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Aggregating Purchasing Volumes in Purchased Services: The Next Wave in Driving Value

By Mark W. Phillips

Using increased purchasing volumes as leverage is a staple for hospitals that want to obtain better product pricing or other concessions from vendors. Since purchased services typically comprise up to 30 percent of a hospital's overall spending, a hospital or health care system should evaluate opportunities to extract more value from their outsourcing partners by aggregating purchasing volumes in purchased services.

Many health care systems have already leveraged their purchasing volumes in purchased services by retaining one vendor to perform one service at multiple facilities. For example, it is common for health care systems to have one food service contractor manage food and nutrition services at all of the system's facilities.

More recently, health care providers have aggregated purchased services volumes by having one vendor perform multiple services at a facility. For example, some vendors, including Aramark, Compass Group, HSS, Inc., and Sodexo, are capable of providing multiple services at one or more facilities (e.g., food, environmental/housekeeping, laundry, vending, plant, operations and maintenance, biomedical equipment maintenance, security). Recognizing that some vendors offer broad and deep expertise in multiple service areas, many hospitals now will issue a joint services request for proposal (RFP) for multiple service areas (e.g., food and nutrition services and environmental services at the same time).

Another way to aggregate purchased services is to have an individual facility look for opportunities to extend a vendor's services incrementally, such as asking the existing food services contractor to provide vending services or the existing environmental services contractor to provide laundry services (which may or may not involve a competitive RFP process).¹ If a hospital uses a competitive RFP process when it is extending services, then the hospital will be able to confirm whether each vendor's proposed costs, fees, service levels and performance standards are consistent with what is available in the market. If a hospital extends a vendor's services incrementally without a competitive RFP process, then the hospital will be required to evaluate the vendor's proposal against the hospital's historical baseline data.

The following overview illustrates some of the

potential benefits a hospital can derive from aggregating purchasing volumes by obtaining multiple services from one vendor:

Fee Reductions. Vendors are generally able to offer reduced fees based on a higher volume of business.

Potential Cost Savings. A vendor may be able to restructure operations to reduce labor or other costs. For example, there may be opportunities to have a general manager run food services and environmental services at a facility rather than have separate directors for each service area.

Capital Investment. In many cases, a company like Aramark, Compass Group or Sodexo will make a significant amount of capital investment funds available for facility improvements or equipment for a hospital's food services or environmental services department. The amount of this investment is based in large part on the volume of the business the vendor will receive. In addition, a larger volume of business may also fund various service improvements or service enhancements, such as the implementation of specialized patient service programs.

Quality Improvements. It would make little sense to provide a vendor with additional service responsibilities if the vendor cannot improve existing performance. Accordingly, a vendor that will be managing multiple services should be expected to provide and guarantee a higher level of performance, including monetary penalties for failing to meet service metrics.

Better Service Coordination. In some cases, having one vendor provide more than one service can result in better service coordination. For example, a facility that has two separate vendors providing environmental services and laundry services may be better served by having one vendor provide both services because the environmental services department and the laundry department are often required to work closely together.

Better Accountability and Visibility. Using one vendor to perform multiple services can lead to better accountability and visibility since a hospital will have one vendor to use as a point of contact for multiple services. This is particularly helpful in situations where service responsibilities are a potential source of contention (e.g., the food services department and environmental services department disagree on who is responsible for cleaning refrigerators or ice machines at a nursing unit).

While using one vendor to provide multiple services may create a number of potential benefits, the decision

¹ Adding service lines to an agreement with a single supplier should not implicate the Medicare fraud and abuse rules and concerns applicable to bundling since the services in this context are not being furnished for free and billing for each service will be separate and clearly attributable to each. To be clear, the federal government programs do not reimburse directly for the types of purchased services contemplated by this article. Amounts reported on Medicare cost reports are used to determine future hospital reimbursement rates.

to consolidate services cannot be made in a vacuum. Items to be considered include the following:

Termination Issues. Does your organization have the right to terminate the existing vendor contract without cause? If it does, are there any early termination penalties or fees that may apply? Even if an existing contract cannot be terminated without cause, a hospital should explore whether a vendor will agree to terminate its existing contract in exchange for the opportunity to bid on additional business.

Management Personnel. It is critical for a purchased service contractor to have a good management team in place in order to be successful. A hospital cannot simply assume that it can terminate a purchased service contractor's agreement and continue to use the members of that contractor's management team after the termination. Many contractors include provisions in their agreements that prohibit the contractor's client and a successor contractor hired by the client from hiring a member of the contractor's management team after termination. Accordingly, the terms of the relevant contracts need to be reviewed to determine whether any members of the contractor's management team will be entitled to work for the client or the successor contractor.

Performance Issues. If a hospital has two different service contractors that are both performing at a high level, then the benefits of consolidating services with one vendor may not outweigh the potential for diminished performance if one contractor is performing both services. For example, a hospital that has a particularly complicated food service operation may not want to reduce costs by having a general manager oversee both food and environmental services if that change may reduce the quality of department performance in one or both service areas.

The need for health care providers to reduce costs and increase performance is always present. Hospitals trying to meet these goals should identify appropriate opportunities for aggregating purchased services volumes by using one vendor for multiple services, while remaining mindful of the factors discussed in this alert.

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