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Purchased services: an untapped source for savings

Introduction

For many health care providers, purchased services spend is a sprawling, untamed frontier. Wild as it may be, this financial territory offers the potential for untapped savings.

Although this spend category represents as much as 20% to 25% of an organization's total expense,[1] it is usually a trove of line items tucked away in the annual budget.

However, for providers that create a strategic vision for using — and managing — purchased services, the potential reward can be millions of dollars in savings that help reduce the total cost of care and positively impact margin. Implementing that vision requires repeatable, sustainable and collaborative processes for managing costs — not as distinct, far-flung individual categories but in the context of total supply spend. Providers who take on the challenge of identifying and addressing their purchased services spend can reduce costs by up to 15%[2], according to an article in the *Journal of Healthcare Contracting*.

A 2019 study by *HealthLeaders*, sponsored by Vizient, reveals that 73% of respondents manage purchased services in-house.[3] For larger health systems (more than 500 beds), only 33% of health systems centralize purchased services in supply chain and then are only focused on the top 10 categories, leaving a wide range of decentralized spend across their system.[3] Identifying the top drivers of purchased services spend can lead to significant savings opportunities, but many providers don't fully realize savings due to challenges around categorization and processing.

During an era of health care reform amid great financial uncertainty, taming the purchased services frontier offers a fresh savings boost to the bottom line and is a worthwhile strategy.

Wide-ranging scope of expense

Purchased services categories include those required to support hospital operations, including physical plant facilities, utilities, repair and maintenance, information technology, financial and administrative services, capital improvements, and clinical and ancillary services. With hundreds of purchased services categories, it's not surprising that hospitals don't have staff with the expertise to manage all of them. However, taking on the challenge can result in a significant uptick in operating margins. In some cases, an organization spending $30 to $40 million on services could see cost reductions of $4.5 to $6 million.[2]

When hospitals contemplate cost reduction initiatives for purchased services, many begin with highly visible categories such as food service, waste management or environmental services. These categories are likely to yield savings opportunities. At the same time, similar attention must focus on hundreds of other categories not routinely visible in daily operations — many often unmonitored and unregulated — yet still accounting for large areas of spend. These areas include more than 350 categories such as health, life and disability insurance; pharmacy benefit management; financial consulting; legal services; marketing and advertising; print management; and equipment repair and reprocessing.

> *"When developing a centralized strategy to tap saving opportunities in this sprawling expense category, start by identifying far-flung components of purchased services spend and then adopt mechanisms to analyze and track expenses."*
>
> **Keith Gregory**
> Principal, Advisory Solutions, Vizient

Process of discovery

Providers that scrutinize the often-murky world of purchased services should be prepared for surprises along the road to beneficial cost reductions. Although the health care industry increasingly manages supply chain and medical-surgical expense with great rigor, in many cases purchased services are managed in a less-centralized, under-the-radar fashion. Examples abound among providers at all levels from the largest integrated system to the smallest rural hospital:

- A Pacific Northwest health system reviewing their laundry and linen processing contract was concerned by high cost and limited vendor variety. By partnering with Vizient®, the member leveraged regional benchmarks in discussions with the vendor. After initial negotiations, a full request for proposal was required for evaluating two competitors. By optimizing the contract with the incumbent vendor, they are now on track to save $761,000 annually after only four and a half months from the engagement start.
- A Southeast health system was fully insourced and using several original equipment manufacturers to service their equipment through a decentralized decision-making structure. Each department was expected to balance in-house maintenance capabilities and lead contracting efforts. Vizient worked with key stakeholders in biomedical engineering and clinical equipment to develop an outsourcing strategy that includes retaining current technicians, adding educational opportunities and creating a centralized reporting structure to support contracting and aid accountability. The health system saved $1.1 million in the first year, enhancing their operation and minimizing maintenance spend.
- Another large health system analyzed total spend for legal services, which was spread among seven vendors. Only $3 million of the $21 million total was hitting the general ledger, with the balance unmanaged and paid at wildly inconsistent rates. By moving commonly used legal services to one preferred vendor, the system saved $2.3 million in less than one year.

Similar savings opportunities often occur in categories such as telecommunications, where agreements for cell phone service remain in place for years without adequate monitoring of bills or renegotiation of terms to reflect market conditions.

Barriers to reducing purchased services spend

Put simply, it's difficult to track millions of dollars in spend without knowing what's in it. A smaller percentage of purchased services are formally sourced through the supply chain, making them difficult to analyze, categorize and track with metrics that provide visibility into line-item spend.

Many of the agreements are noncontracted, paid on an invoice-by-invoice basis, and not subject to the purchasing controls and automated review prevalent in the supply and medical-surgical categories. When contracts are in place, they are rarely audited for compliance with pricing and service-level agreements. Oversight across the enterprise is further hindered by lack of a single decision-maker at the system or hospital level. Rather, purchased services are usually managed by dozens of individuals heading their own areas of responsibility, each making financial commitments — usually without the benefit of a rigorous competitive bidding process — that ultimately affect the entire organization. Table 1 shows how top hospitals address some common barriers.

Some purchased services also tend to be sourced based solely on long-standing relationships or political connections — not competitive bids and value analysis. Undoing these types of business relationships can be a delicate process. But, the examination will drive maximum efficiencies in hospital operations. When contracts are driven by individuals in multiple departments, a negotiation is often perceived as successful if there is only a minor rate increase. However, without oversight and a competitive bid process, the baseline price with a current vendor might already be above the industry average.

Although broad categories of spend for purchased services are fairly uniform for most organizations, the priority areas for examination based on ranking of expenditures can vary and may not be immediately obvious. Costs for top-of-mind areas such as food or environmental services are often overshadowed by spend on "hidden" expense categories that are less formally managed but, when sourced appropriately, offer significant savings opportunities.

Many providers are adopting a centralized, enterprisewide strategy for managing purchased services. Potential savings in a given category average from 5% to 25% of overall spend per category.[2] See Table 2.

Table 1. Overcoming obstacles to reducing purchased services costs

Common barriers most hospitals face	What top hospitals do
Services across large, diverse geographies	Centralize purchasing for better management
Disparate decision-makers, usually not part of the purchasing organization	Scale contracts used across the organization
Usually no service-level agreements and often no contracts	Benchmark costs
Poor record keeping and no data tracking	Analyze spend for cost reductions

Source: Compiled input from Vizient subject matter experts' field experiences.

Table 2. Common services, initiatives by area and potential savings

Area	Potential initiatives		Typical range of savings (%)
Support services	• Advertising, marketing • Asset management • Courier services • Dietary services	• Freight management • Information system software • Maintenance • Laundry-linen services	8-22
Clinical areas	• Dialysis services • Durable medical equipment • Equipment rental services • Hospitalists, all physicians	• Pathology service • Perfusion services • Reference lab • Specialty beds	10-20
Ancillary services	• Ambulance services • Blood products, supplies • Biomedical engineering services • Translation interpreting services	• Forms management • Mobile imaging services • Reprocessing	5-15
Plant operations and utilities	• Alarm systems • Generator-power • HVAC/chiller maintenance	• Telecommunications • Utilities (gas, electricity, water, sewer)	7-19
Repair and maintenance	• Biomedical equipment • Clinical equipment	• Equipment and surgery instrument repair services	5-15
Financial and administrative, human resources	• Accreditation and certification • Accounts payable audit • Benefits administration	• Claims management services • Collection agency services	5-25

Source: Vizient documented member savings.

Strategies to centralize purchased services and optimize margin management across the enterprise

Developing a strategy that overcomes the logistical, structural and cultural barriers across an enterprise and service areas requires a lot of effort throughout an organization. Here are four key strategies for making centralized margin management gains with purchased services.

Spend visibility: view all spend and utilization in one view

To gain visibility into purchased services spend, providers initially should compile contract and accounts payable data from across the organization to create a dashboard that shows total spend, amount by category, number of vendors managed in each area and amount of spend per vendor. For many providers, this type of analysis provides the first opportunity to see the total financial picture of purchased services. It will help them understand the significant scope of spend that is occurring outside established supply chain processes.

Competitive contracting: identify opportunities to consolidate or renegotiate

Once providers understand in which areas and with which vendors their spend is occurring, identifying potential savings and vendor consolidation opportunities is easier and more manageable. When negotiating contracts for health systems, it's important to understand local, regional and national dynamics that can influence price advantages for a hospital system. It's just as critical to have a common contracting approach across the health system, similar to the medical-surgical supplies management.

Expertise across categories: demonstrate deep expertise across portfolio

Tackling the diverse and specialized subject matter in purchased services requires specific contracting expertise. Providers often lack extensive knowledge in these areas and find it challenging to devote the internal resources required to research appropriate pricing, terms and conditions. With significant savings potentially on the table, many hospitals work with outside experts that assist internal teams—a solution for quickly gaining expertise and resources to both reduce costs and maintain or improve service performance and delivery.

Resource and change management: lead across departments for high-impact improvements

Whether handled in-house or with consulting assistance, the pursuit of savings opportunities that involve change management first requires executive sponsorship and engagement. Just as important is buy-in from service end users, who typically serve as primary relationship managers in many spend categories. Involving these stakeholders in a value analysis process to present the data and the benchmarked savings potential—and reach decision points—helps secure their understanding and approval of new service-provider relationships.

Health system saves $4 million a year from dual-contract vendor analysis and contracting process improvement

An East Coast member was experiencing inconsistent performance from a vendor that was on contract for both food and nutritional services and environmental services. While this vendor's food and nutritional services were meeting the member's standards, patient satisfaction scores indicated a need to improve environmental services. The member partnered with Vizient to conduct a request for proposal, evaluate potential vendors, and identify and resolve internal challenges in contracting process and tailoring contract terms to accommodate future needs.

A request for proposal was disseminated and responses evaluated over four months. It was determined that signing with a new vendor would result in savings forecasted at $4 million per year. The member migrated both their food and environmental services contracts within eight and a half months of project initiation, enabling them to incorporate key performance indicators and flexible terms in their vendor agreement.

New strategies, new ideas

The process of applying a strategic vision for purchased services can also generate new ideas that promote greater efficiencies and increased value. Innovative considerations might include outsourcing high capital treatments that are not usually considered a traditional purchased service.

For example, health systems can evaluate outsourcing their wound care operations and the treatment of patients with difficult-to-close wounds. Hospitals using this innovative solution outsource treatment to organizations that provide capital investment and operational expertise. The outside organizations install hyperbaric chambers in the hospitals and establish ancillary wound care centers in nearby locations for follow-up treatment. This model offers hospitals increased contribution margins per case and a commitment from the service provider to a set percentage increase in patient volume.

Another new strategy taking root is establishing more favorable terms for business relationships with retail-branded foodservice providers in settings such as hospital food courts. Brands like Starbucks, Dunkin' Donuts, Subway and others enjoy a strong revenue stream from hospital locations. But many hospitals only receive income from rental agreements on a square-footage basis. As part of a broader purchased service strategy, some providers now negotiate revenue-sharing agreements that give the hospitals a percentage of overall sales and a substantially increased revenue opportunity.

Commitment to change: making lasting improvements

Beyond initial strategy development and implementation, providers must take steps to ensure that improvements and processes are sustained over time. Investments in technology enable ongoing contract management through applied purchasing controls and automated back-office review functions. Replacing paper invoicing and manual approvals for indirect spend with a smart invoicing network allows for a 100% capture of purchasing expense, along with automatic verification of correct pricing. And a continuation of the collaborative communication infrastructure developed during the implementation phase encourages additional conversations and meetings that help maintain savings momentum.

Centralizing management of purchased services can convert this complex, unwieldy and vast expense category into a streamlined operation that lowers overall operational and support services spend—and, helps reduce the total cost of care and ultimately improve operating margins. Using data-driven analytics and pragmatic consulting solutions, providers can gain new visibility into what they are spending and where they are spending it—and use that knowledge to conquer this frontier of untapped savings.

How a Midwestern hospital increased incremental revenue by more than $1 million

A Midwestern member sought to assess how to curb the internal competition between their retail sales locations, costing them revenue and splitting their customer base. Vizient conducted extensive financial analyses on each stand-alone retail site. In particular, the team closely reviewed each site's profit-to-loss ratio and assessed customer preferences through a survey detailing offering preferences by location. Working with the member, Vizient aligned their revenue-to-expense ratio, corrected their raw food cost percentages and aligned the menu offerings and prices across locations. Over the course of a year, the member's incremental revenue increased by more than $1 million, bringing their operating expenses back to a neutral point.

1 Vizient Savings Actualyzer® data.

2 Fincher, Nik. Tackling Purchased Services. *J HC Contracting*. www.jhonline.com/tackling-purchased-services. html. Accessed February 10, 2020.

3 *HealthLeaders* Buzz Survey. November 2019

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Blaine Douglas is a former CEO of a level I trauma center who has more than 20 years of hospital operations experience. Douglas also served as chief operating officer of a health system and as a vice president at two other health systems. His expense-control experience includes leading financial turnarounds at the system and hospital levels and driving a level I trauma center toward survival within a Medicare-only reimbursement scenario. Douglas has a doctorate in health administration from Central Michigan University. He is a fellow of the American College of Healthcare Executives and a past member of the Tennessee Center for Performance Excellence Board of Examiners.

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Keith Gregory's purchased services experience includes categorizing spend to identify opportunities that increase efficiencies and revenue. Gregory is the former vice president of advisory solutions at MedAssets, and he has spent more than 13 years leading business development for group purchasing organizations. Prior to joining Vizient he spent two years as vice president of account management at HealthTrust Purchasing Group. Gregory has a master's of business administration from Auburn University.

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