NAVIGANT

HEALTHCARE

5 KEYS TO A "WIN–WIN" VALUE-BASED CONTRACTING NEGOTIATION

Paul Weintraub and Marissa Burik

The phrase "value-based contracting" is both overused and under implemented in healthcare today, leading to a general misunderstanding of its potential impact.

In the simplest terms, a value-based partnership represents a "win–win" for providers and vendors. The goal of a value-based contract is to derive value from **efficiency**, as opposed to price and quantity. Instead of pushing one another for savings of pennies on the dollar, value-based contracts task both vendors and providers to come up with creative ways to generate clinical and financial value from mutually beneficial improvements.

In effect, vendors and providers create a partnership. If done correctly, both parties are stronger working together than they could ever be working against each other. But these partnerships don't just happen. Both parties need to be prepared and understand what is important to them when entering a negotiation.

Following are five key focus areas necessary for providers to effectively negotiate value-based supplier partnerships.

1. Have an accurate understanding of the current state and a clear vision of the future

Prior to negotiating a value-based partnership, providers should equip themselves with operational, financial, and quality performance results to allow for more collaborative discussions with suppliers. This must be an honest reflection of the current state of not just the vendor, but of how the service truly works for the provider.

Having a clear understanding of the current situation gives both providers and vendors the opportunity to identify the operational model that will work best for their partnership. It is possible that after a review of the current state, it is decided that a service should be either insourced, outsourced entirely, some combination of both, or even a more advanced joint agreement to offer services together in a co-op or joint venture model. In other words, there is not a one-size-fits-all value-based partnership model. Thinking through all possibilities will result in a no-regrets, go-forward negotiation.

2. Generate executive support, streamline contracts

Another essential but often overlooked component is generating executive-level support during the contracting process. Such support shows the importance of the relationship to both parties and promotes a higher level of contract compliance, thus increasing savings potential for everyone.

A value-based contract must also be well structured and considerate of what the next two-to-five years hold for both the supplier and provider. This doesn't mean a 250-page contract is required. Instead, contracts must be written so both parties are clear as to what their roles and expectations are at all levels of their organizations. Both parties should consider what-if scenarios, and plan for events that could, and often do, happen, such as:

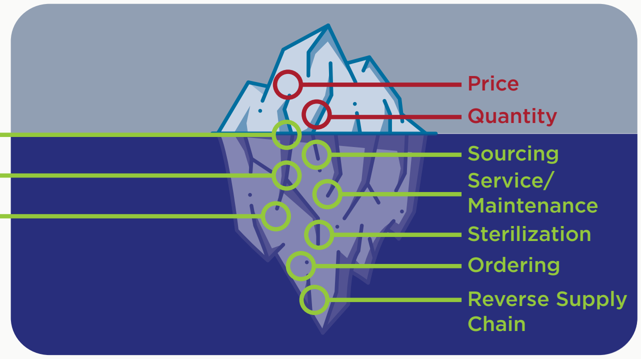
- Changes in supplier strategy/offerings/focus/financial health.
- Changes in leadership or the resources involved.
- Mergers and acquisitions, divestments, or expansions.
- Restructuring or realignment of clinical services.
- Political, social, economic, or regulatory trends.
- Innovations and improved technology.

3. Know your total cost of ownership

A value-based partnership is much more than a simple line item on the balance sheet. These agreements must take into consideration myriad cascading costs and operational factors that ultimately help to determine what the current total cost of ownership (TCO) and what it will be once the final agreement is completed. These factors are typically referred to as being "below the water," and are often blamed for why previous arrangements were not optimized or led to misalignment in what an organization was looking for during initial contract negotiations. Understanding the TCO related to a specific material acquisition, technology, or service offers more transparency into the situation and should be tracked in a regular and systematic manner.

Total Asset Cost Goes Well Beyond Price Paid

- **Supply chain "failures"**
  - Sub optimized insource/outsource and make/buy decisions
  - Inaccurate, missing, or nontransparent data
  - Lost operational capacity
- **Inventory**
  - Consignment versus non-consignment contracts
  - Total in-transit central/supermarket/room/cart costs
  - Scrap, shrinkage, spoilage, expired, or simply not used
- **Material handling**
  - Included in the price and passed on by the 3rd party?
  - How much labor is needed to receive/store/replenish?



Coupling total cost with the cause and effect of these levers will allow organizations to work towards more strategic savings initiatives across clinical and operational components.

4. Be transparent

Simply put, if suppliers and providers better understand what is going on within each other's environment, inefficiencies can be identified and potentially mitigated or eliminated, benefiting both organizations. This requires a perspective that looks below the surface to determine the root cause of non-value-added activities.

Consigned blood inventory represents a clear example of the need for transparency between provider and supplier. Without transparent and timely information into both current and forecasted use across the hospital operations, suppliers incur added cost associated with excess inventory, transportation, and scrap. The provider often indirectly feels these costs, as hospitals see their prices go up for services due to waste in the system. Increasing transparency between partners helps to identify previously unrecognized areas of waste that can be resolved by sharing information. This, in turn, leads to collaboration in reducing costs that can be the basis of a value-based partnership, allowing the financial savings to be shared.

5. Metrics matter

The metrics used to measure a partnership set the tone for how information is leveraged. Certain metrics encourage both parties to drive improvement, while others are seen as bargaining chips.

For example, in a typical linen contract, the pounds of linen received by the provider from the supplier are measured and compared against the weight of linen returned. While this is a seemingly commonsense metric, it sets the wrong precedent for a partnership by focusing on the most traditional two aspects of a contract: cost and quantity. As a result, each party works to maximize this specific measurement versus addressing what really matters to the overall success of the hospital and the supplier, which is how effectively and efficiently they leverage the right linen at the right place and the right time.

In a value-based partnership, better measurement focuses on such metrics as the average cost per inpatient day, coupled with secondary measurements like quality, customer experience, and outcomes. Essentially, this shift requires both parties to evolve from considering the hard cost of linen, to measuring the result of the linen used. Only engaging one measure, like weight used, creates a limited view of the value of a relationship. While it is advisable to start with metrics at the operational level, as the partnership between provider and supplier matures in sophistication, more complex measurements can be introduced, including clinical outcome-based factors.

Value-based contracting represents the next evolutionary phase within the healthcare supply chain. To obtain the benefits of this approach, vendors and providers must put aside a traditionally adversarial relationship to create a partnership where they act in each other's best interests. The five core concepts outlined above, coupled with experienced industry professionals, represent the bedrock on which providers can build a solid value-based contracting foundation.

CONTACTS

PAUL WEINTRAUB
Director
+1.404.602.3486
paul.weintraub@navigant.com

MARISSA BURIK
Senior Consultant
+1.312.583.3776
marissa.burik@navigant.com

healthcare@navigant.com
linkedin.com/company/navigant-healthcare
twitter.com/naviganthealth