

# Taking the Pulse of Today's Human Resources Outsourcing Market

## Introduction

Transforming the human resources (HR) function to make it more strategic as well as more cost effective is a top agenda item for many HR executives and the corporate executives they support. Transformation's importance was borne out of a market study of North American HR management and executives that EquaTerra conducted in 2005. In that study respondents ranked "transforming" HR (i.e., enabling significant and sustainable improvement in the efficiency and effectiveness of core HR processes) a 4.2 on a one to five scale with one being not at all important and five being extremely important. While the value of HR transformation is self-evident, what is more complicated is how to define, enable and successfully drive that transformation.

One approach to enabling transformation that HR organizations have been increasingly undertaking is business process outsourcing (BPO). While outsourcing of single HR processes or sub-processes (e.g., payroll, benefits administration, training) has been occurring for years, what has been changing since 2000 is the scale and scope of the HR outsourcing efforts. Multi-process HR outsourcing or "HRO," often bundling five or more HR processes and sub-processes into a single outsourcing effort, is becoming more common in the market today.

HRO is still relatively immature when compared to information technology outsourcing or single process HR outsourcing. EquaTerra maps the birth of the multi-process HRO industry to the BP HRO deal with Exult in December of 1999 and tallies the number of HRO deals involving five or more process as approaching 100. EquaTerra also estimates that there are approximately 2.5 million employees being supported by HRO, with total contract value of these collective transactions exceeding \$15B. So while the HRO market numbers are large, total employees served or total number of HRO deals relative to the size of the G2000 organization market highlights there is much room for growth.

Organizations have also been actively deploying shared services (e.g., consolidating the management and delivery of core HR services to multiple departments or business units) as another means to improve HR efficiency and reduce operating costs. The use of HR shared services is much more commonplace than of HRO. EquaTerra research finds that nearly three quarters of G2000 organizations have deployed some level of HR shared services.

For many buyers, shared services are in interim step in the HRO continuum. Other buyers achieve enough value from HR shared services that they are able to defer HRO, at least for time being. The key point, however, is that buyers have many tools at their disposal to improve and transform HR, including the use of technology, shared services, selective outsourcing and HRO. Buyers must critically assess which option is the best one for specific situations, recognizing that most organizations will employ multiple HR delivery models over time. Buyers must avoid taking a one-size-fits-all approach to HR transformation or play follow-the-leader in HRO without adequately assessing opportunities in light of their own needs and requirements.

Expected ongoing HRO market growth is based on the premise that buyers are receiving value from their HRO efforts. The proverbial jury is out, however, as to whether HRO routinely delivers adequate value to those organizations that undertake it. There is some concern in the market that the value delivered is not enough given the cost and complexity inherent in larger HRO efforts. Some also question whether HRO service providers have the experience, skills and global reach to consistently and profitably deliver HRO services. So the question becomes: Is the HRO market going through normal growing pains or is it a flawed model and concept that buyers are best to avoid?

Against this backdrop, EquaTerra launched in late 2006 the HRO Buyer Pulse survey. The goal of this market study

is to assess the true state of the HRO market, including determining what is working and what is not, and where is the market going based on the experiences of buyers that are utilizing HRO today. EquaTerra maintains a positive opinion of HRO as a key means to improve and transform HR operations. It does recognize, however, that there is much room for improvement in successfully structuring, executing and managing HRO efforts.

The results presented in these findings are based on surveys of and interviews with North American HR executives and decision makers in more than 50 organizations actively involved in HRO efforts (see Appendix for respondent demographics). The study provides a buyer's perspective to EquaTerra's regular quarterly advisor and service provider Pulse surveys.

The study finds that buyers are indeed facing some challenges achieving the benefits they sought from outsourcing. This is not unexpected given HRO's complexity and the relative immaturity of the market. Interestingly, most organizations are not fully satisfied with the performance and costs of their internal HR organizations. HRO, in some cases, merely provides a new source to blame for HR operational shortcomings.

Overall, the study's findings are positive relative to the HRO industry's long term potential. Most current HRO buyers still have faith in the HRO concept but are seemingly less satisfied with their own current HRO efforts and service providers. If buyers surveyed could "do it again," most would still undertake HRO, albeit with more experience and often a different HRO service provider. While faith in HRO remains, there is still clearly room for improvement. The following details the complete results to date from this HRO market study.

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## HRO Market Penetration

Benefits administration and payroll were the two HR processes most frequently cited as outsourced among study respondents (see figure 1). More than 60 percent of respondents had outsourced or were actively outsourcing these processes. More than 10 percent of respondents had outsourced benefits administration for greater than 10 years. The collective sub-processes that make up organizational effectiveness (e.g., workforce and performance management, succession planning) were the least likely to have been outsourced.

### HRO Penetration and Current Deal Longevity

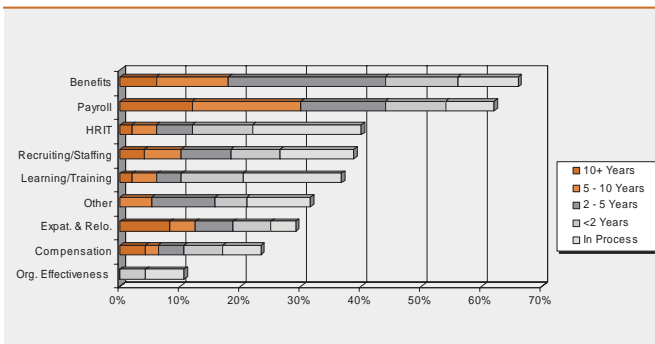


Figure 1

The degree to which a process was partially or more fully outsourced varied among organizations that had outsourced. Figure 2 illustrates the percentage of a specific process that respondents estimated had been outsourced.

### Percentage of Process Outsourced

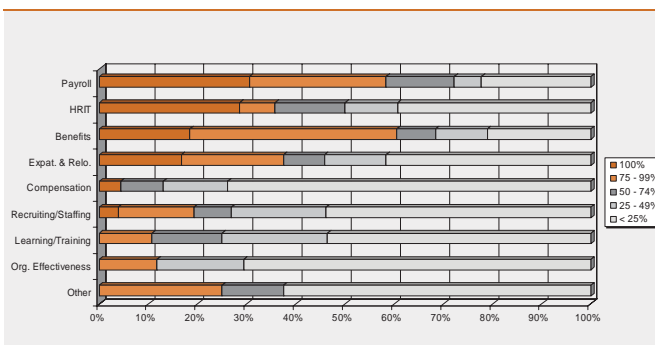


Figure 2

Payroll and HR Information Technology (HRIT) were the processes that respondents said they were most likely to fully outsource. Among respondents that had outsourced payroll, more than 70 percent had outsourced greater than 50 percent of payroll related activities. Benefits administration

was ranked second in terms of percentage outsourced. There was a general correlation between HR processes cited as having been outsourced and the amount of the processes that had been outsourced. The “other” processes cited in figure 2 include the following HR activities: COBRA, tax deferred annuities, EEO/AA case management and filings, immigration and unemployment related activities.

Respondents were also asked to what degree their HRO efforts were selected or comprehensive (see figure 3). In the context of this study, selective was defined as outsourcing an HR process individually while comprehensive was defined as outsourcing multiple HR process areas in a bundle.

### Selective vs. Comprehensive HRO

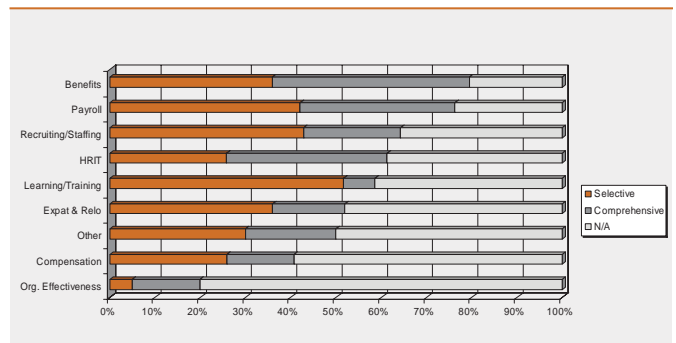


Figure 3

Learning and training was the process group most frequently selectively outsourced (and least often comprehensively outsourced), followed by recruiting and staffing activities and payroll. HRIT was cited most frequently and comprehensively outsourced followed by payroll.

### Selective vs. Comprehensive HRO (Only respondents that had outsourced the process)

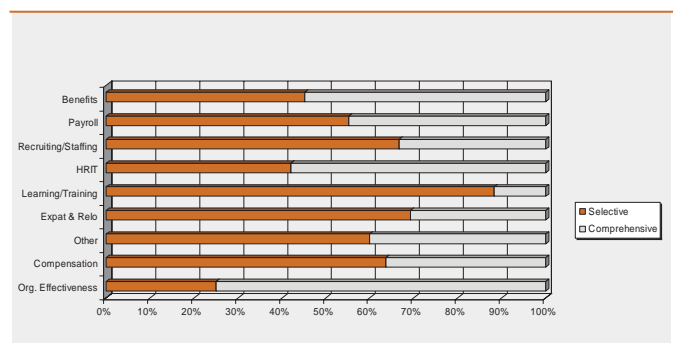


Figure 4

Figure 4 illustrates the mix of selective and comprehensive outsourcing among those respondents that had outsourced a particular process. Similar to the findings illustrated in figure 3, learning and training was rarely comprehensively outsourced while interestingly, the few firms that had outsourced organizational effectiveness had done so more comprehensively. The sample size for respondents that had outsourced organizational effectiveness was small, however, making this finding more directional than statistically significant.

Overall the market study found that buyers are outsourcing a wide range of HR processes. This included more routine and transactional processes like payroll and benefits administration. The study also shows that buyers are outsourcing more strategic activities like learning and training and occasionally even organizational effectiveness related activities. Buyers considering HRO should assess each of these process areas for outsourcing applicability within the context of their own organization and HR improvement needs.

### HRO Benefits Sought and Achieved

There are a variety of reasons why organizations undertake HRO. Reducing HR costs is a common goal but as with other types of BPO efforts, cost savings are typically one of a several benefits buyers seek to gain from outsourcing. Cost savings are expected, along with various forms of HR process improvement and transformation. Figure 5 illustrates how respondents ranked the various potential benefits they were seeking through their HRO efforts. They were asked to rank the nine potential benefits in order, with one being the highest ranking/most important benefit sought and nine the lowest.

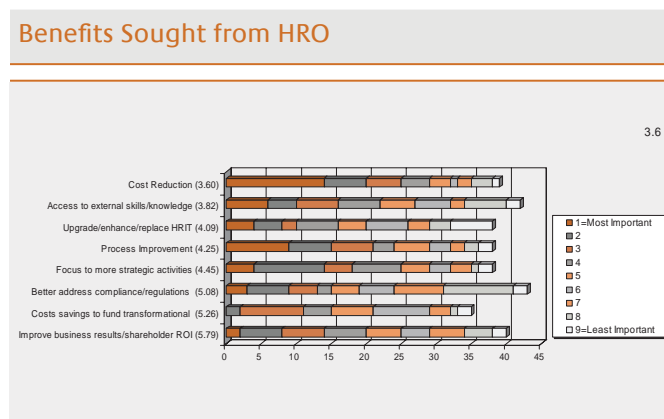


Figure 5

Not surprisingly, cost reduction was most frequently cited as the leading benefit sought with an average ranking of 3.6 on the one to nine scale (with nine being the number of benefits listed in the question). Cost reduction was followed closely, however, by gaining access to external skills and knowledge. The importance placed on this benefit highlights that HRO success will prove difficult to achieve by simply shifting HR work to a service provider with resources in lower cost markets or that has been able to lower costs via economies of scale unless they can pair that scale with proven HR knowledge and expertise. Interestingly, using cost savings to fund process improvement and transformation efforts fell near the bottom of the rankings, despite the fact HR process improvement itself scored higher and also garnered the second most number one rankings. Using cost savings to fund transformation is a benefit EquaTerra has seen ranking higher in other BPO market studies. EquaTerra interprets the lower ranking in this study as somewhat of an exception to the norm, as well as a stronger focus on pure cost savings as opposed to using those savings for other purposes.

Improving business results or shareholder ROI ranked last with an average ranking of 5.8 on the one to nine scale. This is a not an uncommon finding in HRO, especially relative to FAO which normally ranks this benefit higher. While in some respects directly tying HRO benefits to business results is difficult, given the obvious importance of staffing and talent to an organization’s performance, poor HR capabilities can prove a debilitating condition.

There was also an additional question on how important the goal of gaining a global and comprehensive view of HR data via improvements to HRIT applications and systems. A few respondents from larger organizations did indicate this was an important benefit sought, but for the most part it was not a high priority or as high as simply first getting better access to HR data on a country or regional basis.

The key test of HRO success is the degree to which its users have achieved the benefits they sought from its implementation. Data in figure 6 highlights missed expectations respondents set out to achieve through HRO initiatives.

## Success in Achieving HRO Benefits

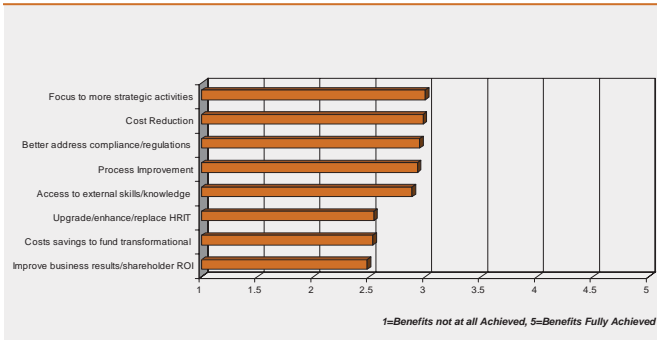


Figure 6

Figure 6 also illustrates the mixed results respondents had in achieving the benefits they sought from HRO. On a one to five scale, with one being benefits not achieved and five being benefits fully achieved, no benefits scored a ranking greater than 3.0. HRO’s ability to enable a shift in focus to more strategic activities and its ability to reduce costs, the leading benefit sought, rank the highest in terms of benefits being achieved. Results for all benefits were clustered between 2.5 and 3.0.

While HRO success levels show a need for improvement, it is important to compare the level of benefits achieved via HRO with pre-outsourcing HR performance and cost levels. The reason most organizations have undertaken HRO is to address problems that existed in pre-outsourced HR operations. An earlier EquaTerra market study on HR transformation found that buyers also gave internal HR mixed reviews in terms of satisfaction levels.

That study of more than 500 North American HR executives and management found that satisfaction with HR “people and processes” score a 3.4 on a one to five scale, with one being extremely unsatisfied and five being extremely satisfied. It is important to note that in these findings HR management was rating its own HR operations, and there is likely some natural positive inflation of satisfaction levels. HRIT applications and systems scored 2.9 on the same one to five scale. This middling rating for IT was registered despite the fact that more than 55 percent of study respondents had already undertaken efforts to upgrade and improve HRIT. So while there is room for improvement in terms of achieving HRO benefits, many buyers also see room for improvement in their internal HR operations, especially HRIT.

HRO buyers in the Pulse study did not lay all of the blame for not achieving HRO benefits at the feet of their service providers. Figure 7 illustrates where respondents placed responsibility for both HRO benefits achieved and sources of problems.

## HRO Benefits & Problems - Who’s Responsible

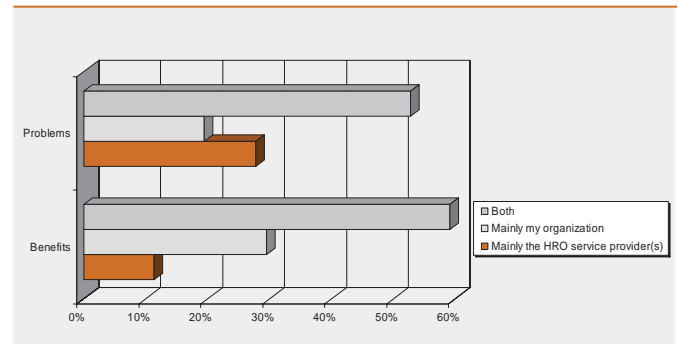


Figure 7

Over half of respondents felt that their organization and their HRO service provider(s) should share the responsibility for HRO successes and problems. Buyers noted, for example, that in some cases prior to outsourcing that they did not have good visibility into their HR process performance and cost levels and therefore had unrealistic expectations about what HRO could achieve, especially in the short run. Buyers were more likely to give credit to their organizations for benefits gained and somewhat more likely to point the finger at the service provider for problems experienced.

Commenting on specific benefits that HRO had delivered, respondents often specifically cited gaining cost savings, accessing external expertise and being able to shift focus to more strategic work. As one buyer stated, “[Because of outsourcing, we] have had time to implement better performance management programs and not spending time on transactional activities has brought us to the board room table more often.”

Another respondent provided this example of where HRO had benefited an organization change effort. “During a recent change in ownership we were able to take on processing for an additional six companies using existing processes, systems, and staff, saving the total organization close to \$500K per year. Time to implement was measured in [just] weeks.”

When commenting on why benefits had not been achieved and what were some of the disappointments in their HRO efforts, respondents consistently cited high cost levels and additional unexpected costs or charges for services. Also noted was a lack of innovation and anticipated process improvement and transformation. Buyers were also often disappointed with the HRO service provider's IT applications and systems, particularly the reality of those capabilities compared to what had been advertised during the sourcing process.

HRO buyers noted several challenges related to running their own retained HR organization and with their overall outsourcing management and governance efforts. Challenges with governance was identified as one of the key causes of unachieved benefits, at least where the buyer bore some of the blame. As one respondent noted, "No matter who is doing the outsourced work, they need to be carefully managed. Unfortunately, over time, the individuals who have the knowledge of the now outsourced task will turn over and the knowledge needed to ensure that all tasks are carefully done will not be replaced."

Other respondents offered the following comments on the retained organization and governance:

- "The biggest challenge is coordination between insourced processes and outsourced process and making sure everyone understands when one impacts the other."
- "[The biggest challenge with governance is] being willing to give up work, i.e., to transform from being transaction processors to working strategically."
- "Training new employees on tasks we do not do anymore due to outsourcing is also a challenge."
- "[The] same cost reduction pressures that drove to outsourcing stress the retained organization. With extensive HRO, the development pool of jobs is largely gone. How will we groom and grow new HR talent?"

### HRO Market Maturation

Given their experiences with HRO, a key question EquaTerra had for these buyers was whether they felt that the HRO industry and the service providers are mature and experienced enough to meet their HRO needs and deliver the

benefits and goals they sought. Survey respondents offered a mixed bag of responses. Slightly more respondents offered a flat out "no" response than offered a "yes" response, but the majority were somewhere in between depending on the provider being considered, the complexity of the work outsourced and the amount of process bundling, and often the global reach of the deal. Respondents offered the following elaborations on their position on the maturity levels of HRO service providers.

- "I believe that for individual processes, yes. However, I do not feel the industry has proven that whole house outsourcing has demonstrated the savings and value as promised."
- "No – they lack flexibility and cannot move quickly enough to meet the needs of business. Additionally, although they handle norms well, they have difficulty dealing with exceptions and providing the required attention."
- "Not yet...this is a maturing industry and it will take some time to get the service models fully defined/deployed."
- "Overall I would say yes - the concern is choosing a company you trust."
- "Still experiencing growing pains. They can deliver the basics, but taking us where we want to be, that is a skill set they are still developing and is probably 2-3 years away."
- "Definitely feel that it [service provider industry] is maturing. Still a little more to go with integrated, multi-function solutions and reporting."
- "I believe they are mature. Procedures are consistent and reliable."

Despite challenges and in some cases lack of maturity, respondents had many positive things to say about the service providers. Commenting on their strengths, respondents made the following comments:

- "Relationship and partnership, willing to put services to employees in front of the client/vendor issues that need to be dealt with."
- "They have software and expertise we do not have. They have economies of scale on boutique tasks such as

deferred compensation.”

- “Attitude (very positive); ability to pull a dysfunctional team together; external knowledge.”

There were negative opinions as well, including:

- “Lack of investment resources to improve process as a win-win for both of us. Limited career opportunity for their staff. Likes to hide behind meeting the Service Levels when most are basic time and accuracy—not whether the process is really improved and making a difference to the business and its employees.”
- “Arrogance. Take it or leave it responses, once we are committed to them. One size fits all mentality. Low balling on prices. Price increases after your in-house expertise goes away. We need to monitor their performance because things are missed.”
- “[Lack of] transformational vision and execution.”

### HRO Future Direction

Given the picture painted by survey respondents, the question becomes given current HRO market challenges and growing pains, what is the future direction that HRO buyers will take with HRO in general and with extending their own HRO deals in particular? This survey found that things are generally positive for buyers and for the market and - to a lesser degree - current leading service providers.

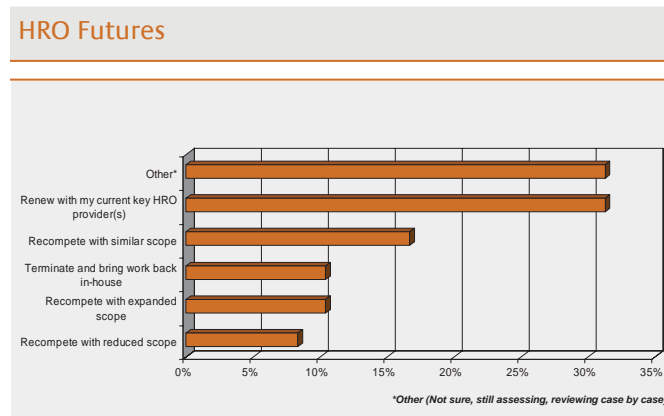


Figure 8

Figure 8 shows the expected directions respondents expected to take with their HRO efforts. A large percentage, represented by “other,” was unclear as to their future course of action. The reasons cited behind this uncertainty included

that they were too early in an effort to have reached a decision, they were making decisions on a process by process basis, or that they simply had not decided yet. An equal number of respondent organizations had made the decision to renew the business with their current provider, which is a positive endorsement of the benefits HRO has brought to those organizations.

Just ten percent of respondents planned to eliminate their HRO efforts and bring the work back in-house. Given some of the problems cited, this percentage is low and was limited to buyers that had done less comprehensive outsourcing. It was also a low absolute number overall given the study sample size, and is therefore a more directional indicator. The balance of respondents plan to recompute some amount of work with either the current or a different service provider. In many respects this tweaking of an HRO effort by bringing some processes back in-house, outsourcing others, and swapping work between service providers is expected and positive in a changing and maturing market as buyer’s needs naturally change over time. Note that respondents had the option to select more than one response as they had different plans for different HR processes and this is why total responses exceed 100 percent.

Buyers were more dissatisfied with their current engagement and service provider than with the HRO concept. When asked if they would “do it over,” the vast majority of respondents indicated that they would and only handful (less than 10 percent) explicitly stated that they would not. Many respondents indicated, however, they would use different service providers or change the mix of work that was outsourced versus maintained internally.

### Making HRO Work

This survey shows that there is clearly room for improvement in achieving HRO benefits. Does this survey imply that organizations that have not already undertaken HRO should look at alternative means to enable HR transformation, like shared services, selective outsourcing or additional investments into internal process improvement efforts and HRIT applications and systems? In some cases the answer is yes and in others, no. However, this is an answer that organizations must arrive at through a tailored assessment of their internal HR operations and its organization’s needs and

available skills and resources to commit to HRO efforts. While there is no evidence to show that internal HR transformation efforts are more likely to succeed than an HRO effort, the cost savings benefits from HRO have been consistently superior to internal cost cutting efforts.

Another key finding from an earlier HR transformation study was that the leading barrier to HR transformation, cited by two-thirds of buyers surveyed, was lack of resources and the costs to fund transformation. These are two challenges that properly constructed HRO efforts can address. HRO services providers can provide HR transformation skills, expertise, and ideally best practice process models. Improvements to HR operational efficiencies can provide cost savings to help fund additional transformation efforts and it is also possible to structure HRO deals to spread the costs of transformation over the life of the agreement. A key point, therefore, is that while HRO can prove challenging, for many buyers it is potentially the only viable means to enable extensive HR transformation efforts.

The issue for current and prospective HRO buyers then is how to make HRO work, more so than debate whether the concept still has merit. One key to success is to avoid common pitfalls that too many HRO buyers make in their HRO efforts. As the HRO market matures, EquaTerra has been able to consistently identify these frequent obstacles to a successful HRO initiative:

- Decision criteria and their relative importance are poorly defined, such as price points, provider qualifications, etc.
- Poor design and implementation of governance and retained organizations are in existence.
- Internal approval levels and decision processes are unclear.
- Potential service providers are permitted to bypass the process and communications protocol.
- Focus is on first/second years savings rather than on balanced short/long term benefits.
- Potential service providers are used to frame the requirements and the sourcing process.
- There is reliance on future negotiations to re-position

the deal.

- There is over-reliance on “free” providers’ advice, assessments and RFP development.
- Choice of commercial model is disconnected from change drivers.
- Shortcuts are taken to expedite the deal.
- Clients under-resource the project before and after the contract is signed.
- Below par service provider personnel are not moved off the engagement quickly enough.
- Poor change management occurs, which often means that users expect perfection Day 1.

The first step to avoiding these pitfalls is to recognize they are likely to occur. Buyers must undertake HRO initiatives fully aware of the challenges that come along with the journey. The next step is for buyers to embrace a common set of principles that will more likely lead to HRO success. These include the following:

- Do not conduct the HRO sourcing effort as a procurement transaction. View HRO as more akin to a joint venture – or marriage – with the service provider and not an adversarial, client/vendor relationship.
- Commit adequate and skilled resources to the sourcing team from day one. This is a full-time job. Some number of these resources should transition to the post-transaction retained organizations and governance teams.
- Focus on post-transaction outsourcing management and governance from day one. Buyers must address governance long before the deal is done and transition begins.
- Commit adequate and skilled resources to the retained organization and governance teams. These groups should not become a home of last resort for legacy staff. It also takes different skills to manage an outsourcing relationship and service provider than it does to run pre-outsourced HR operations.
- The HRO service provider needs to earn an adequate profit on its outsourcing efforts. In HRO, buyers get

what they pay for, and service providers operating at a consistent and ongoing loss will de-prioritize accounts leading to inevitable degradation of services.

- The transition period inevitably can be a painful one in, and many cases, it is 18-24 months before organizations begin to clearly see the benefits of HRO. Buyers must level-set expectations accordingly.
- HRO is a journey. Buyers and their HRO service providers must have mechanisms in place to proactively and constructively adapt to change. This could involve changes in pricing or service levels, the introduction of new services, the swapping of work outsourced and maintained internally or moving work to another service provider as needs dictate.

### Conclusion

The market for buyers undertaking multi-process HR outsourcing continues to grow, though from a penetration standpoint, the HRO market is still relatively immature. Buyers' experiences to date in achieving the benefits sought from HRO have been mixed. Buyers remain generally positive on the HRO concept but are often less satisfied with their current HRO effort and service provider. Going forward, most buyers plan to stay the course with HRO, though they will often change the mix of what is outsourced and which service providers are utilized.

Buyers currently in a problematic HRO effort need to dissect the situation to identify the root causes of the problems. They then must proactively move to collaboratively address these problems with their service provider(s), recognizing that some amount of renegotiation and rebalancing of what HR work is outsourced and maintained internally is possibly needed. Problems left to fester will only get worse over time and an adversarial approach to change is also typically not the best course of action.

Buyers need to determine whether the mechanics of their deal structures and the relationship model with their service provider are structured in a way to drive performance towards the original intent of the HRO effort. Process

improvement, for example, is difficult to achieve in a contract and relationship that is structured on driving costs out of the system. HRO buyers must also reexamine their investments, processes and resource commitments to outsourcing management and governance. This is an area often identified as one source of problems in HRO deals. Finally, buyers must learn and understand the best practices their peers have employed to enable HRO success and apply them to their own situation.

HRO is becoming a mainstream tool for organizations to utilize when addressing cost savings and process improvements efforts in their HR operations. However, buyers need to determine when and where HRO can make sense for them and where it fits with other alternative service delivery models like shared services or selective outsourcing. With a lot of factors at play, most buyers will look to deploy multiple means to improve their HR operations. Most importantly, when HRO does make sense, buyers must focus on how to strategically execute and manage HRO based on their unique situations and lessons learned from their peers that have gone before them.

## Appendix - Respondent demographics

### Respondents Organization Size

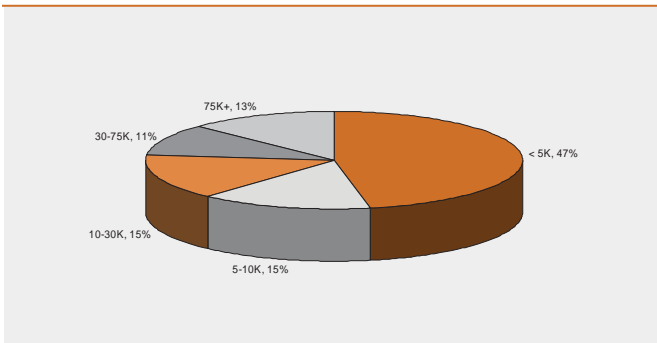


Figure 9

### Respondent HR Organization Size

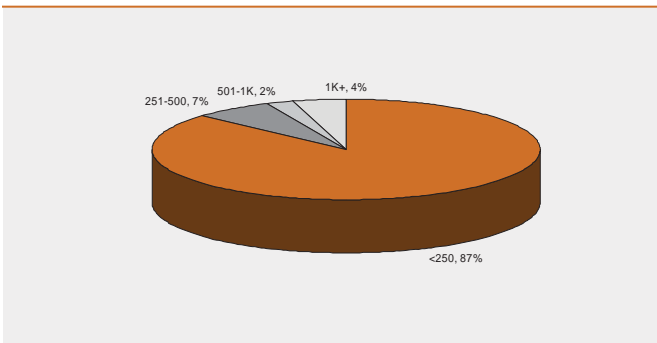


Figure 10

### Respondent Organizations by Industry

Aerospace/Defense	2%
Banking, Financial Services, Insurance	9%
Business Services/Consulting	24%
CPG, Food/Bev, Retail, Whole.	9%
Entertainment/Media, Hospitality	2%
Government, Education/Non-Profit	7%
Healthcare	11%
High Tech Products/Services	11%
Manufacturing	15%
Pharmaceutical/Biotech	4%
Real Estate	2%
Telecommunications	2%
Transportation & Logistics	4%

## About EquaTerra

EquaTerra ([www.equaterra.com](http://www.equaterra.com)) is focused solely on providing global corporations with outsourcing and insourcing advisory, research and governance services that enable them to achieve service delivery excellence for their SG&A processes. EquaTerra's advisors average more than 20 years of industry, service provider and process experience with functional leadership in Finance & Accounting, Human Resources, Information Technology and Procurement, and have been involved in over 600 global business transformation, outsourcing and outsourcing governance projects.

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