SCOTTSDALE INSTITUTE

INFORMATION EDGE

A CEO Resource for Managing Clinical Information Systems

Outsourcing IT

Executive Summary

Information systems outsourcing, common in other industries, is becoming viable for healthcare providers. While still embryonic, this emerging market is the result of several converging factors. Consolidation of the industry into large integrated delivery systems has created entities with enough size to create outsourcing opportunities. Also, the shortage of IS professionals is making it attractive for provider organizations to contract with outside firms to supply expertise and to shoulder the burden of keeping current with fast-changing technology.

Third and perhaps most important, where provider organizations lack the management skills—or the will—to manage IS as a business, an outsourcer can act as an objective third party who installs and manages rigorous procedures that ensure a return on an IT investment. "Most hospital IS departments have been managed more like service cost centers, not as businesses, because that is how they have been positioned," says Bruce Smith, VP of information systems and CIO at Advocate Health Care in Oak Brook, Illinois.

Outsourcing has changed with the times. Gone are the traditional 10-year deals in which a company would sell its IS assets for a quick infusion of cash and to cut data-center costs. Outsourcing firms may still hire an organization's IS staff and take over data-center operations, but—especially in healthcare—organizations should expect to gain business expertise from an outsourcing deal and even risk-sharing. It's entirely possible to develop a contract whose fee is dependent on actual savings generated.

Like any IS strategy, a decision to outsource should be preceded by careful analysis, with an emphasis on answering the question of why to outsource in the first place. In the Conclusions and Recommendations section we include some key points to remember in considering outsourcing.

▲

July 1999
Volume 5, Number 6

SCOTTSDALE INSTITUTE
MEMBERSHIP SERVICES OFFICE
1660 SOUTH HIGHWAY 100
SUITE 140
MINNEAPOLIS, MN 55416
(612) 545-5880
FAX (612) 545-6116
EMAIL scottsdale@fcgnet.com

Outsourcing overview

Outsourcing has been a popular trend in non-healthcare industries for at least a decade. The outsourcing market for all U.S. industries is more than $100 billion and growing at least 20% a year, estimates Jack Benton, director of marketing for Technology Partners International Inc., a Houston-based outsourcing consultant. He cites Dataquest research that predicts the U.S market, including IT and business processes associated with IT, will grow to nearly $400 billion by 2004.

Today, a key driver behind the move to outsource is speed to market.

"It's a huge market in the United States. This is not a passing management trend or fad. Outsourcing is a strategic tool, but like other strategic tools it is neutral and its impact depends on how it is used. But you'll always hear the odd horror story," says Benton, who acknowledges Technology Partners has little experience within the healthcare provider market itself since it is only now emerging. And while outsourcing deals are never perfect, most clients say they're better off than before they outsourced, he says.

Hot areas in the general outsourcing market include e-commerce and software applications. "Most of the big megadeals have been done" in which Fortune 1000 organizations turn over their entire IT infrastructure to the outsourcing firm, he says. Now smaller to mid-range companies seek outsourcing arrangements targeted more at implementing, say, an SAP software module too complex for their IT staffs. Bigger firms are seeking more value-added services such as having an outsourcing firm supply back-office operations.

Consolidation of the industry into a thousand integrated delivery systems in the last five years has created a "critical mass" for outsourcing. "As IT shops get bigger, the market for outsourcing makes more sense."

Steve Heck
President, First Consulting Group

In the past, companies would outsource in order to get an injection of capital by selling their IT assets to the outsourcing provider, who would also hire the client's staff and run the IT operation for the client. Besides the cash, the incentive was also to reduce IT costs. Today, however, a key driver behind the move to outsource is speed to market.

The traditional 10-year term of an outsourcing deal is also much less common these days. "IT costs are spiraling down, so locking yourself into a 10-year deal is not wise," says Benton.

Healthcare a new outsourcing market

Only recently have healthcare providers considered IT outsourcing as a major strategy, says Steve Heck, Dallas-based president of First Consulting Group and head of FCG's outsourcing service. Other healthcare sectors like insurance have outsourced for years, however. For example, Blue Cross plans have traditionally hired EDS to operate their data centers. Besides EDS, IBM, CSC and Perot have provided outsourcing services to insurers. Also, as HMOs have consolidated into bigger and bigger entities, they have increasingly entered into IT outsourcing arrangements with those same vendors.

In contrast, the provider market has been slow to adopt outsourcing until now because of several factors. One was size: The market was fragmented among 5,000 to 6,000 hospitals, each of which was too small to make outsourcing profitable. With the consolidation of the industry into roughly a thousand integrated delivery systems in the last five years, there's now a "critical mass" for outsourcing. "As IT shops get bigger, the market for outsourcing makes more sense," says Heck.

Another factor: healthcare providers' traditional dependence on commercial software packages, which has typically resulted in single hospitals using as many as a dozen separate proprietary software products running on multiple computing platforms. Such scenarios belied the logic of outsourcing, traditionally focused on the economics of centralized mainframe computing power—called "MIPs" for millions of instructions per second.

Providers have lacked formalized service levels and predictable costs. Users receive very broad-based allocations, so they see IT as free.

However, changes in the healthcare industry have now attracted the traditional big outsourcing vendors.

"Consolidation is creating interest for the traditional outsourcing firms," says Heck, adding, that poses a problem for unwary providers. "The problem is those outside consulting firms don't understand the business or clinical issues. They're approaching the market with models that are driven by leveraging infrastructure."

Instead, an outsourcer must understand the business environment surrounding the provider's use of technology. In the 1990s, IDNs played catch-up in IT, spending millions of dollars to build IT infrastructures, automate the desktop and re-deploy applications, while in the process turning the IT department into a highly visible cost center. As revenue ratcheted down and cost pressures have soared, healthcare executives have not seen a return on their IT investment.

What outsourcing does is bring business management to IT—which will result in culture clashes because nothing in IT will be free anymore.

The problem, says Heck, is that providers have not learned to operate their information systems as a business. "There have been no formalized service levels and no predictable costs—unless those costs are abstract, such as adjusted patient days. Users receive very broad-based allocations, so they see IT as free," he says, adding, that is true even on the level of a business manager, for example, who wants five more laptops.

Unbridled demand for such items as more desktops and better clinical systems has been allowed to happen without achieving and/or tracking the business/clinical objectives that justified the technology investment. "In many cases, the user community does not own the outcome," according to Heck. In the early years of IT management, users specified requirements and systems were built to solve specific needs. As commercial software solutions became the standard, solutions became more generic and the accountability for achieving desired outcomes has become less clear.

What outsourcing does is bring business management to IT—which will result in culture clashes because nothing in IT will be free anymore.

Now, when an organization wants to deploy a new $80-million system, an audit trail will determine who owns the $160-million benefit.

MacNeal Health Network

In the Chicago suburb of Berwyn, Ill., MacNeal Health Network basks in the glow of its long-held reputation for quality, financial stability and IT leadership—and wonders if it should turn over its entire IS operation to an outsourcing supplier.

Outsourcing on a large scale has its risks. "We're very much afraid of losing our performance reliability, responsiveness and cost control."

Dave Printz, VP and CIO
MacNeal Health Network

Despite MacNeal's success, the same trends that drive a nascent market for outsourcing nationally are buffeting the quarter-billion-dollar-a-year integrated delivery system, with a hospital and 24 physician offices. Dave Printz, MacNeal's VP and CIO, says the provider expects to take a $40-million "hit" in the next five years as a result of the pressures of managed care and impact from the Balanced Budget Act, which will cut the Medicare payments that provide 40% of MacNeal's revenue.

"We can't continue in this very crazy future. There's not enough revenue stream," he says. That's why MacNeal is publicly seeking to merge with other local provider organizations and evaluating whether it should selectively outsource pieces of its IT operation, or the whole thing. The goals of outsourcing, says Printz, would be threefold:

- save money
- guarantee that the works gets done
  (like everyone, MacNeal faces a shortage of IT staff)
- guarantee performance

MacNeal, which has a $12-million annual IT budget, for the past five years has outsourced its "break and fix" services for PCs, faxes, printers and other ancillary network devices to a local third party as a way to save money and achieve better performance.

But outsourcing on much greater scale has its risks. "We're very much afraid of losing our performance reliability, responsiveness and cost control," says Printz. He wants to carefully evaluate potential outsourcers to determine such factors as lead-time for new applications and percent of downtime for systems. "We already have such a high level of reliability, that if we give IS control to another organization with 50 clients, where does that leave us?" he asks.

Advocate Health Care

Only a few miles away in Oak Brook, another Chicago suburb, Advocate Health Care, a $2-billion-a-year integrated delivery system, has outsourced maintenance and support for its 10,000 combined PCs and printers to a local firm for the last three years. The $1-million-per-year contract includes hardware and software support. "When there's a problem, we place a call and they come out within four hours," says Bruce Smith, VP of information systems and CIO at Advocate.

"Our client services staff was spending all their time on maintenance and support and individual departments were picking up the costs. It was a nightmare," he says.

Advocate owns the devices, which accommodate nearly 15,000 users, and which it has gradually updated to Pentiums as part of the Y2K remediation process.The outsourcing firm is responsible for the technical support under a contract renewed annually to account for usage rates.

Advocate also outsources help-desk services for shrink-wrapped Microsoft software applications like Word and Excel. Under the contract, which is with a firm called PC Helps, Advocate buys a "bank" of several thousand help-desk "units" that it cashes in on a pay-as-you-go basis. So far, seven hospitals are currently utilizing PC Helps at an annual cost of $140,000.

"The new challenge is about people aggregation and deployment, not infrastructure."

Steve Heck
FCG

But Advocate does not expect to save money on the deal. "We predict cost and utilization will go up," says Smith, whose IS budget runs about $24 million a year and covers 200 staffers. Three-fourths of them work in the core services group—networking and telecommunications, registration, laboratory and billing—and the remainder work locally in field services.

Smith acknowledges Advocate hasn't considered outsourcing the entire swath of IS services but rather "selectively picks and chooses" functions, supplementing its staff with vendors such as Compaq and Sun Microsystems, which provide hardware and software maintenance. The organization also has a partnership with a technical firm for network planning.

Excess infrastructure+staff shortage=outsourcing

FCG's Heck sees such selective outsourcing as just the tip of an iceberg that will grow rapidly in the next five years. "What I'm seeing is that there are plenty of companies that have excess infrastructure but very few that have expertise in business and that can manage IT in concert with business needs." Another factor that could drive the move to outsourcing by providers, he says, is the shortage of IT skills nationwide, which translates to only 7.5 qualified people for every 10 jobs. Healthcare has an even greater shortage because non-profit hospitals have not been able to compete with the other industries in terms of salaries.

That factor plays into Heck's view of where the industry is going and why FCG sees outsourcing as a strategic service offering. "I think the new challenge is about people aggregation and deployment, not infrastructure," he says. By being able to aggregate people and skills on an as-needed basis, the outsourcing supplier can effectively expand the capabilities of a 400-person IT staff to that of a 2,400 person staff. For example, if a provider organization needs staff for a large deployment, the outsourcer can rapidly flex up staffing with experts and then phase down appropriately.

Perhaps more important is the outsourcer's ability to reorganize the entire management process surrounding a client's IT by implementing controls related to time and project management, which tighten up the IT operation. A typical outsourcing contract with FCG might involve a three to seven-year term, followed by two to three one-year renewals. That's enough time to establish a relationship and for the outsourcer to recover initial investments.

In some cases, FCG's payback would be risk-based. For example, a hypothetical $20-million-a-year software outsourcing contract might stipulate that, for every $1 saved, FCG would get 40 cents. "You have to go in and find the money, which is not hard because IT departments have been generally overwhelmed by intense project activity and have not optimized the operation itself," says Heck.

Many contracts will be written based upon a cost-neutral solution. For example, a contract with large IDN with an annual operating and capital budget of $50 million to $100 million might require productivity increases of $7 million to $20 million.

The goals for the client:
- Predictable cost
- Predictable service
- Rigorous change-management process (as an IDN adds hospitals, for example)
- Access to expertise

Because of the opportunities for outsourcing, vendors like SMS and HBOC also want to get into the outsourcing business. The obvious problem, however, is that they lack product independence and would fight against having an independent third party making IT judgment calls. "All the vendors are going to fight for account control," notes Heck.

The outsourcing wave also ties in with another, even bigger wave: the Internet. Internet-based firms like Healtheon are aiming to control access to the Net and shared applications. And, with every provider Web-enabling their environments, it's no surprise such vendors view control of the Internet as akin to controlling possibly the most lucrative toll road in the world. An outsourcing vendor like FCG, however, could provide an efficient alternative by building client consortia for shared Internet access.

Conclusions and recommendations

Organizations contemplating outsourcing should consider the following points:

1. Understand what's driving the move to outsource. Is there a compelling reason to change? Often, the decision to outsource depends on the strategic value of the process. You may want to consider outsourc-

ing non-strategic and non-core competencies and keep strategic and core competency technology in-house.

2. How will the outsourcing affect the organization's control of information, which health systems are just beginning to exploit? Companies like Schwab and Amazon.com, whose information *is* the business, do not outsource core systems.

3. How important is cost? What are the needs to reduce cost long-term and short-term? Is there a form of creative financing?

4. What are the requirements for the supplier to hire your existing personnel?

5. What are your current, versus desired, technology capabilities? What needs to be upgraded?
6. What is management's willingness to assume risk?

7. Are there realistic opportunities for a business alliance with an outsourcing supplier?

8. The ultimate question is not whether the supplier is better than you, but whether there is some combination of your capabilities and the supplier's capabilities that is better than yours alone. This combination can result in faster speed to market (for example, if an organization can't roll out an application system fast enough itself), enhanced capabilities or capacity, and service-level guarantees.

9. The contract signing is not the end of the process, but the beginning. The ultimate challenge is managing the supplier relationship. Don't put the contract in the drawer, but don't use it as a club either.

▲

Reminder

1999 Conference on COST MANAGEMENT

Hyatt Regency O'Hare
Chicago, Illinois

October 15, 1999

This one-of-a-kind cost management program is designed specifically for healthcare executives and their key team members. Attendees can expect to hear about solutions that have actually worked in **meeting the challenges of making physician organizations successful; effectively using IT to manage cost; determining when to consider outsourcing; identifying and implementing programs that result in hard dollar savings and more.**

This conference is focused on pragmatic results and case studies of those who have successfully implemented measurable results for improved cost management.

Plan to attend this important event. Register by calling 612/545-5880. Registrations received **on or before** August 15, 1999 qualify for early-bird discount. **Detailed brochure available.**

Sponsored by

Scottsdale Institute and the First Consulting Group