The vast majority of enterprises are now acutely aware of business process outsourcing (BPO), and human resource (HR) BPO represents the biggest portion of the overall BPO market. Some view it as an undertaking that is healthy for the business, since it will enable them to focus on core competencies. Some view it with skepticism, believing that companies lose control through outsourcing.

Regardless of their perspective, all enterprises should be aware of a key principle for success with HR BPO — it cannot be treated as an end unto itself. Outsourcing won’t make a business smarter. Outsourcing HR isn’t strategic – business goals are. How well the gains achieved from outsourcing serve key business goals will be critical to judging HR BPO success — whether these goals involve lowering costs, freeing up resources in other core functions of the business or increasing resource agility.

Crucial to success in HR outsourcing is keeping this bigger picture in mind. What are the business goals of the organization? How will HR outsourcing help or, possibly, hinder those goals? Enterprises must keep these questions at the heart of their decisions about whether to outsource HR, to what extent this business process will be outsourced, and which vendor to choose.

This chapter examines enterprise activities related to HR outsourcing to separate the myths from the reality, and shows how to avoid painful and costly mistakes when choosing the set of services that are right for your enterprise. The analysis in this chapter is framed by the following Key Issues:

- What are the latest trends in HR BPO, what outsourcers provide it, and what services do they offer?
- What human resource management systems (HRMSs) are being deployed, and how do they compare in functionality?
- What can enterprises do to avoid pitfalls and ensure they have successful HR BPO relationships?
15.1 The HR BPO Market

Key Issue: What are the latest trends in HR BPO, what outsourcers provide it, and what services do they offer?

Strategic Planning Assumption: By 2005, 85 percent of U.S. companies will outsource at least one component of their HR functions (0.8 probability).

Gartner’s BPO market model segments this market into three areas: supply management, demand management and enterprise services. In each of these areas, a number of processes are good candidates for outsourcing.

HR and human capital management (HCM) are a component of enterprise services, which tend to involve back-office, intraenterprise processes that are largely characterized as being noncore yet critical to the day-to-day functioning of the enterprise. This category of processes is gaining popularity in the BPO marketplace among both providers and buyers.

Providers are creating and strengthening their offerings in enterprise services, because an offering can more easily be leveraged across several industries. For example, an HR BPO offering can be applied with little customization to financial services, manufacturing and utilities. This is not to downplay the importance of a sound vertical-market understanding by the vendor; however, when it comes to HR outsourcing, process expertise is the most important criterion.

The HCM component of enterprise services can be further segmented into subprocesses that can be outsourced. The most common are payroll, benefits, hiring and recruiting, training and education, and personnel administration. When considering outsourcing HR, enterprises must first determine whether it is appropriate to outsource the entire spectrum of HR processes, a single HR subprocess or a piece of a process. Many companies may choose to forgo BPO entirely, and outsource only process-enabling components of IT, such as HRMS business applications.

15.1.1 Examining Trends in the Market

Strategic Planning Assumption: By 2005, the number of outsourced business processes will have doubled compared to 2000 (0.8 probability).

Tactical Guideline: HR BPO is a vast, mature and growing external-service option for businesses. However, the market is not monolithic, and enterprises must understand what “flavors” of HR BPO can most meaningfully impact their business. Creation of a sourcing strategy for HR that determines the proper mix between internal and external services will be critical to success.

HR outsourcing has long been the vanguard of BPO, and it remains, by far, the most outsourced business process (see Figure 15-1). According to Gartner’s most recent forecasts, published 7 July 2003, the HR BPO market will grow from $25 billion in 2002 to $38 billion in 2007, an 8.6 percent compound annual growth rate.

Gartner includes the following six processes in its definition of HR outsourcing:

- Payroll
- Benefits administration
- Education and training
- Hiring and recruiting
- Personnel administration
- Other HR

Growth in HR outsourcing is underpinned by some of the following market forces:

- The HR department was the last affected by technology innovations in the wave of enterprise resource planning (ERP). As a result, HR departments are in search of alternative ways to meet their technology needs with whatever budget is left from the ERP investments of the late 1990s.
- HR departments have been forced to do more with less during the past decade, with stable or decreasing budgets on the one hand and increasing demand for HCM efficiency on the other. Outsourcing is a way to resolve this quandary.
- Many companies believe that HR is a comparatively low-risk function with which to begin experimenting with outsourcing. Since CFOs continue to be the primary decision makers for BPO, it is not surprising to see them eager to experiment with HR outsourcing while their interest in finance and accounting (F&A) outsourcing remains tepid.
The opportunities for improving service levels in HR are high in most organizations, whereas HR metrics are often ill-defined and operational performance of the HR function is not measured consistently.

One of the key findings for 2002 and early 2003 is that demand for aggregated HR outsourcing services is becoming more mainstream — that is, the aggregation of multiple HR processes (such as payroll, benefits and HR records management) into one outsourcing contract.

Gartner surveys of user enterprises indicate that, within the HR portion of the BPO enterprise services segment, the most popular areas for outsourcing have been, and continue to be, noncore, back-office services such as payroll, benefits, and education and training (see Figure 15-2). Best practices and vendor scalability have been accrued over time, and Gartner believes that enterprises perceive these BPO options as being less risky and offering greater value for the money than other candidate processes.

HR is far more mainstream and common a BPO undertaking than, for example, field sales and service support, so inhibitors are low compared to other processes. Therefore, HR outsourcing services, as a group, have had the most activity among respondents to Gartner surveys of BPO service recipients. However, as BPO is widely adopted for back-office functions, Gartner expects that it will also gain increased traction in additional, interenterprise process areas, such as demand and supply management.

**Action Item:** Decide whether tactical outsourcing of individual processes (like payroll) or holistic, end-to-end outsourcing (of the entire HR function, for example) makes the most sense for your enterprise, and take into account vendor maturity as well as the experiences of other companies in your industry.

### 15.1.2 HR BPO Drivers and Inhibitors

The belief that outsourcing can cut costs attracts enterprises to HR BPO like moths to a flame. Like the moths, these enterprises can become enlightened, but can also get burned.

Enlightenment comes when the cost-reduction-seeking enterprise discovers other beneficial outcomes that outsourcing can provide, such as the ability to focus on the core business and improve service levels. However,
many companies have been burned — badly, in some cases — as a result of misaligned expectations, selection of the wrong vendor or too narrow a focus on why they were outsourcing in the first place.

Companies turn to process outsourcing for a variety of reasons. They include:

- The high cost of transactions
- Too much time spent on daily operations
- The high cost of upgrading applications
- Unintegrated processes
- Difficulty in hiring or retaining process staff
- Lack of timely or accurate reports

These “pain points” in the back office manifest themselves in a variety of drivers and inhibitors to outsourcing. Foremost among the drivers are the goals of focusing on the core business, improving service levels and reducing implementation costs.

A major obstacle for these organizations, however, is doubt or skepticism concerning whether they will actually achieve these business benefits. Other challenges include fear of loss of control (the “not invented here” syndrome) and the resulting impact on employees (the “retained team”). Also, companies often lack the appropriate internal process measurements, which makes it difficult to design contract terms, conditions and metrics to reward the achievement of the desired results.
**Action Item:** Vendors should demonstrate real-life examples of HR BPO customers that have realized value over time. Vendors should also demonstrate a strong dedication to the BPO model in years to come.

### 15.1.3 The Choice of Providers

**Tactical Guideline:** Many of the leading players in HR BPO hail from outside the realm of IT services. Enterprises must select vendors from emerging categories of contenders; there are currently no “runaway” leaders.

Selecting the right HR BPO provider requires that enterprises do their homework. To help them navigate the competitive landscape, Gartner has chosen to highlight particular BPO vendors as examples of six main categories from which enterprises can choose:

- **The consultants** include the former “Big Five” consulting firms: Accenture, BearingPoint, Cap Gemini Ernst & Young, Deloitte Consulting and IBM Business Consulting Services.
- **The IT outsourcers** include some of the largest IT service providers. Examples include Affiliated Computer Services, Computer Sciences, EDS and Unisys.
- **The pure-play vendors** are venture-capital-funded companies that generate all their revenue from BPO. Examples include Exult and Xchanging.
- **The process specialists** include payroll and benefits providers. Examples include Aon, Automatic Data Processing, Ceridian, Convergys Employee Care, Fidelity Employer Services, Hewitt Associates, Intuit, Mellon HR Solutions, Onvi Business Solutions, Paychex, RebusHR, SHPS, SourceNet Solutions, Spherion, Synhrgy HR Technologies and Vsource.
- **The offshore providers** include subsidiaries of the well-known Indian application outsourcers. Examples include Progeon (an Infosys company) and Wipro Spectramind.
- **The business service providers** meld Internet-based delivery — following the application service provider (ASP) model — with a BPO business focus. Examples include Administaff, ADP Emerging Business Services, Employease, Talx and Workscape.

### 15.2 The Systems

**Key Issue:** What HRMSs are being deployed, and how do they compare in functionality?

**Strategic Planning Assumption:** By 2005, fewer than 50 percent of enterprises will rely on a single vendor to enable more than 80 percent of enterprise-centric processes (0.7 probability).

Gartner’s Hype Cycle can be generalized for business applications to identify a pattern of convergence and survival (Figure 15-3). First, innovation occurs outside the suite as small, nimble, innovative application providers create point solutions to meet specific industry needs, and hype increases. Eventually, these niche applications must be integrated with incumbent application suites. Achieving this typically poses two options for user enterprises:

- Performing custom integration of the best-of-breed component
- Adopting the incumbent suite vendor’s offering of the new functionality, if available

At this point, integration costs and the immaturity of suite-based solutions tend to drive down the hype level. Emergence from the resulting “Trough of Disillusionment” follows either of two paths:

- Functionality converges into the suite.
- Fewer niche providers survive, but in a symbiotic relationship with suite providers (in effect, the suite providers source the capability from the niche providers, rather than developing it themselves).

A suite can take many forms, including an ERP suite, an HCM suite, or a fully integrated business application suite that includes ERP, customer relationship management, supply chain management and other applications.

**Action Item:** Look to incumbent suite vendors for added functionality before embracing best-of-breed applications, selecting a best-of-breed vendor only when such a choice is warranted by the return on investment.
15.2.1 Mixed Solution Portfolios

**Strategic Planning Assumption:** Through 2005, enterprises will have no choice but to manage a mixed portfolio of applications and services that support strategic workforce management functionality (0.6 probability).

Strategic workforce management initiatives require management of a portfolio of applications and technologies. ERP and HR vendors do not offer sufficient capabilities for a single-vendor solution today.

To meet the functionality demands of strategic workforce management, enterprises will need to work with a number of vendors offering specialty products. Some of these products are well-developed in terms of functional “build-out,” while others offer only a functional framework that will develop quickly in the next couple of years to include rich functionality and some industry specialization.

Using a mixed-solution approach that includes on-premise, outsourcing, ASP and Web services offerings can decrease the risk of investing when business requirements are unstable, and can build in the flexibility to move to innovative new solutions as they become available.

Begin with the end in mind. Determine the capabilities that the enterprise needs to align the workforce with business strategy. Then, build out the portfolio of applications to meet this vision. Keep in mind the strategy and direction of the enterprise’s core integrated HRMS provider when making the niche solution vs. integrated solution decision.

**Action Item:** Ensure that the payback period for niche solution implementations is short enough to allow movement to integrated solutions when those solutions have matured sufficiently.

15.2.2 Vendor Categories

**Strategic Planning Assumption:** By 2007, ERP vendors will have splintered into “megasuite” vendors, focused vendors and vendors caught in “no-man’s land” (0.9 probability).
Two major categories of enterprise business application vendors have emerged: “megasuite” and focused.

- **Megasuite vendors** provide broad functional capabilities (with some requisite depth) to meet most of an enterprise’s requirements. Vendors in this category include SAP, Oracle, PeopleSoft and J.D. Edwards.

- **Focused vendors** strive for excellence within a niche that can complement or augment the megasuite vendors — in areas where users need solutions, but suite vendors are not yet interested in operating. Kadiri, Workscape and Softscape are examples of the vendors in this category.

This market dualism is healthy and symbiotic. However, focused niche solution providers will have to fight to stay a step ahead of the megasuite vendors, which can invest heavily to catch up.

Vendor viability is a critical issue with focused vendors. Vendors caught between depth and breadth will be severely challenged.

Going forward, the number of megasuite vendors is not likely to grow due to market saturation. During the next few years, however, the market potential for niche vendors will grow. Enterprises demanding deeper vertical-market and business process experience will migrate toward these vendors. Vendors caught in no-man’s land will be candidates for acquisition or liquidation unless they find a niche.

**Action Item:** Look for vendors that satisfy vertical-market or deep business process demands in niche or megasuite categories, and avoid vendors that serve general market demands.

### 15.2.3 Examining HCM Options

**Tactical Guideline:** Enterprises must develop an overall sourcing strategy and plan — there is no “one size fits all” solution.

As shown in Figure 15-4, enterprises have many choices when it comes to sourcing in-house HCM applications, including:

- Integrated ERP/HCM megasuites
- HCM suites
- HCM niche solutions

HR organizations need to evaluate what their core competencies are, and what capabilities they need, in order to determine appropriate areas for outsourcing.

The fully integrated megasuite approach offers the benefit of guaranteed internal integration of data models and processes, but offerings in this category generally lag leading HCM niche solutions in functionality. Megasuites tend to appeal to chief executives and board members, who are comfortable expanding the relationship with their “strategic partners.” To compete, the HCM suite must offer better functionality at a lower cost and ensure good integration with ERP systems. Both approaches usually impose a data model.

An HCM ASP or outsourcing solution can offer cost savings and access to specialist skills that may be difficult for midmarket enterprises to attract and retain. In addition, these solutions can enable enterprises to outsource tactical, administrative functions to allow a greater focus on strategic activities.

**Action Item:** Create an enterprise sourcing strategy that identifies desired in-house and outsourced capabilities before looking at technology solutions.

### 15.3 Keys to HR BPO Success

**Key Issue:** What can enterprises do to avoid pitfalls and ensure they have successful HR BPO relationships?

Enterprises that begin evaluating HR outsourcing options without the appropriate knowledge foundation inadvertently degrade their ability to select the best available option.

The deployment of external service providers (ESPs) for any category of service, HR or otherwise, is always predicated on achieving a specific business benefit. Unless that specific business goal has been identified, and endorsed at multiple levels within the enterprise, it becomes impossible to justify downstream decisions.

Similarly, without the prior identification of the criteria that will be used to objectively determine when those goals have been achieved, the foundation of the relationship between the enterprise and the external sourcing entity cannot be independently audited.
Finally, until an enterprise completes a market scan, it is impossible to determine whether ESPs can be effective in delivering the intended business goal.

### 15.3.1 The Decision Process

**Tactical Guideline:** Avoid outsourcing one HR process at a time — this tactical approach will reduce the quality of service delivery and sourcing management.

HR outsourcing proposals are often evaluated and executed with inadequate information about current services and costs. The result may be an agreement that does not define the full set of services required, does not result in expected cost savings, and requires the retention of significant numbers of internal staff to close service gaps and watch the outsourcer. Good business decisions can only be made with a clear understanding of current services and costs, the impact of change, and the risk associated with HR services that do not meet business requirements.

Problems arise when enterprises engage outsourcers without an adequate understanding of the services offered by their own HR organizations. Often, countless assumed services are provided by the HR group, but are not defined. The outsourcer looks less expensive because the proposal is for something less than what is currently provided. In these cases, cost savings evaporate as the HR environment continues to change and every change becomes an extra cost.

Many business areas also discover that high-level service descriptions open the door to service issues. Service requirements that were learned over time, but not documented, by the now-defunct internal HR group are rediscovered by the internal relationship manager and the outsourcer.

**Action Item:** Enterprises should identify cost savings from standardizing HR processes internally before engaging an HR outsourcer.
### 15.3.2 Understanding the Options

Different varieties of HR BPO services are available to enterprises, depending on their needs. Some vendors offer highly strategic “transformational” processes, while others are more tactical or transactional in nature. Because of these differences (and others, such as vertical-industry specialization), the HR BPO model is far from monolithic and continues to evolve.

**Transactional BPO** is characterized by highly leveraged, repeatable processes that can be replicated with minimal customization across a wide swath of clients. Service delivery in this segment tends to focus on singular, niche processes — multiprocess delivery is the exception rather than the rule.

The following list summarizes typical characteristics of transactional HR BPO services:

- **Attributes**: Point, single-process service; short-term contracts
- **Focus**: Noncore, commodity HR processes, such as payroll
- **Competency**: Niche process efficiency, supplements HR department
- **Pricing**: Per transaction
- **Selection Criteria**: Low-cost provider; price/performance
- **Goal**: Immediate transaction cost reduction
- **Vendor Commitment**: Meet service-level agreements, become HR’s “extra pair of hands”
- **Buyer**: HR department, business units
- **Relationship**: Customer/supplier

**Strategic BPO** vendors tend to act as business partners with their clients, forming “big ticket” (sometimes headline-grabbing) relationships, often via a joint venture or alliance. Many of the contracts from this category are difficult to replicate from customer to customer, since they are totally customized to the needs of individual service recipients. Sometimes these service relationships blend end-to-end HR with other back-office functions, such as F&A.

The following list summarizes typical characteristics of strategic HR BPO services:

- **Attributes**: Multiprocess, multiyear contracts
- **Focus**: Core and noncore, business-impact-driven (for example, end-to-end HR)
- **Competency**: Business process optimization, transforms the HR function
- **Pricing**: Several options, including cost-based plus incentives, fixed and per transaction
- **Selection Criteria**: HR process improvement, price/performance
- **Goal**: Cost reduction, or revenue or profit growth in core business
- **Vendor Commitment**: HR transformation, management
- **Buyer**: CEO, COO and president
- **Relationship**: Business partners

**Action Item**: Understand the differences between strategic and transactional BPO to decide which is right for you.

### 15.3.3 Aggregated HR BPO

**Strategic Planning Assumption**: Comprehensive multiprocess outsourcing will represent 25 percent of the BPO market in 2005 (0.8 probability).

**Tactical Guideline**: The HR BPO market includes mature as well as immature service offerings. Enterprises must follow an analytic process when selecting a provider and a specific service offering.

Maturity in a service offering can encompass a mixture of delivery, relationship and engagement models. In the early evolution of BPO, degrees of maturity in these three areas would depend on the origin of the ESP — that is, internal competence spun out as a commercially facing entity or launched as a startup business venture. Developing an engagement model is easier than developing a relationship or delivery one; therefore, selling can develop more quickly than delivery.
The HR BPO market includes service offerings at various levels of maturity, as indicated in Figure 15-5. Holistic, end-to-end HR outsourcing is in its infancy. While its benefits include lower management by the service recipient and a greater understanding of enterprise needs by the BPO vendor, its drawbacks include complex, long-term contractual lock-in. Its immaturity is its greatest risk — best practices accrue over time, even within the same vendor. What has worked well with one client might not be replicated successfully with another.

By contrast, single-process HR BPO has been tried and tested, and it is a less risky option. Yet it does require a robust sourcing strategy to cohesively manage internal and external HR process delivery.

**Action Item:** Assess whether your organization has the management capability to manage multiple vendors and internal resources in the single-process HR model. If not, aggregated HR BPO should be evaluated as a holistic, end-to-end model for engagement.

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### 15.3.4 Measurement Is Key

**Tactical Guideline:** Gartner experience has shown that the two parties involved in outsourcing relationships often have completely different sets of expectations about the same deal. Measurement is therefore an important success factor for HR BPO.

One of the maxims of strategic sourcing is: “If you can’t measure it, you can’t outsource it.” This is not entirely true — businesses can outsource without a foreknowledge of the status of their HR processes. However, few, if any, of these outsourcing efforts will be successful, and those that are will have a difficult time verifying the levels of their success.

Measurement can entail benchmarking by external, third-party advisors (such as Gartner). Alternatively, it can be an internal affair, using metrics that are mutually agreed on by the ESP and service recipient. Never, under any circumstances, should measurement and benchmarking be outsourced to the ESP; it is a critical core competency that must remain under the control of the service recipient organization.
More enterprises are coming to the realization that measurement in the areas shown in Figure 15-6 is a cornerstone of their strategic-sourcing efforts. Rigorous, regular and ongoing measurement throughout the life cycle of the BPO contract will be essential to confront problems early on.

**Action Item:** Ensure that the enterprise rigorously measures its processes to provide a firm benchmark from which to gauge the progress or failure of service delivery by the vendor.

### 15.3.5 The Pricing Menu

**Tactical Guideline:** The many pricing options for HR BPO services and solutions must be considered as part of the vendor selection process. Enterprises must decide which level of service offering is appropriate for their needs and select a vendor accordingly.

Across the spectrum from HRMS solutions, through single, niche HR BPO engagements, to full, end-to-end, strategic HR BPO, the value proposition offered by these models is hierarchical. End-user responsibility (and, conversely, control) diminishes, while costs and pricing complexity increase as vendor customization rises.

A dining analogy may help summarize the different pricing options:

- **HRMS solutions** are akin to a “gourmet meal at home” — you can have the exact food you want prepared the way you want. However, you need to cook it and serve it yourself. The quality of the food is based on your own skill as a chef and the quality of the ingredients (the internal and external resources assigned to the project). Pricing is typically based on a license fee or PEPM (per employee, per month) model for niche solutions or suites.

- **Transactional, single-process BPO** offers services that often come from a standard menu of vendor offerings, much like a “prix fixe” restaurant. Pricing options for these services may include per-transaction fee-for-service, cost-plus/fixed-fee, base fee plus per-usage, or per-seat packaged-cost payment models.
Strategic, end-to-end HR BPO is similar to dining at a catered private dinner party — the host works with a chef to completely customize the meal being served, from the hors d’oeuvres to final dessert. These engagements may use business-benefit-based, shared-risk/reward, joint-venture, open-book, “pay as you grow” or equity-based pricing models.

In all three cases, “outside caterers” may be called in to supply the things that the prime contractor cannot.

15.4 Summary and Recommendations

The following are some of the key HR BPO trends that Gartner has observed in 2003, and expects to emerge in 2004:

- **Business Focus:** In 2003, we are witnessing long-term HR BPO deals that are signed for short-term, cost-cutting reasons. A short-term drive to cut costs is leading to an increase in enterprises signing HR contracts that are focused on immediate cost ramifications. Many will be disappointed in the longer term, while others will be enlightened by beneficial-for-business outcomes.

- **HR BPO Competency:** As more companies become comfortable with the premise of BPO, they will shift their focus to longer-term engagement models that transform their HR processes.

- **Pricing:** The bulk of HR BPO deals in 2003 are priced on a utility basis, with only the occasional aggregated, multiprocess deal reflecting a complex pricing scheme. In 2004, more of these multiprocess deals will emerge.

- **Contract Flexibility:** Traditionally, HR outsourcing deals have been low in flexibility, but in 2004 there will be an increased ability to change service levels and adjust process delivery outputs.

- **HR as “Strategic BPO”:** By 2004, an increasing number of businesses, impelled by an improving economic and competitive climate, will become mainstream adopters of end-to-end, strategic BPO deals.

In light of these trends, enterprises must understand the evolving outlook for HR BPO and what it means to their own medium- and long-term business objectives. Additional recommendations include:

- Understand whether your business seeks to supplement the skills of your HR department or to transform them.

- Diversify your HR process delivery — leverage core-HRMS, niche-solution and outsourcing approaches within the context of an enterprise sourcing strategy.

- Let the sourcing strategy drive which types of providers are the most relevant — sales acumen may outstrip the ability to deliver.

- Anticipate change — create management processes that enable change within the scope of multiyear HR BPO contracts.