

The Issue: An HR Market Update – The Role of Outsourcing in Making HR More Strategic

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Organizations are clarifying and prioritizing the activities human resource (HR) groups should focus on to become more strategic corporate assets. Talent management has emerged as one area where the opportunity exists for HR groups to clearly add more value to the organization. Finding, attracting, retaining and training talent is a critical and growing challenge in most organizations globally. Before HR groups can spend more time and effort on activities associated with talent management, however, they must free up time spent performing administrative and transactional HR operational work. The expanded use of alternative service delivery models like shared services and outsourcing can play an important role in supporting this shift in focus - if efforts are designed and executed successfully.

The Details

This three-part Perspectives series presents and analyzes the findings from a recently completed EquaTerra and Human Resource Executive® magazine market research study (see Figure 1). This study assessed the current state of human resources (HR) organizations and their progress and success in performing as a strategic corporate asset. The study assessed the realities of HR transformation as a means to make HR

EquaTerra conducted this market study in December 2007 and January 2008 and surveyed approximately 450 HR decision makers. Twenty-nine percent of respondents were VPs of HR (including SVPs and public sector equivalents) and 53 percent were HR directors or managers. The balance of respondents had either other executive or HR operational roles.

All major industry groups were represented, with public sector (30 percent), healthcare and manufacturing (each with 13 percent) comprising the largest industry groups represented. Sixty-two percent of respondents were from organizations with less than 5,000 employees and the balance were from organizations with more than 5,000 staff.

Ninety-seven percent of respondents had operations in North America, while 17 percent of respondent organizations operated in Europe, 16 percent in Asia Pacific and 11 percent in Central and South America.

Figure 1: Study Demographics

groups more strategic, how organizations are pursuing HR transformation, and the role that alternative service delivery models – like shared services or information technology and business process outsourcing (ITO/BPO) – are playing in enabling it. The study was a follow-up effort to a similar research exercise conducted in 2005.

Part one of this study assesses HR's role as a strategic corporate asset and identifies the activities HR groups should prioritize to become more strategic. Part two reviews the role of alternative service delivery models like shared services and outsourcing in making HR more strategic. Part three reviews the state of recruitment process outsourcing in the market today.

Results from this market study illustrate that the quest to make organization's HR operations more strategic remains a paramount initiative. Progress toward this goal, however, continues to remain elusive. The challenge is to both define what will make HR more strategic as well as how to execute on achieving this goal.

Alternative HR Service Delivery Models

The market study assessed the uptake, role and value of alternative HR service delivery models - shared services, HR ITO and HR BPO - in transforming HR to make it more strategic. Adoption rates for shared services and outsourcing varied significantly depending on the HR process addressed and the size and industry of the respondent organization. Overall, benefits administration was the process most frequently cited as supported by shared services (see Figure 2). The use of a shared services group to manage benefits administration was cited by 35 percent of respondents and an additional 8 percent indicated they planned to roll out shared services in this process area. Payroll was the process most frequently outsourced, cited as deployed by 24 percent of respondents and planned by an additional 9 percent.

Recruiting and talent management processes were the third least frequently outsourced, cited by just 5 percent of respondents. An additional 10 percent of respondents indicated their organizations were planning to outsource recruiting and talent-related processes. Recruiting and talent management processes were more frequently managed via shared services operations. Activities associated with organizational effectiveness were the least frequently outsourced. The rates of alternative service delivery model usage were higher for larger organizations and for commercial/non-public sector organizations. Among the largest firms surveyed (20,000 or more employees) 35 percent had outsourced benefits administration.

Overall adoption rates for HR shared services and outsourcing remain below those found in other support function areas like information technology (IT), according to other EquaTerra research studies. ITO adoption rates are as much as double those for HRO depending on the size and industry of the organization. HR shared services and outsourcing adoption levels are similar to those found for finance and accounting (F&A), though the average F&A has been smaller in scope and size. HRO levels are also relatively low in terms of total market penetration. EquaTerra estimates there has been

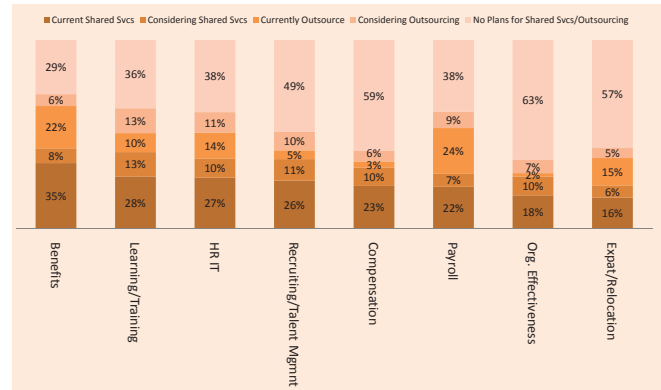


Figure 2: Alternative Delivery Model Adoption

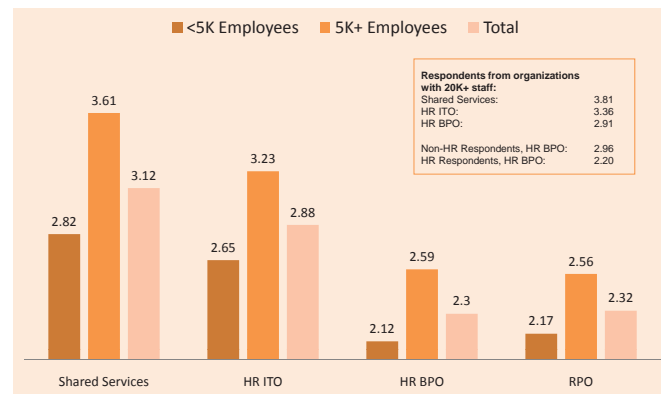


Figure 3: Alternative Delivery Model Satisfaction

approximately 200 HRO deals involving five or more HR process areas. Most but not all of these have occurred in Global 2000 firms, calculating to a market penetration rate of under 20 percent for that market segment. The point is that for many HR organizations, the use of alternative service delivery models remains an untried option for process improvement and cost reduction.

Market study respondents were also asked to rank how important they perceive each of these alternative delivery models are to transforming HR to make it more strategic. The response rates to this question tended to map in line with adoption rates. Respondents scored each of the alternative delivery models in the mid-to-lower-end of a five-point scale where one represented not at all important and five represented very important (see Figure 3). The use of shared services scored the highest, though only slightly above the mid-point on the scale, and was followed by HR ITO and HR BPO in terms of importance.

There were again major differences based on the size of the respondent's organization and whether the respondent was a member of the HR organization. Figure 3 also illustrates the differences between firms with more than 5,000 employees and those with less. Differences among respondents from firms with more than 20,000 employees (see box in figure) were even more pronounced. Respondents from this organization size range scored all three alternative delivery models much higher in importance, with shared services coming in at 3.81, HR ITO at 3.36 and HR BPO at 2.91. Non-HR respondents also scored HR BPO higher (2.96) compared to HR respondents (2.20).

Rankings for each model declined overall from the 2005 edition of the market study. The ranking for shared services fell by seven percent, HR IT by 29 percent and HR BPO by 22 percent. Among respondents from organizations with 20,000 or more employees, levels for shared services rose slightly, while levels for HR ITO and BPO also fell, though by about one half as much as for the sample as a whole. This is, in part, a function of the different sample between the two studies. It also illustrates that the perceived value of these alternative service delivery models has not increased significantly over the past three years, particularly among smaller organizations and those in the public sector. This reflects the reality of an HRO market that is still relatively immature and continues to exhibit growing pains and challenges. Slow uptake of alternative service delivery models for HR services also parallels, however, slow progress in making HR more strategic.

How are HR Organizations Responding?

Both HR ITO and HR BPO are still relatively underutilized tools to enable change within the HR organization. While there was an early market growth spurt in large, multi-process HRO deals in the 2003-2005 time frame, the number of deals of this size coming to market has slowed. The market is much stronger today for one or two process HR BPO deals, typically including payroll and benefits administration bundled, or learning and training or recruitment delivered as a standalone service.

While many buyers today still often have the same long-term goal of outsourcing multiple HR processes, they are more likely to pursue achieving this goal in an incremental fashion. Buyers are also taking a more iterative approach relative

to outsourcing HR processes across multiple business units and geographies. These changes are occurring as the HR outsourcing matures and buyers learn from peers and from their own experiences the significant challenges involved with successfully executing larger, multi-process HRO deals. HR outsourcing service providers also have less of an appetite than in past years to take on large multi-process HRO deals. The shift towards more multi-sourcing and smaller scope deals is being driven by both more muted demand and supply trends in the market.

HR buyers today are more prudent about how much process improvement, transformation and innovation they can get from HR outsourcing, particularly if they are also seeking significant levels of cost savings. Innovation is still a goal, but buyers are more realistic about how quickly and extensively outsourcing and can enable it. The preferred means to achieve innovation are also changing. Buyers and especially service providers are looking more to standardized operating models and IT solutions for HR operations as the vehicle through which to enable transformation. This is in contrast to the historical approach of developing more customized HR services that often were more expensive to build and manage and more difficult to implement. While early adopter buyers suffered bruises, and some pulled back from their outsourcing efforts, the majority have continued to move forward. Most are in a better position today relative to the capabilities of their HR operations than before outsourcing.

While cost savings remains a key driver and benefit sought from HRO efforts, cost avoidance is becoming a strong motivator for buyers. Cost avoidance is to the primary reason buyers defer or defray additional HR IT investments. Many buyers are seeking new options and models more frequently some level of outsourcing to manage HR IT investments. Supporting HR IT environments is becoming increasingly complex, costly and burdensome for buyers, a situation exacerbated by commercial software market trends, including vendor consolidation and the looming push to upgrade these systems to next generation platforms.

How are Outsourcing Service Providers Responding?

The HR outsourcing service provider market is in state of flux and in some respects it has reached an inflection point. When the market for large, complex, multi-process HRO deals took off several years ago, it grew faster than service providers or early adopters could support it. Early deals were characterized by lack of visibility into true buyer performance and cost levels, loosely defined improvement plans and goals, and more business to deliver than qualified resources to support.

Early market service providers have largely retrenched and have become less aggressive in the pursuit of large deals. Most suffered through one or more problematic engagements and in some cases, cancellations. HRO service providers have been working diligently to repair client relationships where problems existed. They are also focusing intently on consolidating, standardizing and optimizing their service delivery capabilities. Both efforts are still a work in process, though progress is being made.

All major HRO service providers have scaled back large deal ambitions, and are much more focused and selective on the deals they will pursue and prospects they will court. They are less likely to offer services in HR process areas where they do not have clear strengths and profit margins. Where applicable, they are still focused on selling complementary consulting and IT services, both to support HRO business, but also to make up for less HRO activity. Both service providers and buyers are structuring much tighter contracts and service levels, setting more realistic cost reduction and process improvement goals. They are paying more attention to transition and ongoing outsourcing management and governance requirements. In short, while not as exciting as it was three to five years ago, the HRO market is maturing.

The HRO service provider market continues to grow and diversify. While early market entrants are going after fewer large deals, most are expanding their capabilities to offer and deliver smaller scope efforts. New entrants in the market are focusing both on specific geographies as well as process areas like recruitment. The entrance into the HRO market by India-based service providers expanding their focus beyond ITO, is beginning to and will have a major impact on the market over the coming years. Indian firms are leveraging strong client relationships, delivering IT and ITO services to gain permission

to compete for HR work that for which, until recently, they were not considered viable candidates. These new entrants increase the volume of capable supply in the market, possess and strongly push offshore delivery capabilities, and are emphasizing standardized delivery models and support IT solutions.

The Advisor Perspective – Critical Points to Consider

The original premises around the value proposition for HR outsourcing still exist in most organizations, even if the growth and success levels of HRO in the market have not lived up to expectations. Most HR groups still spend too much time on administrative and transactional activities and not enough on more strategic tasks, such as that associated with talent management and organizational effectiveness. Too many HR groups are not viewed as - or performing like - strategic corporate assets. This at a time when many organizations are facing serious HR related challenges, such as those related to talent, from increased global competition, aging workforces and skilled staff shortages.

Operationally, efforts to streamline and automate HR processes, map them better to employee's personal and professional lifecycles, and introduce high-quality HR self-service capabilities are still lagging in many buyer organizations. HR IT systems are too often overly complex, costly to support and in need of a major overhaul.

The greater use of alternative HR service delivery models, especially outsourcing, is not a silver bullet to solve these problems. They are valuable tools that can help the cause if executed properly. EquaTerra encourages HR organizations to review and reassess their strategic HR plans as needed, relative to the use of shared services and outsourcing. The HRO market has continued to evolve and mature. For buyers that considered HRO in the past and chose not to move forward, the reality of the market today may lead to a reversal of that decision. For existing HRO users, the changes in the market could mean that a review of existing relationships, contractual terms and services levels is advisable at the next check or renewal point. Minimally HR groups need to ensure they are clear on what the best means are available to them today to shift more focus, emphasis and resources to performing the activities that will make them true corporate strategic assets.

Conclusion

HR executives must overcome a range of barriers to transform HR to make it more strategic. These include the often cited high costs associated with major change efforts and the lack of management support to undertake them. These barriers are not new. Another reorganization or more investment in HR IT, commonly tried change agents in the past, will not likely eliminate these barriers or improve overall HR strategic capabilities. Many HR organizations need to define new and improved mechanisms to overcome barriers to change.

Greater use of alternative service delivery models has the potential to help HR organizations transform their operations. Through these models, HR groups can offload transactional work and then focus on more strategic HR activities, ideally cutting costs in the process. HR organizations can also leverage third-party expertise to improve the overall efficiency and effectiveness of their operations. The uptake of these models, especially for outsourcing, has been occurring slowly in the market. While some early adopters have faced challenges in making these models work, all HR executives are well served to thoroughly assess their options relative to the deployment and expansion of these models. Alternative service delivery models alone will not make HR more strategic; but they represent a potential key lever for change that too often has not been thoroughly explored.

About EquaTerra

EquaTerra sourcing advisors help clients achieve sustainable value in their IT and business processes. Our advisors average more than 20 years of industry experience and have supported over 2000 transformation and outsourcing projects across more than 60 countries. Supporting clients throughout the Americas, Europe, Middle East, Africa and Asia Pacific, we have deep functional knowledge in Finance and Accounting, HR, IT, Procurement and other critical business processes. EquaTerra helps clients achieve significant cost savings and process improvement with internal transformation, shared services and outsourcing solutions.

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