



Fall 2010 IDN Summit and Expo

Peer-to-Peer Learning Exchange Research Report

Purchased Services Contracting: The Future is Now



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Introduction

As hospitals focus ever more intently on their core competencies, what used to be known simply as outsourcing has morphed into something far more complex. Purchased services contracting incorporates the more traditionally outsourced areas such as food service, housekeeping and facilities maintenance, but also encompasses areas such as accounts receivable, allied health staffing and even electronic medical records – basically any service that can be purchased from a third party. Though a vendor supplies the service, many functions take place in-house, some done by vendor employees who work full-time within the hospital, others by hospital employees.

As a result of this change, a lot of the focus in the supply chain has now shifted to the complex business of issuing requests for proposals, negotiating contracts and managing vendor compliance/performance.

While each IDN or health system is different in its level of purchased services, some basically contract for everything that does not involve the work of their salaried, full-time employees or the outright purchase of supplies such as pharmaceuticals and capital equipment. Even information technology, not all that long ago thought of as a last bastion of in-house expertise, is increasingly being contracted out, particularly as the pace of government demands for electronic transactions accelerates. Other providers purchase far fewer services, either because of tougher union contracts or a culture of doing more in-house.

There are several reasons that the level of contracting activity has changed so dramatically. One is that much of the potential savings in the traditional supply chain has already been realized. Another is that as much of a third of total hospital spending is on services, so the potential for savings is huge. Meanwhile, the demand for many services, such as electronic medical records and nurse and technician staffing, is growing as a result of changes in the healthcare delivery system.

Adding urgency to the matter is the fact that most hospitals have seen their margins slip to a perilous state. A recent Thomson Reuters analysis found that half of U.S. hospitals lost money in 2009, with the median total net margin for U.S. hospitals declining to near zero. Thus, any savings through purchased services present a very appealing opportunity for a hospital struggling to stay above the water line.

What's being purchased

The main opportunities for purchased services contracting are in the following areas:

- Nurse staffing
- Allied health staffing
- Commercial/non-clinical staffing
- Clinical equipment maintenance
- Information technology, including clinical applications such as imaging
- Billing/medical coding
- Transcription
- Revenue cycle management

According to *Modern Healthcare* magazine's 2009 Outsourcing Survey (see chart), laundry services remained the No. 1 area of outsourcing, with 7,986 facilities purchasing that service in 2008. Housekeeping was a distant second at 2,932 facilities. The "hot" purchased services, however, were clinical and diagnostic equipment maintenance, up 17% to 2,929 facilities in 2008; emergency department management, which rose 11% to 1,091 facilities; pharmacy, up 25% to 499 facilities; accounts receivable (also known as revenue cycle management), up a whopping 252% to 440 facilities; and electronic medical records, up 29% to 331 facilities.

In total, more than three-quarters of all hospitals outsource at least one clinical or nonclinical function, according to Doug Brown and Scott Wilson, co-authors of the Black Book of Outsourcing, an annual report on the industry. Brown and Wilson predict the healthcare outsourcing market will grow at about twice the rate of the overall outsourcing industry over the next five years, or 15%.

The *Modern Healthcare* survey found that information technology outsourcing fell in 2008, but that may have been a temporary lull due to the recession. Since then, new developments have pushed providers to look hard at IT purchases. A Brown and Wilson survey of hospital chief information officers found that about half intended to implement some element of IT outsourcing by the first quarter of 2010. The most obvious driver of that development is the American Recovery and Reinvestment Act of 2009's promise of government subsidies for the widespread adoption of electronic medical record systems, and the associated requirement that any purchased technology be put to "meaningful use" in order to qualify for the EHR grants. Recently the final regulations for meaningful use were released by the Department of Health and Human Resources.

How contracting happens

Hospitals contract for services in a wide array of means. Many use the services of their GPOs, sparing themselves much of the spadework of the RFP process and taking advantage of larger contracts. Some vendors will not contract with a GPO but might contract directly with a health system if it is willing to commit all of its spending for that service to a single vendor. Still others will use the services of their state hospital associations or use a combination of all three opportunities.

In 2007 VHA surveyed its members on purchased services and found the following:

- 79% of members look to purchased services to reduce costs
- 74% said resources to provide services were not available internally
- 85% turn to other hospitals/health systems for guidance and/or referrals for vendors
- 69% come directly to VHA for solutions

One state association that has extensive contracting for services is the Greater New York Hospital Association. Its for-profit subsidiary, GNYHA Ventures, not only operates a GPO but also Nexera Consulting, a division that provides several outsourced management services to hospitals. Those services include a central sterile-processing business that manages in-house sterilization of clinical equipment; a management services business that provides interim staff in key hospital positions and assists in the recruitment process; and a biomedical engineering business that handles maintenance of hospitals' clinical and diagnostic equipment.

Clinical and diagnostic equipment repair is a hot area for contracting because hospitals are challenged to find skilled engineers and technicians capable of maintaining and repairing sophisticated imaging equipment and other diagnostic tools to meet accreditation standards.

With some service agreements, it's not uncommon that an outsourced employee will actually be housed within the hospital. In fact, many hospitals transfer employees to the vendor company, allowing them to cut payroll while keeping their experience and expertise.

As mentioned above, revenue-cycle outsourcing is fast becoming a leading area for purchased services. It is no surprise; in fact the surprise is that it took this long to grow. Hospitals aren't very good at collections, and they need days' cash on hand.

However, industry observers say that although revenue cycle is one of the quickest ways to turn a profit from outsourcing, it's also prone to some of the most severe problems if not closely monitored. An IDN or hospital should demand regular reports, not quarterly statements, including metrics like collection rates and days-cash-on-hand. It should also monitor collection methods, which in some cases get very heavy-handed, exposing the healthcare provider to charges of being a poor corporate citizen or worse, inviting the scrutiny of regulators.

Case studies

BryanLGH Health System in Lincoln, NB.

BryanLGH contracted in February 2006 for support of its computer printers. The deal with the vendor IKON provides a complete workflow assessment, from which the vendor designed a customized solution to help the organization maximize resources, minimize costs, and save time and effort. BryanLGH had been working for six years with IKON for copier service and support. Based on that successful relationship, the health system signed on to IKON's printer fleet management through VHA in February 2006.

BryanLGH now has two full-time IKON employees on site, one at each of its main campuses. IKON supports 960 printers, 175 fax machines and more than 320 copiers/multifunction devices and scanners for BryanLGH — freeing the health system's six-person personal computer support team to concentrate on other things.

IKON says it has saved BryanLGH approximately \$44,000 since the printer fleet management program began, but the system's chief information officer believes the savings are far greater, including the cost of two full-time employees it did not have to hire.

Good Samaritan Health System, Lebanon, PA.

Good Samaritan was in the midst of a major facility and services redesign initiative in 2003 when administrators realized that food services were lagging behind. It turned to Sodexo, which turned a previous snack bar-type setting is now a modern eatery called the Courtyard Café. The café offers many new dining experiences, including specialty grilled items, innovative chef specialties, and fresh salads and sandwiches made to order. In 2006, Good Samaritan implemented Sodexo's At Your Request – Room Service Dining program, which incorporates a traditional restaurant approach to meal preparation and delivery using sophisticated software. The program allows patients to eat when they desire, while also ensuring that their dietary needs and restrictions are met.

Good Samaritan's Press Ganey patient satisfaction scores for food service were above the 90th percentile for nine of the last 10 quarters in 2007, 2008 and 2009, much of which can be attributed to Sodexo's proprietary CARES behavioral training program, specifically designed to reinforce critical behaviors for health care service workers in the areas of compassion, accountability, respect, enthusiasm and service.

While increasing retail sales was never the priority for Good Samaritan, it has proven to be a benefit of the organization's improved food service offerings. Sales increased from \$250,000 to \$330,000 in the first year after Sodexo's arrival, and are currently more than \$425,000 annually.

Some caveats

Obviously saving money is the main reason many IDNs are involved in purchased services contracting, but there are a number of potentially serious pitfalls to the practice.

One is that if cost saving is the only goal, problems can quickly arise in quality of service. For example, if a hospital decides to outsource housekeeping but goes with a low-cost vendor that is not able or willing to provide high-quality service, patient satisfaction scores for cleanliness of facility could take an immediate and drastic decline. As has been proven again and again, there is a direct correlation between patient satisfaction and hospital revenue, meaning the savings from the low-cost housekeeping vendor could quickly evaporate — and then some — if patients stop being willing to recommend a hospital to family and friends.

Another caveat is that sometimes services are so decentralized within a healthcare system that it is both hard to manage a contract for services and difficult to assess if there really are savings in the deal. An example is food service, where costs are spread throughout the system in cafeterias, inpatient food service, physician and employee dining, etc. Toss in trying to account for capital equipment amortization and the cost of labor for things like tray delivery, and the picture gets even murkier. Often, no single person knows what the total cost of all of the different components is, making an assessment of any savings highly problematic. There aren't a lot of benchmarks in the industry for food service or many other areas, making it a highly complex matter to make contracting decisions.

Purchased services is growing so large that it is not unusual for systems to be unaware of how much business they're actually outsourcing. For example, in nurse staffing, several departments of a hospital may be outsourcing nurse duties, using several staffing services. As a result, hospitals often miss the opportunity to maximize savings by applying the same type of volume-purchasing principles to their service contracts as they do to their typical supply contracts. GPOs can offer purchased-services advisors to help hospitals get a handle on their outsourcing needs.

Health systems need a lot of analytic capability and experience to manage contracting effectively. Understanding the basics of contracting is essential; without it they are unable to exert their influence until complaints from patients or staff arise. They also need information and the technology to be able to process into actionable data for assessing whether a contract will save money or provide better service.

One thing for sure is that falling hospital margins and changes in the larger health system will make purchased services contracting an even more enticing strategy in the coming years.

Questions for the Peer-to-Peer Exchange

1. As we look to the future, what areas for purchased service contracting carry the most potential for saving?
2. What are the limits of contracting in terms of health systems being able to manage these contracts effectively while keeping service quality high?
3. Looking at the hot areas for contracting, what are some of the biggest opportunities and the biggest potential pitfalls in outsourcing?
 - a. Revenue cycle management
 - b. Information technology
 - c. Clinical and diagnostic equipment
 - d. Pharmacy
 - e. Emergency department management
4. How can health systems better utilize existing resources (i.e., GPOs, peer organizations) for contracting expertise?