

Using Outsourcing to Transform Human Resource Functions



As a result of the stalled economy, declining payment levels, staff shortages, and increased patient care costs, hospitals throughout the United States are increasing their focus on improving efficiency and reducing costs. Organization leaders are asking all of their departments to “do more with less,” and functions in human resources (HR) are no exception. In fact, as a cost-generating area of the hospital, HR is a logical target for efforts to streamline operations and save money.

Hospitals looking to improve HR efficiencies are increasingly considering opportunities to shift responsibility for certain processes—such as payroll, benefits administration, and recruiting—to an outside vendor or vendors that specialize in these areas. When examining such an outsourcing strategy, hospital leadership should weigh benefits and challenges and understand several key needs associated with a transition of services.

Benefits of Outsourcing

Outsourcing one or more of an organization’s HR functions can provide several benefits. Three chief advantages are access to enhanced expertise, greater efficiencies, and support for strategic positioning.

Expertise. “Because many HR vendors, including those offering payroll services, have been around for a while, they have developed a high level of knowledge and a track record of delivering these services,” says Michael Gretczko, principal with Deloitte Consulting LLP. “These vendors are able to bring stable, well-vetted, high-quality products and processes to the market, which allows them to provide reliable service. Leveraging the expertise of a vendor whose primary focus is the HR process in question may be advantageous if your in-house department does not have the capability or resources to consistently deliver a similar level of service.”

Certain aspects of HR that are impacted by changing regulations, such as benefits administration, may also be appropriate for outsourcing, because a vendor offering this type of service can devote time and energy to understanding and keeping up with all the emerging rules and nuances associated with enactment, notes Michael J. Scott, LUTCF, CMFC, president of the Colorado Hospital Association Financial Advisors, a subsidiary of the Colorado Hospital Association. “Healthcare reform is keeping many things in flux, and an outside vendor may help an organization better avoid risk in terms of noncompliance,” he says.

Efficiencies. Outside vendors can also provide economies of scale, notes Jay Holden, vice president of human resources at Michigan’s Beaumont Health System, a regional healthcare provider that includes three hospitals, medical centers, nursing homes, family medicine centers, rehabilitation facilities, and physician practices.

“Because these companies offer a limited number of HR functions and provide them to many clients, they are able to deliver a high level of service while spreading out the cost,” he says. “For example, a company that provides payroll services to several different clients can spread the hardware, software, and staffing costs associated with payroll across the contracts of the different clients. That same service, if provided internally by your organization, might require significant up-front capital.”

Strategic positioning. One of the most significant benefits of outsourcing is the time that it can free up for in-house staff to dedicate to more strategic priorities. “By outsourcing the routine administrative functions of HR, the department is able to focus on activities that address the specific needs of the workforce and better align itself with the strategic priorities of the organization,” Scott says. “To compete in the changing healthcare marketplace, you want your HR department to be spending less time on purely administrative functions and more time on strategic ones. Activities such as leadership development, succession planning, and staffing may all warrant increased attention.”

Considerations

Despite such benefits, outsourcing is not an automatic answer. Leadership should be heavily involved in identifying potential drawbacks or risks, determining appropriateness of services to outsource, and analyzing costs.

Each of these tasks will vary considerably by strategy. For example, the potential risks for a total outsource strategy where HR would be responsible for managing sensitive employee concerns, such as workplace safety or security breaches, would be far different than one based on leveraging external efficiencies for processing garnishments or printing checks.

In the first instance, strong communication and likeness in overall philosophy between both of the organizations would be critical for success. “If not carefully considered, such an outsourcing strategy could result in an HR department that

seems somewhat removed from employees,” explains Stephanie Drake, executive director for the American Society for Healthcare Human Resources Administration (ASHHRA). “The organization could lose the face-to-face aspect of HR, as the relationship between the HR department and the employees becomes more transactional and less relational.”

Another consideration could be how employees will perceive an outsource strategy, particularly if there is likelihood for restructuring or loss of jobs: Will outsourcing be received positively as a means to minimize highly repetitive or specialized functions so staff can more effectively focus on core issues—or a threat to their positions? “Before embarking on an outsourcing endeavor, organizations must carefully review the impact of the decision on employees and their jobs,” Holden says. “Without such consideration, you could face a troubling morale issue that limits success.”

Choosing What to Outsource

Perhaps the most important consideration for leadership is whether the services identified are truly optimal targets for outsourcing. For most hospitals, outsourcing the entire HR department is not advisable. Organizations should be tactical, focusing on opportunities that will support—not compete—with the core pieces of HR and help elevate the department within the organization.

Hospitals generally find greatest success by selecting areas such as the following for outsourcing.

Seasonal or specialized functions. Because some HR functions—employee satisfaction surveys, for example—are performed only at certain times of the year, they can be a logical option for outsourcing. Other good candidates are those functions that require specialization or are done en masse, such as benefits enrollment and payroll.

Functions that require particular hardware or software. Outsourcing these functions may provide the greatest cost savings because the vendor takes on the chief capital expense and spreads that across multiple clients and contracts. Vendors generally require only a small one-time investment for initial implementation costs that can often be spread over the course of a contract. Also, vendors typically will take on the responsibility for system upgrades and ongoing maintenance.

Functions that require significant time and resources that take away from more strategic opportunities. As previously mentioned, the department may be shifting its attention from

administrative functions to strategic ones. Outsourcing highly transactional functions that take time away from strategic priorities may help achieve this shift in approach.

“When thinking about outsourcing a particular function, it can be helpful to get the people currently performing that function involved in the decision-making process,” Holden says. “Doing so accomplishes two things: Seeking opinions from those who do the work helps you better understand all the factors involved in a process before making the decision to outsource. Also, involving these individuals at the outset and explaining how an outsourcing strategy could positively impact their jobs and the organization’s future helps gain their buy-in and support for change as you move forward with the decision.”

Also important is examining the overall purpose and value of an outsource strategy to the organization. “For some hospitals and health systems, a shared services approach or investing in technology internally to achieve greater efficiencies may be more appropriate,” notes Gretczko. “If you already have robust and mature shared services in place, for example, then outsourcing may not be the way to go. Conversely, if you have fragmented technology, a lack of efficiencies, diverse policies and procedures, and/or high HR staff-employee ratios, then there may be opportunities for outsourcing that make sense.”

When deciding whether an outsourcing strategy in HR is right for the hospital, leadership should first take a close

SPECIFIC FUNCTIONS TO CONSIDER FOR OUTSOURCING

- Payroll
- Time and Attendance
- Total Compensation Statements
- Benefits Enrollment
- Benefits Administration
- Flexible Health Spending Accounts
- Reference Checks
- Employee Assistance
- Compensation Surveys
- Employee Engagement Surveys
- Recruiting

look at the department and identify its core strengths and weaknesses. “The purpose of this analysis is to see not only what your current processes are, but also how they align with the mission and goals of the organization,” says Roger DelGiorno, a director with Deloitte Consulting LLP.

“Although outsourcing can be a good strategy, it is not a panacea for poor HR processes,” he says. “In other words, merely outsourcing won’t fix inherent problems with your processes. You need to look holistically at the way your department provides services, determine how you will support the strategic objectives of the organization going forward, identify opportunities for improvement, and evaluate if outsourcing can enhance any improvement efforts. You also need to support any improvement efforts with robust change management and communications to help the organization adapt and realize the benefits of the changes in HR services.”

During this strategic analysis, organizations should be looking at the skill sets of their current employees as well as the availability of different skills via a vendor. Leadership should examine which tasks the department performs well versus those that need help. Also important is thinking about the future of the organization and how to optimize current HR staff to best meet the mission, goals, and objectives of the organization.

Analyzing Cost

One crucial element to consider when performing a strategic analysis is what the organization’s current costs are for performing HR functions in-house, and how those costs could change if these services shifted off site. According to a January 2011 study conducted by PwC, organizations from both inside and outside of health care tend to underestimate the true expense of performing HR functions. Frequently, they fail to consider costs beyond the direct labor needed to perform the functions and any systems involved. This oversight generally leads to underestimating costs by 50 percent or more.¹

Based on survey respondents, the PwC report indicates that the cost of administering payroll, workforce administration, time and attendance, and health and welfare benefits ranges from \$1,400 per employee per year for large organizations (1,000 or more employees) to nearly \$2,000 per employee per year for mid-size organizations (100-999 employees). The 2011 study is the most recent in a number of studies conducted by PwC since 2003. An important finding of the 2011 study is that despite the introduction of improved technology and

new delivery models, in addition to department cutbacks due to the economic environment, the total cost of ownership for administering these functions has continued to increase since 2003.

According to the study, outsourcing can be helpful in reducing the costs of administering these services. Organizations that use multiple in-house platforms to deliver payroll, workforce administration, and time and attendance on average experience a total cost of ownership that is 32 percent higher than organizations outsourcing these three functions to a single vendor. Large organizations experience even greater benefit to outsourcing. For organizations with 1,000 or more employees that use multiple in-house platforms for these functions, the total cost of ownership is 41 percent higher than organizations outsourcing these functions to a single vendor.

To get a true sense of the expense involved in administering HR functions in-house as they compare with an outsource approach, hospital executives should comprehensively assess costs and review all of the different components that go into providing, supporting, and maintaining an HR function. Possible costs to consider when conducting this type of analysis include the following:

- **System installation:** One-time cost related to the initial acquisition and implementation of HR systems.
- **System upgrade cost:** Periodic cost that ensures any systems remain current and at peak functionality.
- **Direct labor cost:** Salary and benefits of workers directly involved in providing the HR function or functions.
- **Direct nonlabor costs:** Consultant fees, facilities, supplies, and so forth.

HR OUTSOURCING: BY THE NUMBERS

According to the PwC study “The Hidden Reality of Payroll and HR Administration Costs,” January 2011:

- Organizations managing payroll, workforce administration, time and attendance, and health and welfare benefits in-house using premise-based or hosted software solutions spend on average 18 percent more administering these functions than organizations that outsource these functions.
- Organizations outsourcing multiple functions to a single vendor see even stronger cost efficiency—on average 32 percent—versus organizations using a multiple vendor or “best-of-breed” in-house approach.

- **System maintenance costs:** IT costs specially related to maintaining current systems.
- **Indirect labor costs:** Costs for the employees not directly related to the HR department who are helping to support HR functions.
- **Outsourcing costs:** Total annual costs of any outsourced services.²

Selecting a Vendor

Once a solid business case for outsourcing is made, focus then turns to identifying an appropriate partner. The importance of this process shouldn't be underestimated. "Not every company providing outsourcing services is the same, and subsequently not every company is appropriate for your needs, culture, and strategic goals," notes Holden. "Spending time researching, vetting, and selecting the correct vendor can mean the difference between a successful outsourcing effort and a failed one."

Among the key considerations when selecting a vendor are the following.

Service offerings. "First and foremost, you need to look at a vendor's breadth of capabilities and performance," Gretczko says. "The vendor should be able to meet your current needs and also be able to scale up or down to adjust going forward. A commitment to process improvement and performance monitoring is also essential."

Cultural similarities. Even if the outsource relationship is separate from internal operations in terms of technology, process, or transactional support, leadership should still ensure the outsource partner shares its overall philosophy around service quality. "Because a vendor may represent the face of Human Resources for a particular function, you want to make sure that the vendor is committed to communicating with employees in the same manner that your organization does," Scott says. "You want to verify that their approach is similar and that culturally your two organizations match. Doing so will help contribute to the cohesiveness of service delivery."

The closer the outsource relationship is to core department functions, the greater the importance of finding the right fit. In such instances, HR managers may visit a potential vendor's office and observe the vendor's employees to get a better sense of the company's corporate environment.³

Reputation. Before committing to a vendor, leadership should make sure the vendor has the expertise to meet the organization's needs. Verifying experience, track record,

and reputation is critical to ensure the selected vendor can provide the level of service required.

Technology. "Many HR functions will involve extensive technology, and you should check that your vendor has the necessary software, automation, and connectivity to adequately support you," Gretczko advises. "They also must be committed to keeping that technology current and up-to-date. Technology also should support performance reporting to show whether the vendor is adequately servicing the organization and meeting any service-level agreements. The vendor should also have the ability to recover data during a disaster and guarantee the security and confidentiality of your information."

Healthcare experience. Ideally, a vendor should have experience or at least familiarity with the healthcare field. However, the level of experience needed can vary. "For some HR functions, such as managing workers' compensation benefits, it may be advantageous to have healthcare experience because there are aspects of the function that are unique to the industry," Holden explains. "However, other functions, including oversight of flexible spending accounts, may not require a high level of healthcare experience."

Transition planning support. The transition to outsourcing can be challenging, particularly if the outsourcing strategy involves several functions or is one that will affect job status. "Some vendors will work with you to develop a transition that involves hiring your employees," says Holden. "If the vendor needs to hire additional staff to adequately service your organization, they may agree to hire or at least interview your current staff for these roles. Working with a vendor that has the best interests of your company in mind can help with the overall transition."

Commitment to predefined service levels and ongoing performance monitoring. "A vendor should work with you at the outset to define what services they will provide and how they will be held accountable for providing those services," Holden says.

Cost. "Although maybe not the most important factor, the return on investment [ROI] associated with a vendor can be a valuable data point," Scott says. "Asking the vendor to provide you with an anticipated ROI can help you determine whether the cost involved in using the vendor's services is worth it. The data can make a compelling argument for outsourcing." Again, ROI should be based on a comprehensive breakdown of direct and indirect costs.

Multiple service offerings. It can be beneficial when outsourcing multiple HR functions to use one main vendor. Doing so can not only improve efficiency but also save costs. According to the PwC report, organizations that outsource multiple functions to a single vendor can see on average 32 percent more efficiency than those organizations using multiple vendors or an in-house approach.⁴

Regardless of selection criteria employed, gathering information about a vendor does not have to be challenging. "It can be helpful to put together a detailed RFI [request for information] that describes what you're looking for and that provides specific ways vendors can demonstrate these features and characteristics," Drake says. "By having every vendor provide the same information, you can do a fair, side-by-side comparison that ensures the selected vendor aligns with your organization's mission, vision, and overall culture."

Looking to colleagues for insight is another important way to determine whether a particular vendor will meet the organization's needs. "Reaching out to other hospitals that use a vendor, seeking information from professional associations, and conducting general research on the Internet can all help uncover information about vendors that is valuable to the decision-making process," Drake says.

Crafting the Contract

Once leadership selects a vendor, it will need to structure a contract that defines the relationship and that ensures both parties understand their roles and responsibilities to each other. Key items to address in the contract include the following.

Service-level agreements. Terms should outline specifically the services the vendor will provide and ways the hospital can verify whether the vendor is performing the services adequately. "Service-level agreements should be customized to the needs of your hospital," Drake says. "For example, when working with a benefits vendor, you want to make sure the vendor provides comprehensive access for employees. Your average night nurse is not going to be able to call for assistance during regular business hours, so you want to make sure the vendor provides adequate staff during week-end hours to support *all* your employees."

A hold-harmless agreement. "Your hospital should not be held accountable for the actions and mistakes of the outsourced company's employees," Scott says. If, for example,

a company providing recruiting services misrepresents compensation structure, then your hospital should not be held responsible for that action.

Means to opt out. "You want to avoid any 'evergreen' or automatic renewal clauses in the contract, so you can reevaluate the relationship on a regular basis," Drake says. Many commitments are multiyear and often entail initial investments from both the hospital and the vendor. If the relationship does not work out, it's important to be able to terminate the contract without being subjected to excessive or unreasonable penalty in a way that fairly recognizes these investments.

The hospital or health system's legal counsel should be active in developing and reviewing the contract to ensure that it supports a productive and long-lasting relationship. Says Drake, "Allowing plenty of time for contract development and approval is critical to ensure that you hammer out all elements of the contract ahead of time and engender a positive working relationship going forward."

Supporting Change

To reduce potential for any bumps during the transition of one or more services to outsourcing, leadership should give the strategy considerable forethought and put plans in place to minimize common trouble spots. "You must be transparent with employees as to why you are pursuing an outsourcing strategy, and what that decision will mean for them in both the short and long term," notes Drake. "The more employees know and understand the changes taking place, the more likely they are to be supportive."

Also, it can be helpful to dedicate a full-time employee to overseeing vendor relations. This type of employee would arrange monthly meetings to identify successes, challenges, changes, and so forth. He or she could also bear responsibility for monitoring service-level agreements and making changes as necessary.⁵

Ultimately, the transition should be as coordinated as possible. "If you are outsourcing to a benefits administrator, for example, the only change in service that employees should perceive—other than an improvement—is a new number to call for assistance," Drake says. "You can achieve this seamlessness by selecting an appropriate vendor, working closely with that vendor on a transition plan, communicating information to employees about the new vendor, and continuously monitoring the level of service."

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DRIVING EFFICIENCY IN OUTSOURCING RELATIONSHIPS

Terrence McCrossan, vice president of national account services at ADP, provides tips to healthcare organizations considering or pursuing outsourcing as a human resources (HR) transformation model.

Q How would you describe the changing perceptions of HR outsourcing?

A Healthcare organizations have continued to outsource a multitude of noncore services, such as housekeeping, food service, laundry, and the call center. Outsourcing of another such service, human resources (HR), has been gradual to date. Yet healthcare organizations are becoming more receptive to the value and benefits that outsourcing delivers within the highly transactional aspects of HR functions. In simple form, the outsourcing model leverages a third-party expert to perform particular processes, usually administrative in nature, on behalf of an organization. Often these processes are farmed out because they require labor resources, technology, or expertise that is not affordable within the contracting organizations.

Q Aside from cost reduction, why else might hospitals outsource HR functions?

A Equally, if not more important is the model's ability to meet the overall needs of the organization. A third-party firm's expertise and high client satisfaction scores can be critical to ongoing success. Also, outsourcing can serve as a powerful transformative agent. HR leadership can move away from transactional activities and deal with more strategic issues, such as performance monitoring and management, innovation, and long-term talent planning. Staying focused on the strategic elements of HR is critical for healthcare organizations as they look for ways to meet the challenges of declining reimbursements, the impact of healthcare reform legislation, and IT projects related to the continuum of care. This mindset is key to turn HR from a cost center to a strategic asset.

Q What lessons should organizations consider when pursuing HR outsourcing?

A Understand the options. When considering the best path forward, communicate goals and requirements to the potential outsourcing partner. Ask the vendor to develop a list of possible solutions that address your specific needs by drawing from experiences with other healthcare organizations. Invariably, other HR departments have faced similar challenges and opportunities. This exchange of ideas will provide a better understanding of alternatives.

Second, obtain management support. Driving transformation and progress often requires cultural shifts. There will be expectations to manage, new processes to implement, and budgets to balance. As the key influencer of the organization, management can ensure that proper priorities are set and that adoption moves at the correct pace for the organization.

Also, set goals. As with any organizational effort, HR transformation requires goals. For an HR department, the goals might be to improve payroll accuracy and management reporting; to introduce new services, such as flexible spending accounts and employee self-service; or simply to control budget costs. For each goal, assign quantitative metrics that can be measured and assessed for progress. Goal-setting based on mutually agreed-upon metrics is crucial for creating accountability.

Finally, measure results. It is essential to regularly assess progress toward—and achievement of—goals. This includes measuring internal performance against goals and commitments and the outsourcing partner's performance versus expectations. Before metrics are agreed upon, consider how data will be captured, tracked, and analyzed. The natural tendency is to over-measure. If data become harder to capture than anticipated, consider focusing on the crucial measurements that best reflect the progress being made.

Source: ADP.

Measuring Success

Moving to an outsourcing relationship is not a once-and-done effort. Hospital leadership should regularly examine the relationship and make sure it is a positive one. Performance indicators, such as the following, can help identify when the strategy is succeeding or any aspects in need of attention.

Cost savings. Looking at how much the organization will save by going with an outsourced vendor is valuable, and in fact, 77 percent of companies inside and outside of health care use cost savings as a way to monitor the success of their outsourcing initiatives, according to the Conference Board.⁶ Although this metric will quantify dollars saved, it

is important to keep it in perspective. Leadership should set a reasonable goal for cost savings and monitor progress to reach that goal.

Enrollment rates. These figures can show whether service levels are translating into increased benefits enrollment for your organization.⁷

Employee satisfaction. It is important to pay attention to employee complaints and see whether they indicate a potential problem. Performing periodic surveys can also help garner employee opinion, both positive and negative.

Data security and confidentiality audits. Vendors should provide the healthcare provider with the methodologies they employ to guarantee data privacy and security. However, organization leadership should also be verifying that these methodologies are in place and effective. This verification may involve assessing security standards, searching for possible loopholes, and observing employees.⁸

Positioning for the Future

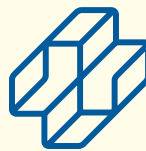
HR is a critical function in any hospital because of the variety of services provided and its role in supporting the emotional and physical health and well-being of employees. “The HR function has to be consistent to effectively support an organization’s mission,” Scott says. “When considering outsourcing, organizations should think about how to maintain consistency across both internal and external activities.” The key is putting the time into researching options so that the vendors selected and the transition plans put in place foster a strong relationship.

Endnotes

- ¹ *The Hidden Reality of Payroll and HR Administration Costs*, PwC, January 2011.
- ² Ibid.
- ³ Waxer, C., “What Should You Know About HR BPO?” *Human Resources Executive Online*. <http://www.hrexecutive.com/HRE/story.jsp?storyId=5176103> (Accessed October 10, 2011).
- ⁴ *The Hidden Reality of Payroll and HR Administration Costs*, PwC, January 2011.
- ⁵ Waxer, C., “What Should You Know About HR BPO?” *Human Resources Executive Online*. <http://www.hrexecutive.com/HRE/story.jsp?storyId=5176103> (Accessed October 10, 2011).
- ⁶ Ibid.
- ⁷ Ibid.
- ⁸ Ibid.



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