2)
\]

\[
\sum_{t \in L_i} z_{it} \leq \sum_{s=1}^{\bar{\alpha}_i} n_i \bar{x}_{is} + \sum_{s=\bar{\alpha}_i+1}^{\bar{\alpha}_i} n_{\bar{\beta}_i} \bar{y}_{s} \quad \forall i \in I, \quad (A.3)
\]

\[
\sum_{t \in L_i} z_{it} \geq l_i q_i \quad \forall i \in I, \quad (A.4)
\]

\[
\sum_{s=1}^{M} h_{\bar{\beta}_i} \bar{y}_{s} \leq H \quad (A.5)
\]

\[
\sum_{k=s}^{\bar{\alpha}_i} \bar{x}_{ik} \leq u_i - (s - \bar{\alpha}_{i-1}) \quad \forall i \in I, \forall s \in [\bar{\alpha}_{i-1} + 1, \bar{\alpha}_i] \quad (A.6)
\]

\[
0 \leq \bar{x}_{is} \leq m_i q_i, \quad \bar{x}_{is} \in Z^+ \quad \forall i \in I, s \in [1, \bar{\alpha}_i], \quad (A.7)
\]

\[
\bar{y}_{s} \in \{0, 1\}, \quad s \in \{1, \ldots, M\} \quad (A.8)
\]

\[
q_i \in \{0, 1\}, \quad i \in I \quad (A.9)
\]

\[
z_{it} \in \{0, 1\}, \quad i \in I, t \in L_i. \quad (A.10)
\]

The objective function (A.1), and constraints (A.3), (A.4) and (A.7) are the same as (2.2), (2.4), (2.5) and (2.7) respectively in model MIP1. The reader is referred to Lodi and Monaci (2003) for the other constraints.
APPENDIX B

EXAMPLE OF \((R,S,S)\) AND \((R,S,Q)\) PROBABILITY TRANSITION MATRICES

The following matrices are for \((R,s = 4, S = 12)\) and \((R,s = 4, Q = 8)\) respectively. Note that \(C = 12\) for both policies.

\[
P(R, 4, 12) = \begin{bmatrix}
    b_0 & a_{11} & a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 \\
    a_{11} & a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 \\
    a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 \\
    a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 \\
    a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 \\
    a_7 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 & 0 & 0 & 0 & 0 \\
    a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 & 0 & 0 & 0 \\
    a_5 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 & 0 & 0 \\
    a_4 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 & 0 \\
    a_3 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 \\
    a_2 & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 \\
    a_1 & a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 \\
    a_{11} & a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 \\
\end{bmatrix}
\]
$$P(R, 4, 8) = \begin{bmatrix}
    b_4 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 & 0 \\
    b_3 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 \\
    b_2 & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 \\
    b_1 & a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 \\
    b_0 & a_{11} & a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 \\
    b_7 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 & 0 & 0 & 0 \\
    b_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 & 0 & 0 \\
    b_5 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 & 0 \\
    b_4 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 & 0 \\
    b_3 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 & 0 \\
    b_2 & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 & 0 \\
    b_1 & a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0 \\
    b_0 & a_{11} & a_{10} & a_9 & a_8 & a_7 & a_6 & a_5 & a_4 & a_3 & a_2 & a_1 & a_0
\end{bmatrix}$$
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