



CORPORATE RESEARCH FORUM

Outsourcing the HR Function

Possibilities and Pitfalls



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1 Executive summary

A primary concern of the HR outsourcing (HRO) market has been the lack of independent and objective data for rigorously evaluating the business case for HRO and its actual performance.

This report is the first of its kind to bring together different stakeholders within HRO - including practitioners, suppliers, academics and consultants - to produce an independent, objective academic research project.

What HRO is

The increasing focus on HR's contribution to the performance of the wider business has led to more emphasis on cost reduction. HRO has grown out of this debate - from re-engineering and cost reduction on the one hand to a potential transformational capacity on the other.

HRO is an evolving industry and can be defined as:

The purchasing by an organisation of ongoing HR services from a third-party provider that it would otherwise normally provide for itself.

HRO is a strategic tool aimed primarily at chief executives. Though organisations may have different strategies and performance models, all will relate in some way to HRO. These can involve the following.

- **Capability:** for any organisation where there is a need to either improve or acquire HR capability.
- **Scale:** providing for large organisations with 50,000 or more employees well-delivered HR administration and services - and to justify the return on investment.
- **Technology:** for most organisations where technology can be acquired and leveraged through shared services or outsourcing.

Outsourcing varies dramatically by type, level, contract and provider.

HRO providers

While HRO providers may seem to offer little that is different between them, differences do occur in

their size, culture, HRO methodology and track record. However, they offer their services in three distinct ways.

- **Single-service** or transactional solutions for a particular HR activity.
- **Multiple HR services** as part of a large-scale deal.
- **Transformational deals** which radically change the purpose and role of HR.

Three different types of providers are active in the HRO market - pure HRO specialists, business/HR transformation firms and HR process technology suppliers.

Selling points of HRO

HRO providers use these main selling points.

- Increased efficiency of HR with estimated cost savings of up to 50%.
- Increased effectiveness of HR through operational improvements.
- Improved strategic focus from HR on business goals.
- The role of HRO in transforming the performance of HR and the business.

While many HRO users can point to improvements in the first two points, evidence is lacking for the impacts on strategic focus and business performance. This is a major problem for the HRO industry.

Strategic debates around HRO

These debates are ongoing in HR outsourcing among user - or prospective buyer - organisations, providers, HRO advisers and academics.

- The future purpose and contribution of HR because of the possibilities of functions being transformed, or part-outsourced, through HRO deals.
- The strategic and management complexities of HRO deals, especially so-called 'mega-deals'.
- Deciding what is 'core' and 'non-core' in HR - the critical competencies to be retained versus peripheral activities that might be outsourced.

- The difficulty that HR has in assuming more strategic or value adding roles after implementing HRO.
- The position of offshoring as it affects HRO decisions and raises emotive issues such as job losses and redeployment .
- The challenges of trying to manage HR process delivery on a global scale and across different cultures.

The HRO debate ultimately turns on the perceived quality of, and returns from, investments in the HR function. Those organisations under pressure to reduce costs are more likely to consider outsourcing at least part, if not all, of their HR administration.

The future of HR

HR itself is also locked in a debate over its future. Though some organisations have evidence that the function is an integral part of its capability to deliver business success, many view HR as

- over-resourced
- inefficient
- vulnerable to the cost reduction possibilities of HRO.

HR outsourcing raises questions over HR's future skills, capabilities and career paths. Its developments are creating pressures for practitioners to shift from being reactive and administrative problem-solvers to more proactive, value-driven 'business partners'.

Shared services

Research revealed much discussion about the definitions and position of shared services. For our purposes, it is defined as

the transfer or insourcing of HR services and their resources to a separate unit within the business - and often with a separate P&L system.

Shared services is often adopted by organisations who are against outsourcing as a matter of principle - but still seek some of the transformational and streamlining advantages connected with outsourcing.

Alternatively, some organisations use shared services as a halfway house to prepare the specific lines of HR they intend to outsource.

The HRO logic

No amount of preparation, however extensive, can safeguard outsourcing deals completely. Leaders need to clarify what their core logic is for creating value by demonstrating the following.

- How HRO can enable the organisation to meet the requirements of its stakeholders - be they internal (employees) or external (customers).
- How outsourcing will transform the way the HR function works in a radical and sustainable way.
- Crucially, how transforming the HR function will influence the planning, operations and performance required by the business model.

Managing the transition

In some organisations, HRO is akin to changing the engine while the plane is still in the air which is a potentially catastrophic exercise. The consequences of HRO must be thought through - before agreeing a contract.

Handing over single, multiple or all HR service processes represents for many organisations their first experience of complex projects - project management is a critical HR capability for HRO to work well.

A successful transition minimises employee angst - but botched handovers could have long-standing repercussions on relationships with providers, employees, other stakeholders and corporate image.

Governance of HRO performance

Managing and measuring performance after HR outsourcing is pivotal to the relationship between HRO client and provider. Performance measurement in HRO traditionally concerns the following.

- **Efficiency:** mainly through cost reductions.
- **Effectiveness:** through improved service outcomes against criteria in service level agreements (SLAs).
- **Transformation:** indicators of deeper change at the level of the organisation, its employees, systems - and at intangible levels.

- **Strategic governance:** evaluating the management of performance - including the decision rights, rules and agreed management processes defined with and before providers are engaged.

Future directions and recommendations

Research for this report found these trends.

- Increased outsourcing of 'higher value' HR processes such as recruitment.
- Increasing use of shared services models.
- Performance issues surrounding HRO deals.
- The continued evolution of e-HR activities.
- The emergence of new HR roles and competencies.
- Continuing debates over HR and HRO measurement.

Guidelines are offered for HR practitioners, third party providers and HRO advisers. In addition, CRF's position on HR outsourcing is explained to help members come to an informed view of a crucial topic. This is supported by recommendations.



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