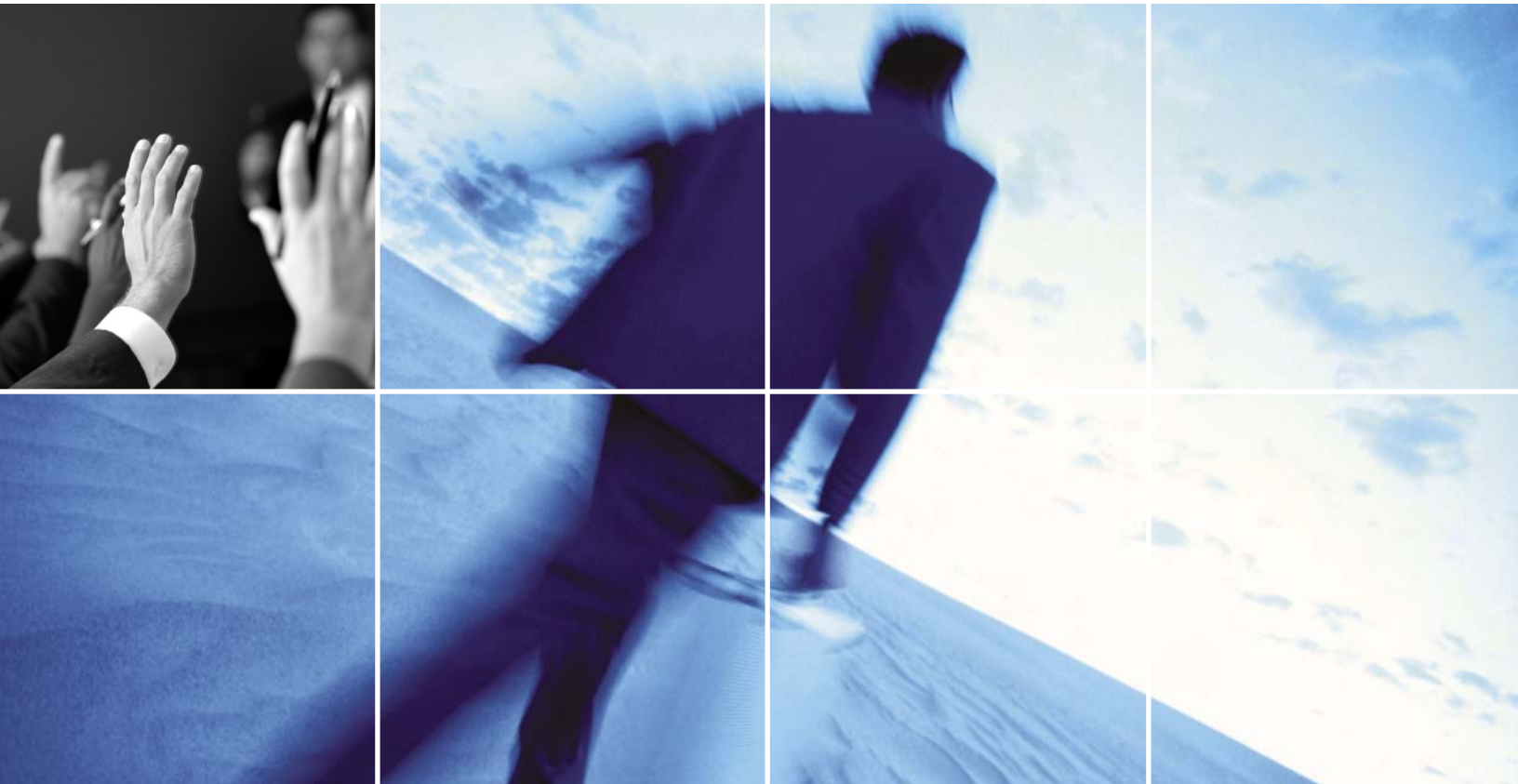


Preparing for human resources business transformation outsourcing

Key questions and decisions



An IBM Institute for Business Value executive brief

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efficiency and effectiveness, and create business value. Based on secondary research, and interviews with outsourcing providers, academics, consultants and individuals responsible for outsourcing arrangements, we have outlined practical guidance for organizations investigating the potential for HR BTO, as well as those that are looking to expand outsourcing arrangements already in place.

Key questions associated with outsourcing human resource processes

Based on our research and discussions, we identified six important questions that companies should focus on as they decide whether to outsource some or all of their human resource processes:

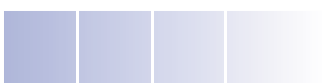
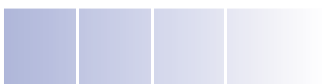
1. What are the *external forces* that are driving the company to examine the opportunities for outsourcing HR activities?
2. What are the *internal drivers* that make HR BTO an attractive proposition?
3. How should the company *identify potential processes* to be outsourced?
4. Who should be *involved in making the decision* to outsource HR processes?
5. How should the company *evaluate potential vendors*?
6. How should the company *begin to prepare itself* for HR BTO?

1. External forces

Globalization, restructuring, increased administration complexity and cost pressures are all driving companies to consider the use of HR BTO. As companies begin to operate in more countries, they are finding it increasingly difficult and costly to keep track of, and manage, the variety of benefits and regulatory requirements in each area. For example, a multinational organization that has been built over time from a series of acquisitions and buyouts can find itself with a bewildering mix of compensation packages, pension plans, human resource management (HRM) systems, hiring guidelines and HR contact centers. Further, as compliance directives and legal regulations change in each of the countries in which the company operates, the company's ability to stay current becomes more difficult and costly as extensive resources are required to maintain and apply this knowledge. Allowing an outside party that has already built existing capabilities in these areas to manage the process becomes an increasingly attractive proposition.

Those interviewed also suggested that increasing numbers of spin-offs continue to propel interest in HR BTO. As companies spawn new businesses, these new organizations need to rapidly establish an HR infrastructure without raiding the talent of their

What are the *external forces* that are driving the company to examine the opportunities for outsourcing HR activities?



parent organizations. Outsourcing provides these newly founded companies with existing resources, processes and technology that they can quickly adopt as they are ramping up their new operations.

Finally, overall cost pressures are forcing companies to identify new methods for cutting administrative expenses. A number of recent studies suggest that reducing costs is the primary benefit that companies seek when outsourcing HR processes.² As new competitors enter the market, particularly those with lower labor costs, many companies' profit margins are put at risk, prompting them to examine closely all activities where cost reduction is possible. Outsourcing provides an opportunity for companies to leverage the cost base and experience of an outside provider, which can potentially lower the cost of delivering HR services, while maintaining or improving service levels.

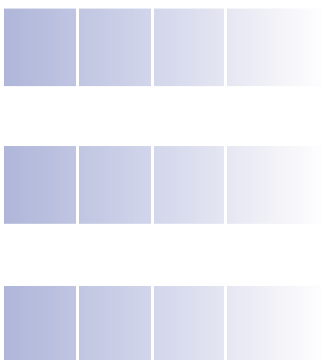
What are the *internal drivers* that make HR BTO an attractive proposition?

2. Internal drivers

A number of internal drivers are also pushing firms to investigate HR BTO. For example, some companies see it as a means of controlling the cost and effort associated with operating their HRM systems. After evaluating the total cost associated with upgrading and maintaining these systems, companies are increasingly turning to outside providers to manage their HRM systems and take responsibility for upgrades and system availability. Companies are also recognizing that they are unable or unwilling to bear the cost of developing employee or managerial self-service tools; they would prefer to "rent" these applications from outsourcing providers who have already invested in development, have the ability to keep up with the latest technology solutions and can provide best-in-class tool sets.

Also, the level of complexity involved in administering complicated programs and processes in multiple regulatory environments and managing data across borders often requires sophisticated expertise which many companies may not have in-house. Sourcing this capability from a vendor could offer lower costs and a higher likelihood of staying current on recent developments.

Third, companies want to reduce the risks associated with business volatility. Having gone through numerous hiring/layoff cycles, they are looking to increase process capacity without commensurate increases in full-time headcount. For example, companies need to increase their ability to recruit without having to bring on a number of full-time recruiters (because, typically, recruiters are the first people exposed to layoffs during a business slowdown). Another example might be providing HR support for mergers and acquisitions. At companies where mergers or acquisitions are made infrequently, it may not be feasible to maintain in-house HR



How should the company identify potential processes to be outsourced?

skills that can support activities such as benefit plan reconciliation, outplacement assistance and HRM systems integration. A vendor can more efficiently maintain these skills and provide them only when they are required by the company.

Fourth, as organizations try to shift resources from administrative to more strategic activities, outsourcing offers one way to build a new sense of focus within HR organizations. Many HR organizations believe being able to reengineer their internal processes *and* deliver strategic HR services is simply too much for one organization to undertake at the same time. However, by allowing a vendor to manage many of the administrative processes that take time and energy away from HR organizations, the internal HR organization can focus its limited resources on delivering the services that truly provide strategic benefits to the entire company.

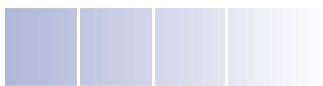
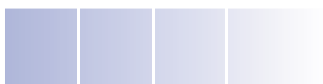
Lastly, for many organizations, outsourcing serves as a catalyst for change. Implementing and maintaining a client service orientation and metrics-driven approach are difficult for most HR functions to achieve on their own. In an outsourced environment, these skills are critical in determining the success or failure of the arrangement. Therefore, outsourcing efforts can be used as motivation to move HR service delivery toward a more accountable, results-oriented focus.

3. Selecting the right processes

Determining the scope of the outsourcing effort is among the most important and difficult decisions companies make. Recently, several studies have indicated that the processes most likely to be outsourced are retirement program administration (including defined benefit, defined contribution and retiree services) and health and welfare administration (including flexible spending and COBRA administration in the U.S.).³ Further, these studies found that HR processes closely associated with employee evaluation and communication are the least likely to be outsourced. To make the right decisions on which processes to outsource at a particular company, it is helpful to establish a formal set of evaluation criteria.

Paul Adler, a management professor at the University of Southern California, suggests six dimensions an organization can use to evaluate HR processes when identifying their potential for outsourcing:⁴

- a) *Dependency* – are there specific assets that require dedicated facilities, equipment, capacity, training or investments?
- b) *Spillover* – is there confidential information or sources of advantage that could be leaked to competitors?



- c) *Trust* – is there a positive relationship between the two organizations that could reduce transaction costs associated with contracting and monitoring?
- d) *Competence* – can greater vendor capability in process execution lead to improved results?
- e) *Core capability* – is this process viewed as a differentiator for the organization in the marketplace?
- f) *Commitment/flexibility* – is the process stable enough so that changes in capacity/technology are not required on a frequent basis?

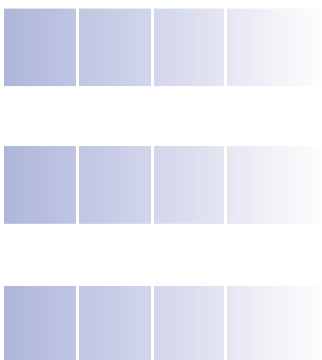
In addition to the criteria that Adler has developed, our discussions with outsourcing practitioners suggest a seventh dimension that should also be considered:

- g) *Need for physical presence* – does the process require regular assistance from a local onsite presence (i.e., it cannot be provided remotely)?

To understand how these criteria can be applied, it is useful to contrast two processes: *benefits administration* and *succession planning*. The following figure illustrates the key differences:

Figure 1. Comparing the potential for outsourcing benefits administration versus succession planning.

	Benefits administration	Succession planning (non-administrative)
Dependency	Little interdependency with other processes within the organization	Succession often closely linked to recruiting, leadership development and executive compensation
Spillover	Potential risk for claims data to be exposed to unwarranted parties – can be mitigated through appropriate security controls	Significant risk if key personnel decisions are exposed to competitors or financial markets
Trust	More easily developed through meeting key deliverables and measurements	Possible, but difficult to evaluate whether vendor is performing to specifications
Competence	Experience with volume processing and changing insurance regulations suggests use of outside provider	Experience with key personnel and company objectives favors internal provider
Core capability	Often not a differentiator in the marketplace	Can be a significant differentiator in the marketplace
Commitment/flexibility	Components (e.g., insurance programs) are relatively standard across companies	Often closely tailored to specific corporate goals or objectives
Need for physical presence	Most processing/inquiry activities can be physically detached from normal work operations	Often requires face-to-face discussions with key personnel in the process during evaluation discussions



As the figure illustrates, benefits administration appears to be more amenable to outsourcing, while most succession planning activities should more likely be handled by an internal HR organization. However, companies should also perform this evaluation at the subprocess level, not just for overall processes. For example, there are some highly administrative subprocesses in succession planning – e.g., collecting information on high potential candidates – that might be candidates for outsourcing, as they more closely resemble the characteristics of benefits administration than the non-administrative elements of succession planning.

Further, organizations should examine the potential synergies associated with outsourcing multiple processes. For example, payroll administration, employee data management and benefits administration processes are often tied together through the use of a common master employee record. Outsourcing these processes as a group can reduce complexity and cost of independently managing the processes and associated systems through multiple vendors.

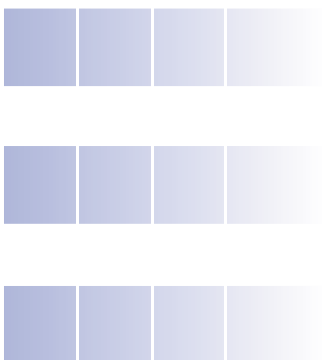
Although many of the companies that we spoke with had not gone through a systemic analysis of their processes in this fashion, we believe that companies can benefit from applying these criteria to all of their HR activities. Formal evaluation criteria can also be useful in assessing the viewpoints of multiple stakeholders and serving as the basis of discussion during the early planning stages of an outsourcing arrangement.

4. Who should be involved in making the decision to outsource HR processes?

4. Getting the right people involved

During our research, we asked about the key individuals who need to be involved in the HR BTO decision. Three sets of participants became apparent during these discussions:

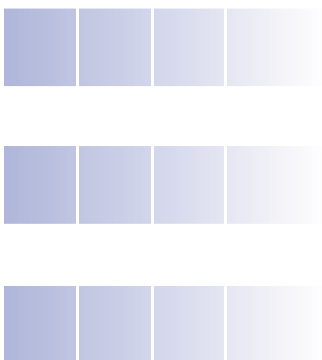
- *Decision-makers.* Our interviewees viewed four individuals from three different functional units as integral in making the decision to outsource an HR process. Within the HR organization, the *CHRO* (or equivalent title in the organization) usually plays an active role in making the outsourcing decision. Ultimately, it is the CHRO's responsibility to determine whether the outsourcing arrangement will enable the HR organization to provide cost-effective, quality service to its internal clients, while, at the same time, support the organization's larger strategic objectives. In addition to the CHRO, the *HR Operations Leader* (usually a direct report to the CHRO) is often involved in developing the specifications of the outsourcing arrangement. While the HR function clearly has primary responsibility in this area, two other individuals play important roles in the outsourcing decision.



The *Chief Financial Officer* often participates in the decision-making process, as entering into a long-term contract with an outsourcing vendor can have potentially significant financial ramifications for the corporation. In addition, the *Procurement Manager* assumes a prominent role during the vendor selection, negotiation and contracting process, leveraging experience in developing terms and conditions that are favorable to the organization.

- *Influencers*. Two groups of individuals were seen as influencing, if not directly participating in, the HR BTO decision. Given the importance of integrating HRM systems with various vendor-driven applications, the *Information Technology (IT) organization* should have input in the HR BTO decision process. IT must determine how the outsourcing arrangement will impact current and future technology investments and plans. Also, the *leaders of the various business units* supported by HR usually provide input into the decision, as their employees are the ones most likely to be impacted by changes in processes and service levels.
- *Approvers*. Typically, the CEO and the Board of Directors are responsible for final approval of the decision to outsource HR processes. This is particularly true if a significant number of processes are involved, if the outsourcing arrangement will impact a large number of jobs throughout the organization or if the arrangement will require communication with important external stakeholders such as industry analysts and financial markets. A significant outsourcing deal can signal changes not only in overall strategy and approach to managing human capital, but also efforts to cut costs, focus on core competencies and mitigate risks. Further, a decision to outsource components of the human resources organization may be perceived by the others in the organization as the first step toward outsourcing other non-core processes. Given the impact of these types of arrangements, the CEO and Board of Directors need to understand *and* articulate the rationale for the decision.

How should the company evaluate potential vendors?

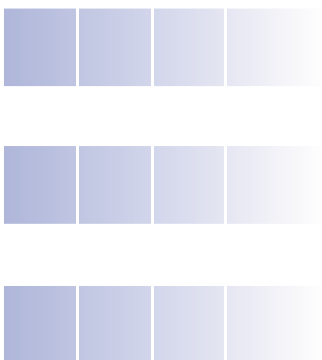


5. Selecting the right vendor

Once the right individuals have been identified to make the outsourcing decision, the next major step in the process involves selecting an appropriate vendor. A number of recent studies have highlighted three primary criteria that companies use to evaluate vendors.⁵ These include: the vendor's track record for delivering service, the costs associated with the outsourcing service and the willingness of the vendor to guarantee service levels. Other criteria highlighted by these studies included: the vendor's technological capability and competence, process expertise, flexible contracting, recommendations from other companies, relevant industry experience, the

ability to manage transition risk and client experience. To evaluate vendor capabilities in these areas, we found companies undertaking a host of activities including:

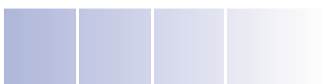
- *Distributing experience questionnaires.* As part of this activity, a company develops a standard experience questionnaire that it sends to multiple vendors early in the evaluation process to obtain initial insights and compare vendors' capabilities. Information that is usually collected as part of this process includes understanding the vendors' areas of expertise, client experience, approach to contract development, service level creation and how they address changes in project scope. There are a number of third-party consultants who, having participated in many vendor selection efforts, have developed and refined these types of questionnaires to quickly ascertain a vendor's particular level of experience.
- *Conducting a financial and credit review of the vendor.* Companies undertake this activity to determine whether the vendor has the financial resources to maintain appropriate service levels throughout the lifespan of the contract. During this review, the potential client examines the vendor's history of fiscal responsibility and regulatory compliance, its credit rating and analysts' predictions of ongoing viability. Companies are also looking for signs that the vendor is a potential takeover candidate, as an acquisition can often redirect senior management attention and increase the complexity of the ongoing relationship.
- *Conducting a security and compliance review.* Given the sensitivity of the employee data associated with an HR BTO relationship, and the governmental/industry regulations and standards associated with the privacy of employee data, companies should conduct a review of the vendor's security and compliance policies and procedures. As part of this assessment, companies should investigate whether a vendor has a demonstrated knowledge of, and is in compliance with, the regulatory requirements of each of the countries in which it operates. They also should determine if the vendor has been fined as a result of noncompliance and if the vendor has access to regulatory and legal specialists on staff or on retainer.
- *Conducting reference checks/site visits to other clients.* Organizations considering outsourcing often speak with or visit current clients of vendors under consideration. This allows them the opportunity to validate other clients' experiences and identify potential issues in working with the vendor. During these meetings, evaluators can get a sense from their counterparts at those other firms as to the vendor's flexibility, willingness to support new client programs, ease of partnership and whether the vendor has met the client's overall expectations.



- *Visiting processing/contact centers.* Many companies find it quite useful to visit the actual locations where the vendor is answering employee calls and processing documents. This gives the prospective client a sense for how the vendor is organized and what technology is being used. This first-hand view can be coupled with assessments of the attrition rates at the center and how service center staff are trained, evaluated and given feedback to continually improve their performance. These visits also provide potential clients a glimpse at the level of professionalism and service that their internal clients will likely receive and the level of investment the vendor is putting into its own staff and operations.
- *Meeting potential delivery team leaders.* Given the importance of personal relationships between client and vendor, potential clients should meet the individuals who will be responsible for both service delivery and the overall account relationship. These face-to-face meetings can help potential clients understand the managerial style of their counterparts and the extent to which specific individuals have authority to act on behalf of the vendor in addressing client concerns. Further, should the potential client decide to engage the vendor, these initial face-to-face meetings can begin to lay the groundwork for the type of trust building that is critical during the transition phase and subsequent ongoing operations.

In some situations, we found organizations that were willing to undertake the overall vendor evaluation process on their own. However, several companies that we talked with engaged third-party consultants to help them during the vendor evaluation and selection process. According to one study, 53 percent of companies who outsourced a component of HR used consulting help during the decision-making process.⁶ Activities performed by a third-party consultant typically include:

- Determining requirements
- Developing bid process and evaluation criteria
- Developing the request for proposal
- Determining which vendors will receive the request for proposal
- Evaluating submissions and determining the short list of potential candidates
- Conducting screening interviews and site visits
- Assisting in the due diligence process
- Developing service level agreements
- Assisting with contract development and negotiation



How should the organization begin to prepare itself for HR BTO?

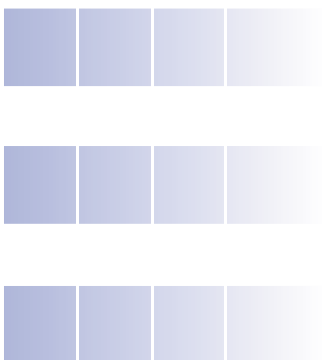
Individuals we interviewed reported a number of advantages in working with a third-party consultant. Outsourcing consultants can provide a clearly defined process and methodology for evaluating vendors that has been used with multiple companies. Their knowledge of vendors can help ensure that only the appropriate organizations are asked to provide bids for service, saving evaluation time later in the process. They can also help standardize vendor responses, making it easier to evaluate and compare different vendor options and also making the process fair, especially when there are conflicting views within the organization. Given the variety of demands placed on today's executives, outside consultants can also help ensure that the selection process obtains the focus and momentum needed to be successful.

However, companies also reported a number of challenges in working with these third-party consultants. First is the short-term expense, which can run over US\$1 million for large-scale, integrated, multiyear, outsourcing arrangements. While this may represent only a fraction of the total amount of the outsourcing contract, this up-front cost is a substantial initial investment and commitment. Second, some individuals that we spoke with indicated that the structured processes employed by these providers increased the time and labor effort needed for the evaluation process. Finally, they noted that using a third-party consultant can limit the level of interaction between the prospective client and the vendor, making it difficult to develop a strong, up-front relationship early in the process.

6. Preparing the organization

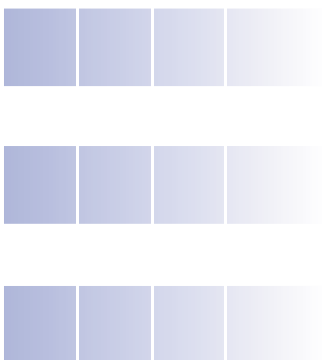
As executives get closer to making the decision to outsource HR processes, they need to pay special attention to preparing the organization for the eventual transfer of people, processes and/or technologies to the vendor. While an extensive discussion of the strategies needed to successfully migrate activities from a client to a vendor is beyond the scope of this paper (see *Preparing for human resource business transformation outsourcing: Risk mitigation strategies*⁷ for more on this subject), we discuss three issues here that should be addressed early in the planning stages of an HR BTO effort:

- *Assembling the team that will lead the outsourcing effort.* Once the decision to outsource has been agreed upon, the organization needs to identify and select individuals to lead the transition and ongoing management of the outsourcing arrangement. Initially, the organization needs to identify the roles and skills that will be required to transfer the outsourced activities to the vendor and oversee the



vendor relationship. Finding these individuals can be a time-consuming effort, as they often have other significant responsibilities and need to be made available to work on the outsourcing effort. Therefore, it is beneficial for the organization to obtain the time and commitment of these individuals and their managers early in the process, rather than waiting for the final contract to be signed.

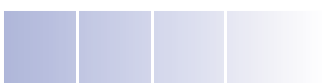
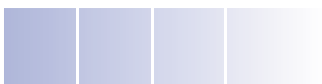
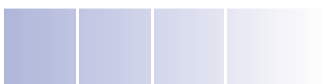
- *Communicating the effort throughout the HR organization and the lines of business.* Many organizations fall into the trap of developing their communication strategy after the outsourcing agreement is put into action. However, effective companies start executing a tailored communication plan far earlier in the process, as they recognize that rumors will likely surface long before any formal discussions are in process. Organizations need to develop formal mechanisms for communicating to HR leaders and staff during the early stages of an outsourcing effort since these individuals may be called upon to provide data or reallocate their time to work on outsourcing related tasks. Further, organizations need to listen closely to informal influencers within the HR organization and business units, as they may have insight into potential areas of resistance and concern that can have a negative impact on the outsourcing effort.
- *Gathering data on the current state of the HR organization.* To develop a compelling business case for HR BTO, organizations often need to obtain a clearer understanding of their current spending for HR activities and measure levels of operational effectiveness. Also, many organizations do not have a strong sense for the industry and competitive benchmarks that are useful in comparing HR cost and performance across companies. Collecting this data can be a time- and labor-intensive process that often must be accomplished in a relatively short amount of time. While outside resources can be used to facilitate this collection, both internal HR process experts and individuals with experience in obtaining information from HRM systems need to be involved. Dedicating these scarce resources is well worth the effort, as it can help ensure that the organization is entering into a financially beneficial arrangement.



Summary

Overall, there are a number of questions that decision-makers should consider as they determine whether outsourcing HR processes is the right opportunity for their organizations. These include:

External forces	<ul style="list-style-type: none">• Has the complexity of global operations made it more difficult to manage the organization's HR programs, in terms of the number of programs and the associated regulations?• Is the organization's HR cost structure out of line with other competitors in the industry? If so, has the company determined if this is the result of higher labor, process or technology costs?• Does the HR organization have the capacity and capability to integrate recent acquisitions or provide HR services for newly created businesses?
Internal drivers	<ul style="list-style-type: none">• To what extent does the organization believe that the HR department should focus on more strategic activities, such as talent and performance management?• In what ways is the HR organization being asked to increase its scope and capabilities without increasing its overall headcount?• Does the organization want to invest in upgrading its HRM system capability without assuming the risks and responsibilities of a major systems upgrade?• What factors are limiting the HR organization's ability to transform to meet the needs of its internal clients (e.g., limited resources, inadequate skill sets, small time horizon)?
Process selection	<ul style="list-style-type: none">• Has the organization conducted an analysis of its processes and subprocesses to determine what activities are candidates for outsourcing?• Does the company have a sense of what percentage of HR activities are performed by the HR organizations versus the business units themselves?• Has the company identified the synergies associated with outsourcing multiple processes?
Decision making roles	<ul style="list-style-type: none">• Who are the key stakeholders that need to be involved in making HR BTO decisions?• What level of involvement is required from the various functional departments participating in the outsourcing decision process?
Vendor selection	<ul style="list-style-type: none">• Has the company identified the appropriate organizations and individuals to be involved in vendor selection and have their roles and responsibilities been clarified?• Has a standard set of evaluation criteria been developed for potential vendors?• How is the organization planning to undertake due diligence for each of the potential outsourcing vendors?• To what extent has the use of a third-party consultant been considered to help with the decision making process? If using one, what sort of process and deliverables are expected?
Preparing the organization	<ul style="list-style-type: none">• Does the company have a sense for who needs to be involved in leading the outsourcing effort and how and when these individuals will be released from their current responsibilities?• Has the organization developed a communication strategy that addresses issues and concerns prior to the formal start of the outsourcing arrangement?• Has the company developed a strategy for formulating a business case for outsourcing, including a plan for collecting the necessary data?



Conclusion

HR BTO has the potential to benefit organizations that want to transform their ability to manage human capital. Outsourcing relationships can provide the right blend of cost, service levels, experience and economies of scale that allow companies, and specifically HR organizations, to move away from administrative activities and focus on more strategic issues. In evaluating options, organizations should consider their motivations, the desired scope of their outsourcing activities, the appropriate level of decision-makers to involve and the fit between vendor capabilities and organizational needs. These thorough assessments can set the groundwork for a strong relationship between client and vendor and smooth the transition process as the outsourcing arrangement moves forward.

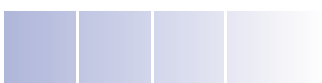
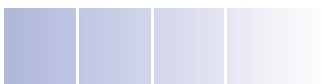
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