

Outsourcing



LONG-TERM PAIN FROM SHORT-TERM GAIN?

The HR function is rapidly becoming the latest focus for outsourcing in a financial services industry still striving for further cost efficiencies. But Chris Callaway sounds a cautionary note.

Many readers may have been surprised to learn from Wanda Warhaftig's article¹ on outsourcing and offshoring in the last issue of *Argent* that relatively-few customer call-centres are actually outsourced, and only a small proportion of these are located offshore. IT is by far the largest sector in terms of global outsourcing, but human resources is in second place, accounting for about 15% of all outsourcing.²

There is no doubting the recent growth in outsourcing – expenditure in Europe, for example, doubled between 2002 and 2004³ – nor that these trends are likely to continue. A recent survey⁴ suggests that 57% of HR professionals see outsourcing as a way of concentrating on more important issues, with only 19% seeing it as a threat to HR. There has, of course, been a degree of adverse press coverage, but this has tended to focus on customer-contact centres based in India and on ill-starred government IT contracts, and companies will be encouraged by further developments such as the recently-announced ten-year \$575m deal between BT and Accenture.

In fact, the consensus amongst the pundits is that these trends will accelerate in the medium term, with single

process HR outsourcing (worth £27 billion in 2004) projected to increase to more than £42 billion in 2008, and multi-process outsourcing (where organizations outsource more than one element of, in this case, HR to the same company) expected to grow by 21% a year to \$7 billion in four years time.⁵ Such rapid growth clearly reflects the desire and opportunity for significant cost-cutting⁶ and process streamlining, but it is important to recognize that there are certain tactile areas to which outsourcing cannot add value without potential downsides elsewhere in the organization.

Options

Several different solutions are available to companies wishing to outsource their HR activities. The whole function can be managed, or just specific areas such as payroll, benefits, training, recruitment and pensions. These disciplines are all time-consuming, and most of them are seen as administrative and "non-core" to HR. Thus, by getting rid of the mundane elements, the HR professional can concentrate on more pressing issues such as strategic planning ...

That sounds good if you say it quickly. But pension

NON-CORE BUT STILL AFFECTING THE CORE?

Outsourcing has been a key focus in the UK National Health Service since the 1980s, when a new emphasis on applying best practice from the private sector emerged.

The central principle seemed clear: the core competencies of a hospital, and the elements on which the patient/customer will judge, depend on the skill of the surgeons and the quality of the nursing care. Everything else is non-core, and thus a candidate for outsourcing.

One such area is cleaning – but perhaps the short-term cost-savings, after a decade or so of general application, are now being judged against emerging longer-term downsides.

Cleaning in wards is a labour-intensive operation, with little opportunity for cost-reduction through technology or automation, so the outsourcers tend to pay rock-bottom wages, which scarcely promotes staff enthusiasm or loyalty.

And operational control of the cleaners is divorced from the (nursing) ward management, which introduces bureaucratic delays and discourages the feeling of *esprit de corps* that generally characterized the traditional arrangements.

Perhaps at the time cleaning was seen merely as a necessary cosmetic exercise – a basic hygiene factor in the sense that Herzberg later borrowed for his theories on employee motivation – but the seemingly-inexorable spread of MRSA infections, and the difficulties in eradicating them, now cause many health service executives to question whether the short-term gain was worth the long-term pain now being suffered.

provision is an increasingly sensitive area: if something goes wrong, especially on the investment front, will employees blame the insurance company to whom the pensions are outsourced – or you, for making a lousy outsourcing decision? And if you sub-contract your training to an “industry specialist”, is there not a risk that you will get just industry-standard courses rather than the exceptional and insightful training that might differentiate your company, through the actions of your employees, from the rest?

And I would argue even more strongly that recruitment and retention should be at the very heart of the personnel department. The websites of nearly all leading banks and insurers stress the value that they put on their staff – who, after all, are the main source of differentiation in a service company. It might be different if customers only met the marketing department, but in practice it is other staff who have most of the contact, and therefore make most of the impressions on customers. And remember that it is not

just the face-to-face stuff that counts – someone struggling with a clumsily-designed form or a recalcitrant website is interfacing with one of your back-room boys – unless, of course, that function has been outsourced as well. So outsourcing your recruitment should be viewed as a dangerous gambit rather than a no-brainer cost-saving opportunity.

Context

These issues must, of course, be judged not just in an absolute sense but also in the context of the current environment. The new millennium ushered in a more subdued job market and a wealth of unemployed yet skilled talent. Many employers have reduced costs by establishing preferred supplier lists (PSLs), which most recruitment companies accepted pragmatically on the grounds that a lower percentage of something is better than a larger percentage of nothing.

This strategy is not unique to HR, but – as elsewhere – there are grounds for doubting that it is sustainable in

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the longer term. The jobs market is becoming more buoyant, with skilled staff less available – so recruitment agencies are busier and have less need to work with those companies who demand reduced margins, and will be more willing to “go the extra mile” for those clients paying more appropriate rates. Many of those who continue to depend on PSLs to cut costs are potentially jeopardizing future company growth, by distancing themselves from the main marketplace and limiting their opportunities to find the best, rather than merely the cheapest, candidates.

Recruitment is an area that has to be taken seriously. Key individuals need to be attracted to your organization, kept happy within it and must want to strive to make it successful. This is the area that cannot be delivered by outsourced administrators who know little about your company, its structure, history or ethos. The last five years have been kind to this new industry, as recruitment levels have been very low and skilled workers have been readily available. The next three years will be more “interesting”, as the market turns into a candidate-led environment and recruitment levels rise.

Pay for quality

PSL cost-cutting will become a less important factor, and the need for quality candidates and service will take centre-stage. Recruitment works best when the client and the consultant know each other’s business and have an affinity. Outsourced HR just doesn’t work in the same way: you are unable to get detailed information on

candidates or developments; any information you do receive is second-hand, as you are unable to talk to the line manager directly; and rapport is difficult to build.

Worse still, if the new outsourced HR facility consists of a recruitment administrator passing information backwards and forwards, then someone else (usually in the commissioning department) bears the brunt of the recruitment process, instead of concentrating on the work that they do best – and which is most important for the company.

A company's brand is not the logo or the glossy brochures but the sum of the impressions that customers receive from all of their contacts with the organization, and HR and recruitment are therefore vital to brand identity and the development of a long term strategy. This was confirmed by Leslie de Chernatony in *Argent* last year,⁷ when he noted that a recent academic study had shown that:

broadly speaking, marketing and HR worked together in the better-branding companies and the challenger to reinforce the brand through recruitment, induction, training, appraisal and rewards.

A properly-coherent brand is also a modern necessity, as customers are discomfited, and in the extreme repelled, by incoherence in brand delivery.

It seems unlikely that many outsourcing contractors will be sufficiently well-versed in the multi-faceted aspects of a complex financial institution to sustain, let alone enhance, the brand. The millions of pounds being spent by the main banks and insurers specifically on

marketing and HR are seen as non-core in many organizations – the distinct lack of HR and marketing professionals on the boards of financial services companies suggests that these disciplines do not play key roles in setting strategic direction.

Like any emerging sector, outsourcing is bound to suffer from trials, tribulations and highs and lows before it settles and finds its common ground. But the best way to avoid the tribulations and the lows,⁸ and to experience the highs, is to really understand the dynamics of the outsourcing process and where sustainable value can be delivered.

In some routine and administrative areas, such as payroll management, there is little doubt that the outsourcers can deliver both acceptable service and the economies of scale that offer the revenue savings that companies seek.

But there are other areas in which customer service failures will prove fatal for the relationship, or where consummate application is a potential source of competitive advantage. In these fields – and I would suggest that the management of staff recruitment and retention is one – companies must be much more circumspect in following the outsourcing fad. True, the immediate benefits to the revenue line may appear attractive, but the downside risks to the quality of staff, on whom the definition and the delivery of the brand ultimately depend, are likely to be too great. □

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In managing staff recruitment and retention, companies must be much more circumspect in following the outsourcing fad.

image and branding rather than mere sales promotion suggests that few of the majors regard cost-cutting as more important than the continued development of brand identity. But do they recognize the importance of a fully-integrated HR department in achieving this? And do they recognize the risk that individual performance targets (which tend to concentrate on short-term profits rather than long-term foundations) may inadvertently encourage cost-cutting rather than business-building?

Sustainable value

Perhaps not, at the moment. The same question is often asked of marketing (which, in contrast to simple sales promotion, also requires an investment mentality), and perhaps the diagnosis is the same. Both

¹ *Passages to India? – Argent 4.1*, January 2005, pp6–9.

² See <http://www.bizbrim.com>, for example.

³ Reported by global sourcing advisors TPI – *Europe overtakes US as world's leading market for new outsourcing contracts* January 2005.

⁴ Carried out by HR Zone – *Is outsourcing a threat to HR?* February 2004

⁵ According to, respectively, the Yankee Group and NelsonHall. *Mid-sized companies to lead outsourcing into the mainstream* – Yankee Group, 19 January, 2005. *NelsonHall forecasts 21% annual growth in multi-process HR BPO market by 2008* – *Personnel Today*, 26 July, 2004

⁶ John Willmott, the founder of NelsonHall, suggests that outsourcing the HR function typically reduces costs by 20–40%.

⁷ See *A valuable experience*, in *Argent* 3.6, November 2004, pp28–32, in which Leslie de Chernatony and Susan Drury, both of the Birmingham University Business School, discussed their latest projects and thinking with Malcolm Oliver. The survey quoted compared attitudes to brand in three different groups of companies – those judged to have strong brands, those with weaker brands, and some “challengers”.

⁸ For example, a survey of 150 British companies released by Proudfoot Consulting found that 38% thought outsourcing had been a complete failure or delivered fewer benefits than expected. See *Outsourcing fails for a third of firms*, at www.management-issues.com, 12 November 2004.