

## **Impact of HR Outsourcing Functions on Organisational Performance**

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### **Introduction:**

Today, every organization is aiming at achieving productivity by enhancing return on investments and achieving the economies of scale. In this context, it makes sense to focus only on the organization's core competencies and outsource non-critical business activities. Therefore, routine administrative work, although important, can be outsourced to third party vendors.

HR outsourcing has the potential to benefit organizations that want to transform their ability to manage human capital. Outsourcing can provide the right blend of cost, service levels, experience and economies of scale that allow companies to move away from administrative activities and focus on more strategic issues.

The Human Resource (HR) department is critical for employee satisfaction in any firm. Some businesses don't have the staff, the budgets or the inclination, to deal with the nitty-gritty of HR management, so they opt for outsourcing. Deciding which functions to offload and which firm to outsource is also a major decision.

### **Reviews on Outsourcing:**

There are a number of reasons, at both the strategic and operational level, why firms want to outsource HR activities. Many share similarities with the outsourcing of other organizational functions. In particular, demands for increased productivity, profitability, and growth have forced organizations to examine their internal HR processes, resulting in a move toward strategic outsourcing services and away from discrete services. As Greer, Youngblood, and Gray (1999) observe, HR outsourcing decisions are frequently a response to an overwhelming demand for reduced costs for HR services. Downsizing and tougher competition mean that the HR functions is under increasing pressure to demonstrate value, both in terms of efficiency and effectiveness (Roberts, 2001).

Although some elements of the HR functions may have always been performed by external service providers, Brewster observes that a new dimension "is this finance-driven idea connecting outsourcing to human resource management – the idea that you can save a lot of money by outsourcing" (quoted in Turnbull, 2002, p. 10). In addition, outsourcing is seen as a way of liberating HR professionals within the client organization to perform the more consultative and strategic role of designing and implementing programs aimed at retaining the workforce and enhancing its performance. This rationale is in line with Ulrich's (1998) influential thesis of the four roles of HR, in which he proposed that HR should be a strategic partner, an administrative expert, an employee champion, and a change agent. In a similar

vein, Greer et al. (1999) argue that HR outsourcing is consistent with the business partner role that the in-house HR department is attempting to assume. These roles arguably are where HR can add the greatest value to the organization, but they are difficult to measure quantitatively.

Outsourcing HR is also seen as an effective way to bypass organizational politics and improve efficiency. For example, according to the sales and training manager of United Kitchen, a company that has outsourced all personnel and training, the company's aim was to buy an expert who could maintain an objective view, would not get embroiled in office politics, and yet could call on the support of a wide range of other experts in their own organization (Pickard, 1998). In short, the main reasons for outsourcing HR appear to be fairly consistent (Sisson & Storey, 2000). Typical reasons include seeking specialist services and expertise, cost reduction, and enabling HR specialists to take on a more strategic role. In general, most commentators are convinced that outsourcing is seen not only as a cost-cutting exercise but also as a strategic tool. As Oates (1998) suggests, the outsourcing decision is a strategic one and is generally taken at a senior level.

Another survey, by IDC ([www.idc.com](http://www.idc.com)), reports that worldwide HR business process outsourcing (BPO) will be the fastest-growing segment of the HR service spending market. Worldwide and U.S. HR Management Services 2005-2009 forecast predicted that BPO will grow at a compound annual growth rate of 16.1% to more than \$16 billion. Gartner, Inc. (Stanford, Conn.; [www.gartner.com](http://www.gartner.com)) predicts that worldwide BPO this year alone will generate \$133.7 billion, up 8% over last year. The growing choice to outsource, especially HR services, means that you may soon be in the position of choosing a vendor, or helping to do so. This choice requires great care, as the vendor must be held accountable. If you outsource HR correctly, it can improve service quality, save money and time, and free HR time for core functions, noted Geoffrey Dubiski, director of operations at Yoh HR Solutions

(Philadelphia), an HR outsource vendor. Poor outsourcing, however, could bring lower service quality and the employee complaints that lower quality can spawn. "Most HR outsourcers provide satisfactory levels of service, but none of them provide exceptional service," claims Michael Cornetto, a senior consultant at Watson Wyatt Worldwide (Washington, D.C.).

Service quality is also something you must consider and explore, notes Patrick Wright, professor of HR studies at Cornell University (Ithaca, N.Y.). "The expectation is that the quality of service gets better, [but] there's no quantitative data out there to support the actual decision saying that outsourcing is always cheaper and better." While a lack of clarity in expectations is partly to blame, HR professionals who are setting up the transfer of services to an outsourcer may also be at fault, Wright says. How? They may not have the skills in vendor management to make sure the process – from contract to implementation to monitoring results – is properly handled. The top reason that many employers outsource HR is the desire for more services at a lower cost.

Perceived savings stem from having fewer in-house HR staff. In SHRM's 2004 survey about HR outsourcing, 56% of the 169 surveyed HR professionals said that their companies outsourced HR functions to save money or reduce operating costs, and 41% to reduce the number of HR staff and related expenses.

Outsourcing is never a fix for poor internal systems, Wright stressed. “You have to fix your own processes within the company first, before outsourcing, or you will have a bigger headache on your hands than when you started.”

Dissatisfaction with surprise additional costs was a powerful negative in an outsourcing review of 25 large companies by Deloitte Consulting ([www.deloitte.com](http://www.deloitte.com)) “Calling a Change in the Outsourcing Market Report, 2005”. The study looked at both business process and information technology outsourcing: 70% of the companies said they have had significant negative experiences with outsourcing projects – and were dissatisfied with its costs and complexity. Also reported was the need for more senior management attention and skills than anticipated. Additional costs came from unexpected complexity of the outsourcing process and lack of transparency in vendor pricing or cost structures. 57% said they absorbed costs for services they believed were included in contracts with vendors or outsource providers. Many indicated there were “hidden” costs in managing outsourcing projects, as well.

One reason for the results, according to Ken Landis, a senior strategy principal at Deloitte, may be that vendors and the companies that hire them have “conflicting Objectives.” Another observation: “The structural advantages envisioned do not always translate into cheaper, better, or faster services.” As a result of the findings, he observed, “outsourcing will become less appealing for large companies because it is not delivering the value as promised.”

As Prahalad and Hamel (1990, p. 84) point out, “outsourcing can provide a shortcut to a more competitive product, but it typically contributes little to building the people-embodied skills that are needed to sustain product leadership.”

### **Impact of HR Outsourcing:**

#### **Benefits:**

According to KPMG International (2006), 78 percent of their respondents in Asia see cost saving as the primary reason for outsourcing the HR function. It could be said that cost saving is the first reason for many organisations to outsource their internal HR function. There is also evidence that shows organisations can avoid a huge investment because they can deal with cost-effective HR providers (Marquez, 2007a). Shelgren (2004) agrees that outsourcing the HR function may help organisations forecast their HR activities budget because providers are paid on a monthly or yearly basis.

Another cited benefit of outsourcing the HR function is a more efficient service. It is argued that the ability, skill and knowledge of HRO providers is better than that of in-house HR staff (Heywood, 2001). Thus, the organisation will benefit from HRO providers because HR activities are their core competencies. For instance, Stainburn (2007) reported that the expertise of HRO providers on different employment and remuneration regulations is an advantage for organisations operating in more than one country.

Another significant benefit from outsourcing the HR function is that the organisation can focus on core business or core competencies. In research

conducted by KPMG International (2006), 68 percent of respondents in Asia see outsourcing of the HR function as the opportunity to focus on their core competencies. Moreover, organisations can gain many benefits from the more efficient services provided by HRO providers. Indeed, they can improve the quality of their HR activities, a conclusion which is supported in The Conference Board survey. For example, Shelgren (2004) reports organisations can pay 99 percent of employee claims within two weeks and provide service responses as required within 48 hours, when compared with running HR activities in-house. Outsourcing HR activities also provides organisational flexibility in dealing with the challenges of a constantly changing environment (Makenna & Walker, 2008; Young S., 2007).

Another example of an organisation that enjoys the benefits of outsourcing HR activities includes BP Amoco and Exult (Outsourcing Provider). The case study of BP Amoco and Exult provided by Robinson and Kalakota (2004) shows that British Petroleum (BP) Amoco (an international energy and petrochemicals organisation) uses the service of Exult as a outsourcing provider, responsible for procedures and administration of HR activities. This strategy enables BP Amoco to focus on strategic planning, and policy decisions. BP Amoco and Exult have agreed to multi-year contract valued at \$600 million. As a result of this contract, outsourcing HR activities simplifies operations at BP Amoco. Furthermore, BP Amoco enjoys the benefits of a professional service from Exult. For instance, Exult provides HR high technology activities including web-service for employees. Moreover, HR activities at BP Amoco, including payroll, and employee services have become quicker, more convenient and more accurate. There are three significant factors that have contributed to the successful outsourcing of HR activities at BP Amoco. First, it is quite clear that BP Amoco was paying attention to organisational decision making regarding organisational core competency. BP Amoco decided to increase their budget for their core competencies – which are locating and drilling for oil – rather than investing their money in other activities.

Second, it seems BP Amoco was paying attention to their employees. BP Amoco allowed employee representatives to get involved in the outsourcing decision. Later, some of their employees become Exults employees. Moreover, BP Amoco paid termination contract fees for their employees who were laid off and this termination contract fee satisfied most of their employees.

Third, in terms of the outsourcing process options, BP Amoco used a transition option for the first stage. This option provided BP Amoco with more time to convert, integrate, compile and transfer their activities and data to Exult. Moreover, BP Amoco was able to evaluate the service provided by Exult before signing a full contract. The case studies of the Royal Borough of Kensington and Chelsea, provided by Northgate HR Information Solution (2007), show that the Royal Borough of Kensington and Chelsea are home to over 150,000 residents, employing over 6,500 workers. After they outsourced their HR activities, including personnel services and recruitment processes, they received an ‘excellent’ rating by the Comprehensive Performance Assessment.

A significant factor that led to the successful outsourcing of HR activities at the Royal Borough of Kensington and Chelsea was the level of employee satisfaction with the process. The Royal Borough of Kensington and Chelsea could benefit from the state of the art technology used by the outsourcing providers. This outsourcing

process, therefore, helped to reduce employee workload and make the HR activities operate more efficiently. In turn, employees were no longer having to be involved in complicated routine transactional HR activities and could focus on more interesting and challenging work.

Both of these examples demonstrate that employee involvement is integral in determining the success on outsourcing decisions. In contrast to this, a lack of employee involvement and understanding of the outsourcing process can lead to a negative experience when it comes to outsourcing, as the following research shows.

### **Pitfalls of Outsourcing HR:**

KPMG International Research found that many problems can occur when organisations introduce outsourcing processes. The research found that 52 percent of the respondents said outsourcing providers are lacking in knowledge, 47 percent of respondents said outsourcing providers are non-responsive, and 35 percent of respondents said outsourcing providers have low performance standards. Therefore, not every organisation will have success when outsourcing their HR activities. An example of an organisation disappointed with the decision to outsource is the case study of British Telecom and Accenture's ePeopleServe, provided by

Robinson and Kalakota (2004). Accenture, a leading outsourcing provider, provides outsourcing HR services to many organisations. ePeopleServe is one of the many services provided by Accenture. On the other hand, British Telecom (BT) is one of the world leaders in communication services, operating in Europe, America, and Asia. ePeopleServe was outsourced by Accenture for \$75 million to BT. For unknown reasons, this outsourcing effort cost BT dearly, having to pay up to \$5 million for additional costs, totalling \$80 million. As a result, BT concluded that this additional cost was unacceptable. Robinson and Kalakota (2004) comment that there are many hidden costs behind the outsourcing agreement which organisations might not be able to control. These include expenditure for upgrading the system due to the rapid improvement in computer reliability and functionality, expenditure for training costs due to a lack of skilled employees, and the expenditure for incomplete projects due to the inability of some outsourcing providers to effectively transfer their knowledge.

Hence, outsourcing HR functions may not be the best pathway to cost savings, especially if effective HR activities in the organisation already exist (Marquez, 2007a). Marquez (2007b) provides an example of an organisation that invested their budget in building self service benefits, and related internal activities.

As a result, HR costs were decreased by 11 percent. Marquez also suggested that while HR outsourcing might be the best option for many organisations, it is better if organisations try to develop their own HR activities before going for HR outsourcing trends. Thus, it could be said that the investment in internal HR activities could bring a cost saving benefit to organisation as well (Thomas D., 2005).

Research also reveals that there may not be an issue if outsourcing HR functions are linked to mechanical processes such as payroll, but problems could arise when organisations outsource HR functions related to employees (Kessler, Shapiro &

Purcell, 1999). According to research conducted by Kessler et al. (1999), organisations may face serious obstacles when outsourcing HR activities if adequate attention is not paid to the remaining HR employees. Outsourcing can produce negative feelings in employees that remain in-house (Kakabadse & Kakabadse, 2000), and these feelings can impact on organisational culture. There is some evidence to suggest that in-house employees may suffer from job insecurity, decreased productivity, decreased employee morale, decreased employee loyalty, increased absenteeism, and increased employee turnover (Kakabadse & Kakabadse, 2000; Labib & Abbelbaum, 1993). Not only that, if not managed well, outsourcing HR can result in interpersonal and group conflict between the external and internal employee groups (Grauman & Paul, 2005).

Research conducted by Grauman and Paul (2005) shows that outsourcing HR activities can also increase the risk of losing confidential information; including reports, audit trails, and personal data. Domberger (1998) believes that in-house knowledge and skills could also be lost. Furthermore, Domberger cites that, similar to the issue of lost in-house knowledge and skills, is the issue of lost organisational innovation and knowledge when outsourcing occurs. Research has also shown that organisations may have to face decreasing organisational productivities, as a consequence of this loss of employee skills and knowledge (Berry, 2005; King, 2004).

In addition to this, organisations may experience a loss of control over HR activities if they introduce outsourcing (Domberger, 1998; Marquez, 2007b). This is affected by the quality of HR provider and the service agreement that exists between the provider and the organisation (Grauman & Paul, 2005).

One could speculate that in order to determine if outsourcing HR functions is a good idea, the dependencies on many situations of each organisation, including employee attitudes, should be considered. There is some evidence showing that employee perspectives, including attitudes and behaviour, play a significant role in organisational decision making to determine whether or not to outsource (Kessler, Shapiro & Purcell, 1999).

Mehlman (2003) postulates that outsourcing can also impact on an organisation at a macro level. For instance, when organisations consider outsourcing their activities to other countries, it may lead to many problems, including community disruption, unexpected lay-offs, and displaced professionals in the home country. These problems occur because the home country is at a permanent cost disadvantage when compared with other places like China, India, Russia and Eastern Europe, where HR costs are low. If organisations shift their plants or industries to low-cost counties, significant economic flow-on effects which include an increase in the unemployment rate and a decrease in the skills of the available workforce in the long term may occur.

Failure to realise cost savings because of hidden costs, poor service and lack of responsiveness by outsourcing providers emerge as a result of an ineffective outsourcing relationship.

## **Conclusion:**

The results of this study created a valuable finding that shows an understanding of the impact of outsourcing HR activities in organisation. The finding pointed out that there were many factors that affect the decision to outsource the HR function. However, the finding suggested that these factors must produce a higher competitive advantage, and employee perspectives should be watched closely by organisations when they are deciding to outsource the HR function.

Moreover, the results suggest that organisations should (1) establish effective communication across all levels of the organisation; (2) be aware of knowledge perspective issues, especially internal knowledge, provider knowledge and knowledge transferring; and (3) involve employees in the phases of the outsourcing HR process if HRO is to be considered a successful strategy.

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