

Life After Outsourcing: HR

The right mix in the workforce is essential for
smooth, streamlined business

by Donald L. Lowman, Towers Perrin

Human Resources Outsourcing (HRO) is a key stop on the path to HR transformation—the road out of the “administrivia” of overseeing day-to-day operations and into providing managers with more time to focus their attention on higher-impact strategic issues, such as workforce globalization, shifting demographics and developing people-dependent business strategies.

But HRO is just a stop, not the ultimate destination. Companies are finding that they cannot transform the HR function simply by taking work out of the organization and passing it on to someone else. Transforming HR requires a variety of integrated initiatives, including people, processes, and structural and technology changes supported by well-designed change management processes—and all must be focused on the HR organization and the “customers” of HR.

A painting depicting a large, golden-yellow pyramid being held up by a group of people in business attire. The pyramid is the central focus, with a small figure standing on its peak. The background is a dark, textured sky with shades of blue, purple, and brown. The ground is a reddish-brown color. The overall style is expressive and somewhat surreal.

Now the Heavy Lifting Begins

A World of Change: Why HR Needs to Become More Strategically Focused

Companies today are entering a period where workforce issues will dominate and receive significant high-level executive focus. For starters, they operate in an increasingly challenging business environment. Consider the following:

■ Demographic shifts are gathering speed because, as an aging population in developed countries begins to deplete the workforce, a far younger population in the developing nations forms a new source of labor. These forces will not only create shortages in both numbers of people and in critical skills, but will also pose challenges in finding, retaining, and transferring knowledge capital, and in managing far more diverse and far-flung employee populations.

■ Globalization is introducing new competitors, facilitating the free flow of knowledge and enabling a wide variety of work to be offshored and completed at a high level of quality for a lower cost.

■ People-dependent business strategies—including leadership, innovation, collaboration, process excellence, customer service, and compliance—increasingly rely on key workforce segments for successful execution.

■ New technologies are continuously redefining how, where, when, and by whom work is performed, thus changing the required skills and deployment of many workers.

■ Evolving social attitudes and individual expectations about work are creating a need to continually refresh insights about what

drives workforce attraction, retention, and engagement.

While these trends have been well documented for at least five to 10 years in academia and the media, it's only within the last few years that companies have begun to face the practical fallout. And this is intensifying the focus on workforce strategies to ensure an adequate supply of talent, deploy the workforce effectively, and enhance employee capability and performance, particularly given the ever-narrowing margins of competitive differentiation. As a result, attracting, retaining, and engaging the right workforce is viewed as an essential strategic focus, not only for the HR function, but for the entire business as well.

The Case for HRO

With all of this as background, it's easy to understand the heightened interest in HRO as an increasingly important step on the road to greater workforce effectiveness.

Outsourcing is one of the most compelling and controversial topics in and outside of HR today. Barely six years old, the market for HR outsourcing is growing exponentially. In mid-2005, approximately 70 companies worldwide had sizable HRO deals in place—defined as a minimum of six major HR processes outsourced to a single vendor—up 20 percent from the beginning of the year and 50 percent since the comparable point in 2004. Add to this the proliferation of new outsourcing vendors, and the increasing number of midsize companies entering the outsourcing marketplace, and it's clear that HRO has moved beyond a temporary phenomenon to emerge as a popular and viable service delivery strategy.

So, is HRO working as a strategy for workforce effectiveness? The short answer to that question is “Yes, but...” With its track record of growth, you would think that outsourcing was a resounding success. Yet, despite (or perhaps because of) its meteoric growth, HRO re-

Despite (or perhaps because of) its meteoric growth, HRO remains very much a work in progress, just beginning to achieve some of its intended benefits.

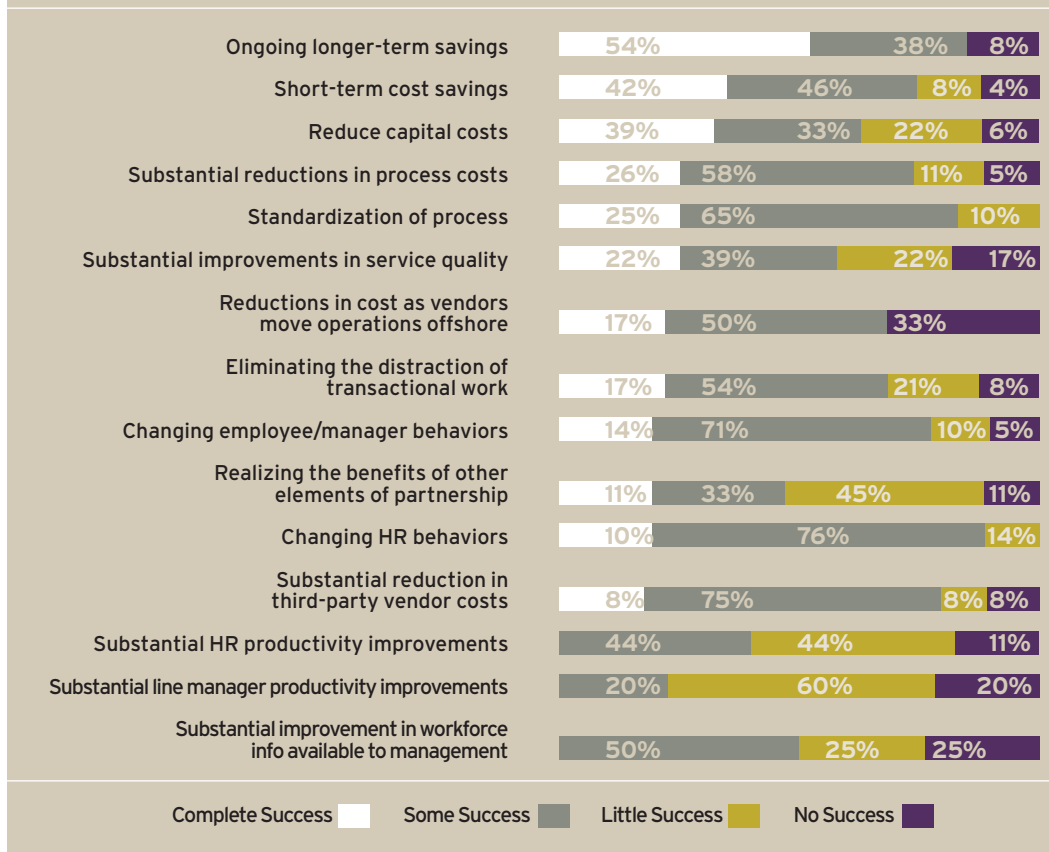
mains very much a work in progress, just beginning to achieve some of its intended benefits.

To measure the success of HRO to date, one needs to understand why companies outsource in the first place. Based on recent Towers Perrin proprietary research,* more than 70 percent of companies with sizable outsourcing deals in place choose one of three key objectives—cost savings (37 percent), transformation/freeing time for strategic HR (23 percent) or service quality improvements (14 percent)—as their primary outsourcing goal.

On the plus side, HRO is delivering cost savings, the primary reason most companies outsource. Eighty-eight percent of companies reported some or complete success achieving their short-term cost-saving goals (see Exhibit 1). And 92 percent reported success realizing ongoing, longer-term savings. Reductions in process costs to deliver HR services were equally impressive. >>

Exhibit 1

While companies are seeing cost savings, challenges remain in improving service quality, among other areas



*HRO: NEW REALITIES; NEW EXPECTATIONS: RESULTS FROM TOWERS PERRIN'S 2005 STUDY OF HRO EFFECTIVENESS

Employees need to anticipate some bumps in the road as the transition to outsourcing occurs. By helping them understand what and where those bumps will be and how long they will last, employers can keep distraction and disruption to a minimum.

But in almost all HRO arrangements, costs quickly become a secondary success measure to service quality. And service quality remains a thorny issue. A disappointing 39 percent of survey participants in our 2005 study of HRO effectiveness indicated that, to date, they had experienced little or no success realizing improvements in service quality beyond what they could have achieved on their own.

More significantly, HRO has not turned out to be the transformational experience many expected. Companies are not yet getting the lift from HRO they need to drive a more strategic HR transformation agenda. A majority of companies report little or no success making substantial improvements in HR and line manager productivity, as well as management information and reporting. And productivity improvements are an essential first step if HR is to free itself from day-to-day operational responsibilities to concentrate on more strategic corporate issues.

The bottom line is that outsourcing is working in some areas but not in others. Overcoming implementation challenges continues to be the biggest hurdle. Companies wanting to increase the effectiveness of their current, or planned, outsourcing initiatives need to focus on three key areas of change: guiding employee/manager behavioral change, reskilling the HR generalist, and developing the “right” client-vendor partnership.

Guiding Employee/Manager Behavioral Change

Some of the toughest HRO implementation challenges involve the impact of outsourcing on people in the organization—both employees and HR staff. Across a dozen different outsourcing challenges we assessed in our 2005 study of HRO effectiveness, respondents rated the following areas as somewhat or very difficult to achieve:

- Reshaping employee/manager behaviors (92 percent)
- Managing employee/manager expectations around service quality during transition (87 percent)
- Managing HR staff resistance to the concept of HR outsourcing (85 percent)
- Managing employee/manager resistance to the concept of HR outsourcing (82 percent)
- Reshaping the role of the HR generalist (82 percent)

Whether you are a small company using the latest advances in Internet self-service technology to empower your employees and managers, or a Fortune 1000 company outsourcing several dozen HR services, HRO represents a major change for everyone in the organization, not just for the HR function. Expect it. Companies that don't address it as such are far less successful than those that prepare internally for what everyone agrees is a seismic culture shift. Invariably, the difference between success and disappointment is less about process improvement and technology upgrades than it is about people and culture.

Sustainable change and performance improvement require modifications in behavior among HR professionals, employees, managers, and business leaders alike. Business leader sponsorship and involvement, vendor governance, program management, and transi-

tion management are some of the key ingredients in making the new service delivery model work. While the transition process involves managing hundreds of details, the step that matters most is developing influential and effective leaders and HR professionals who are committed and passionate about making the arrangement work.

As with any process change, large or small, a well-planned and executed approach to internal communication—especially during the first three to six months of transition—can keep employees and HR staff aware of the changes taking place and what these changes mean for them. Employees need to anticipate some bumps in the road as the transition to outsourcing occurs. By helping them understand what and where those bumps will be and how big they are, employers can keep distraction and disruption to a minimum.

A second frequently overlooked but equally important communication initiative involves tracking and then “packaging” outsourcing success stories for corporate audiences. Internal marketing of HRO successes ensures that people in the HR community and in employee communities, including valuable constituents among senior management, are routinely reminded that outsourcing is indeed succeeding.

Reskilling the HR Generalist

Many of the earliest companies to outsource HR services looked to their vendors to manage not just the transactional aspects of outsourcing, but the transformational aspects as well—how the HR function will deliver genuine strategic value to the business. What they found from firsthand experience is that transformational processes are primarily the companies’ responsibility, not the vendors’.

Having stripped out much, if not all, of the administrative and transactional work from the HR function, companies are realizing that >>



Exhibit 2

Ongoing senior HR involvement matters

Keeping HR leaders involved in all aspects of the outsourcing process increases the likelihood of success. The longer leadership remains involved, the greater the overall satisfaction with the results. Senior HR teams typically are highly involved in the earliest (more strategic) stages of the outsourcing deal—during negotiations and at deal signing. But their involvement declines during and after implementation, when things take on a decidedly more operational focus. Companies that are ultimately the most satisfied with their outsourcing arrangement are more likely to have maintained continuous senior HR involvement throughout the various phases of outsourcing—a lesson that companies with more recent outsourcing deals appear to have learned and embraced.

Senior HR involvement in deal phases

	Satisfied Companies	Dissatisfied Companies
Pre-deal	4.45	4.45
Deal signing	4.59	4.55
Implementation	4.05	3.27
Post-implementation	3.86	3.09

BASED ON RATING SCALE WHERE 1 = NOT AT ALL INVOLVED AND 5 = VERY INVOLVED

SOURCE: HRO: NEW REALITIES; NEW EXPECTATIONS: RESULTS FROM TOWERS PERRIN'S 2005 STUDY OF EFFECTIVENESS

this was the easy part. HR functions (post outsourcing) look and act radically different from those that existed at deal signing. And managing the new outsourcing arrangement requires at least as much attention, often more, than managing internal resources. Staffing, skills, structure, and strategic ability of the HR team are all elements that need to change accordingly. That's why, in order to achieve real transformational value from outsourcing, companies need to take a long, hard look inward, to the makeup and skills of the retained HR organization and its HR generalists.

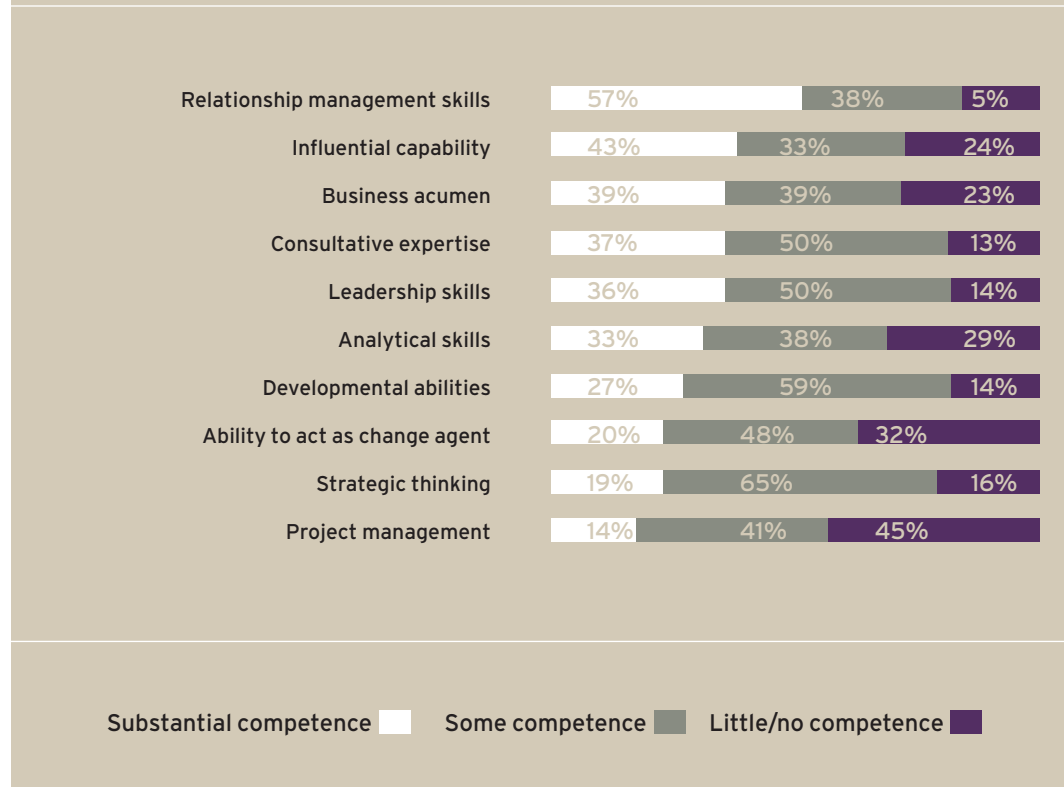
To appreciate the magnitude of the organizational challenge confronting HR, consider that 86 percent of respondents in the HRO

effectiveness study said that their generalists required new competencies post-outsourcing, with 62 percent indicating the need was great or very great. Only 14 percent indicated “very little” or “no” needs. In only one of the 10 skills competencies we measured—relationship management—did a majority of respondents rate their generalists as having substantial competence. At the other end of the spectrum, ability to act as a change agent and project management skills, two areas of particular importance as companies transfer operational responsibilities to a vendor, received especially low ratings (see Exhibit 3).

These results are pivotal because our research showed a direct correlation between the level

Exhibit 3

Outsourcing was intended to free HR for more strategic work, but HR continues to lack the required skills



SOURCE: HRO: NEW REALITIES; NEW EXPECTATIONS: RESULTS FROM TOWERS PERRIN'S 2005 STUDY OF HRO EFFECTIVENESS

of perceived generalist competence and overall client satisfaction. Better-satisfied companies are more likely to rate their HR generalists as having greater skills. Clearly, if the HR generalists aren't cutting it, clients are not satisfied. The problem is that too many companies keep the wrong people with the wrong skills in the wrong jobs after outsourcing. Companies must decide fairly quickly whether to replace or retain HR staff. And those companies that make the decision to retain their HR staff (at least as many as possible), need to retrain their HR generalists—and not just using off-the-shelf training programs. These companies need to assess where specific gaps exist relative to skills requirements in the reconstituted organization and design training programs consistent with their unique needs.

Ironically, we know from experience that many of the most effective reskilling techniques are also the least used. For example, while replacing HR generalists with HR professionals from outside the organization is having a significant positive impact for companies using this technique, 40 percent of companies still do not use this approach. Similarly, selecting HR generalists based on competency assessment shows positive results—and yet more than one-third (37 percent) of companies still are not doing this. In too many instances, companies are not initiating process changes in those areas where they can make a real difference.

Finally, timing is a critical component of reskilling HR generalists. Addressing generalists' capabilities and competency gaps should be incorporated into the outsourcing process and done during the formative stages of the negotiations, at the same time that companies are developing the overall HRO contract. Some companies do it sequentially, executing the contract first and then worrying about generalists' competencies. This is a mistake. Not addressing skills gaps early creates the false impression that it isn't important, that "the change doesn't affect us." And it does. For the best results, competency assessments should always be done in conjunction with the initial outsourcing deal design and parameters.

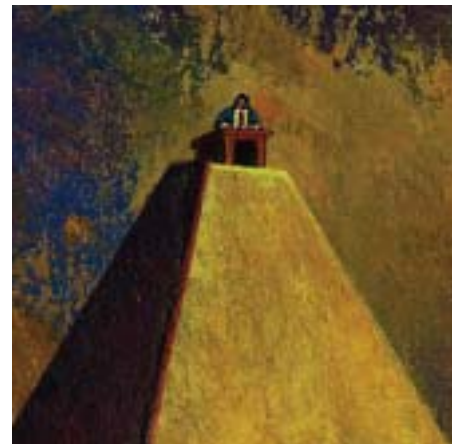
Developing the "Right" Client-Vendor Partnership

Companies generally envision their HRO vendor relationship as running along a continuum—from purely commercial (strictly a fee-for-service relationship) at one extreme, to mutually beneficial (joint resolution of issues, give and take to get the best solution) at the other extreme. Because of the pressure to demonstrate positive results quickly, companies and vendors initially gravitate toward the purely commercial end of the spectrum, satisfactorily delivering on contractually mandated terms of the contract. Then, as companies become increasingly comfortable that they are achieving their primary cost and quality objectives, they explore new ways to work with outsourcers to improve process efficiency and effectiveness across the entire organization.

During our 2005 research and follow-up conversations with participants, companies were consistent in describing the types of vendor attributes they felt would add the greatest incremental value to their existing HRO arrangement. Companies singled out those vendors that look for better ways to get the job done and share good ideas or best practices that help the rest of HR improve; share or leverage the (nonproprietary) insights learned from working with its other clients; and consistently mine company data to help improve overall HR service delivery.

These same companies were quick to add, however, that progress to date is mixed and that this next step in the evolving client-vendor relationship definitely remains a work in progress.

By their very nature, outsourcing vendors represent an invaluable resource. For starters, they are generally in possession of companies' >>



HR-related operational data as well as insights and best practices across multiple companies and industries. In many cases, what they've learned elsewhere can be applied to a company's own outsourcing situation. But despite their inherent expertise, many outsourcers are reluctant to volunteer new ideas. The ongoing challenge for companies is to work with vendors so that outsourcers become more forthcoming with ideas, suggestions and best practices.

Like any good relationship, client-vendor partnerships need to be continuously nurtured. This includes agreement on the boundaries and expectations of the relationship, as well as the respective roles and responsibilities in managing the impact of outsourcing on the organization, employees, and managers. And, finally, both parties need to agree on which skills and competencies should be contributed by the vendor and which by the organization.

Why Outsourcers Are Sometimes Reluctant Innovators

One interesting discovery that came from our discussions with companies in our HRO effectiveness study is that it's the companies themselves, not the vendors, that must constantly be the initiators of process innovation and change. And this continues to be a sore spot for many clients. It's not that vendors can't do it; it's that they don't want to do it, and for a very valid reason. Every time you try to innovate, you create instability. And vendors are paid for STABILITY. They are paid to deliver consistent performance day after day. When you start to innovate, when you start to bring new ideas to the table, you also start to upset the applecart. So the idea that vendors will come forward with new and interesting ideas that could help companies improve, but may cause instability in the process, is not in their best interest. Companies need to work with vendors to develop mutually agreeable ways to tap into vendors' vast experiences, but in ways that won't penalize vendors for their initiative or jeopardize their ability to meet contractually mandated cost and service levels.

A Snapshot of Offshoring

No discussion of outsourcing and workforce effectiveness would be complete without a brief mention of offshoring—exporting processes to another country, typically to take maximum advantage of lower labor and infrastructure costs or tax savings. Like outsourcing in general, the market for offshoring HR processes is growing rapidly. More than half (58 percent) of the participants in our HRO effectiveness survey are engaged in some form of offshoring, 27 percent of whom plan to move additional work offshore. Clearly, any lingering doubts about the value and increasing popularity of shifting IT/programming support and non-customer-facing (back office) activities offshore are rapidly disappearing.

Despite some controversy, the benefits of offshoring are compelling. Companies with far offshore (for example, U.S. to India) deals report significant advantages over near offshore deals (for example, U.S. to Canada) and home country outsourcing (see Exhibit 4).

Companies with far offshore deals also reported greater success with short- and long-term cost savings, improvements in third-party vendor costs, and achieving clarity of scope in work.

Successful Offshorers Leave Little to Chance

Moving customer-facing work offshore depends in large measure on home country acceptance. The keys to successful offshore process implementation are really no different from those of home country outsourcing. Companies with greater offshoring success are those that follow more rigorous internal communications, vendor preparation, and training regimens. Their employees have to become prepared to speak with individuals who are from another country, perhaps even with a different accent. Pre-implementation employee communication can greatly overcome possible political or cultural prejudice. Similarly, successful companies have generally spent a great

deal of time and effort working with their vendors on the selection and training of offshore customer service representatives, ensuring that these individuals have the right customer service attitude and that they have been properly educated and trained in the company's own processes and ways of serving customers.

A Glimpse Ahead

The HRO landscape is far different today than it was just a few years ago. And with today's rapid growth, it will likely be very different in another two years. Symptomatic of a relatively young and dynamically growing industry, there are a number of complex issues that vendors and clients are facing, or will face shortly. All have a bearing on both the structure of the client-vendor relationship and its ultimate success. For example, process quality and satisfaction issues continue to be front and center for most clients. And these issues are bound to intensify over the next few years as outsourcing growth rates increase and vendors reach their operating capacity, threatening service quality.

Second, clients and vendors are still searching for the ideal client-vendor relationship—

the point at which outsourcers move beyond just doing the basics and instead become real value-added partners. Success in the next generation of large HRO deals will demand greater clarity around the respective roles and responsibilities of clients versus vendors. New competencies along with a clearer sense of what drives service quality and client satisfaction will also be required.

Finally, a number of early adopters have been in their HRO deal since the year 2000. The rapidly approaching first round of contract renewals will push vendors and clients to formalize more aggressive improvement targets in areas that drive client satisfaction and service quality, along with increased contract flexibility in order to better address constantly changing business conditions. |S|

About the Author: Donald Lowman is a managing director of Towers Perrin and serves as a member of the firm's Board of Directors and Executive Council.

Exhibit 4

Far offshore successes are compelling Outsourcing success rates by location

Process Outsourcing Benefit	Far Offshore	Near Offshore	Home Country
Ease of implementation	67%	44%	38%
Success with vendor governance	33%	10%	14%
Experienced greater operational success	79%	75%	55%
Success building relationship with outsourcer	47%	30%	29%
Success with cost structure	53%	20%	33%

SOURCE: HRO: NEW REALITIES; NEW EXPECTATIONS: RESULTS FROM TOWERS PERRIN'S 2005 STUDY OF HRO EFFECTIVENESS