

## Feature

### Don't Forget About Contract Services When Cutting Supply Costs (One Hospital Saved Millions!)

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Like many hospitals, Providence Everett Medical Center in Everett, Wash., used to spend more money than necessary on supplies. Supply costs at the 300-bed, two-hospital system represented approximately 18 percent of net patient revenue, compared with a market average of 15 percent. But supplies weren't the only nonlabor cost eating away at the hospital's profits. Upon investigation, hospital managers saw enormous opportunities for reducing the costs of contract services, such as medical transcription and ambulance services.

All in all, hospital managers were able to identify almost 100 nonlabor cost-cutting initiatives, saving the hospital more than \$7 million over a two-year period.

#### Focusing on Four Areas

Because its own management team was spread thin, Providence Everett decided to retain a healthcare performance improvement firm to assist with the initiative. The consulting firm had previously assisted the medical center's parent, Providence Health and Services, on a broader performance improvement project, which included a turnaround initiative at Providence Everett.

The nonlabor cost reduction project was spearheaded by Providence Everett's CFO. The project began with a four-week assessment of current operations: Invoices were pulled, purchase histories were analyzed, and interviews were conducted with individuals connected to purchasing decisions. The interviews were focused not so much on what products were being used, but rather on what led to the decisions to use those products, and the satisfaction with them.

After the assessment, a list of potential improvements was proposed to management. The organization decided to focus on four broad, high-cost areas. Three of those areas are traditionally thought of as components of the supply chain: pharmacy, food service, and clinical and nonclinical supplies.

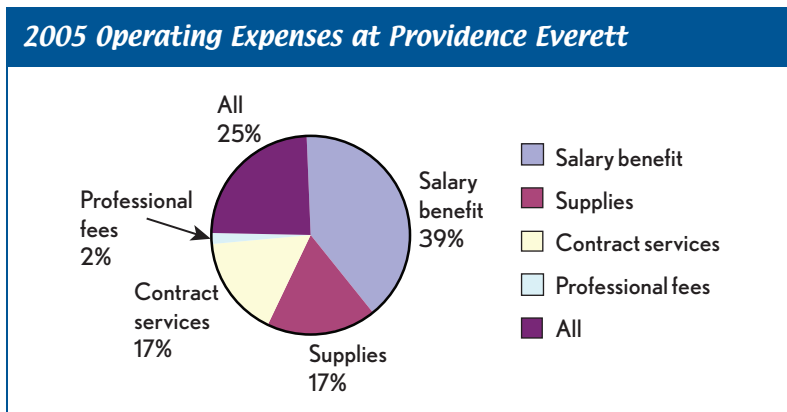
The fourth area was contract services, which consists of a wide variety of outside services provided to the organization on a regular basis. Typically defined as purchased services on the general ledger, contract services include:

- Marketing and advertising
- Energy and utilities
- Employment agencies
- Legal and consulting fees
- Waste management
- Record archival and retrieval
- Maintenance agreements

Contract services are not typically associated with supply chain initiatives, and the savings were not factored into the medical center's percentage of net patient revenue benchmark. However, analysis showed that this area provided major opportunities for savings. At Providence, the annual expense for contract services was equal to the total supply expense budget.

To implement the improvements, oversight committees were formed for each of the four areas. These committees comprised medical center senior leadership (including the CFO, COO, chief medical officer, and chief nursing executive), health system representatives, and key

management staff. Committee meetings were held at least monthly, allowing senior leaders to keep projects on track, remove roadblocks, and launch new cost-saving projects. Work groups were also assembled for each identified project.



In 2005, Providence Everett Medical Center's contract services ranked as high as supply costs.

Some initiatives were easier to implement than others. For example, it was relatively easy to cut costs on clinical and nonclinical supplies, such as exam gloves and suction canisters, by simply switching to less expensive medically equivalent brands. Some of these changes required physician approval, which was relatively simple to get because the chief medical officer and medical staff were active in the process. The chief medical officer and the consulting team presented potential savings opportunities to the medical staff at various sectional and departmental meetings.

Other improvements—especially in the area of contract services—produced more cost savings because Providence Everett negotiated prices in coordination with other hospitals in Providence Health and Services. As various savings opportunities were identified, the regional representatives for Providence Health and Services coordinated meetings with key stakeholders. The consulting team pulled together data to help solicit support for aggregating purchasing volumes. The stakeholders and consulting team then developed requests for proposals and negotiated new contracts with vendors.

The combined buying power of the hospitals resulted in tremendous savings on many contract services, including:

- Transcription
- Records management
- Document omanagement
- Waste management and shredding
- Freight management

The most challenging improvements involved working with outside service providers. Providence Everett purchased many contract services, such as dietary management and food purchases, through one outsourced service provider. For the improvement efforts in food services to be successful, the service provider's cooperation was essential. Fortunately, the food service provider worked closely and amicably with the consultants and the hospital management team to implement cost-saving recommendations. Developing a win-win outcome with the provider was key to creating a high level of cooperation. The food service provider recognized that increasing efficiencies at Providence would prove mutually beneficial in the long term.

### Project Conducted in Phases

Given the broad scope of the task, it was determined that the best approach would be to tackle the project in phases, each of which would last approximately six months. Phase 1 consisted of 22 initiatives, including:

- Switching from disposable to reusable pulse oximeter monitors, which saved \$279,000
- Renegotiating the medical transcription and office supplies contracts, which resulted in a savings of more than \$450,000
- Implementing a staffing agency vendor management program that saved \$600,000 (The medical center was using multiple agencies at varying rates of pay for temporary help. The consulting group was able to get a group of vendors to agree to the same rates and shift pay structures, resulting in fewer vendors and better pricing.)

Phase 2 addressed 19 initiatives, including:

- Eliminating kits for an unused cardiovascular laser, for a savings of \$234,000
- Reducing the cafeteria subsidies given to hospital employees, for a savings of \$248,000

- Improving Providence Everett's ability to maximize the use of reduced prescription drug prices available through the Medicare 340B drug purchasing program, which resulted in a savings of \$372,000
- Restructuring Providence Everett's document management contract, resulting in a savings of \$237,000 (This was accomplished by consolidating existing leases, negotiating better rates on lease and supply/maintenance costs, and upgrading to more robust devices.)

Phase 3 addressed 54 initiatives, including:

- Reducing expenses for sequential device sleeves by converting to a more cost-effective product that provides the same or better clinical effectiveness, and by eliminating equipment rental, resulting in a savings of \$215,000
- Negotiating better pricing for ambulance charges, resulting in a savings of \$80,000

## Results to Date

Providence Everett was successful in reducing its net supply costs by more than \$5 million, decreasing its supply cost as a percentage of net patient revenue from 18 percent to a more acceptable 15 percent. The efforts in contract services added an additional \$1.9 million in cost reductions, for a total net savings of more than \$7 million during phases 1, 2, and 3.

The medical center is now implementing phase 4, which is devoted to reducing pharmacy costs. Additionally, it continues to use the oversight committee meeting system to identify additional cost savings opportunities and to monitor the maintenance of existing savings.

## Lessons Learned

- Keep an open mind and let the data do the talking. Whether done internally or with consultants, open all the books and don't limit the overall view.
- Consider carefully whether capable internal resources exist to undertake the project or whether external consultants should be retained.
- Get buy-in from the entire organization.

- No expense should be overlooked. A number of initiatives resulted in savings of less than \$25,000 for Providence Everett. But when added up, the total reductions were significant.
- Communication is critical. It is important to have clear and frequent communications so that momentum continues to flow and everyone understands individual responsibilities and remains informed on the progression of the project.▲

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