Weighing up the Business Case for HR System Outsourcing

An assessment of the potential benefits and challenges, from IT cost and efficiency to HR effectiveness

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Executive Summary

This Briefing Paper explores the emergence of HR system outsourcing, a form of outsourcing that can potentially cut costs, reduce risk and enable organisations to make better business use of their HR systems. In an HR system outsourcing set-up, customers pass responsibility for system maintenance, efficiency improvements and data management to a third party.

The paper argues that:

- While the cost and quality factors that influence outsourcing decisions vary from company to company, outsourcing can potentially provide a more **cost-effective** approach to HR system management. A third party service provider should be able to maximise economies of scale and streamline HRIT resource allocation across numerous clients
- Practitioners' experiences show that by taking advantage of the grey area between system maintenance (an operational expenditure item) and new development (often a capital expenditure item) HR system outsourcing can provide a means to **fund projects** that would otherwise require senior management sign-off
- Other factors for the business case analysis include potential improvements in:
  - o **Risk reduction**, particularly where organisations are over-reliant on one or more specialist employees for HR system management
  - o **HRIT efficiency,** where outsourcers take advantage of the broader range of skills and resource at their disposal to squeeze greater efficiencies out of the system
  - o **Flexibility** in handling system management peaks and troughs
  - o **Maximising system capability** – for example, by identifying software capability that may have been purchased under the original licence for the HR management system but never used
  - o **Maximising system enhancements** – for example, by supporting newer technologies such as manager self-service that may stretch the capabilities of an in-house team
- As with any outsourcing arrangement, the success or failure of the relationship will depend in part on how well responsibilities are defined and allocated, and whether the parties build a **meaningful partnership**. It's important that the relationship between the two parties is strong enough to focus on solving problems when they arise, rather than allocating blame or simply imposing penalties

Introduction

Outsourcing has a long tradition within HR, from tactical disciplines such as pension administration to full-blown business process outsourcing, where the bulk of the HR function is managed by a third party. But it's only comparatively recently that organisations have looked to hand over specific control of their HRIT systems to a third party.

Two forms of HRIT outsourcing have now emerged. The first is hosted services, otherwise known as 'software as a service' – a well-established form of outsourcing where the vendor runs HR software on its own IT infrastructure, and the customer uses it via the internet. This technique frees the customer from the hassle of implementing, maintaining and upgrading the software. Hosted services initially proved particularly popular for standalone HR disciplines such as recruitment, but increasingly, organisations have the option of handing over responsibility for their entire HR management system.[1]

A second flavour of outsourcing is now emerging for organisations that want to outsource the ongoing management of the system. Known as HR system outsourcing, it sees the service provider take on responsibility for a range of system management activities such as cleaning up data, adding new users, building reports and squeezing out IT efficiencies. This is not just an IT issue: the aim is to make more effective use of all of the system's capabilities so that it better meets the organisation's business needs. HR system outsourcing can be used by organisations that either run their HR software in a traditional in-house set-up or through a 'hosted services' arrangement.

At a high level, the arguments in favour of this form of outsourcing primarily come down to economies of scale, risk management, improved flexibility and the ability to better support an organisation's people management requirements. Managing HR systems requires specialist skills – a combination of IT platform knowledge, experience of the specific system and HR domain expertise – and it's not always easy to provide this capability efficiently in-house.

It's important to keep in mind that HR system outsourcing doesn't suit everyone. Typically, the business case stacks up best for medium to large-sized organisations that have reached a point of complexity where they may be struggling to support their systems efficiently in-house, or where the risk factors reach a critical point. In some of these cases, HR system outsourcing also becomes a test bed to establish whether other forms of technical support services can be delivered successfully by a third-party.

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[1] See 'From automation to business intelligence: the next generation of hosted services', published by Webster Buchanan Research November 2008, www.websterb.com/hcinsider

Part 1: Assessing HR System Outsourcing

1.1 The outsourcing value proposition

As globalisation has made it easier for organisations to source cheaper products, services and human resources from around the world, outsourcing has become an increasingly popular, if sometimes controversial, business option. Virtually every business function can now be outsourced, from internal support services such as HR, payroll, finance and IT to client-facing functions like marketing, customer support and even sales. At the same time, however, stories of failed outsourcing projects continue to haunt the sector, not least in the business process outsourcing industry where large-scale outsourcing of entire business functions has met with mixed results.

For organisations considering the outsourcing route, the decision-making process tends to combine high-level management philosophy with down-to-earth practicalities. From the strategic perspective, business gurus such as Geoffrey Moore have long argued that organisations should outsource their "non-core" activities, focusing their efforts on whatever areas give them competitive edge.

While this argument has a lot of merit in principle, in practice decisions about what's core and what isn't are rarely cut and dried. For one thing, what constitutes a non-core activity in one organisation may deliver significant competitive edge to another: IT, for example, may be seen as an easy-to-outsource service in a professional services firm, yet it's a source of strategic advantage for many financial services companies. In addition, the cost and quality factors that underpin outsourcing decisions vary widely, and many organisations have made sound business cases for keeping activities in-house that others might dismiss as non-critical.

For HR, the argument is a little clearer cut than some other business functions. The outsourcing phenomenon is nothing new – many HR professionals have years, if not decades, of experience outsourcing activities such as payroll processing. And with its strategic focus on hiring, retaining, developing, measuring and managing key talent, activities such as IT system management clearly fall into the "non-core" category. The issue, then, is whether it's best carried out by an internal business function or handled by a third party.

1.2 Different flavours of outsourcing

HR outsourcing services can typically be divided into seven types:

- **Tactical services**, such as pay slip printing or employee reference checking. Most organisations engage tactical outsourcers in some form, even though they may not perceive it as an outsourcing arrangement
- **Hosted services**, or 'software as a service', which is predominantly an IT service. In a hosted set-up, the service provider runs and maintains the software on its own IT infrastructure, while the customer uses it over the internet. The customer typically retains responsibility for system management activities related to its own specific needs, such as modifying screens, building custom reports, cleaning data and setting up new users
- **HR system outsourcing**, where the vendor takes over responsibility for this user-based system management – again, including activities such as modifying screens, cleaning data (e.g. after a merger) and setting up new users (*see Part 1.3 below*). HR system outsourcing services can be provided both when the customer's software is hosted and when it's run in-house
- **Next-generation hosted services**, where vendors wrap consultancy and other high-value services around their hosted offerings. These might include analytical services, where the provider takes advantage of advanced software tools to carry out sophisticated people-based reporting and analysis of the customer's data[2]
- **HR process outsourcing**, where a service provider takes control of an entire HR service or discipline, such as recruitment
- **Managed services**, where the outsourcer takes over responsibility for parts but not necessarily all of a business function. Managed services are commonly offered in payroll, where an outsourcer may take responsibility for running the payroll IT systems and processing payroll, but an in-house team is responsible for core activities such as data gathering, reporting, compliance and employee service
- **Business process outsourcing (BPO)**, a full-blown service where the provider takes over control of the bulk of the HR function, from administration staff to systems, usually in conjunction with other functions such as payroll and finance. The customer often retains a team of core specialists, for example in setting policy and employee relations

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[2] See 'From automation to business intelligence: the next generation of hosted services', published by Webster Buchanan Research November 2008, www.websterb.com/hcinsider

1.3 The components of HR system outsourcing

HR system outsourcing is a relatively new approach to systems management that provides access to skilled resources for the management and support of key HR systems. These kinds of outsourcing arrangements encompass a range of different activities and tend to be negotiated on a case-by-case basis.

Key components of an HR system outsourcing agreement may include:

- **Ongoing support of the core HR system** This includes customer-specific management activities such as adding new users, setting up a new screen layout or configuring non-standard HR reports for business managers. In cases where the customer continues to run the software in-house, it also includes handling minor upgrades to the system, such as interim releases of software enhancements or security patches. (If the software is hosted, upgrades to the core software will automatically be handled by the service provider). Typically, it does not include significant coding work, such as customisation of the software or development of bespoke features
- **Data Management** This is one of the most important tasks in HRIT management, given that the quality of HR data impacts everything from day-to-day operational efficiency to reporting and analysis. Under an HR System Outsourcing agreement, the outsourcer will take on responsibility for data quality – including data "cleansing", where it conducts spot checks to ensure details are accurate and corrects problems where necessary. Typically, the outsourcer will also carry out bulk data uploads and change database fields as required
- **Maintaining interfaces** to manage the flow of data to and from other systems, such as finance or payroll
- **An IT service desk** for tracking problems, incidents and major change programmes related to the HR system. Issues should be tracked from the point where they're first raised through to resolution. In an outsourcing set-up the service provider has access to all events relating to the HRIT system, which will sometimes make it easier to identify root causes of problems: for example, users might experience poor performance in their self-service application because maintenance is being carried out on the back-end records. It's important to bear in mind that the service desk focuses purely on the HR system: problems rooted in other systems or telecommunications issues will be passed back to the customer's in-house IT team
- **Continuity planning and back-up** The customer's IT department will have its own back-up plan and business continuity policy, and it's important that the outsourcer's procedures meet or exceed the same standards. One advantage of handing responsibility for HRIT continuity

planning to a third party is that it reduces HR's reliance on the central IT team, which may be overwhelmed in the event of a major incident

- **Training and systems support.** While formal training programmes will be managed through a separate contract, ad hoc on-the-job advice can save HR employees significant time and effort when they encounter a problem
- **Advice on maximising investment,** whereby the provider offers recommendations about ways in which system use can be improved. This can range from techniques to improve performance – which benefits both HR and employees – to implementing software modules that the customer may have paid for but not installed. This kind of "shelfware" is common among users of broad-based HR systems, who typically only install selected components during an initial implementation. Putting these modules to use may allow organisations to automate key processes and improve their people management capability: competency management and succession planning modules, for example, are frequently overlooked
- **Easing adoption of newer technologies** such as manager self-service, which may stretch the capabilities of an in-house team. The limitations of HRIT support capability can be a barrier to adoption of new technologies that could streamline the HR function and improve quality of service, and these factors should be brought into the business case analysis for HR system outsourcing

Responsibility for IT-related tasks will vary from organisation to organisation, so the parameters of the service need to be clearly defined (*see Part Two*). In a mature outsourcing agreement, where a strong level of trust exists between the customer and outsourcer, different elements of services can be drawn down at different times during the lifetime of the contract. Some agreements are structured in a way where clients pay an umbrella fee for services and then commission them as required, with the outsourcer providing a burn-off chart indicating how much resource remains available.

1.4 Weighing up the business case
While most organisations will approach HR system outsourcing with one eye firmly fixed on the potential for cost reduction, there are a number of other factors to consider in a business case analysis. They range from reducing risk and reliance on key support personnel, to providing more timely support for HR systems and key projects.

As with any outsourcing arrangement, the cost reduction factor needs to be approached with care. In some outsourcing arrangements – particularly larger-scale Business Process Outsourcing deals, where the service provider takes over responsibility for the bulk of the HR function – the potential for cost savings is sometimes limited. And for good reason: many of these deals are

based on customer demand for significant service improvements, and cost benefits only kick in when automation investments start to deliver rewards. The more this kind of BPO service is customised to meet the client's specific need, the less savings will be generated by the service provider through economies of scale.

HR systems outsourcing is a different beast, not least because it's a highly-targeted activity. In most organisations, HR systems are typically supported internally by one or more experts with specialist knowledge of the software application and underlying IT environment. This system supervisor in turn is usually supported by resource from a central IT department. It's not always easy to calculate the exact cost of systems support, as it may only be a part of the supervisor's overall role, but it's possible to get a reasonably accurate estimate to compare to the outsourced service.

In many cases, the in-house set-up will be inherently inefficient, largely because the peaks and troughs of ad hoc work requirements mean the systems supervisor will often be either under-resourced or under-utilised. By contrast, an outsourcer should be better able to balance workloads between different clients and maximise the economies of scale. Of course, the outsourcer is also looking to make a margin on the activity, so this will pare back some of the potential gain.

Equally important is risk reduction, the benefit that comes from reducing dependency on one or more individuals who can get sick, go on holiday or be tempted away by a better offer. In building a business case, organisations need to assess how exposed they would be if this key individual were unavailable, how easy it would be to find a replacement, what the cost would be to the business if support were suddenly turned off – and how much it would cost to put back-up capability in place and develop a succession plan.

The cost equation can also generate unexpected benefits. There's a grey area between HRIT work that's normally itemised as capital expenditure and work carried out under an ongoing maintenance agreement. Depending on the nature of the outsourcing agreement, in some cases organisations may find that they can carry out work under the banner of maintenance that might otherwise have to go through a capital expenditure approvals process.

From a service quality perspective, organisations are recommended to:
- Assess the availability, flexibility and cost of support resources. A central IT department supporting an HR systems supervisor will typically have to juggle competing demands, and even something as straightforward as a management request for a newly-configured report may rank as a low priority. Similarly, it's hard to scale system supervisor capability up or down at short notice. Organisations should weigh their past

experiences of in-house service quality with the different service level options on offer from the outsourcer, taking particular note of speed of response, scalability, and of course cost

- Compare the level of expertise provided through the HR outsourcing arrangement with their own in-house capability. It's the outsourcer's business to support HR systems: for the customer, this is simply a necessary overhead. As organisations' HRIT requirements get more complex – for example, with the introduction of employee and manager self-service – they may find they're constrained by a lack of in-house support expertise. At this point, HR system management moves from a predominantly IT-focused exercise to something that directly impacts HR efficiency, effectiveness and the quality of service provided to the business
- Assess the potential value of having a third party review the way their IT systems are set up and used, and spot opportunities for new efficiencies and improvements (*see Case Study, Part Three*)

While HR System Outsourcing can be provided for both in-house HRIT systems and hosted services, the greatest efficiencies come when a single provider both hosts and manages the software. By controlling every aspect of the HRIT environment – from changing operating systems in the core IT infrastructure to reconfiguring users' screens – the service provider is able to fine-tune all the components that need to gel together to provide an optimum HRIT set-up, as well as having visibility into the complete picture if and when problems arise.

Part 2: Collaboration and Confrontation

2.1 Effective partnerships

Much has been made in recent years about the nature of the relationship between outsourcing service providers and their clients – and for good reason. For all the talk of partnership and collaborative relationships, clients go into outsourcing arrangements looking to minimise risk, contain costs and improve service quality – and they're paying for the privilege. The easiest way to secure their investment is to eliminate as many uncertainties as possible, usually by closely defining service quality levels and expectations.

The problem is that you can't legislate for the unexpected - and the unexpected happens. Ultimately, the real test of a business relationship is how effectively the two parties work together when things go wrong. Some customers reach for the contract and start searching for penalty clauses: others work with the provider to tackle the issue and do the blame allocation afterwards. In fact, some organisations now prefer not to introduce penalty clauses at all, instead building creative risk-sharing contracts where providers are incentivised to deliver on performance goals. The unexpected is still tackled in the initial contract, but primarily by way of establishing an escalation process to manage issues as they arise.

This kind of trust-based relationship is particularly important in a systems outsourcing agreement. Firstly, when you outsource HR system maintenance and support, the technical expertise relating to the workings of the system passes over to the service provider. Clearly, therefore, the client has to trust the service provider's analysis of problems as they arise.

Secondly, the outsourcing provider will be carrying out a significant amount of work behind the scenes, including maintaining the security of employee data. The client has to be confident that this routine but nonetheless essential maintenance is being carried out.

Finally, as we indicated above, HR systems outsourcing is sometimes the first step in a phased approach to fuller outsourcing – perhaps as an interim step between in-house deployment and a hosted environment. Building a trust-based relationship through the systems outsourcing contract can make the transition to additional services less daunting.

2.2 Meaningful SLAs and contracts

None of this is to suggest that organisations should skimp on defining Service Level Agreements and contracts: they remain the backbone of the relationship, helping to define and allocate responsibilities. A typical service level agreement will include an outline of the services being delivered; expected performance

levels; procedures for managing any problems that arise; the client's responsibilities; warranties and remedies; back-up and recovery provisions; and termination clauses.

The performance criteria require particularly firm management. It's tempting for customers to go into great detail here, but this can quickly overburden the monitoring and reporting process and undermine actual fulfilment. There's an argument in favour of keeping the criteria relatively simple, ensuring that performance levels are tracked across no more than half a dozen variables. These might include:

- Initial response times
- First time query resolution
- Length of time to resolve any escalated queries
- Time taken to dispatch an engineer
- Volume of service issues, including recurrent issues
- Customer satisfaction ratings

Response targets are particularly important – not least because they're so visible to the customer – and there's value in taking a creative, pragmatic approach to setting goals. Some service level agreements specify a range of responses, from agreed minimum service levels, through expected average service level up to best-in-class. This can encourage a more practical approach to service fulfilment by matching optimal service delivery to greatest need. You may not need best-in-class service for uploading bulk data, for example: but repairing an interface to the payroll system as the month-end cut-off approaches will be critical.

Part 3: Case study: KCOM

Most HR teams are resigned to the fact that when it comes to their IT department's priority list, they're often at the tail end of a very long queue. Software systems that support frontline operations – from manufacturing and sales software to the desktop productivity tools employees rely on for their day-to-day work – tend to get first shout. New types of software– the kind that present a technical challenge to IT – are also high on the list. The general perception about HR systems, however, is that as long as they're up and running properly, minor fixes and enhancements can wait their turn.

So how feasible is it to have an HRIT outsourcing partner on tap to help with systems and data management, step in when something goes wrong, and offer advice on developing your HR system for the future?

That's the approach taken by KCOM Group Plc, a publicly-quoted communications provider to businesses, public sector organisations and consumers. Its 34-strong HR function, which serves in the region of 2400 employees, is heavily reliant on technology to execute its people management strategy. The company previously set up an arrangement whereby Computers in Personnel, the supplier of its on-premise people management system, Ciphr, will provide HR systems and data outsourcing services. And it argues that the move has helped it push people concerns to the front line of the organisation's strategic development.

"It gives us the agility to operate at the speed we need, to deliver what we want to do," says Jason Boyle, director of HR operations. "We want to get more efficient and smarter in the way we deliver our services, and embrace technology in doing that. But we can't do it unless we have the expertise to take it forward."

KCOM's HR function has been largely restructured over the last three to four years, with a central service centre set up to manage employee transactions and link to HR business partners located in the business. When it first implemented Ciphr as its HR Management System, systems maintenance was handled by an internal team that managed support, report writing and basic system changes, such as modifying table structures or adding extra fields to the database. But as the company's requirements became more demanding – not least through the introduction of self-service – that wasn't enough. "What quickly became evident was that firstly, it was costing us too much, and secondly we didn't have the in-house expertise to take it to another level," says Boyle. "We were coping, but we didn't feel we were getting the most out of the system. And we wanted to ensure we weren't missing any tricks."

Under the outsourcing agreement, KCOM purchases a number of days service from Computers In Personnel each month, which it can call on whenever they're required. The current arrangement consists of four key elements:

- Maintenance of the Ciphr system, including minor configuration changes such as changing fields or modifying data tables. While the system is still sited on KCOM's premises, much of this work can be done remotely
- Bulk uploads of data, which are often time-consuming for in-house IT teams
- An HRIT helpdesk, providing support to tackle any problems that KCOM service centre staff encounter while using the Ciphr system, such as data errors. The parameters for the services agreement, including response times, are predefined in a standard Service Level Agreement
- Consultancy for larger projects, which may move from the realm of maintenance (such as minor configuration changes) into development (including small customisation projects, where the underlying software code in Ciphr is changed.) This kind of service, which is closer in nature to traditional systems integration consultancy, can be paid for through spare capacity in the outsourcing budget. One recent example was the development of a custom performance review function, allowing managers and employees to add comments on reviews directly into the system

Computers In Personnel's services team works closely with KCOM's IT department, and if it needs to make substantial changes, change control procedures are in place to try to minimise the impact on overall system performance. While it's fair to expect to encounter difficulties in coordinating these different services internally and externally, KCOM has found it relatively straightforward. "It's pretty clear what the arrangement covers from both their and our perspective," says Boyle.

In addition, as Computers In Personnel refines its core maintenance service provision, improved efficiencies will leave greater scope in the budget to focus on other services. Already, the outsourcing arrangement has allowed KCOM to push through projects that might previously have had to be justified as capital expenditure. It recently implemented a new phase of manager reporting within its self-service system, Ciphr Net, giving managers access to upcoming reviews, staffing reports and employee pay lists. "The flexibility on how we use it has to me been one of the real benefits," says Boyle. "If you're just adding in another field, in real terms, that could be a separate development project. But we can do it under the [outsourcing] arrangement and execute it more quickly."

The outsourcing arrangement is seen as the first step towards using other outsourcing services, and in the next phase, KCOM plans to take the Ciphr

system off-site and have it run by Computers In Personnel. This 'hosted services' set-up – where the service provider runs and maintains the software and users access it over the internet – has partly been driven by the need to provide self-service access to employees in companies previously acquired by KCOM, some of which have not been brought onto the core IT platform. "Sometimes the cost of bringing all the companies onto a single infrastructure is difficult to justify," says Boyle. "While we'll roll it out to the majority of them, there are still pockets that are not on the system."

Boyle concedes that there's "a real element of nervousness within the IT community," about transitioning the company's core HR system to an external provider, pointing out that they want to ensure the right checks and balances are in place. But this is not a new model for KCOM: hosted systems are already in place for flexible benefits, e-learning, recruitment and online payslips, and Boyle believes the KCOM HR team has already answered most of the questions.

Going forward, KCOM is also interested to see how Computers In Personnel's outsourced services can be extended to support enhanced reporting and people-based business intelligence, allowing it to improve its trend analysis and forecasting. A business case will shortly be submitted for approval internally, demonstrating a number of tangible business benefits.

As one of the first exponents of this type of outsourcing arrangement, KCOM concedes it's still working out how to get the most out of it. "We've learnt from this and we're still learning through the partnership approach," says Boyle. "Did we get it right first time? Not always. But we'll take the learning on as we move to the bigger outsourcing agenda." Ultimately, he believes technology is fundamental to what KCOM is trying to achieve in people management. "Part of my goal in transforming the HR function has been changing the way we deliver services back to the organisation – and that definitely involves the systems, data and providing access to information 24/7."

End Notes

About the Author

Webster Buchanan Research is a market research company specialising in business management and the supporting role of technology. Webster Buchanan's primary focus is on People Management, Multi-country Payroll, Strategic Payroll, Customer Relationship Management and Financial Management. The company is based in London, San Francisco, Singapore and Hong Kong. For more information and copies of recent research reports, visit www.websterb.com.

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