OUTSOURCING IN MALAYSIAN HEALTHCARE SUPPORT SERVICES: A STUDY ON THE CAUSES OF INCREASED OPERATIONAL COSTS

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ABSTRACT: This paper explores the causes of the significant increase in the Malaysian Ministry of Health (MoH) healthcare support sevices. The issue was derived from the drawbacks of outsourcing which surfaces from the transaction costs. Coupled with the benefits to the host organisation are the drawbacks namely the information costs, negotiating and bargaining, and the costs of policing and enforcement. It later affects the outsourcing process and requires additional spending to the client. The findings showed that the bounded rationality, opportunism and the asset specificity are the main reasons for the existence of the three. Another contributing factor that led to the increment is was the broad scope of the outsourcing implemented by MoH for an extension of 15 years. It exposed the private service provider to uncertainty that later created a risk averse behaviour particularly on their pricing.

Keywords: Healthcare support services, Outsourcing, Drawbacks, Transaction Costs and Operational Costs.

1. INTRODUCTION

The idea of outsourcing the public healthcare of Malaysian Ministry of Health (MoH) was raised in 1996 by the government while announcing the Seventh Malaysia Plan in which to increase the efficiency of services and to retain its own qualified and experienced manpower. In the sense to gradually reduce its role in the provision of health services, the Government will increase its functions as enforcement and regulator (Economic Planning Unit, 1996). Its mechanisms implemention are very diverse that includes sale of equity or assets, lease of assets, management contracts, build-operate-transfer or build-own-operate, and management-buy-out (Chan, 2002).

The method of privatizing support service or other peripherals services is known as outsourcing in the UK and it carries narrower scope from privatisation. Hence, to avoid misunderstanding of concept, the term outsourcing will be used throughout this paper.

The outsourcing project has created a mixture of reactions from the public and other public interest groups concerning the low-income, the elderly, and the disabled (Sangaralingam and Raman, 2003; Chan, 2000). Their concern is based on an increased in the operational costs of support services (Chan, 2000). The same issue was also raised at the 3rd parliamentary meeting of the lower hall (Dewan Rakyat) on the increase of the operational costs from RM470 Million (£67 M) to RM510 M (£7.25 M) in 1999. [1]

[1] 1.00 £ is equivalent to RM 6.90.

Additional issue raised was the function of Sistem Hospital Awasan Taraf Sdn. Bhd. (SIHAT). Hence, this paper tries to generate a better understanding on the causes of the significant increase in the operational costs of the Malaysian healthcare support services.

2. OVERVIEW OF OUTSOURCING

Outsourcing which previously known as contracting out has been recognised and established successfully (Kakabadse and Kakabadse, 2002). Hence, it could not be regarded as a new idea in management (Jenster and Pederson, 2000). It is a process of externalising tasks and service previously performed in-house, to outside vendors (Jenster and Pederson, 2000). Hence, it can be seen as an action took to minimize the workload of any practice firm by subletting its services or tasks to another firm. There are differences in the aim and arrangement of outsourcing subject to the nature of the firm (Kakabadse and Kakabadse, 2000).

It was only in mid-1990s that the scope of outsourcing outstretched to administrative work (Stright and Candio, 2000) with a distinctive approach between a public and private sector. While the aims of private sectors are to achieve cost reduction (Kakabadese and Kakabadse, 2002; Burnes and Anastasiadis, 2003), the public sector on the other hand, seeks to "achieve best practice, to improve the cost discipline skills of managers, to improve the quality of the service and to help senior managers focus more clearly on the core competencies of the organizations" (Kakabadse and Kakabadse, 2001, 406).

Another study on benefits of outsourcing portrays an increased in flexibility on staffing where "less expenses related to employee salaries, health and benefits, training, administrative costs, and retirements programs are taken into account" (Martin and McDermott, 2001, 47). This is an opportunity sought by the government to reduce government's spending (Kakabadse and Kakabadse, 2001, Burnes and Anastasiadis, 2003).

Despite the benefits and advantages offered by outsourcing, there are a few disadvantages emerge. The issue is much related to the risks in transaction costs explained by Williamson (1975 and 1985). The definition of transaction costs given by Williamson (1996, 379) is "The ex ante costs of drafting, negotiating and safeguarding an agreement and, more especially, the ex post costs of maladaption and adjustments that arise when contract execution is misaligned as a result of gaps, errors, omissions, and unanticipated disturbances; the costs of running a system".

Transaction costs constitute of motivation costs and coordination costs in which have different scopes. For instance, the motivation costs are the costs of motivating specialized agents to align their interests which usually derived from opportunism while coordination costs are the costs of coordinating the actions between the specialized agents and derived from bounded rationality (EncycoGov.com, 2004).

Human beings exhibit bounded rationality whereby they have limitations on information and hence restricts them to process the information (Davies and Lee Lam, 2001) meanwhile opportunism is defined as 'self-interest-seeking with guile' (Williamson, 1985,47) which carries the same meaning as lying, cheating, concealing information and breaking contracts (Davies and Lee Lam, 2001).

There are three elements in the transaction costs mainly the search and information costs, bargaining and decision costs, and policing and enforcement costs (Ismail, 1997). Research by Lyson (1996, 268) found out that "it will take up to two years before organizations starts to achieve any financial benefits from outsourcing and in some cases the process may be cost natural".

The success of outsourcing lies heavily on the managing outsourcing relationships (Kakabadse and Kakabadse, 2001; Burnes and Anastasiadis, 2003; Stright and Candio, 2000; Wechsler, 2002; Malek, 2000; Kakabadse and Kakabadse, 2003; Heikkilä and Cordon, 2002). Wechsler (2002) suggested that defining the function, procedures and supporting processes are the main criteria.

Fndings of Burnes and Anastasiadis (2003) showed that the public sector have more stringent relationship that results the gap between the host organizations and the service provider. It could due to the nature of the public organization which emphasizes on implementing policies rather than seeking maximum profits as pursues by the private sector.

Managing understanding, efficacy and transparent relationship between the service provider and the host organisation are very crucial to achieve the aims and objectives of both parties. Without a transparent understanding of the management strategies and having mutual understanding with vendors, the choice to outsource might result a bad consequences.

3. RESEARCH METHODOLOGY

This section outlines the methodologies that guide the research project and the measures taken to obtain the necessary data for this study. Interviews were carried in several places based in Kuala Lumpur and one in Negeri Sembilan, both in Malaysia. The interviewed parties are the procurement and privatization department and engineering services division of Ministry of Health, Sistem Hospital Awasan Taraf Sdn. Bhd. (SIHAT), Hospital Besar Seremban, and Faber Mediserve Sdn. Bhd.

The interview questions were based mainly on the brief history of the management of healthcare support services before and after outsourcing to make comparison. However, there has been no hard evidence found to support the explanation on the history of the healthcare support services particularly on the operational costs before outsourcing. Hence, the arguments and explanations were present totally from the interviews.

The scope of this paper covers the differences between the operational costs of in-house and outsourced provision of healthcare support services. The comparison are based on the planning of work, the implementation, the performance monitoring, the parties involved and the equipment and machineries used to carry out the tasks.

4. RESEARCH FINDINGS

4.1 The operational costs of outsourced service provision

There has no proper records on the exact operational costs carried out by the in-house provision. Hence, quantitative comparison could not be made due to the difference in the weight age. Table 4.1.1 shows the operational costs of healthcare support services after outsourcing.

Company	*1997*	*1998*	*1999*	*2000*	*2001*
X	£37,000,000	£38,100,000	£39,600,000	£39,200,000	**£40,100,000**
Y	£21,400,000	£21,800,000	£22,900,000	£22,200,000	**£24,700,000**
Z	£10,450,000	£10,700,000	£11,200,000	£11,600,000	**£11,500,000**
Total	**£68,850,000**	**£70,600,000**	**£73,700,000**	**£73,000,000**	**£76,300,000**

Table 4.1.1: The operational costs of the healthcare support services after outsourcing

The breakdown of the operational costs according to the service types are as Table 4.1.2 that follows;

Services	Year of Operations			
	1997	1998	1999	2000
Linen and Laundry Service	£5,700,000	£6,440,000	£7,830,000	£8,750,000
Clinical Waste Management Service	£2,920,000	£2,932,000	£3,260,000	£3,550,000
Cleaning Services	£14,781,000	£15,520,000	£15,620,000	£15,390,000
Biomedical Engineering Maintenance Services	£14,790,000	£15,420,000	£15,790,000	£14,700,000
Facility Engineering Maintenance Services	£29,730,000	£30,270,000	£31,100,000	£30,530,000

Table 4.1.2: Breakdown of operational costs according to service type

Facility Engineering Maintenance took up almost 40% in average of total operational costs of healthcare support services. It then followed by Cleaning Services of 21% average and Biomedical Engineering Services of 20% average.

4.2 Additional items in general

Generally, there has been a significant change in the healthcare support services due to outsourcing. These additional items as per table 4.2 were prepared and developed to ensure an effective and transparent outsourcing projects as well as safeguarding the parties involved.

No.	Scope of Services	Before	After
1.	Computerised management information system	No	Yes
2.	Compliance to Occupational Health and Safety Act	No	Yes
3.	ISO 9000 certification within five years	No	Yes
4.	Compliance to all legislative requirements	Partial	Yes
5.	Implementation of quality assurance program	No	Yes
6.	Deduction and fees due to poor performance	N/A	Yes
7.	Preparations and negotiations of Concession Agreements	No	Yes

Table 4.2: Comparison on General aspects.

Apparently the additional items were prepared in order to safeguards the contract and interests of both parties. The followings are the discussion on supporting the propositions that the increased operational costs are due to the transaction cost analysis's effect.

4.3 The causes of the increased operational cost

As noted in the table 4.1.1, the costs of the healthcare support services increase from £25M to nearly £69M in 1997. A 37% increased from the original expenditure is said to be the consequences of a few additional items related to the outsourcing's drawbacks.

4.3.1 The costs of drafting the operation contract

The need to draft a contract between MoH and the private service provider is due to the risks of bounded rationality and opportunistic behavior of transaction analysis. The preparation of the contract needs to be carefully written to safeguards both parties. It also involves search and information costs for the preparations of the standards and guidelines for the outsourced services in order to meet certain rules and requirements of the services. Although the costs of drafting and preparing the contract was borne by the private service provider, the costs however has been included in the operational costs and spread over the duration of the contract.

4.3.2 The costs of negotiating and bargaining

The duration of the outsourcing projects is related to the risk of uncertainty. As noted, by transferring the work load to the private service provider, it transfer the risks of uncertainty to the private service provider which will makes them behaving in risk averse. Hence, they tend to increase the price of the contract.

Additional type of services has increased the risks and hence contributed additional spending. The scope of work for clinical waste management and a few additional scopes are seen as one of the main reasons. Table 4.3.2.1 below shows additional service while table 4.3.2.2 shows the comparison in the scope of work of the in-house and outsourced provision.

No.	Support Services	Before Outsourcing	After Outsourcing
1.	Cleaning Services	Yes	Yes
2.	Linen and Laundry Services	Yes	Yes
3.	Facility Engineering Maintenance Services	Partially	Yes
4.	Biomedical engineering Services	Partially	Yes
5.	Clinical Waste Management	Partially	Yes

Table 5.3.2.1: Comparison on the type services

No.	Scope of Services	Before Outsourcing	After Outsourcing
	CLEANING SERVICES		
1.	Guidelines on infection control	Yes	Yes
2.	Disinfection and sterilization Policy and Practice	Yes	Yes
3.	Code of Practice for prevention of infection accidents in the hospital, laboratory and post-mortem rooms	Yes	Yes
4.	Universal Infection Control Precautions, MOH	Yes	Yes
	FACILITY ENGINEERING SERVICES		
1.	Comprehensive maintenance of all facilities, plant and equipment including infrastructure, utilities and services	Partial	Yes
2.	Planned preventive maintenance	Partial	Yes
3.	Breakdown maintenance	Partial	Yes
4.	Compliance to legislative requirements	Partial	Yes
5.	Quality Assurance Program for all equipment and systems	No	Yes

Table 5.3.2.2: Comparison on the scope of works between the in-house and outsourced service provision

4.3.3 The costs of policing and enforcement costs

The involvement of additional parties to the contract is because of some measurement taken to avoid any act of opportunism by another party. For example, before outsourcing, there was no third party to carry and monitor the work and that there were no incentives provided to the staff to carry out the work efficiently. The appointment of a third part to carry out the tasks involving a large sum of contract needs to be monitored to ensure that the contract is carried out as per the agreement.

The following tables show the comparisons of parties involved in the planning, implementation and monitoring works between the in-house and outsourced service provision.

Parties	Before Outsourcing	After Outsourcing
Ministry of Health	Contract and Supply Department	Procurement and Privatisation Department
		Regulatory Unit
Private Service Provider		- Faber Mediserve Sdn. Bhd
		- Radicare Sdn. Bhd.
		- Pantai Medivest Sdn. Bhd. (previously known as Tongkah Medivest Sdn. Bhd.)

Table 4.33.1: Comparison on parties involved in the planning of work before and after outsourcing

No.	Type of Services	Item	Before Outsourcing	After Outsourcing
1.	**Cleaning Services**	Scope of Work	Nil	Clearer scopes of works and anticipated minimum frequency of cleaning services
		No. of workers involved	Limited and being burden with other jobs requirements	Significant increase in the number of appointed workers to carry out work
2.	**Facility Engineering Services**	Maintenance of medical equipments	Carried out by outside vendor via open tender for an agreed period of time stated in the contract	Carried out by the in-house expertise of the private service provider.
		Other maintenance works	Carried out in house but limited to the minor work only.	Carried out by the private service provider itself with a proper scheduling on checking of all the equipment.
		Buildings maintenance	Contractor by tender selection by virtue of the Contract and Supply Department.	Private service provider for the mechanical, electrical and civil engineering support.
		Scheduling for checking of electrical equipment	Done in randomly order.	Checked in a special schedule according to the frequency of use as well as the degree of importance of the machine.
		Plant Preventive Maintenance	Conducted partially for some equipment.	Total planned preventive is practiced with degree of tolerances at an agreed standard.
		Quality Assurance Program	Not recognized.	Implemented for all equipments and systems.

Table 5.3.3.2: Comparison on the parties involved in the implementation of healthcare support services before and after outsourcing

To safeguard both parties in the contract, which falls under the category of policing and enforcement costs, a more comprehensive and stringent performance monitoring has been planned and practices to achieve value for money for both parties

No.	Type of Services	Item	Before Outsourcing	After Outsourcing
1.	**Cleaning services**	Performance Monitoring	Hospital's supervisors.	Private service provider's supervisor, Hospital's committee management, the Regulatory Unit and SIHAT.
		Frequency of inspection	Nil	Monthly, daily and weekly inspections.
		Ad-Hoc inspections	Not stipulated, but for a very urgent case, the nurses can complaints to the supervisor.	Ad-hoc inspections and complaints could come from the hospitals staff and public users.
2.	**Facility Engineering Maintenance**	Contractors performance monitoring	Supply and Contract Department.	SIHAT with the aid of records from planned preventive reports and reports from the public hospitals through the CMIS.

Table 5.3.3.3: Comparison on monitoring of performance of the support services before and after outsourcing

4.4 Other causes that contributes to the increased operational costs

There are a few factors that contribute to increased operational costs. Due to poor records management of the operational costs and the separation of the healthcare support services provision with the costs of utility bills, the space rental, staff's salaries, tax payments and maintenance and depreciation, it make the quantitative comparison impossible. Hence, the cause of increased operational costs could not be blame to outsourcing alone.

In addition, the transfer of risks from the public to the private service provider will result the act of risk averse by the private service provider. As such, the longer the duration of the contracts, the longer will be the uncertainty.

5. CONCLUSION

Throughout the discussion in this paper, the significant increase in operational costs could not be blame entirely on the effects of drawbacks of outsourcing as there are no reliable records of historical costs and that there are differences in the calculations of the operational costs. Earlier, the funds allocated for the healthcare support services provision was exclusive of the costs of staff's salaries, utilities bills, rental costs, taxes and the maintenance and depreciation costs. Moreover, the improved quality of the

service provision is passed onto the client as increased operational costs. In the case study, there are several causes identified that helps contribute to the increased operational costs in the healthcare support services. It is expected that the reasons of the increased operational costs is due to the cost of improved service provision that has been passed onto the client and the transaction cost's effect.

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