

# Executive Brief: HR Outsourcing Becomes Strategic

## Times Have Changed

Managing a business has changed fundamentally during the past five years. The overall objectives are the same: attaining profitability and growth, building shareholder value and other similar goals are foundational requirements for most companies, large and small. What has changed is the business environment: the climate in which executives must manage, the parameters within which they must work and the criteria on which they are judged by their Boards of Directors and shareholders, have all become much more constraining and demanding. Adding to these pressures are increased data integrity and reporting requirements, such as the recently passed Sarbanes-Oxley Act, that make individuals as well as corporations legally accountable in ways they never were before.

Business as usual won't do anymore.

Executives are being asked to manage their companies much more closely, to do more with less, to meet their growth and profitability commitments predictably. From the CEO on down this means a shift in priorities and focus. Traditional responsibilities must now co-exist with the increased demands for efficiency, profitability and accountability. Corporate officers must find ways of redefining and restructuring their operations to achieve traditional objectives more efficiently and effectively, while focusing more time on the strategic issues central to the organization's survival and growth.

These trends are well documented in the business and trade press. They've made headlines as major corporations are wracked by the sea change of reform required to affect the fundamental behavior of large organizations, such as those in the Fortune 1000. Less well-documented, but just as dramatic, are the ways these trends affect small and medium-sized companies. Executives in medium-sized firms face additional challenges, however. Unlike their counterparts in larger organizations, executives in mid-sized companies (companies with more than 500 employees, but less than 10,000) must meet the same challenges with fewer resources and strategic alternatives.

The common trends running through mid-sized companies today can be easily recognized:



- Every budget dollar spent is evaluated time and again to ensure it contributed value to the corporation;
- Every process, no matter how simple or complex, is being evaluated for necessity, efficiency and effectiveness;
- Every piece of technology, installed or proposed, must support core functions
- Each employee position is judged on its required return to the organization;
- Virtually every investment is evaluated on whether it will contribute to the bottom line during the current budget year;
- Every strategy must focus on the core business and its profitability;
- Core business processes are being continuously refined;
- Many traditional but non-critical business processes are being eliminated; and
- Required non-core functions, such as payroll processing, are routinely considered as candidates for outsourcing to other organizations that can execute the processes better and less expensively than internal resources.

The impact of these new imperatives doesn't affect just the Chief Operating Officer. CEO's are looking to their key managers to assume part of the burden, to become strategic partners in the quest to restructure the business to survive and prosper. Key officers, such as the CFO, the CIO, and others are being asked to restructure their organizations and duties. The focus is on spending less time on functions that are required, but don't add value to the corporation's core business, and investing more time and energy on those functions strategic to the corporation's core mission. After years of consultant's scrutiny, internal audits and cost-

cutting, there aren't many functions left that can be eliminated outright without affecting the basic performance of the company.

### **BPO Offers a Strategic Alternative**

Many firms are finding that even trimming budgets and restructuring departments can't deliver the savings and performance improvements required to meet the new business imperatives. One solution seems to be a viable alternative for managing virtually any critical, non-core function: business process outsourcing (BPO). Outsourcing, or subcontracting responsibility for completing certain business functions, has been a fact of corporate life for a number of years. Traditionally, corporations have outsourced individual business functions, such as computer hardware infrastructure or payroll processing. With the pressure to refocus and restructure without degrading the service levels of critical functions, corporations are outsourcing responsibility for entire business processes. In many cases, only a small monitoring function remains within the corporation.

Several key trends in business process outsourcing are emerging:

- Most if not all transaction-intensive, back-office functions have already been or will shortly be outsourced, if the corporation is to remain competitive.
- Most all BPO is transactional or administrative functions, which others can do better and cheaper due to economies of scale and focus.
- The trend toward outsourcing non-core functions is critical to refocus the precious skills and resources of the business on its central mission.

Massive business process outsourcing contracts have been the stuff of business news for a number of years. Fortune 50 firms have negotiated multi-year, multi-billion dollar contracts with major service providers such as Accenture, IBM and EDS, to name a few. HRO TODAY recently published a list of 34 HR BPO client / vendor relationships, with the employee bases of these companies ranging from 900 to 300,000. These clients are signing these agreements to save much needed costs and resources, and to protect the

bottom line in the midst of a struggling economic recovery. The projected financial savings and ability to focus on core functions are luring one Fortune 500 firm after another into BPO agreements. However, the sheer scope and magnitude of these contracts has created a belief that outsourcing only makes sense for huge, multinational corporations.

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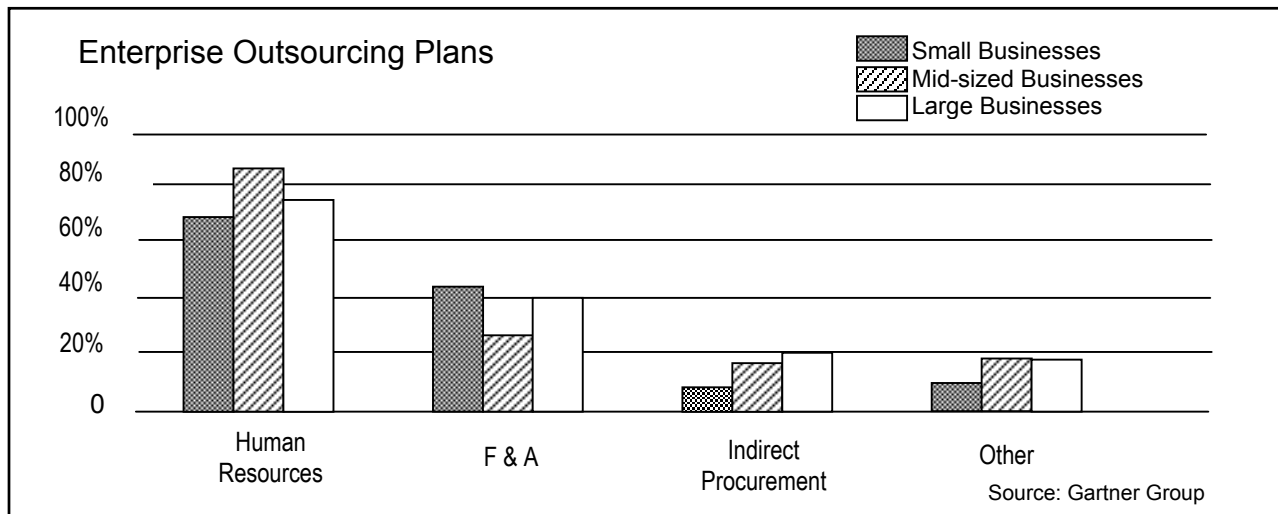
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Recent studies by Gartner Group and other analyst organizations are showing this perception couldn't be further from the truth. According to Gartner Group, a February 2003 survey indicated that 73% of mid-sized firms outsource some portion of their enterprise business functions. Of the respondents that do outsource at least one function, 89% say they use payroll outsourcing service bureaus. More important, 25% of mid-market firms also indicate they already use BPO services, such as financial and accounting services, HR or tax management.

This is a significant change from recent years, when comprehensive outsourcing was considered a viable choice only for the largest companies. In fact, most studies and firms offering outsourcing services believe the growth in mid-market demand for business process outsourcing will grow more rapidly than any other segment of the market during the next few years.

Examples of the growth abound. Although about 43% of mid-sized firms currently outsource some of their training and education functions, 89% indicate they will do so by 2005. Likewise, only 7% of mid-tier firms use accounts payable services today, but more than 20% say they will do so within two years. And in the U.S. alone, end-to-end HR BPO is expected to triple by 2006, from 2002 reported billings.



## Why Consider BPO?

For years, outsourcing's singular purpose was to achieve cost savings in transaction-intensive, back-office business functions. Today, BPO has emerged as a flexible and powerful alternative that business leaders can use to achieve a wide range of more strategic goals:

- **Drive Corporate Value** - craft an outsourcing relationship that specifically meets the corporation's needs, gaining access to technology and unique expertise immediately, at a fraction of the cost and time required to bring in-house.
- **Competitive Superiority** – transform average business processes into world-class capabilities, increasing business disciplines through standardization, centralization, and new technology.
- **Simplified Operations Management** – improve information flow to management, while streamlining the numerous business processes into a more efficient few.
- **Renewed Investment in the Core Business** – lower recurring costs significantly, redirecting savings to more strategic aims.
- **Guaranteed data integrity** – meet regulatory requirements to guarantee the integrity of employee data.
- **Reduced Capital Expenditures** – Convert upcoming, planned capital expenditures to period operating expenses.
- **Revived Management Focus** – redirect management time toward strategic initiatives that focus on the real profit drivers of a company, outsourcing repetitive operational processes.
- **Managed Growth** – handle business fluctuations, support acquisitions and divestitures, stimulating company growth by achieving unique, competitive capabilities.

- **Accelerated Time to Market** – launch new businesses, fully operational with state-of-the-art capabilities in weeks rather than months.
- **Improved Integration** – reduce the number of outsourcing vendors, asking a single provider to handle multiple processes, simplifying relationships and improving integration.
- **Enhanced Efficiencies** – share service centers, extending the operational boundaries of the company to utilize less expensive labor and increase efficiencies.
- **Improved Service Levels**– accelerate technology roll out, beyond what any company could achieve by itself. Outsourcing applications that run on the Web offers the benefits of self-service processes for customers, vendors, and employees.

Business process outsourcing is becoming a standard strategy for mid-sized companies. A study completed by The Conference Board in early 2003 concludes that some two-thirds of larger companies use outsourcing, while

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even more mid-sized companies do. The next logical step is for more mid-sized companies to embrace BPO services, like many larger companies have.

The market is recognizing this trend and is converging on BPO as the solution. Realizing that many technology initiatives have failed, and the ones that have not failed cost too much, software vendors have been trying to perfect their business models for some time. Other software vendors are moving toward service provider models altogether.

Traditional, niche oriented service providers (such as payroll services) are realizing that they must expand their services offerings to remain competitive. Outsourcing a single function is rapidly moving toward outsourcing an integrated set of business processes. A single source provider that can deliver solutions across multiple business functions can service the client better and cheaper than several niche vendors, due to economies of scale.

## **Human Resources: A Prime Candidate for Outsourcing**

When the various functions within the organization are evaluated as candidates for outsourcing, many critical, non-core functions seem to be viable alternatives. Yet studies show that many firms are focusing on outsourcing human resources functions as their primary initiative.

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### **“Midsize companies with mediocre HR departments can ascend to world class HR levels...”**

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According to a report dated Spring 2003, The Outsourcing Institute takes the conclusion one step farther, pointing out that tactical human resources processes lead the list of most common outsourcing initiatives.

The Outsourcing Institute report quotes Professor Ed Lawler, distinguished professor of business at the Marshall School of Business at the University of California at Los Angeles: “. “Most midsize companies don't have competency in the administrative and transactional activities that go on in HR,” he said. “Outsourcing to a company whose specialty is payroll, employee training or benefits administration, one that has state-of-the-art technology and up-to-the-minute awareness of changing laws, process advancements and best practices, is a viable, cost-effective alternative. Midsize companies with mediocre HR departments can ascend to world class HR levels.”

Human Resources Business Process Outsourcing (HR BPO) is a logical extension of the trend toward outsourcing and the inclination of companies to delegate individual functions. In HR BPO, the company outsources complete responsibility for an integrated set of functions such as Benefits Administration, Payroll Management and general Human Resources Administration to a third party.

In deciding to outsource HR functions, most companies choose to outsource the tactical, transaction-related activities while keeping strategic functions in-house. These tactical activities include functions such as payroll

processing, human resources administration (adding and terminating employees and the like) and benefits administration. These functions affect the performance of virtually every part of the company and consume a tremendous amount of the HR department's time and energy. Many companies report that these transaction-oriented tasks require more than 80% of the HR staff's time. Likewise, implementing the systems to support these functions is complicated, time-consuming and expensive. Once implemented, maintaining HRIS systems over their expected life cycle can approach or exceed the cost of the original implementation. This on-going investment translates directly into the first compelling argument for HR BPO: most companies can achieve immediate, significant cost savings compared with the processes they're employing now.

A strong second argument focuses on the alternatives available to companies wanting to use their HR infrastructure as a contributor to the strategic missions of the company. Since traditional approaches to decreasing costs, improving data accuracy and enhancing employee service have had limited effect, shifting many functions to employee self-service has proven to be the answer for many companies. Internet-driven portals shift responsibility and control directly to the end-user, the employees and managers. Some benefit can be achieved by providing self-service capabilities in-house, although the cost of the IT and HR resources consumed to make the services available can offset much of the cost benefit.

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### **(With HR BPO)...”most companies can achieve immediate, significant cost savings compared with the processes they're employing now.”**

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In considering web self-service as a strategic HR alternative, companies must consider four alternatives:

1. Convert your present in-house HRIS system to its new web-based capabilities by upgrading to its latest release, if the vendor provides such capabilities. Be prepared for the budget and staffing costs and resource requirements to implement and sustain the system through numerous upgrades and versions of the system, until it is stable.
2. Build your own internal, proprietary HR self-service capability through your IT staff. IT will love that (if they are not already overloaded with projects), but again, be prepared for the budget and completion date overruns.
3. Continue to outsource HR functions piecemeal, requiring employees to use multiple solutions to meet their HR self-service needs. Be prepared for

frustrated employees, non-integrated information and the cost and staffs required to manage multiple vendors.

4. Consider outsourcing the web self-service function as part of an overall HR BPO partnership. Be prepared to carefully evaluate the vendor's capabilities to meet your detailed requirements.

The better providers of HR BPO include outstanding web self-service with their solutions both to better serve employees and to better leverage the provider's expertise.

## What is Comprehensive Business Process Outsourcing?

While many outsourcing initiatives focus on specific business functions, some providers are trying to help their clients achieve more broad-reaching benefits. By carrying BPO to its next logical step, a company can outsource not single functions, but entire business processes and the overall responsibility for managing them. In these cases, the outsourcing provider becomes a strategic partner and the client provides only guidance and oversight of the provider's activities.

Human Resources is a logical candidate for comprehensive BPO. It's generally accepted that Human Resource departments provide 22 standard services to the

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### Typical Mid-Market HR BPO Services

#### Administrative Services

- Comprehensive Payroll
- HR Management
- Benefits Administration
- Workers' Compensation Administration

#### HR Technology

- Comprehensive HRIS Applications, extended to the Web
- Technology Hosting Services
- Application and Technology Management Services

#### HR Professional Support

- HR BPO Transition Services
  - HR Operational Service Centers
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corporation, some of them strategic (they contribute to the central mission of the company), and some of them tactical (they don't contribute to the central mission, but they're necessary to carry on business day-to-day). In comprehensive HR BPO, the provider assumes responsibility for most, if not all, of the tactical, back office HR functions because these are transaction intensive and can consume as much as 80 percent of the

time and energy of an HR department. Of the total list of 22 functions, eleven are tactical, back office functions: compensation, benefits, payroll, time and expense reimbursement, employee data and records management, HRIT/HRIS, employee and manager self-service, workforce analytics, expatriate administration, domestic relocation and policy and legal compliance.

Generally speaking, comprehensive BPO relationships require a closer partnership between vendor and client and tend to extend for a number of years, sometimes as long as ten years. Characteristic of these relationships is an overriding concern that the arrangement be collaborative, that both partners achieve significant benefits from the deal.

## Who Provides Comprehensive HR BPO?

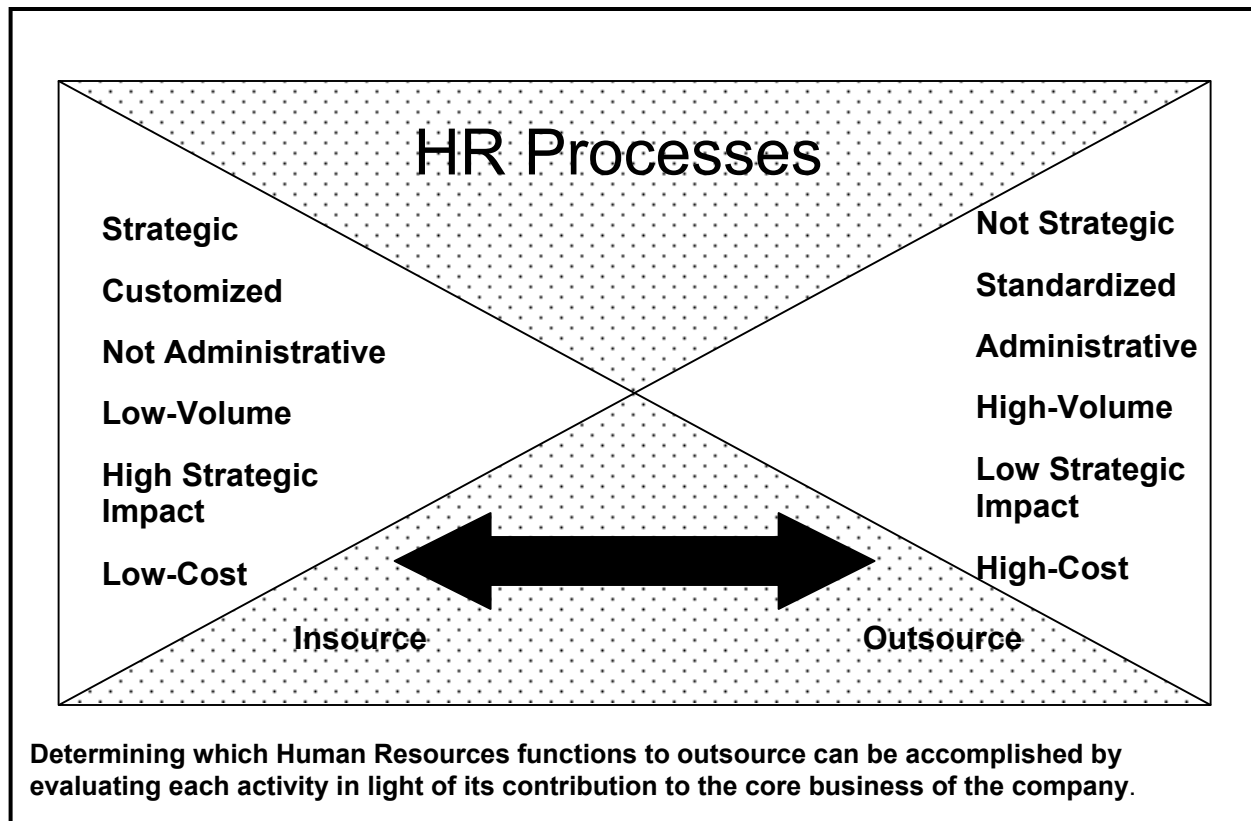
Many of the traditional providers in the outsourcing space are realigning themselves to take advantage of a huge new market swing toward HR BPO. They include:

**Traditional HR Outsourcing service providers.** Many providers of traditionally discrete HRO services, such as payroll processing and benefits administration, are attempting to add services and shift their marketing and sales efforts to emphasize their breadth of services across the spectrum of HR needs. These traditional HR outsourcers leverage their strengths in HR process expertise, management, and quality to offer new, related services to, and capture more business processes in, their current customers.

**HR and IT consulting firms.** A number of consulting firms are expanding beyond their core project-based work and seeking to leverage their business process and technology expertise to deliver HR BPO services.

**IT outsourcing firms.** Some IT outsourcing firms are evolving from IT outsourcing to BPO. Traditional IT outsourcing firms expect year-over-year growth to slow to single digits, largely because of the impact of the computing utility model eroding demand for broad, long-term engagements. As a result, IT outsourcers are attempting to shift from these commodity-like services to more value-based BPO services. These firms can leverage their strengths in IT infrastructure and process services, as well as their existing consulting and management expertise.

**Financial service providers are returning to HR Outsourcing.** Financial service providers are increasing their involvement in HRO services. HR BPO services can complement the strengths of financial firms, including financial and tax expertise, infrastructure to process financial transactions, favorable reputations, and strong client bases.



**Tier 1 PEOs are revising their target market and expanding their capabilities.** Professional employer organizations (PEOs) have provided outsourced HR departments to small companies long before the term BPO was coined. PEOs deliver co-employment services and administer payroll and benefits for clients. These firms are shifting their target markets from blue-collar markets, such as construction, to white-collar services markets. They also are expanding the scope of their services, making greater use of technology, and offering HR portals that enable self-service for timekeeping, payroll, and benefits. Strengths of these firms include strong client bases, HR expertise, and infrastructure to deliver payroll and benefits administration management services.

While most mid-tier companies are only considering “on-shore” providers like the ones characterized above, “near-shore” and “off-shore” solutions are options being considered by the larger firms. A company can deploy and manage these solutions internally, or contract with a provider to oversee “off-shore” outsourcing. Determining the value of the chosen solution is critical, and sometimes difficult for the mid-tier company possessing limited resources.

Which type of HR BPO provider is right for your company? The answer lies in your unique current and future requirements, the list of “must-haves” that define the services and capabilities your company needs in order

to provide the quality and level of service your employees have come to expect or that you want to attain in order to achieve your strategic objectives and to make your company more competitive. One rule of thumb is to begin by looking to firms that have experience in providing a wide range of transaction-oriented HR services to companies like yours. For the middle market company, a good place to start is with firms with a depth and breadth of HR service experience, such as those originating in the Tier 1 PEO market.

### **HR BPO Benefits Key Executives**

Outsourcing tactical human resources processes can be a key strategic initiative for a company wanting to focus its efforts on its core business. The role of each leading corporate executive is to drive some aspect of that strategy. For executives, BPO can be a valuable tool in achieving their specific strategic charter. Key executives who could benefit from HR BPO include:

**The Chief Executive Officer** leads the organization and focuses its people and resources on the central mission - profitability and increased shareholder value. CEO’s have the responsibility for setting corporate strategy and managing the company’s assets to achieve that strategy. For the CEO, HR outsourcing represents an important initiative to refocus the organization's limited resources on the core business.

**The Chief Operating Officer** executes the central mission of the company on a day-to-day basis, managing

tactics toward an agreed to strategy. For the COO, HR outsourcing is a means to refocus the HR department as an ally, gaining the strategic and tactical support the COO needs to execute the core business plan.

**The Chief Financial Officer** creates the corporate financial strategy, and manages all financial resources, maximizing corporate value. For the CFO, HR outsourcing represents a pure cost reduction initiative - getting HR transaction and administration functions accomplished more effectively, at a fraction of the cost to do them internally. Once in place, it provides resources to drive more strategic, profit and growth-oriented objectives. Like most key executives, CFOs say they spend far too much of their time managing activities that don't drive the strategic objectives of the business.

**The Chief Information Officer** drives corporate information technology strategy, and manages the mission critical corporate information and systems, thereby improving internal processes and their efficiencies. For the CIO, who must work with limited IT resources, HR outsourcing provides one means to focus limited IT personnel, skills and budget on the core business information systems.

**The key HR executive** creates the human resources strategy and executes the HR functional plan. HR BPO gives the human resources executive a vehicle for refocusing the HR staff on strategic activities. In turn, the HR department enhances its strategic value to the corporation, forming a closer alliance with the rest of the executive team.

## HR BPO Benefits The Corporation

Every organization is different, but the benefits achieved are fairly consistent from company to company. Among the benefits you may achieve are:

- Offload high-cost, low-value transactional processing
- Empower companies to focus on HR strategy and analysis (mission-critical functions)
- Decrease period operating costs
- Shift HR expenses to a predictable variable cost (improved cash management and risk reduction)
- Create a flexible HR BPO engagement model, tailored to your business requirements
- Centralize and standardize HR processes and fulfillment
- Increase flexibility to acquire or divest business units
- Reduce compliance costs and risks
- Gain access to advanced HR expertise without hiring
- Avoid technology administration and maintenance risk, effort and expense
- Reduce capital investment in HRIS or ERP implementations
- Enable employee and manager self-service
- Improve employee service and enhance employee satisfaction

Human Resources Business Process Outsourcing can be a key initiative to enable your company to refocus on those priorities and activities that truly add value to your business.

### About The BrightTrack Group

The BrightTrack Group provides sales, marketing and business development services, including market research and validation. You can contact BrightTrack at [info@brighttrackgroup.com](mailto:info@brighttrackgroup.com).