

October 2024

## Purchased Services Are a Mystery Worth Solving

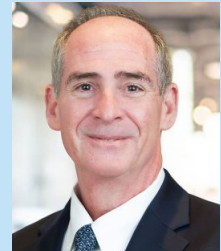
**P**urchased services represent a significant—but often unknown and overlooked—opportunity for cost savings. Discovering and quantifying the size of this opportunity requires a lot of detective work, but for most organizations, it is a mystery worth solving.

Hospitals and health systems have made significant strides in supply purchasing. Supplies typically go through a standard purchase order process, are easily benchmarked, and at many organizations, have been centralized to take advantage of bulk, leveraged, and consolidated discount opportunities.

In contrast, purchased services tend to be:

- **Fragmented.** They are typically not centralized or controlled with a strong oversight function. They also are prone to “rogue buying,” often by departments or units without strong expertise in contract negotiations.
- **Inconsistent and localized.** Because these services are often purchased locally or by individual departments or units, purchased service contracts are often written on vendor paper and there is little consistency in the terms and conditions. This also means that organizations may be missing out on opportunities for leveraged discounts that could be negotiated at the institutional level.
- **Not easily benchmarked.** Unlike supplies, purchased services typically do not have easily benchmarked unit costs. There is also substantial variation by market in the cost of purchased services.
- **Difficult to quantify.** Because there is often no centralized repository for purchased services agreements, they can be found anywhere in the organization: on individual laptops, on desktops, in file drawers. Sometimes they cannot be located.
- **Automatically renewed.** In many instances, vendor contracts for purchased services have automatic renewal clauses unless they are affirmatively cancelled by the buyer. Organizations can find themselves in a position much like that of subscribers to video streaming services, who often pay for services that they are not fully utilizing (or may have stopped utilizing at all).

Given the complexity of purchased service agreements, leadership may be reluctant to take on the work required to untangle the web of agreements that runs through the organization. Failing to do so, however, can leave significant dollars on the table.



**Tom Behrens**  
Senior Vice President

### Solving the mystery

The work begins with the accounts payable (AP) file. Key questions that can be answered by an AP review audit that includes how many vendors are providing products or services for a particular service line or spend category, and what is the market share of the various vendors?

The more fragmented a spend category is—with multiple vendors providing the same or similar services—the more opportunities there are for consolidation or rationalization of contracts. And the more significant market share is for any particular vendor, looking across contracts, the more opportunities there are to seek more favorable pricing terms, as vendors traditionally pay for market share. Our analysis typically begins with the largest vendors, as this is where the biggest opportunities often lie.

Beyond more favorable pricing opportunities, an investigation of purchased services can identify additional opportunities and raise important questions for the organization to consider. These include:

- **Redundancies:** Where do duplicative services exist, with multiple vendors providing products or services for the same spend item?
- **Utilization:** To what extent are products or services being fully utilized by the organization. When was the last time the service was used by the organization? What value does the service provide, and is that value worth the price the organization is paying?

- **Outsourcing vs. in-house:** Does the organization have the in-house capabilities to provide a service that is being outsourced? For example, could the health system's catering service be used for more meetings? Could in-house cleaning services at the hospital also be used to clean physician offices? Conversely, is an in-house service a core competency, or would the health system be better off outsourcing the service to a single vendor?

Once the mystery of purchased services has been solved, organizations should also put in place contract management processes to ensure that the problem does not return. This process begins with education, with the purchasing department educating ancillary departments on why it should be brought into the purchasing process, the assistance it can provide in negotiating contract terms, and the advantages the organization can gain by contracting for products and services at the institutional level. Education can be followed with checklists detailing the processes (including purchasing department involvement) to be followed before a contract is signed. The purchased services agreements that are discovered across the organization as part of the initial organization

**Given the complexity of purchased service agreements, leadership may be reluctant to take on the work required to untangle the web of agreements that runs through the organization. Failing to do so, however, can leave significant dollars on the table.**

also should be consolidated in a centralized repository, with purchasing department oversight and query capabilities of expiration and renewal dates, termination requirements, and other terms and conditions.

Organizations should also speak to their group purchasing organizations (GPOs), several of which are developing sophisticated approaches to benchmarking, managing, and contracting for purchased services.

Vizient® data indicates that up to 25% of hospital operating expenses are purchased services. For most organizations, this represents too big of an opportunity to leave undiscovered.

*For more information, contact Tom Behrens at [tbehrens@kaufmanhall.com](mailto:tbehrens@kaufmanhall.com).*