



Executive White Paper:

Outsourcing Your Human Resources Functions

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Introduction

One of the hot topics in human resources (HR) today is the trend toward outsourcing. In a recent survey by The Conference Board, more than three-quarters of companies who responded reported that they currently outsource a major HR function or plan to in the near future. And a recent SHRM study reported that more than 42 percent of employment and recruiting functions have been outsourced. According to Dataquest Inc., the HR outsourcing market in the U.S. is expected to grow from a \$21.7 billion industry in 2000 to a \$58.5 billion industry by 2005. This executive white paper will explore some of the drivers behind the movement and present you with a strategic overview of outsourcing.

Why Outsource?

The Outsourcing Institute's annual survey of outsourcing end users yielded the **Top 10 Reasons Companies Outsource:**

1. Reduce and control operating costs.
2. Improve company focus.
3. Gain access to world-class capabilities.
4. Free internal resources for other purposes.
5. Resources are not available internally.
6. Accelerate reengineering benefits.
7. Function is difficult to manage/out of control.
8. Make capital funds available.
9. Share risks.
10. Cash infusion.

Jeffrey Lanzet of Aon consulting believes that the growth of outsourcing is, in part, a response to rising costs of regulatory compliance and the accelerating pace of technological change. Outsourcing offers the organization access to cutting-edge technology that many companies do not have the resources to invest in or continually update. HR outsourcing companies also provide greater expertise on compliance issues.

According to the Small Business Administration, small-business owners spend 20 to 40 percent of their time performing "non-productive" tasks. Human resource administrative functions do not generate revenue, and many small and mid-sized businesses today simply cannot afford managers dedicated strictly to human resources (HR). For these companies, the answer is to outsource some or all of their HR operations.

Before making the decision to outsource HR services, companies should complete an analysis referred to as a SWOT [Strengths, Weaknesses, Opportunities, and Threats] analysis. Lynda Ford, a 19-year HR director who now runs The Ford Group in upstate New York, advises companies to ask themselves where they want to go and how the HR outsource component will help them get there.

The four most common mistakes made by companies when hiring for outside HR services, Ford says, are:

- Not having clear goals or a strategy
- Not doing a detailed analysis of the vendor
- Not doing a good job of communicating the service to the staff
- Not setting up standards to measure results once the service begins

It is crucial for companies considering HR outsourcing to develop a sourcing strategy before evaluating vendors. According to Gartner Group analyst Lisa Stone, the strategy should include metrics on the cost and efficiency of the company's current service delivery and the goals it expects to achieve through outsourcing.

The Outsourcing Institute has also developed information on what is required for successful outsourcing.

Top 10 Factors for Successful Outsourcing

1. Understanding company goals and objectives
2. A strategic vision and plan
3. Selecting the right vendor
4. Ongoing management of the relationships
5. A properly structured contract
6. Open communication with affected individual/groups
7. Senior executive support and involvement
8. Careful attention to personnel issues
9. Near term financial justification
10. Use of outside expertise

What to Outsource

Companies have many options when it comes to outsourcing HR functions. Once the analysis has been completed and the specific needs have been determined, companies must choose from a wide variety of offerings. A company may opt for short-term services, such as hiring a recruiter for a special project or a contractor to write an employee handbook; choose to outsource a portion of HR services, such as payroll and benefits; or turn over the entire HR function.

The decision a company makes is dependent on the reasons for choosing to outsource in the first place. According to the Outsourcing Institute, the top ten drivers behind outsourcing decisions are:

1. Accelerate reengineering benefits – Reengineering aims for improvements in critical measures of performance such as cost, quality, service, and speed. The need to increase efficiency can come into direct conflict with the need to invest in core business, and as non-core internal functions are continually put on the back burner, systems become less efficient and less productive. By outsourcing a non-core function, a company can begin to see the benefit of reengineering.
2. Access to world class capabilities – World class providers make extensive investments in technology, methodologies, and people. They gain expertise by working with many clients facing similar challenges. This combination of specialization and expertise gives customers a competitive advantage and helps them avoid the cost of chasing technology and training.
3. Cash infusion – Outsourcing often involves the transfer of assets from the customer to the provider. Equipment, facilities, vehicles, and licenses used in the current operations have value and are sold to the vendor. The vendor then uses these assets to provide services back to the client. Depending on the value of the assets involved, this sale may result in a significant cash payment to the customer.
4. Free resources for other purposes – Every company has limits on the resources available to it. Outsourcing permits a company to redirect its resources, most often people resources, from non-core activities toward activities that serve the customer or drive revenues.
5. Function is difficult to manage or out of control – Outsourcing is certainly one option for addressing this problem. When a function is viewed as difficult to manage or out of control, the company needs to examine the underlying causes. If the expectations or needed resources are not clearly understood, then outsourcing won't improve the situation; it may in fact exacerbate it. If a company doesn't understand its own requirements, it won't be able to communicate them to an outside provider.

6. Improve company focus – Outsourcing lets a company focus on its core business by having operational functions assumed by an outside expert. Freed from devoting energy to areas that are not in its expertise, the company can focus its resources on meeting its customers' needs.
7. Make capital funds available – Deciding where to invest capital funds is one of the most important decisions that senior management makes. It is often hard to justify non-core capital investments when areas more directly related to producing a product or providing a service compete for the same money. Outsourcing can reduce the need to invest capital funds in non-core business functions.
8. Reduce operating costs – Companies that try to do everything themselves may incur vastly higher research, development, marketing, and deployment expenses, all of which are passed on to the customer. An outside provider's lower cost structure, which may be the result of a greater economy of scale or other advantage based on specialization, reduces a company's operating costs and increases its competitive advantage.
9. Reduce risk – Tremendous risks are associated with the investments a company makes. Markets, competition, government regulations, financial conditions, and technologies all change extremely quickly. Keeping up with these changes, especially those in which the next generation requires a significant investment, is very risky. Outsourcing providers make investments on behalf of many clients, not just one. Shared investment spreads risk, and significantly reduces the risk borne by a single company.
10. Resources not available internally – Companies outsource because they do not have access to the required resources within the company. Outsourcing is a viable alternative to building the needed capability. New organizations, spin-offs, or companies expanding into new geography or new technology should consider the benefits of outsourcing from the very start.

How to Outsource

Once a company has completed all the analysis and determined what functions are going to be outsourced and for what reason, it is time to shop for a provider. Before choosing a provider for any HR function, companies must perform due diligence to ensure not only the service provider's quality of work but also its financial stability. You want to make sure the provider will be around to fulfill the contract!

It is recommended that companies complete a request for proposal process, check references, and perform site visits to the providers' call centers and other facilities (if applicable). Pay close attention to the quality of staff who will be assigned to your account, and inquire about turnover and how staff changes are handled. There should be a solid procedure in place to ensure you do not experience any business interruption due to your provider's internal staffing changes.

Review contracts carefully, and make sure that your company and the provider are crystal clear on performance levels and roles. All contracts should include a service level agreement that details the parties' obligations and expectations, from estimated workloads to performance measures to service guarantees.

And don't neglect to manage the relationship with the provider once the contract is signed. Monitor ongoing performance to ensure that service levels are being met and employees' concerns/needs are being addressed in a satisfactory manner.

Conclusion

HR Outsourcing is a viable alternative for companies that do not have the internal resources to handle all or part of the function themselves. To be successful, however, outsourcing must be chosen only after considerable analysis has been completed and a strategy developed.

Sources:

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