



## **The Top 10 Concerns Every Hospital CFO Should Have About Purchased Services**

**By:**

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**Healthcare**

The Experts in Reducing Non-Labor Expenses

**The Power to Negotiate**

## *Executive Summary*

Are we headed for a **The Healthcare Tsunami?**

To say hospital and health system operating margins are different today than they were a decade ago may be an understatement. Medicare reimbursement reductions, cuts to state Medicaid programs and rising tides of uncompensated care have created an atmosphere where some hospitals, particularly smaller, community hospitals, are simply happy with a break-even balance sheet.

### **The environment is unlikely to change in the short term**

Moody's Investors Service found that 20 percent of non-profit hospitals examined by the credit rating agency were losing money on operations. Additionally, 63 percent of non-profit hospitals had operating margins of 0 to 5 percent, and overall, the median revenue growth rate of non-profits is at 4 percent, the lowest in two decades. For-profit hospitals have not been immune to the stagnant financial times either. Operating costs have increased by more than 5 percent over the past three years.

9 percent of community hospitals reported they currently have an operating margin of less than 2 percent, according to a Community Hospital 100 survey. Most community hospitals surveyed reported they had cuts in Medicare and Medicaid reimbursement of \$5 million or more.

All of this takes place in an increasingly competitive market place that is rapidly changing the relationship of the voluntary physician to the hospital. The commercial and governmental payors are insisting on demonstrable enhancements to quality outcomes and systemic changes to the delivery system without making the investments that would facilitate these changes.

The ever-changing economic landscape due to the recession, job loss and overall financial downturn for so many individuals has resulted in a decrease in inpatient admissions and outpatient visits, as well as overall revenue.

While 2012 may appear to be a grim time for hospitals to keep finances positive, there are several things hospitals can do to go beyond just maintaining solvency. Hospitals and health systems essentially have two options: You can either cut costs or create new revenue streams. Both need to be looked at closely.

***Analysis predicts that hospitals must cut operating costs by 10 to 20 percent in the next three to five years in order to survive.***

**In this white paper, we discuss one area you can look to for immediate expense reduction.**

## Purchased Services

### Characteristics of Purchased Services Contracting

1. High areas of spend
2. Decentralized decision-making and purchasing
3. Multiple contracts for same service with varying term dates
4. Lack of understanding of current performance on key indicators

### Here are some purchased services facts:

- Purchased services spend is often considered a secondary target for cost reduction, yet studies suggest that services spend can account for 30 percent to 70 percent of an organization's total purchase dollars. Fearon and Bales (1995) state that **“the opportunity to increase profits through more effective purchasing probably is greater in the buying of services than in the purchase of goods.”**
- **Research shows that when cost savings are pursued, savings on services ranged from 10 percent to 29 percent versus an average of 5 percent to 17 percent for other commodities or materials (Stradford and Tiura 2003).**
- The same study by Fearon and Bales (1995) showed that the purchasing department did the buying for only 41 percent of the total purchase dollars in the organizations surveyed. **The effectiveness of the 59 percent of purchases that is handled by other departments should be examined more closely.**
- The potential for savings on services purchases is large, and other departments should eventually come to realize that purchasing can bring much to the table.
- Stradford and Tiura (2003) identify common areas of savings leakage in services purchases that can be addressed through integrated sourcing strategies with a collaborative approach.

### Did you know?

- **Because benchmarks on purchased services costs are not readily available**, providers have difficulty determining whether or not they are spending too much or too little. In this country, providers drive approximately \$150 billion of supply spending through their GPOs each year. **However, what many of these organizations don't realize is that the amount of money they spend annually on purchased services can be equal to, or just slightly less, than what they spend on supplies.**
- The good news is that hospitals and IDNs that have taken on the challenge of identifying and addressing their spending on purchased services can reduce their costs up to 15 percent. This reduction can be significant and, in some cases, immediate.
- **In fact, an organization spending \$30 to \$40 million on purchased services could see cost reductions of \$4.5 to \$6 million. Unlike supplies, where the goal is to reduce the cost of items yet to be bought, reducing spending on services means that dollars never leave the bank.**



## **Top 10 Concerns**

### **Concern # 1: Least Understood**

Lost cost saving opportunities exist every day at hospitals because there is a lack of knowledge within each specific area of purchased services spend and a minimal understanding of the many aspects of the purchased service agreement which impacts the costs of these services. The root cause of this is often that the agreement cannot be located by the hospital or if it can, it has not been audited or measured against actual invoices on a consistent basis.

### **Concern # 2: No Benchmarking Data**

Since there are numerous variables within a purchased services agreement, it makes price comparisons and performance reviews very difficult. Price benchmarking data can help identify whether or not a hospital is spending too much for a purchased service, however that information is very difficult to obtain if available at all for all hospital purchased services agreements.

### **Concern # 3: High Amount of Error Rate**

Historically Purchased Service Spend is known to be an area containing costly errors, and with a hospital's typical Purchased Service Spend being 90% of a hospital's total supply spend; these errors can result in substantial financial loss within an already strained hospital budget.

### **Concern # 4: Regionalized**

Regional purchased service contract rates can vary tremendously and need to be monitored continuously to ensure your hospital is receiving the most competitive pricing within your region. The market changes rapidly and many purchased services agreements are aged with pricing which is not favorable and unnecessarily costing hospitals to pay more for services than they should.

### **Concern # 6: Large Decentralized Spend with No Accountability**

In the procurement of services, the largest percent of dollars are spent by someone other than the Purchasing Department. Only 41% of the total purchasing dollars of the organization are spent by the Purchasing Department. The other 59% is spread amongst many other departments and individuals and is rarely spent in compliance with set purchasing procedures. Most hospitals do not even categorize their purchased services correctly and are not capturing all of the opportunities to see their service spend. Hospitals also have multiple contracts for the same service and do not realize the large spend in many categories.

### **Concern # 7: Spend Services Increasing**

Industry trends show during the next five years spends for purchased services is expected to increase by 13% which will further impact hospital's strained budgets.

### **Concern # 8: More Cost Savings able to be achieved than most people think**

Most think that they are "stuck" with the purchased service agreement given to them by their vendor and they accept a 3% to 5% increase every year. The truth is that taking a hard look at purchased services agreements and renegotiating market competitive rates will reap significant savings to your hospital. The research shows it: **"That when cost savings are pursued, savings on services ranged from 10 percent to 29 percent versus an average of 5 percent to 17 percent for other commodities or materials."** However, most hospitals are satisfied and even "celebrating" if they can get a cost neutral or a 3% reduction in purchased services. Imagine the impact of a 15% expense reduction on a \$40 million purchased service spend? That is \$6 million. **A Massive Difference in the overall impact for hospital.**

## **Concern # 9: Major Increase expected in future IT Spend**

Spurred by federal incentives for the use of electronic health records, anticipated changes with pending healthcare reform, along with constant technology upgrades, there is an increasing trend in IT spend that is expected to grow over the next several years. Especially in support agreement, license agreement and software agreements which typically do not get negotiated as aggressively as they should for best pricing.

## **Concern # 10: Have you looked into your purchased services for 2012 cost savings?**

Physician Preference Item Cost Reduction has been a priority over the last 5 to 7 years for hospitals; an area of constant concern, yet one of the most challenging to achieve which has caused “PPI Cost Reduction Fatigue.” Other areas that have been tapped or close to being maximized are: Utilization, Med/Surg & GPO cost savings. Purchased Services is a ripe and untapped opportunity for all hospitals. Begin 2012 with a focused plan to achieve immediate cost savings in your purchased services spend.

### ***The Solution to these Concerns: A PSPS Subscription***

***Purchased Services Pricing Strategy*** is the only advisory pricing membership for benchmarking service costs in your hospitals purchased services spend. PSPS gives insight into your Purchased Services Agreements BY identifying all savings available in your purchased services contracts.

PSPS was created with the Vision to what healthcare needs now and in the future---***new and untapped opportunities to reduce non-labor costs.***

A Membership to PSPS is for CFO's and Purchasing Directors to focus on Purchased Services Spend and to have a specialized resource to give insight into cost reduction opportunities which exist in their purchased services agreements and to provide direction & mentorship through the vendor negotiation process.

### **Benchmarking Your Services Costs & Helping You Purchase Services in Confidence.**

**PSPS is a Complete Advisory Service for the Procurement of Purchased Services. You will no longer have to pay too much for your purchased services.**

**Purchased Service Pricing Strategy will** Benchmark your Existing Purchased Services Costs with a detailed market comparative pricing report from an experienced healthcare analyst and provide you with the most competitive pricing available in the marketplace and the average price—AND on **more than 117 unique purchased service contracts.**

***Purchased Services Pricing Strategy*** is a complete benchmark advisory service to assist you with getting the best price on the purchase of ALL of the services your hospital purchases. We compare your proposed pricing with prices paid by your peers in similar facilities with a Purchased Services Pricing Strategy Analysis.

## Actual PSPS Results

A 200 bed hospital sent us a renegotiated specialty reference testing laboratory agreement which they had spent a few months pricing with their vendor. Upon finalizing, they sent the new pricing proposal and agreement for a “PSPS-Review” and we immediately identified there was a 16.7% further opportunity to reduce pricing. They went back to the vendor and were able to achieve this pricing, saving the hospital an additional \$220,000 from their finalized agreement price.

*That is a \$1.1 million cost savings over 5 years for only 1 purchased services agreement.*

## Subscription Information

- **Purchased Services Pricing Strategy Spend Analytics:**

- Price Benchmarking Services for all Purchased Services Contracts (over 107 areas) with insight into best pricing available in the marketplace.
  - Send us your current agreements
  - Send us new proposals
- A Review of Business Terms & Conditions.
- An Overview of the Vendor Marketplace & Trends.
- A Detailed Negotiation Strategy.
- Email and Phone Support through the entire process.
- Monthly Purchased Services Newsletter
- Quarterly Advisory Purchased Services Conference Calls

Call Us Today to Start Reducing your Purchased Services Spend

732-359-7646 Ext 500 or email us at [dbisogn@viehealthcare.com](mailto:dbisogn@viehealthcare.com)

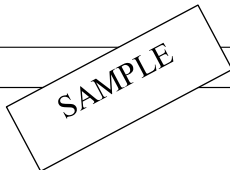
[www.PurchasedServicesPricingStrategy.com](http://www.PurchasedServicesPricingStrategy.com)

PSPS Total Identified Savings \$105,851

Client: Hospital	Overview of Purchased Service
Date	MM/DD/YY
Vendor/Contract	XYZ
Purchased Service	Reference Lab

PSPS is a tool that provides hospitals with a comparison of the price paid by service type. A PSPS report gives the user benchmark pricing and recommendations of contracting next steps.

Contract Analysis - Breaking it Down	
Total number of tests on proposal	709
Total Previous Spend	\$869,648.19
Proposed Spend	\$724,221.94
Proposed Savings	\$145,426.25
Proposed Savings Percentage	16.72%
Tests with the same value	494
Proposed cost	\$518,612.17
Total tests	104
Total tests cost increased	\$18,438.40
Previous value	\$26,813.39
New value	\$45,251.83
Loss %	68.77%
Total tests with price decrease	111
Previous value	\$324,222.63
New value	\$106,357.94
Savings	\$163,864.69
Savings %	50.54%



**The Power to Negotiate**