revenue cycle outsourcing requires focus on service standards and risk

Outsourcing revenue cycle functions may seem like an attractive strategy to providers, but this prospect should be approached with great care.

As payment processes for healthcare services become increasingly complex, many healthcare provider organizations choose to outsource some or all their revenue cycle functions to a third-party vendor. The reasons for this approach may vary, but they usually involve some combination of the following perceived benefits:
> Access to expertise (e.g., management, coding, compliance) that does not exist internally
> Ability to deploy superior billing technology without the usual licensing fees and system transitions
> Opportunity for expense reduction, particularly if the labor is provided in a lower-cost community
> Scalability

As attractive as these benefits may seem, they also can turn out to be illusory. All too often, executives assume that outsourcing the revenue cycle function will somehow free them from this time-consuming and burdensome responsibility, leaving them with extra time and energy to devote to matters they find more impactful or interesting. This is a naive expectation, and a rude awakening often follows when leaders find themselves devoting even more time to revenue cycle management than before, because of the following circumstances:
> Cash flow decreases as accounts receivable (A/R) balances grow.

AT A GLANCE

When outsourcing revenue cycle functions, providers should address five key considerations in their vendor contracts:
> Give full attention to specifics in defining roles and responsibilities.
> Clarify the role and authority of the account representative.
> Ensure transparency across the relationship.
> Clearly define the process and means for reviewing performance.
> Develop a precise plan and structure for payment based on performance.
Root causes of denials remain unclear due to a lack of effective reporting, analytics, and transparency.
The billing team turns out to be less capable, less professional, and/or less sophisticated than advertised during the sales cycle.
The vendor becomes unresponsive, restricts access to decision makers, and exhibits a general lack of partnership and collaboration.

Although it may not be possible to avoid these issues altogether, they usually can be mitigated through contract terms that clearly define performance and service level expectations and include meaningful financial incentives for meeting those expectations.

An outsourced revenue cycle partner must be managed with the same degree of diligence that would be required if the function were performed in-house.

The Challenge of Getting Alignment
Revenue cycle outsourcing poses a type of challenge that social scientists refer to as the principal-agent problem, which can occur in arrangements where one party (the agent) is charged with making decisions that affect another party (the principal) for whom the agent is supposed to be working. The problem arises when the agent does not share the principal’s best interests and, in pursuing its own interests, doesn’t do what the principal wants. The principal could respond by micromanaging the agent, but a much more attractive remedy would be for the principal to find a way to align the agent’s interests with its own interests, obviating the need for extensive oversight and management.

Ideally, the parties’ interests should be so well aligned that the agent becomes virtually an extension of the principal.

Achieving such alignment should be a fundamental goal in structuring financial arrangements for revenue cycle outsourcing arrangements. These arrangements usually are priced on a percentage-of-collections basis, and that percentage typically varies little, if at all, with respect to the vendor’s performance. Billing companies commonly suggest this approach is sufficient to align their incentives with their clients’ interest, offering the argument, “We only get paid when you get paid.”

There is some truth to that argument, but not much. A percentage-of-collections arrangement provides a strong incentive for the agency to be efficient in processing the large volumes of claims that its customers generate, knowing that most claims will get paid without incident. However, it does not give the agency any incentive to be diligent in working claims that need extra effort (e.g., management of denials), because such an effort requires committing resources up front in exchange for a small percentage of revenues that may or may not be collected at some point in the future.

Not only is the “carrot” for good performance (increased revenues) weak, but the “stick” for bad performance (risk of losing the account) is only a little stronger. Granted, if performance is particularly bad, the customer has the option of walking away at the end of the contract term or possibly sooner, depending on the termination provisions. However, as billing agencies are fully aware, unwinding the relationship is costly to the customer as well, and as a result, the agencies often can (and do) get by year after year with performance that is merely mediocre.
Simply put, achieving alignment with an outsourcing agency is inherently difficult. As desirable as it may be, it is simply not realistic to expect two parties to craft an arrangement that will run on autopilot and produce good results. An outsourced revenue cycle partner must be managed with the same degree of diligence that would be required if the function were performed in-house. That said, a well-designed arrangement, with structured deal terms and financial incentives, can help the partnership run smoothly and according to the provider organization’s expectations.

**Key Terms to Consider**

Healthcare providers all too often do not recognize the importance of building effective protections and incentives into revenue cycle outsourcing arrangements. They also often mistakenly believe, based on pushback from the vendor, that these considerations are not up for negotiation. Even though the proposed terms may not conform to the vendor’s standard practices, the vendor may be willing to accept them if they are properly presented and explained. Here are some key concepts to keep in mind when developing effective contract terms.

*Get it in writing.* Attention to the details is critical. Given the complexity of the billing process, it is amazing how vaguely many revenue cycle outsourcing contracts describe the billing services that the vendor is being engaged to provide—especially when one considers the tremendous turmoil a lack of specificity can create down the road.

Revenue cycle management is a complex process with multiple discrete activities and hand-offs. Therefore, contracts must spell out—in painstaking detail—both the vendor’s and the provider’s duties, the standard to which those duties are to be performed, how often, and what proofs will be required to show that the duties were performed. Without these details, people will naturally fill the void with their own assumptions about the arrangement’s intent. These assumptions invariably surface when something goes wrong, in which case both parties respond with, “That’s not our responsibility; it’s yours.”

*Know who’s got your back.* The quality of a provider organization’s experience with an outsourced revenue cycle arrangement will depend in large part on the person or people assigned to manage the account. The provider will expect account representatives who are seasoned professionals with a solid understanding of revenue cycle management and who know how to deploy their organization’s resources to produce results. Too often, however, the provider perceives that its account representatives are functioning more as gatekeepers—as if their role is to limit access to the billing agency’s internal experts who may have the answers, but not the time, to address the customer’s needs.

The provider therefore should be sure to clarify the role and authority of the account representative and have these points described in the contract as thoroughly as possible. Also, the provider should try to negotiate contract provisions that give it a voice in selecting the people...
Managers and executives on each side should be able to reach out to a counterpart from the other side, as necessary, with the assurance that they will receive a prompt and appropriate response.

It’s also important to establish the escalation path between the two organizations. Managers and executives on each side should be able to reach out to a counterpart from the other side, as necessary, with the assurance that they will receive a prompt and appropriate response.

**Insist on transparency.** Complete transparency from the vendor is critical, yet this matter typically receives far too little attention either in the sales cycle or the contract language. Providers should always keep in mind that it is their organization’s money and that they should never be placed in a position of not knowing what the billing agency is doing to collect it. It can be a profoundly frustrating experience for an executive to watch his or her organization’s billing performance deteriorate and be unable to get straight answers regarding the reasons why.

To ensure an arrangement is fully transparent, the two parties should address the following questions (with documentation and evidence of compliance), before they sign the contract:

> What are the vendor’s internal operating policies and practices for key functions, such as account follow-up, denial management, credit balance resolution, and customer service?
> How are the account teams organized? Are subcontractors used? Are overseas resources used?
> How are staff trained and developed? What standards for productivity and quality exist, and how are they enforced?
> Who decides when an account is considered “fully worked” and eligible for write-off? How are these write-offs communicated to the provider partner? What adjustment codes are used and tracked?

**Ensure effective performance management.**

Knowing what goes on behind the scenes is critical, but results ultimately are what matter. The two parties therefore should undertake regular, robust, data-driven reviews of billing performance, with the following considerations stipulated in the contract:

> The frequency of revenue cycle performance reviews, the format for discussions of findings (e.g., in person, teleconference), and who should be included in the discussions
> The performance measures to be tracked as part of the review, how those measures are to be calculated, how the data are to be defined and pulled, and the level of granularity (e.g., group, specialty, location, physician) at which the information should be made available
> Who should be charged with keeping meeting minutes, when the minutes should be distributed, and how outstanding issues are to be tracked
> What tools will be available for the provider to monitor performance independently
Pay based on performance. The rate of payment (typically as a variable percentage of collections) should be tied to the billing agency's performance. Creating such an arrangement is a tricky matter, because an effective revenue cycle operation requires both parties to do their job. Therefore, vendors will quite understandably resist being held accountable for outcomes that they don’t control outright, and as a result, meaningful performance incentives tend to be the exception rather than the rule.

That said, incentive structures can be created that hold both parties’ feet to the fire. One effective arrangement is to tie the collections percentage to a schedule that considers the clean claims rate and the net collections rate. At the risk of oversimplification, the clean claims rate is determined by how effectively the provider organization captures appropriate information needed to process claims, and the net collections rate essentially measures how effectively the billing agency collects the allowable amount on claims. The exhibit below illustrates how these factors could determine the percentage of collections the vendor receives.

Under this structure, the billing agency receives a higher percentage of collections for achieving a higher net collections rate. However, the bar is raised or lowered based on the provider’s performance. If the provider struggles to produce clean claims, the billing agency’s job becomes that much more difficult, and consequently, the expectation for the net collections rate is reduced. Conversely, if the provider delivers a high clean claims rate, then the back-end functions become easier and the billing agency must achieve a higher net collections rate to earn a given percentage of collections.

These types of arrangements require creative thinking and insight, as well as considerable skill in negotiation and modeling of results so that both parties can fully understand their risk exposure and opportunities. Also, as noted previously, attention to the details is critical to success—these arrangements can work only if both sides have complete clarity regarding how each of these inputs within the incentive structure will be determined.

Have an exit strategy. To protect against the (hopefully) unlikely event that all the above precautions are insufficient to produce an acceptable relationship, contracts should include provisions that facilitate termination. The contract language should establish a process for

---

**REVENUE CYCLE VENDOR PERCENTAGE OF COLLECTIONS BASED ON CLEAN CLAIMS AND NET COLLECTIONS RATES**

<table>
<thead>
<tr>
<th>Net Collections Rate</th>
<th>Clean Claims Rate</th>
<th>Percentage of Collections Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>80%–85%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>86%–90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>91%–95%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>&gt;95%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>&gt;97%</td>
<td>6.50%</td>
<td>6.25%</td>
</tr>
<tr>
<td>96%–97%</td>
<td>6.25%</td>
<td>6.00%</td>
</tr>
<tr>
<td>94%–95%</td>
<td>6.00%</td>
<td>5.75%</td>
</tr>
<tr>
<td>91%–93%</td>
<td>5.75%</td>
<td>5.50%</td>
</tr>
<tr>
<td>&lt;91%</td>
<td>5.50%</td>
<td>5.25%</td>
</tr>
</tbody>
</table>
triggering a termination, including the steps required to signal increasing levels of dissatisfaction leading up to a declaration of the intent to terminate. At a minimum, this process involves the following:

> Clearly defined performance and service level standards, as described previously
> A definition of what can trigger termination for cause
> Provisions addressing notice of breach and opportunity to cure
> Operational protections (e.g., return of documents and billing data maintained by the vendor)

Naturally, the exit strategy is a two-way street. If the termination provisions are designed just to make it easy for the provider to back out of the arrangement, that would likely be a deal breaker or, at a minimum, necessitate major concessions in return. Besides, not all providers are good partners, and billing agencies undoubtedly find themselves from time to time wishing they could exit a relationship if they could. Therefore, it is only fair and reasonable for a vendor to expect that the path to termination apply equally to both parties.

Lastly, depending on the scale of its operation, the provider might find it useful to engage more than one agency. That way, if one doesn’t work out, volume can be shifted to another (assuming such flexibility has been negotiated into the contract). Moreover, if the agencies are aware that this possibility exists, they are more likely to act accordingly. This approach may be more feasible when outsourcing select “add-on” services, such as coding, rather than full billing and collections.

**Fundamentals for Successful Partnerships**

No services contract can perfectly align the incentives of the buyer and seller, regardless of the nature of services provided or the industry served; ultimately, success will come down to the degree of partnership and professionalism the two sides exhibit. In those rare instances where there’s a perfect fit, the contract language becomes almost superfluous. At the opposite end of the spectrum, when the relationship proves dysfunctional, termination is the only viable option. Between those two extremes lie the vast majority of cases, for which a thoughtful crafting of the deal terms will set expectations appropriately, eliminate ambiguity, mitigate business risk, and set up both parties for a long-lasting and successful relationship.

About the authors

David A. Wofford, MBA, is an associate principal, ECG Management Consultants, San Diego (dwofford@ecgmc.com).

John C. Whitham, MHA, is a principal, ECG Management Consultants, Dallas (jwhitham@ecgmc.com).