
Volume 1 / Issue 2 Summer 2006 - Management

Looking Beyond Economics in Outsourcing

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Background of the Outsourcing Agreement

There is a story behind every outsourcing agreement. In 2001, Catholic HealthcareWest (CHW), an organisation with the mission of providing high quality healthcare to the poor and disenfranchised in the community, was in economic trouble. Like many other organisations across North America and Europe^{1,3}, CHW considered the outsourcing of information technology (IT) services as a source of acutely needed cost efficiencies and to build a foundation on which to support standardisation of financial operations, clinical processes and procedures. During the summer of 2001, in a \$600 million, ten-year deal, the organisation outsourced its IT services. Now, halfway through the contract, while cost efficiencies were foremost in CHW's decision to outsource, it is clear that the economics of an outsourcing approach is only part of the story.

Establishing a Good Fit Between the Outsourcer and Customer

In a Gartner survey, North American outsourcers identified cost savings as the top driver in more than 80% of organisations that outsource IT⁴. Despite the fact that published surveys repeatedly indicate that cost savings were a primary reason for considering IT outsourcing, a balanced approach that includes the ability to deliver operational effectiveness, alignment with the core business, and flexibility to move in concert with changes to the customer's business strategy must be considered. Additionally, the less obvious but hard impact of softer issues such as compatible leadership styles, core values, and cultural fit between the outsourcer and customer must be examined when selecting potential outsourcing partners.



Key Economic Drivers

To start with the key economic driver, it must be said that saving costs is a legitimate goal but expectations must also be set realistically and have associated metrics that will allow for objective measurement. The outsourcer must be able to achieve economies of scale through standardised offerings or leveraged models of service. CHW's original business model prior to 2001 was a decentralised, holding company model in the early stages of evolving to a more efficient operating company model. Redundant services and costs were inherent in the holding company model for IT.

One of the first steps taken to resolve these issues, in partnership with the outsourcer, was to eliminate redundancy through the consolidation of more than 20 data centers and 19 help desk locations. This was accomplished during the first 22 months of the contract. The co-location of these functions created labour efficiencies as well as reductions in maintenance and utility expenses. With the initiation of the contract and in consideration of the outsourcer's expertise in technical services management, the contractual run rate for IT expenses was set below CHW's previously existing run rate. This metric was measurable from the first day in t e r n a l resources were transferred to the outsourcer. Additional cost efficiencies have since been realised through centralisation of technology contracting and procurement.

Realisation of Cost Efficiencies

For the successful execution of tasks that lead cost efficiencies, it is important to consider elements of a measurable partnership that benefit both the customer and the outsourcer⁶. Year over year savings in maintenance have been realised every year of the contract to date. While some of the savings from efficient negotiation and management of maintenance contracts serve as a hedge against inflation, it should be noted that in the tenance contracts for newprojects and installations, CHW has experienced an actual expense reduction. Another metric that points to a realisation of cost efficiency is the cost of IT as a percent of business operating expenses. Prior to outsourcing, CHW's total cost of IT was 2.8% of operating expenses as compared with the Gartner average for integrated health care delivery systems of 3% (published in 2001). The year following the transition to outsourcing, the total cost of IT fell to 2.1% of operating expenses. While this metric has increased during the subsequent years, analysis reveals that the increases are primarily due to the business-driven implementation and support of new technologies to support the core business of the delivery high quality patient care and management of associated business processes.

Overcoming Operational Complexity

If economics opened our story, the need for simplicity to overcome complexity was the next chapter. We understood that centralisation and standardisation would bring opportunity for greater efficiency but learned that accompanying the consolidation was unprecedented operational complexity. We also found that the initial discipline required managing processes involving user requests for services and projects was greater than had been in place prior to outsourcing. In outsourcing and the consolidation of services, potential complexity needs to be identified and simplified and its impact on the users served must be measured and minimized. Most outsourcing agreements contain service level agreement (SLA) measurements that customarily measure system and network uptime as well as metrics that capture the user experience with the help desk and desk side services. We found that the SLA measurements, even when results were positive, did not fully capture areas needing improvement in the user experience.

More than a year into the outsourcing relationship, we determined a need to augment the contractually required SLA measurements with a method to address the perception of service at the business unit/ hospital level⁵. While not traditional in outsourcing measures, our partner created a process to solicit subjective perception of service and value to the business. This method is called Performance Evaluation Report Card (PERC). The PERC consists of an in-person interview of local leadership covering five questions intended to capture the perception of service. This monthly interview and subsequent "stop light" report creates a venue, information, and action plans that fill in the gaps in service measurement that exist in a SLA only scorecard.

Shared Strategies

The SLA measurements and PERC assist in the alignment of outsourced IT services with the core business, but additional activities are needed to assure that the IT strategy is created in support of business goals and strategies. An internal IT function has many of the same requirements for alignment but when an outsourcing partner is providing the IT service, their business goals and strategies must also be examined for areas of alignment as well as areas of potential conflict. CHW accomplished this exchange of information routinely at the IT leadership level but also created a meeting between CHW executives with executives of the outsourcing partner, specifically to share relevant goals and tactics.

Sharing strategies at least once annually is key to alignment but to be most effective, requires flexibility on the part of the outsourcing partner. Particularly in a long-term agreement, the business strategy during the initial transition to outsourced IT services is likely to change in later years. A method to remain flexible with the business must be embedded in the contract, and more importantly, be part of the culture of the outsourcing partner. CHW has specifically experienced the importance of flexibility in the outsourcing agreement. As noted above, in 2001 at the time of the initial outsourcing of IT, CHW was experiencing economic pain. At that time, while CHW never wavered from its mission to care for the disenfranchised of society, strategies were focused around financial improvement and long-term viability to assure the continuance of the mission. Those strategies have been successful and five years later, strategies are now focused on growth, innovation and leadership. The technology strategy to support CHW today must enable transformation as it also focuses on growth, innovation and leadership, rather than solely on the original direction to standardise and consolidate. IT flexibility from the outsourcer has been key to the continued alignment and support of the core business.

Monitoring and measuring contract deliverables, SLA metrics and customer service in alignment with business strategy call for seamless integration between the business, the internal Office of the CIO, the outsourcing partner vendors and others providers of technology services.

Managing the rest of the story - alignment, flexibility and service - is an extremely complex task but one that successfully supports business strategies.

About Catholic Healthcare West

Catholic Healthcare West (CHW) is a system of 40 hospitals and medical centers in California, Arizona and Nevada and is the eighth largest hospital system in the US. The CHW network of more than 7,500 physicians and approximately 44,000 employees provides health care services to more than four million people annually.

Published on : Sun, 16 Jul 2006