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HR Outsourcing for SMBs

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Successful HR Outsourcing Strategies

Internal Analysis and Baselining

It is impossible to determine whether value is being delivered by an outsourcing partner without first understanding the value delivered by internal resources. For this reason, companies must pay close attention to the full costs of and value delivered by their current operations. The most common factor for determining value of human resources (HR) departments is by examining headcount. By reducing headcount but maintaining productivity (a sign of increased efficiency), companies are able to exact greater value from their employees. However, there are additional factors to consider, such as attrition levels, employee morale, reduced litigation, and reductions in time-to-hire. Without understanding these factors, companies are unable to properly baseline in-house operations prior to shifting functions externally. Companies also need to factor in the expense of building and supporting in-house technology platforms and 24/7 benefits administration portals when considering whether to keep functions in-house or outsource them.

In looking at these factors, Linda Merritt, AT&T HR strategic planning director, states, "I advise people to think about not what you want on Day One but what do you want in Year Four, Year Five, Year Six—and think about how you're structuring the deal that will allow that to evolve or develop over time."[1] Echoing her advice, Robert Brown, Gartner analyst, remarks, "Before companies seek bids, they should quantify their current service levels and costs" (qtd. in Henneman). These quantifications are essential to understanding how to structure outsourcing deals to ensure that companies are not disappointed in subsequent years.

[1] Todd Henneman, "Measuring the True Benefit of Human Resources Outsourcing." *Workforce Management,* 2005.

Understanding Cost vs. Value of HR

Although employee morale, satisfaction, and turnover are some indicators of HR performance, researchers have a difficult time agreeing on the most important HR performance indicators. The reason is possibly because HR has historically been viewed as a department that does not add value in terms of competitive advantage to the company; therefore, one of the more popular measures of its performance has been cost reduction. The theory is that by outsourcing HR functions and lowering headcount, remaining employees can focus on the company's core business, driving greater efficiency and overall performance; however, it is obvious that there is value in human resources. The difficulty arises in how HR can contribute to the competitive advantage of a company—which begins with HR working alongside company executives to align corporate objectives to the skills, abilities, and motivations of personnel.

Identifying Core Competencies

The first priority in determining whether HR outsourcing (HRO) will help a company achieve competitive advantage is to outline the company's core competencies. By identifying those areas that define a company—without them, the company would have no advantage at all—executives can then isolate those areas as *core competencies*. Once those areas have been isolated, all other areas are possible avenues for outsourcing.

In addressing this strategy with me a couple of years ago, a CIO friend of mine, and 25+ year technology executive, stated that he considered all the operations within his department and wrote them on a page. He then drew a line between those that, if held in-house, would add value and competitive advantage to the organization and those that would not. Everything that fell below the in-house value line was outsourced to a provider that specialized in that area. This focus on core competencies is essential to small and midsize businesses (SMBs), which must always be mindful of the opportunity cost of their operations. By investing money into an operation that does not deliver competitive advantage, an SMB is wasting capital that could be better used elsewhere.

Aligning Technology to Support Operational Objectives

A growing reason for SMBs to outsource HR functions is the desire to leverage current HR information system (HRIS) technologies. Current platforms are expensive to roll out and maintain, and the window for technology obsolescence continues to shorten, making it impractical for SMBs to build these applications. For this reason, it is far more sensible for SMBs to leverage their vendor's platform, the expense of which is stretched across many clients (making it more affordable to the vendor). Furthermore, by using a vendor's technology, the SMBs are able to mitigate the risk of building such an application in-house.

The types of technologies available extend from simple payroll and benefits administration platforms to sophisticated dashboard/business intelligence tools that provide reporting metrics across the company. Of additional benefit to organizations are the HROs that utilize Software as a Service (SaaS)-based platforms that require minimal computing resources, are scalable across the enterprise, and can be delivered in as little as weeks—as opposed to years for in-house developed applications.[2] The company will quickly become reliant upon the vendor's technology (which may create a barrier to exit for the client company), so it is imperative that in reviewing potential vendors, an organization chooses a company that will be in business several years into the foreseeable future.

Agreeing on Expectations with HR Outsourcer

Engaging vendors in technology discussions over upcoming years might seem a little outside the immediate needs of a company; however, it is important that executives understand what types of technologies are offered by potential vendors, the costs associated with those technologies—both in terms of external fees for technology and support and for internal maintenance (hardware/storage requirements)—and the vendor's future technology planning. If the company's data will be housed externally, the executives of the firm must feel confident that the HRO partner has plans to address obsolescence, upgrades, governance, business continuity, and security. These expectations must be discussed early with vendors so that both parties have a clear view of what is being offered and what is being requested.

Similar to technology discussions, all stakeholders of the organization need to have input into the HRO discussion to ensure that all parties agree upon a set of achievable objectives that can then be passed on to the vendor. Once expectations are clear and the deal is finalized, it is important that periodically the vendor's performance is reviewed and matched against expectations, and measures are taken to bring performance in line with expectations.

Addressing Performance Metrics

In addition to addressing technology concerns, SMB executives need to lay out expectations for delivery of all functions. These metrics can be as simple as response policies that lay out how quickly a firm returns a call to time-to-fill ratios for recruiting and selection. Increased employee morale as seen by decreased attrition levels (employee relations) and increased job performance through training are additional metrics that can be used to determine delivery of objectives.

[2] Fenil Shah, "The New Era of Outsourcing Why Web-Based Human Resources has Come of Age," *Workspan*, 2006.

After understanding business needs, determining future strategies, and having examined the costs and benefits of keeping HR functions internal, savvy executives should consider the performance metrics they will establish with their service provider. One of the benefits of outsourcing HR can be access to business intelligence technology that would be otherwise unavailable to a small business, making it critical for metrics to be considered closely and agreed upon as part of negotiation. In "Measuring the True Benefit of Human Resources Outsourcing," Todd Henneman notes that by mutual agreement of metrics, which can include “data on cost per person…accuracy of work, timeliness and customer satisfaction,” both parties will have an understanding of expectations, which will create a stronger, more successful partnership. (Henneman was paraphrasing Larry Kurzner, senior VP with Aon.)

By mutual agreement of metrics—which can include data on cost per person, accuracy of work, timeliness, and customer satisfaction—both parties will have an understanding of expectations, which will result in a stronger, more successful partnership. After all, the closer the vendor comes to being a trusted advisor, the closer the organization will be to having third-party services feel more like they’re being handled in-house—without the hassles of overhead or compliance.

Enforcing Performance Metrics

Once companies have invested the time and energy into understanding the baseline performance metrics of in-house functions, they can identify achievable objectives and the coordinating metrics with their HRO partner. Once those metrics have been verbally agreed upon, it is important to have expectations and penalties stated within the outsourcing agreements. Outsourcing can be expensive both in terms of time and capital, so it’s imperative that all parties agree upon what will be measured and how, in addition to when and how often the measurements will be taken. SMBs want to feel that they have security that their expectations will be realized, and vendors want to show their clients how they are meeting and exceeding objectives. For this reason, all objectives and penalties for non-performance should be clearly stated in the outsourcing agreement. Although it is assumed that the person in charge of the HRO initiative maintains consistent communication with the vendor, regular reviews of the expectations compared against performance should happen at a minimum on a quarterly basis to address any issues early on and give the vendor time to fix any problems.

Methods for Shifting HR Functions Outside Company

Once the company has agreed upon its HRO policy and secured its preferred vendor, the process of shifting the functions externally begins. In the case of small companies, it can be as simple as a CFO happily turning the HR reigns over to the vendor and refocusing his or her time on finance and accounting measures. In the case of midsize companies, the roll out can be more complicated.

Midsize companies have more employees, some of which might be HR staff. These companies have a tendency to outsource functions that were previously completed by staff. This situation can oftentimes result in layoffs of non-essential employees and promotion of those deemed key players into more strategic roles. Unfortunately, as recent research has shown, too few of these employees are able to make the transition to strategist and advisor. If part of a company's strategy is to focus on getting higher value out of HR personnel who were previously performing traditional or transactional functions, it is imperative that the company provide extensive training and continued support to prepare the employees for the new role.

Realignment of Internal Staff to Transformational Functions

In addressing the difficulties of post-outsourcing with internal HR staff, Samuel Borgese, CIO of Catalina Restaurants remarked, "It's a question of whether the HR executive wants control or wants what is best for the organization. The HR executive has to look at the business intelligence and constant process improvement that can be achieved, and at his or her goals and responsibilities within the executive team."[3] For any person, being promoted into a new role carries with it excitement as well as anxiety—particularly when a staff member has previously been involved with the business but not considered a key, strategic member of executive decision-making. This evolution can be a difficult one that can only be resolved through extensive, continuous training and education.

Support through Training/Additional Education

The transition to HRO can be difficult on HR staff, making it critical that sufficient time, training, and education are given to foster their growth into higher-value activities. In Jean Woodall et al., "Making the Decision to Outsource Human Resources," an HR director of a surveyed telecom company observed, "HR staff needs to be up-skilled to work as HR Business Partners and form part of the leadership team."[4] Two other organizations surveyed (one a county council and the other a finance company) stated that, since outsourcing, their key HR staff had moved into change management, consultancy, "learning, management development, and governance and standards" roles. The results were mixed, however, with some respondents indicating that personnel were actually less skilled in their new role and that the quality of strategic insight or consultancy skills was lacking. For this reason, companies should look closely at the personnel they want to elevate into change agent roles, and provide adequate training and support for those staff members. Otherwise, companies might be better off outsourcing the transformational function to a company specializing in these higher-value operations (some of whom have the titles of "HR consultant" or "human capital management consultant").

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[3] Fay Hansen, "Special Report: Midmarket Outsourcing," *Workforce Management,* 2007.
[4] Jean Woodall et al., "Making the Decision to Outsource Human Resources," *Personnel Review,* 2009.

Top Ten Recommendations for HRO

Before a company engages in HRO, it should have:

- Identified how outsourcing fits with strategic objectives
- Agreed which core strategic competencies must be kept in-house and what can safely be outsourced
- Identified a complete view of internal HR service delivery costs, the main cost drivers, and the potential savings and investment
- Assessed internal outsourcing and explored how shared services might deliver the same benefits but with greater retained control
- Identified the technological challenges and solutions around outsourcing—have the costs of running and retiring legacy systems been calculated accurately, for example?
- Developed a clear view of the capabilities and reputation of each of the main outsourcing providers
- Standardized and simplified processes and procedures prior to considering outsourcing
- Discussed in detail the concept of outsourcing with customers (employees and business managers) and other key stakeholders in the company
- Defined the key success measures that will be used to judge the performance of the outsource provider and the structure of the deal
- Considered the history of the organization in terms of managing complex transition processes—is there the will to see an outsourcing initiative through to completion?

(Source: Corporate Research Forum, “Outsourcing the HR Function: Possibilities and Pitfalls”)

Conclusion

HRO is a complex industry with a broad spectrum of products and services that can be bundled or delivered a la carte, depending upon the individual needs of the company. Because of its complexity, potential risk, and requisite capital expenditures, HRO is not a practice to be engaged lightly. For a successful HRO endeavor, companies must be mindful of the value of and costs associated with their internal operations and understand the service levels provided by those in-house functions prior to entering into relationships with potential vendors. Although deals can be structured any number of ways to meet the unique needs of an individual company, the one area that cannot be overlooked is that of the client-vendor relationship. For SMBs considering outsourcing, particularly companies seeking to leverage the vendor’s platform, nothing is more important than creating a partnership built on trust, respect, and commitment to meeting a company’s organizational goals.