
Volume 5 / Issue 1 2003 (English) - Cover Story

Outsourcing : Hospitals Apply the Brakes on Costs



Author

Heinz Kölking, *Managing Director of the Diakonissen-Mutterhaus Rotenburg, President of the German Association of Hospital Directors*

Incessant pressure to reduce costs in the German health system, combined with a recent pay freeze announced by the country's Minister for Health, Renate Schmidt, have forced hospitals to introduce measures to curb costs. The pace of structural change in the health system moved up a gear at the turn of the year when hospitals were forced to grapple with the first phase in the introduction of a new financing system based on the Diagnosis Related Groups model.

The far-reaching transformation of Germany's health sector has been triggered by a number of factors, principally demographic trends (specifically the "greying" of the population), ongoing medical advances and increased awareness of quality among patients. In an effort to boost effectiveness and efficiency and improve service quality, many hospitals have turned to contracting out or "outsourcing" some operations, which have been traditionally performed in-house. The following analysis considers the experience of outsourcing in German hospitals from the perspective of the Diaconate Hospital in Rotenburg an der Wumme. The hospital has 800 beds, 19 departments and institutes and treats some 30,000 inpatients and 75,000 outpatients each year.

Recent disappointing trends in hospital funding coupled with significant pressure to ease costs have forced hospitals to pursue far-reaching rationalisation. As part of its endeavours in this respect, the Rotenburg Hospital has adopted a policy of systematically outsourcing many internal functions and operational areas. Although the reasons for outsourcing various functions differed in each case, certain common motives come into play when arriving at the outsourcing decisions:

- The reduction of fixed cost risks, particularly in terms of personnel costs. Once a particular function has been outsourced, its associated fixed costs generally become variable costs. This means they become dependent on output levels.
- Outsourcing allows German hospitals to shift to different wage structures. Most hospitals are governed by rigid public sector wage agreements, which are uncompetitive in many service and care sectors and do nothing to promote efficiency. Outsourcing provides the employees affected by outsourcing an opportunity to transfer to other, more competitive pay systems.
- Outsourcing creates new mechanisms for financing investments. However, these are hampered by the fact that investments in Germany are financed at local level, which effectively means that investment activity is dependent on public budgets. Frequently, this leads to entrepreneurial decisions being delayed.
- The outsourcing of business activities such as catering, laboratory and technical operations allows hospitals to go on the offensive by extending their activities to servicing the wider market. Once incorporated as a private company, an outsourced catering division, for example, can supply other hospitals or run a delivery service.
- Outsourcing also offers useful opportunities for realizing new partnerships, which can be valuable in terms of raising capital and acquiring specialist knowledge.



Approaches to outsourcing vary. While in some cases, only the management function of the operational area will be farmed out to an outside contractor, the most common model involves outsourcing an entire function such as catering to an external provider.

Insourcing, as it has become known, continues to gain currency in Germany and the Diaconate Hospital in Rotenburg has also benefited from the trend. Essentially, insourcing entails making a certain function independent, both legally and as an economic entity, while retaining ownership of it. Ownership varies in form. It can be a 100% share in the company or a majority stakeholding. In such cases, the new ventures become subsidiaries.

The following functions and operational areas of the Diaconate Hospital Rotenburg have been outsourced.

- Laboratory medicine, magnetic resonance tomography; first aid and security arrangements have been outsourced in their entirety to external partners.
- Catering and the restaurant as well as the materials management, purchasing, technology and transport departments have been contracted out to limited companies in which the hospital has a 100% shareholding (full insourcing).
- Cleansing, sterilisation, stationary supplies, medical controlling and the internet service have been contracted out to either limited or public limited companies in which the hospital holds a majority holding (insourcing with the participation of an external specialist).
- Operational and service models: In the area endoscopy, the hospital has selected a model in which instrumentation is supplied alongside a comprehensive staff and after service package. In the area of PACS, the hospital opted for a delivery model, which guarantees the availability of all equipment and after service.

An analysis of both models – outsourcing and insourcing - reveals the following common structural characteristics:

- Co-operation contract: This contract regulates the conditions of service between the service provider (the outsourced function) and the hospital.

The nature and quality of the service provided are defined, as are the conditions of service e.g. prices.

- Rental agreement: In most cases, the outsourced operations continue to be housed within the hospital. The use of hospital facilities by the new venture is regulated by means of a rental agreement.
- Personnel arrangements: Staff transfer contracts are drawn up for those members of staff who will work in the newly outsourced entity. While these employees remain in the employ of the hospital and continue to receive their hospital salary, the new company reimburses the hospital for salary costs it incurs.

Before outsourcing an internal function, a hospital must first complete a series of preparations and crucial tasks. The closer a function is to the hospital's core operations, the more difficult the process will be. Given the complexity of the necessary tasks, it is imperative that systematic project management is in place during the preparation and implementation phases. A key task is the drawing up of an operational strategy for the outsourced function (the new company) and the service relationship.

Essentially, the latter means the way in which relations between the new company and the hospital are arranged.

In addition, the new structures and processes envisaged as part of the outsourcing must be operationally defined and quantified in figures. The decision must be underpinned by calculable rationale. The basis of the contract must also be spelled out, which requires in particular, that all aspects of the arrangement need to be clarified insofar as they relate to employment law, legislation pertaining to salaries and contracts and, not least, taxation law.

A key aspect of the process, which should not be underestimated under any circumstances, is the need to ensure that staff affected by the measure are involved in the process and are prepared for what is to come. As with all processes of change, honesty is vital and employees should be told that the situation will get worse before it gets better. Success usually takes time. It has been possible to identify a series of common features in all our outsourcing and insourcing projects. Firstly, once implemented, it usually takes a year or two for some semblance of normality to return. Nevertheless, it is our contention that the overall impact of every project implemented in our hospital has been largely positive.

This holds true both in terms of the identifiable reduction in fixed cost risks and the shift to another salary structures, both factors that generate significant potential for financing new investment. Another, no less important benefit of outsourcing has been that it allows access to new markets. The ability of these new ventures to attract and integrate partners is also extremely positive.

On the other hand, one should not gloss over the fact that outsourcing and its associated diversification increases the centrifugal energies of an organisation. Keeping these in check requires a consistent and powerful internal energy and identity.

Published on : Wed, 2 Feb 2005