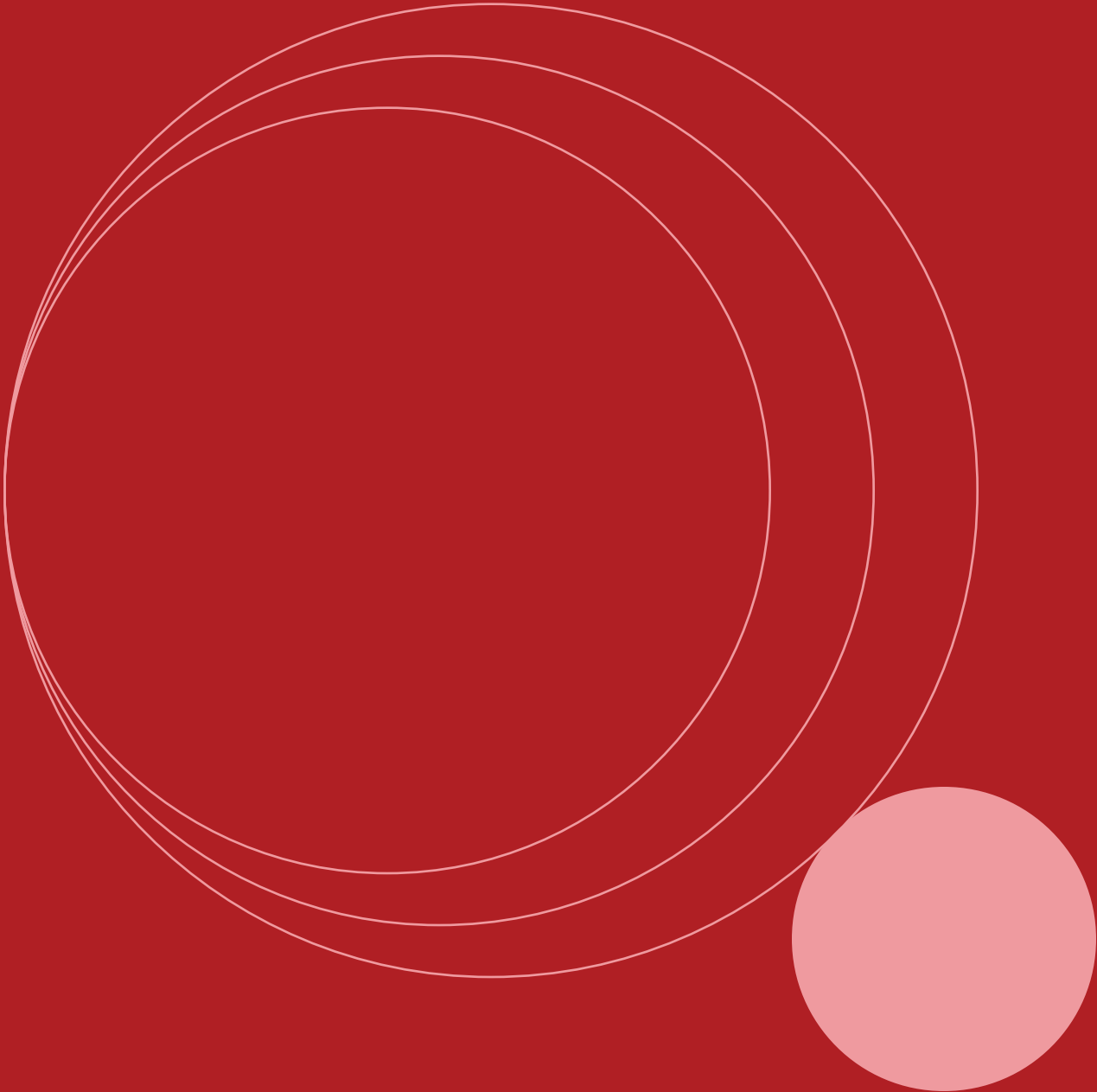


# Cicero

CICERO GROUP / THE ART OF OUTSOURCING IN A MULTI-DISCIPLINARY HEALTH SYSTEM



# THE ART OF OUTSOURCING IN A MULTI-DISCIPLINARY HEALTH SYSTEM

JAKE STEVENS

Health systems have never had so much trouble envisioning the future as they do today. Hospitals and health systems need to do more with less to stay relevant and endure market dynamics. Some of the challenges they face include the shift from volume-based to value-based care, the evolution of consumer-driven healthcare, and the need for economies of scale. Just as reimbursement models continue to shift there is an acute pressure on operational costs, buoyed by supply cost increases. And to compound the tension, there is a heightened awareness of lagging patient satisfaction and other service scores. This tension has certainly resulted in some exciting innovation, but only for a select few. Most will struggle with the fiscal crunch for years to come, if they survive at all. By some estimations, we are in the middle of the second wave of healthcare consolidation with a record number of deals announced first in 2017, then bested in 2018<sup>i</sup>. Similar analyses showed that in 2007 approximately half (52.8%) of community hospitals belonged to a system and by July 2018 that had increased dramatically to two-thirds (66.8%).

These trends seem to imply that sheer size will allow the lucky victors to survive. Yet, almost counterintuitively, another interesting trend continues to persist: Outsourcing. In early 2018, one of the nation's more innovative healthcare systems decided to outsource some 2,300 non-clinical employees, a move that was projected to save the system \$70 million over three years<sup>ii</sup>. The Chief Operating Officer of that system stated that shifting those 2,300 employees to a large employer that specializes in these services would help slow the rise of medical costs. By the same report we learned that healthcare providers across the country are looking to shed ancillary business segments amid softening inpatient admissions, lower reimbursement levels and rising labor, compliance and pharmaceutical costs.

## THE LURE OF OVER-EMPHASIZING NEAR-TERM INCENTIVES

Health systems have historically operated on very tight margins, if they're profitable at all. Partnerships, mergers, acquisitions, outsourcing, and consolidation are parts of an inevitable evolution. To survive, and perhaps even thrive, hospitals and health systems need to focus on their core capabilities. Outsourcing offers health systems an opportunity to focus on their inherent strengths while allowing productivity enhancements and increased accountability in areas of relative weakness. There are many reasons to outsource services, including reducing costs, increasing efficiency, focusing on core processes, improving skills, reducing service delivery time and increasing competitive advantage .

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However, while most economists would agree on the benefits of outsourcing, there is another much darker side to the practice. Some of the most significant obstacles of outsourcing have been described as 'lack of senior leaderships understanding', 'inherent service contract vagueness', 'overstretched outsourcing vendors', and 'unrealistic expectations'<sup>iii</sup>. Another criticism that has been levied is that outsourcing is easy to be replicated and can't be a source of sustainable competitive advantage<sup>iv</sup>. By its very nature, outsourcing is something that the organization has decided isn't a current priority. And accountability for failed outsourced arrangements is difficult to pinpoint. Yet according to various studies, one of the main reasons for failure in outsourcing projects is the ineffective application of a strategic decision-making framework<sup>v</sup>. Most decision frameworks consider, if not overly state, cost reduction as a primary objective. While there are certain immediate benefits from cost savings measures, one of the inherent problems is the over emphasis of near-term incentives. Even the savviest management teams will tend to over-focus on the near-term incentives because of their tangibility. One practice that can be leveraged in forcing a longer-term decision when considering outsourcing options is to elevate capabilities in the decision-making framework. Often, this will require reaching deeper into the organization to fully capture the current and future capabilities. It may also require a great deal of persistence and determination.

### CASE STUDY: CLINICAL LABORATORY

One illustrative example highlighting the need to consider longer-term capabilities preservation could be the health system laboratory. There are a variety of issues plaguing the lab that can overwhelm any health system administration. Examples include the impact from legislation like Protecting Access for Medicare Act (PAMA) of 2014 which implements significant changes to how Medicare pays for clinical diagnostic laboratory tests under the Clinical Laboratory Fee Schedule (CLFS). Another significant source of concern is the potential laboratory-developed test (LDT) oversight of the FDA, which has been hanging over the collective head of the laboratory industry for several years. Both have far reaching operational and financial impacts that may at first glance incite fear. A near-term decision may accommodate those financial concerns allowing costs to outweigh laboratory capabilities and outsource the laboratory operation to a national laboratory with significant economies

of scale. Such a decision is largely based on the premise that most laboratory tests are a commodity and the line item savings of outsourcing provides health system financial relief. The reality is, like in virtually all aspects of healthcare, the laboratory is much more complicated than a long list of diagnostic commodities. While savings from outsourcing may add up on laboratory tests as a direct expense item to the system, other expenses may increase from an outsourced relationship. For example, because the speed with which a test can be 'turned-around' can be critical to care, there is an indirect cost associated with not having the fullest menu of testing available as near to the patient as possible. Or more practically, when the health system is evaluating the laboratories capabilities, most systems don't have the accounting systems and processes necessary to credit the laboratory for a test paid under a bundle like the diagnostic related group (DRG). This can have a remarkable impact on the valuation of the lab, and hence the decision to outsource.

## **CONCLUSION**

There are too many variables to outsourcing in a multi-disciplinary health system for a templated recommendation to embrace or discourage outsourcing as a practice. Rather, outsourcing in each system requires careful consideration of the decision-making framework. Outsourcing decisions are a vital management process in any health system. And the reality is that every system should have a unique output to that process based on internal capabilities, near-term obstacles, and a variety of other variables like strategy, patient care, quality metrics, technology, economics, system capabilities and more. Additionally, properly weighting of near- and long-term incentives and impacts could determine the success of such decisions such as outsourcing.

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## ABOUT THE AUTHOR

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Jake's expertise covers a variety of specialties spanning analytics, strategy, market research, mergers & acquisitions, and change management. His experiences in healthcare, technology, automotive, life science, non-profit and private equity industries help drive consistent transformation and realize effective change.

Jake earned an MBA from Thunderbird School of Global Management, and a Bachelor of Science in Economics, Finance & International Business. While in school, Jake served extensively in student government including as Chief of Staff. He also served as a University Ambassador and Board Member for several non-profit organizations.

## ABOUT CICERO GROUP

Cicero Group is a premier management consulting firm focused on implementing data-driven strategies for a broad mix of private, public, and social sector organizations across the globe.

Cicero Group uses data and experience to generate insights, create actionable strategies, and drive transformation with an overarching purpose of helping people create and continuously deliver extraordinary results.

For more information, visit [www.cicerogroup.com](http://www.cicerogroup.com).

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