

# HR Outsourcing:

## The Value Proposition

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HR outsourcing (also known as HRO) is the process of sub-contracting human resources functions to an external supplier.

Reviews of business processes have led many organizations to decide that it makes business sense to sub-contract some or all non-core activities to specialist providers.

Administrative HR, as a non-profit center, is an obvious candidate for outsourcing.

There are many ways in which outsourcing human resources can be done:

1. Business process HR outsourcing (also known as BPO ), where an external supplier manages discrete HR activities, such as payroll administration or recruitment, or perhaps the whole human resources function.
2. Shared service HR outsourcing, where only the transaction or administrative elements of HR's activities are subcontracted to an external supplier. This may include the personal interface with employees.
3. Application (and facilities) service HR outsourcing, where external providers look after the technological (and physical ) infrastructure (HRIS) to support human resources activities.

Outsourcing the human resources function or some of its processes to an external provider is a major business decision that while it may be cost-effective, introduces new elements of risk, including:

1. Loss of control
2. Impact on the employer/employee relationship
3. Loss of flexibility
4. Failure to deliver cost benefits
5. Legal or regulatory requirements
6. Industrial relations issues

The operation of any HR outsourcing arrangement should be governed by a service level agreement (SLA). This will define the required standards of performance by both parties and any penalties for non-compliance. The (SLA) is a crucial document and must be negotiated with great care to mitigate the above risks.

People management plays a crucial role in delivering organizational performance. In today's modern, knowledge economy this is more true than ever before. The decision to outsource human resources is therefore not to be taken lightly. There are many circumstances in which outsourcing HR services can deliver tangible benefits to the organization, for example by freeing HR professionals to devote more time to a strategic role supporting organizational objectives and performance.

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A number of strategic drivers for outsourcing HR services are:

1. Reduced cost
2. Increased efficiency
3. Access to improved HRIS systems
4. Improved management information including human capital metrics
5. Access to HR expertise not available internally
6. Increased flexibility and speed of response
7. Reduced risk
8. To free HR resources to operate more strategically

There are potential pitfalls of HR outsourcing. These include:

1. Don't outsource what you don't understand. The HR outsource provider will only have to subsequently solve the problem (at a cost) and the provider's solution might not be most suitable from your organization's perspective.
2. HR outsourcing does not absolve the organization of good people management practices nor the overall responsibility for the provision of HR services.
3. Increasingly, HR outsourcing arrangements are often long term (three to ten year contracts are not unusual). An understanding of the organization's current and future business strategy and potential changes in the business (and hence risk) profile is important before entering into any contractual arrangement. This helps avoid being tied into unfavorable contractual arrangements.
4. Loss of local knowledge and processes which instead reside with the outsource provider
5. Standardization of processes in line with outsource provider rather than organizational preferences.
6. Traditionally, business process outsourcing is seen as a means of driving efficiency through cost reduction. While the financial business case is important and should always be understood, forward thinking organizations will consider other factors in addition to cost reduction, when evaluating and designing HRO solutions. HRO value can be considered to be a function of a number of interrelated factors. Different organizations will have different drivers and choices for each of these factors, resulting in different HRO value propositions. We can refer to this wider view as "balancing the HRO value equation", to provide the specific HRO value proposition that is right for each given organization.

HR Outsourcing Value = (Time Reallocation + Cost Reduction + HR Service Model + Business Flexibility + Retained HR)

The formula sets out the HRO value equation as a function of time reallocation, cost reduction, the HR service model, business flexibility, and the retained HR organization. This framework allows for the development and assessment of the benefit side of a business case for HR outsourcing, but also needs to recognize that these elements are interrelated, for example, the size of the retained HR organization will influence the overall cost reduction.

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Another major benefit of HRO is the service provider's ability to assist the client to achieve a desired future state for the HR function. HRO can provide extra capacity for acquisitions, entry into new geographic markets and the launch of new lines of business without the internal fixed cost.

The SBA estimates that it costs \$1,469.00 per year per employee to administer human resources in-house. For a lot of small to medium sized businesses (50 – 1,000 employees), that's too many resources taken away from innovation, marketing, new product development, sales or the onboarding of additional staff. According to a 2012 survey by the Society of Human Resources Management, the top three motivations for businesses to outsource HR are to access the skills and knowledge of a third party, to ensure quality and to reduce costs.

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