The consequences of outsourcing human resources

Research into the management of the human resource function within organizations is based upon the assumption that it is a unitary function, operating in a single workplace or in a uniform manner across multiple workplaces within the organization. However, it has become increasingly common for organizations to subcontract specific services, including human resource activities.

This is evident from the findings of the 2004 UK Workplace Employment Relations Survey (WERS) which revealed that 86 per cent of all workplaces employing ten or more employees had arrangements for subcontracting some activity, including (in descending order of importance):

- building maintenance and cleaning;
- computing services;
- security;
- payroll;
- transport and training;
- temporary employment;
- printing;
- catering; and
- general recruitment.

So, a number of HR activities (such as payroll, training and recruitment) have for some time been delivered by other agencies and consultancies for a number of organizations. That the professional human resource activity for an organization might also be controlled and delivered elsewhere has only recently been considered.

The shift from HR subcontracting to outsourcing

A significant finding of the WERS survey was that a similar proportion of public (86 per cent) and private (85 per cent) sector workplaces in the UK had subcontracted services, and that 19 per cent of these reported that such services had been carried out by employees of the workplace or organization five years previously – that is, they had been outsourced. The main difference between the public and the private sectors was that the public sector was more likely to employ former employees as subcontractors (38 per cent) than private sector workplaces (13 per cent). So, subcontracting is extensive, and a significant growth appears to have occurred as a consequence of employees being transferred to the contractor, namely the outsourcing of staff. For the majority of organizations and the majority of employees affected, this relates to work in low skilled occupations such as building maintenance, cleaning and catering.

However, in addition to such low-skilled work, since the early 1990s large organizations, particularly in the USA and the UK, have begun to move from subcontracting to outsourcing various management functions. Starting initially with IT outsourcing, the practice has spread to include core business functions such as finance, marketing and human resources. Until recently, IT outsourcing received most attention. By contrast, HR outsourcing, has only recently received attention, and has been approached from a variety
of perspectives, including employee relations in outsourced call centres and the impact of inter-organizational contracting on employee relationships and on trust.

The definitions of outsourcing are often implicit, or where explicit, they are fairly elastic, stretching from the rather minimalist long-term subcontracting of HR service delivery to an external provider, to “spin-off” joint ventures or shared services, and finally a contract with a fully independent service organization. More recently, the model of Business Process Outsourcing where the client organization participates in a partnership with key suppliers to deliver “back office” services, adds further complication to any definition of outsourcing.

A good definition is: The delegation of one or more business processes to an external provider, who then owns, manages, and administers the selected processes based on defined and measurable performance metrics.

The justification for outsourcing HR

Superficially, it would seem that the most obvious reason for outsourcing would be to make cost savings. However, the “make or buy” decision at the heart of outsourcing is often quite complex. While short-term cost savings are usually seen as the major reason for outsourcing, recent research has shown that they are not the only one. A desire to achieve “best practice”, to improve service quality, to focus upon the “core competences” of an organization, and to utilize new technology are also prominent reasons offered by organizations. With respect to the outsourcing of HR activity, earlier studies have shown that organizations undertake outsourcing to reduce costs, gain access to HR expertise, achieve workforce flexibility, focus managerial resources on strategic matters and also to keep up with workplace regulation.

The rationale for different drivers has received strong theoretical underpinning from economic theories of the firm – especially transaction cost economics, and the resource based theory of the firm. Transaction cost economics has previously been applied to analyze the outsourcing of information technology, and only more recently to HR outsourcing. According to this, the human resource activity most likely to be outsourced was that which was most unlikely to incur high costs due to uncertainty, the threat of opportunism, asset specificity, frequency, and ease of measurement.

Turning to the resource based view (RBV) of the firm, this provides another perspective on what HR activities might be considered for outsourcing, and also whether outsourcing is necessarily of advantage to an organization. According to the RBV, only those HR activities that could not meet the criteria of deliverability, inimitability, durability and non-substitutability should be outsourced. The argument hinges upon the identification of what are called “core competences” that are intrinsic to that organization. These attributes or qualities are to be nurtured and retained in-house. Externalization can be a way of providing internal coherence, by allowing a concentration upon core competences. But by implication, this would mean that the selection of HR activity for outsourcing would be contingent upon sustaining the “core competences” of the organization and in certain circumstances this might preclude a consideration of outsourcing.

Recent research has summarized the empirical evidence from both Europe and the USA, and the activities most likely to be outsourced were:

- outplacement;
- pre-employment testing;
- training;
- payroll administration;
- employee assistance;

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• counselling; and
• pension plans.

The implication is that activities such as strategic HR policymaking, succession planning for key staff, employee relations, or diversity management would be less likely to be outsourced.

However, it has been argued that if an organization adopted a distinctive approach to the management of some or all of its HR activity, then it would be ill-advised to consider outsourcing. In a similar vein HR outsourcing can limit the ability of firms to develop distinctive competencies within the workforce, and it may also create inefficiencies because contractors are often unfamiliar with client organization strategies and cultures. This is backed up by some evidence that outsourcing can change the nature of work, especially among professionals who lose discretion over their tasks as their work becomes deskillled in order to facilitate monitoring of output. Other research has shown that HR outsourcing can lead to problems of poor service, vendors with insufficient knowledge of the business, and therefore higher costs than anticipated.

The decision to outsource HR, also has implications for the way in which the HRM function is organized. One argument, that in the changing business climate there are four ways of delivering HR "excellence" (as a strategic partner to the business, as a change agent, as a champion for employees, and as an administrative expert) is relevant to outsourcing. The implication is that the delivery of the HR service can not be conducted in a uniform manner. There may well be "back office" activities, such as pay and benefits, recruitment and selection, that should be outsourced in order to concentrate "administrative expertise" in one place. The remaining HR staff could divide between those "embedded" in business units tasked with overseeing the delivery of the HR service as "champions for employees", and those who could work as internal consultants or "change agents", engaged in trouble shooting, and providing a range of development interventions. The senior HR team could then become "strategic partners" by integrating all these activities, but above all, by aligning themselves with general business needs.

Consequences of outsourcing

Outsourcing represents a step change beyond simple sub-contracting, and is now extensively used in respect of a range of low skilled work throughout UK workplaces. However, the outsourcing of core management functions such as HRM is a growing area that has only just begun to receive attention.

The consequences of HR outsourcing for the future of organizational HR functions are quite serious. It is often difficult to reassign the HR staff that remain within the organization to "higher value-added" work. Deskilling, job-enlargement, new skill shortages and the disappearance of expertise present problems that can only be resolved by increasing the HR budget.

Furthermore, the disruption that outsourcing may bring to the internal labour market for HR staff has serious implications for both succession planning, and also for individual career planning within organizations.

In future, from where within organizations, will experienced HR staff come to fill the new roles of "change agent" and "business partner"? Conversely, what will motivate early career entrants aspiring to a professional career in HR to consider starting as "administrative experts" in a call centre? In any case, where outsourcing is adopted, the skills that are acquired and developed in the course of a traditional professional HR career may need to be supplemented not just by those of leadership and change management, but also by those of project management, customer relationship management, and management accounting.

A question therefore arises about the adequacy of traditional initial professional training in HR. Is it preparing HR professionals for this new world of outsourcing, customer services management and stratified careers?
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