



Purchased Services



Purchased services

It's time to talk about purchased services. Provider consolidation, and the subsequent rapid horizontal growth of many health systems, has created a decentralized purchasing nightmare. When health systems grow, supply chain teams typically remain centralized. That's not the case for purchased services contracts, which often exist in numerous departments across each facility. Purchased services is a big, highly complex challenge that has been decades in the making. There is no denying cleaning up the purchased services space can be a daunting and seemingly impossible task, but the potential savings are well worth the effort.

Whether an organization is beginning its purchased services journey or has started to tackle some of the "low hanging fruit" opportunities abound. The savings achieved in purchased services can be huge for both the health system and the nation's healthcare industry as a whole.

The healthcare industry has long been focused on bringing down costs on medical products, devices and drugs through price-point negotiations or resource utilization efforts. While the work is not finished on medical - surgical products, the focus is appropriately shifting to reducing purchased services spend. This change is due in part to the number of health systems that are now seeing outsourced labor and services spend exceed supply and pharmaceutical spend.

\$50 BILLION
COMBINED ANNUAL SPEND



20% – 25% OF
TYPICAL IDN
PURCHASED SERVICES
TOTAL SPEND

Premier, a leading healthcare improvement company that offers supply chain solutions, integrated data and analytics, and advisory services, reviewed the Accounts Payable (AP) data of more than 150 of its members. The data, which came from both IDNs and stand-alone hospitals and health systems, represented a combined annual AP spend of more than \$50 billion. A typical IDN allocates between 20 and 25 percent of its total operating expense to purchased services, while large, multi-state IDNs may allocate as much as 35 percent of their spend to

purchased services. Thus, the average health system in the member cohort spends between \$600 and \$800 million annually in operating expenses.

A decades-old challenge

Long-existing problems in the purchased services arena have been compounded by recent and sudden shifts in the industry. Payment reforms – which put health systems' skin in the game in terms of penalties and rewards for total cost of care – have naturally increased internal scrutiny on all costs. These reforms have happened quickly and on a large scale, exacerbating the already big problem of decentralized contracting decisions. Historically, contracting for services has been done at a service-line leader level. In other words, legal departments contracted for external counsel; IT departments contracted for technology products and solutions; and facilities management teams hired building and property management providers. Broadly, different groups within a hospital (or individual hospitals within an IDN) are responsible for acquiring outsourced services relevant to them.

For instance, one hospital would give its respiratory unit responsibility for contracting gasses, while another hospital would give that responsibility to the ICU unit. If these two hospitals then merged but the combined organization did not centralize its services contracts, it could mean years of overlapping or even competing contracts.

Adding to the issue of service contracting is another underlying problem for many providers. Their purchased services contracts are not (and typically have *never* been) put through any type of real sourcing event, much less one with multiple bidders and a multidisciplinary team that is looking at all suppliers and making decisions in a holistic way. And because these contracts aren't managed by sourcing professionals, they can often contain evergreen clauses and other problematic terms – meaning if no one cancels them, they never expire.

Although many of these contracts may have initially been in the \$250,000 to \$350,000 range, over the years they have grown into multi-million dollar expenses. Even a

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contract for call answering services at a large IDN with multiple physician practices could exceed \$500,000 per year. In areas such as biomedical engineering and IT, where new innovations are constantly replacing the old, failure to keep an eye on those contracts could mean an organization is paying for things it no longer uses. These years of wasteful and needless spending all stem from a lack of oversight and management of the original small-dollar contracts.

More responsibility than ever before

In the past, many supply chain departments had oversight of medical devices, services, and (maybe) pharmaceuticals. Now, with health systems increasingly responsible for total cost of care, many supply chain departments are responsible for managing all of their organization's non-labor spend, as well. On top of that, they are challenged with adjusting and scaling supply chain resources to meet the needs of an ever-growing organization, including additional services found outside of a non-acute care setting

Getting and maintaining control of an organization's purchased services spend is not just simple housecleaning. Achieving success in this area requires both an enterprise-wide cultural and operational shift.

However, those changes are easier said than done. A wealth of variables make it such that there is not one canned approach all organizations can use to reduce spend.

And although each organization will have a unique journey achieving savings in purchased services, they all start at the same place: the data.

A great deal of time needs to be spent on the collection and analysis of data, beginning with research on who the organization is paying and what services those vendors are providing. Once vendors are categorized, services can be prioritized by number of vendors used or the perceived size of the savings opportunity. **One best practice at this stage is to turn to the experts. A provider organization would be shrewd to have an independent analysis done of all of the system's purchased services, something that Premier has been doing at no cost to its members for the last 18 months.**

Achieving success in purchased services requires both an enterprise-wide cultural and operational shift.

Tips and tricks for successfully driving savings through purchased services:

National vs. local contracting

When deciding between national and local contracting, consider:

- The degree to which the direct relationship between the provider and the vendor will affect the quality of the service.
- How much the service and the contract must be tailored to fit the unique needs of a provider.
- How many variables are involved in the service.
- If the vendor needs to be onsite

Reducing purchased services spend:

When beginning the endeavor of reducing purchased services spend, consider:

- Getting the C-suite executives engaged and on board with this process from the start.
- Working with the C-suite to get a clear determination of which areas are hands on and which are hands off.
- Anticipating some of the biggest opportunity areas may be deemed hands off.
- Being mindful of the internal and local politics that may be at play in decision making.



Expect challenges

Each purchased services category is unique and will present its own set of challenges, but across the board, a decision will have to be made whether to contract at a national level or local level. The nature of purchased services can make this tricky.

A few things to consider when deciding between national and local contracting are:

- 1) The degree to which the direct relationship between the provider and the vendor will affect the quality of the service.
- 2) The necessity of specifications and tailoring of the service to suit the unique needs of a provider.
- 3) How many variables are involved in the service? The greater number of variables (e.g., driving distance, volume, etc.), the more challenging it is to ensure value and consistency for everyone at every stage. Consider contracting locally for these kinds of services.
- 4) Does the vendor need to be on-site? For services that do not require an on-site presence (i.e., financial services), it likely makes more sense to contract at a national level.

During this stage, best practices include:

- 1) Get C-suite and executive sponsors engaged with this process from the start.
- 2) After all of the data is in, supply chain should work with the C-suite to get a clear determination of which areas are greenlit and which are off-limits.
- 3) Supply chain leaders should anticipate some of the biggest opportunities for potential savings may be deemed “hands-off.” There may be some areas that have a lot of potential but the organization lacks the capability or tolerance to pursue at the given time.
- 4) Be mindful of the human element. In purchased services more so than with medical devices, internal and/or local politics play a big factor in whom an organization contracts.

While it is possible the organization actually does not have the capability to take on a certain area, it is also possible the pushback is due to social or political reasons or hesitancy.

It is not enough to get a list of areas that are “hands off,” especially when those areas have lucrative opportunities. Running the numbers is the easy part of deciding with whom to contract. It is important supply chain leaders come to the table with strong data to back them up, especially when reviewing contracts that have a heavy relationship component.

KPIs

Determining the value of purchased services can be tricky. That's why key performance indicators (KPIs) are extremely important when establishing appropriate pricing for services. An organization needs to determine KPIs that are measurable, demonstrable and consistent before going out to bid. And there needs to be broad understanding of the service requirements, including population being served, the volume of usage, and case-mi index.

In addition to negotiating a better price for a given service, creating value around contracts involves developing criteria as to when and how the service should be used, and ensuring all compliance measures are in place.

Building KPIs with these elements in mind will pave the way for developing the right type of contract and ensuring the organization is getting a service that complements the price point.

Sourcing events

When an organization is ready to start looking for service vendors, it is important for supply chain leaders to be mindful of not limiting its search to companies that already have a healthcare footprint.

Keep in mind purchased services is an area where a supply chain leader can really show the value a disciplined strategic sourcing process can bring to an organization.

Demonstrating how the sourcing process works and how supply chain is capable of driving a process that brings great value to the organization will elevate the department and allow leaders to shine.

That said, start small, smart, and, if need be, slowly. It is more important to get some early wins and successes to prove value than it is to take on larger categories that may encounter hiccups along the way.

Purchased services is an area where supply chain leaders can show the value a disciplined strategic-sourcing process brings to an organization.



How Premier can help

With sourcing expertise, a vast contract portfolio and subject-matter knowledge, Premier works with healthcare providers to help them get their arms around purchased services and to reduce the cost of care for everyone. First, time is spent analyzing the health system's data, in order to create both short-term and long-term cost reduction and service improvement goals.

To do this, education is the key. Premier is working to create value for members at every level.

Through a value analysis process, Premier has found best practices for purchased services that apply to hospitals of all sizes. When signing purchased services contracts, it is important to establish a defined and controlled internal process surrounding who can sign contracts and the amount for which they can sign. This ensures all contracts are reviewed by necessary parties and cleared through supply chain. That also allows supply chain to maintain a copy of the contract within their resources, so that if other departments are looking to contract for that service, the supply chain team can ensure they use the same vendor whenever possible.

Best practices for contract review include:

- Legal review
- Financial review
- Multidisciplinary team discussion around how the service change may impact other departments

Premier's dedicated team works to give guidance on what to look for in a service contract, provide best practices on how to negotiate, suggest metrics at which to look, and move purchased services initiatives forward.

Premier is actively searching for the companies and categories where national contracts can create additional value for its members, while still providing value to suppliers. In order to ensure members receive the best selection of services, Premier's sourcing team walks suppliers through the opportunities they have with Premier and ensures they understand the processes.

Based on analysis of more than \$50 billion in AP spend from 150 different health systems, Premier can typically identify 10 to 12 multi-million dollar categories where health systems can save 8-25 percent.

10 - 12
MULTI MILLION DOLLAR
CATEGORIES

DRIVE COST SAVINGS OF
8% - 25%

Exactly how much savings depends largely on three things:

- 1) How long it has been since the member sourced the category;
- 2) How able and willing the member is to drive standardization in the organization and put the areas through a formal bidding process; and
- 3) How willing the member is to look at utilization of services, not just price.

Working with Premier to ensure proper contracts and terms are in place, it is possible to drive savings by as much as 30 or 40 percent. The impact of these savings on total operating expenses can mean the difference between winning and losing in value-based care.

“The impact of purchased services savings can mean the difference between winning and losing in value-based care.”