

Risks and Rewards in HR Business Process Outsourcing

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Managers have expressed differences of opinion about the risks and rewards of outsourcing companies' human resource activities, including the entire business process. This paper reviews the literature to date and studies the example of one of the earliest cases of outsourcing an HR business process, when EDS took on the responsibility for Canadian Imperial Bank of Commerce. With the offloading of functions such as payroll and recruitment, a company's HR department can therefore concentrate on strategy and become a facilitator for change. The paper concludes with lessons that managers can apply when considering the outsourcing of HR functions.

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Introduction

Authors have advocated a variety of criteria for making outsourcing decisions. In the strategy literature concerning “make or buy”, a focus on the core versus non-core dichotomy has led to the recommendation that activities essential to a company's competitive advantage should not be outsourced, while all other activities should be candidates for outsourcing. Some commentators have emphasised certain characteristics of the company itself, leading to the conclusion that the appropriate decision may differ among companies and over time. For example, companies that need to cope quickly with impediments to the development of new Human Resource (HR) processes may outsource to gain management expertise. Some authors have also emphasised costs, asset specificity and the degree of precision in contracts. To the extent that HR activities differ in regard to these features, appropriate outsourcing decisions may also differ. For example, if an activity such as payroll can be quantified with certainty, then the contract may be precise enough to minimise risks. At the other extreme, it may be particularly difficult to quantify HR business process outsourcing (HR-BPO) in terms of deliverables over time. Here the risk of uncertain outcomes may argue against outsourcing, unless the vendor and buyer can develop ways to mitigate this risk.

Product development necessarily entails incomplete contracts with uncertainty and risk, and so authors examining the outsourcing of product development recommend creation of a strategic alliance and emphasise the need for trust. Related concerns include how best to stimulate innovation,

and how best to direct it. Ongoing innovation has been particularly important with IT, and so an extensive literature on IT outsourcing has analysed this partnership perspective and the need for “trust”. Product development and IT literature have pointed to the nature of the inter-corporate governance structure as a crucial determinant of outsourcing success. This article applies insights and lessons from this literature to the subject of HR outsourcing. In HRO-BPO, for example, both buyer and vendor expect that ongoing innovation will improve IT-HR technologies and HR practices. Consequently, risk mitigation in HR-BPO focuses largely on the inter-company processes and structures for decision-making and dispute resolution, and the cultures and capabilities that are necessary for a successful strategic alliance.

Over the period 2001–2004, the number of multinational corporations that outsourced their HR business process rose from approximately six to 40, and several vendors now offered global HR-BPO, including Exult, Accenture and IBM.¹ However, as [Exhibit 1](#) indicates, surveys of decisions concerning HR outsourcing have revealed a wide range of managerial opinions. The complexity of issues has led to the creation of HR consulting firms that specialise in providing advice on whether to outsource, how to design a contract and what governance structures to establish.

Surveys of decisions concerning HR outsourcing have revealed a wide range of managerial opinions

How to choose HR activities as potential candidates for outsourcing

[Exhibit 2](#) presents a summary of issues that authors have emphasised in deciding which activities are potential candidates for outsourcing. Prahalad and Hamel say a company’s core competence should be a major determinant in the make or buy decision, and this view plays a central role in the HR outsourcing debate.² Stroh and Treehuboff express the opinion that “When considering outsourcing the focus should be on keeping core activities in-house and outsourcing non-core activities only.”³ They believe that the activities that define a company’s competitive advantage may be too important to outsource. This view is linked to the resource-based theory of the firm which argues that the capabilities of a company are dependent on resources within it, and so to outsource certain resources might limit any capabilities that depend on them.

For some authors, core competence means more than a unique technology or product design. For Javidan, a company’s capabilities relate to its ability to exploit its resources, while a competency is a cross-functional integration and co-ordination of capabilities; and a core competency is a collection of competencies that are widespread in the corporation.⁴ Hamilton et al. also recommend that the company retain those capabilities that encompass the entire value chain.⁵ These perspectives suggest that the cross-functional attributes of some HR activities, with their impacts on the entire value chain, may form a core competency and competitive advantage, providing a warning against HR-BPO.

However, new roles for the HR department, particularly as an agent of change, complicate these recommendations. Post demonstrates that a company “can stretch to build new competences”, thereby altering the competitive environment in its favour and offering new strategic opportunities.⁶ Today, as companies face pressure to automate, downsize, become more international, adopt e-business procedures etc, the HR department has new responsibilities as an agent of change.⁷ The ability to fulfil these responsibilities is becoming a potential core capability, and to outsource HR-BPO may enable the HR department to focus on this new core capability. Gilley et al. have analysed relationships between HR outsourcing and organisational performance in manufacturing companies. They conclude that outsourcing of certain HR activities has a positive impact on overall innovation within the company.⁸ Boselie and Paauwe have examined HR competencies in European companies and conclude: “we foresee a development by which the time spent on the traditional transactional HR activities will decrease, while at the same time the HR professional is required

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