executive briefing

aim research
Advanced Institute of Management Research

The Future of HR

How Human Resource outsourcing is transforming the HR function

Written by:
Mari Sako, Senior Fellow, Advanced Institute of Management Research, Saïd Business School
Abigail Tierney, Research Fellow, Advanced Institute of Management Research, Saïd Business School

EPSRC
Engineering and Physical Sciences Research Council

E·S·R·C
ECONOMIC & SOCIAL RESEARCH COUNCIL

AIM – the UK's research initiative on management

The Advanced Institute of Management Research (AIM) develops UK-based world-class management research. AIM seeks to identify ways to enhance the competitiveness of the UK economy and its infrastructure through research into management and organisational performance in both the private and public sectors.

Written by:
Mari Sako, Senior Fellow, Advanced Institute of Management Research, Saïd Business School
Abigail Tierney, Research Fellow, Advanced Institute of Management Research, Saïd Business School

about AIM

AIM consists of:

- Over 200 AIM Fellows and Scholars – all leading academics in their fields…
- Working in cooperation with leading international academics and specialists as well as UK policymakers and business leaders…
- Undertaking a wide range of collaborative research projects on management…
- Disseminating ideas and shared learning through publications, reports, workshops and events…
- Fostering new ways of working more effectively with managers and policymakers…
- To enhance UK competitiveness and productivity.

AIM's Objectives

Our mission is to significantly increase the contribution of and future capacity for world class UK management research.

Our more specific objectives are to:

- Conduct research that will identify actions to enhance the UK's international competitiveness
- Raise the quality and international standing of UK research on management
- Expand the size and capacity of the active UK research base on management
- Engage with practitioners and other users of research within and beyond the UK as co-producers of knowledge about management

contents

AIM research themes

Current AIM research projects focus on:

UK productivity and performance for the 21st century.
How can UK policymakers evaluate and address concerns surrounding the UK's performance in relation to other countries?
National productivity has been the concern of economists, government policymakers, and corporate decision-makers for some time. Further research by scholars from a range of disciplines is bringing new voices to the debates about how the productivity gap can be measured, and what the UK can do to improve the effectiveness of UK industry and its supporting public services.

Sustaining innovation to achieve competitive advantage and high quality public services.
How can UK managers capture the benefits of innovation while meeting other demands of a competitive and social environment?
Innovation is a key source of competitive advantage and public value through new strategies, products, services and organisational processes. The UK has outstanding exemplars of innovative private and public sector organisations and is investing significantly in its science and skills base to underpin future innovative capacity.

Adapting promising practices to enhance performance across varied organisational contexts.
How can UK managers disseminate their experience whilst learning from others?
Improved management practices are identified as important for enhancing productivity and performance. The main focus is on how evidence behind good or promising practices can be systematically assessed, creatively adapted, successfully implemented and knowledge diffused to other organisations that will benefit.

executive review

The Human Resources (HR) profession is going through possibly the most significant period of upheaval since it became established as a distinct organisational function. The principle reason for this is the impact of Human Resource Outsourcing (HRO), part of a widespread move to outsource business processes.

The HRO market is predicted to grow rapidly, from $23 billion in 2005 to $31.7 billion in 2009. Market analysts are not always right, however. This briefing takes a closer look at the prospects for the HRO market – a key segment of the business process outsourcing market. Will HRO grow as predicted, and, if it does, in what way will it grow, and what impact will that growth have on end-users and the HR profession?

…some organisations are now looking at HRO as a means of transforming and improving the entire HR function…

Initially, the motivation for HRO was the immediate cost savings produced from switching internal spending on various HR processes into investments with external providers. However, some organisations are now looking at HRO as a means of transforming and improving the entire HR function, and not merely a means of getting rid of non-core transactional processes such as payroll or benefits administration, for example.

As an approach to HRO, our research shows that organisations tend to adopt one of three paths to facilitating transformational HRO: they create a shared services centre (SSC) internally before outsourcing the ownership and management of the SSC; they outsource the existing processes first to a vendor, which in turn makes process improvements; or they outsource and transform HR processes at once, in a 'big bang' approach. Each has its own merits and challenges.

On the supply side the HRO market is growing rapidly as vendors find multiple points of entry. The way in to HRO tends to be in one of four ways: through deep domain expertise in one corporate function; by supplying a single end-to-end process such as payroll or benefits administration, through technology expertise initially, or through consulting. In terms of growth we expect the market to go through a period of consolidation as providers search for economies of scale.

Perhaps the most significant effects of the growth in HRO, however, concern the way relationships are governed between service providers and end-users, and the nature of the HR profession in the future.

On the relationship side our research suggests that organisations will need to accept the important role 'relational' contracts, (informal contracts unenforceable in a court of law), play in the HRO marketplace. The importance of these types of agreement is driven by three factors: the complexity of HRO deals; the increased duration of HRO deals; and the transformational nature of HRO deals. Each of these increases the need for the kind of flexibility delivered by relational contracts, alongside traditional, legally enforceable contracts. Alignment of interests and a mutual understanding between the parties to an HRO deal will be critical if transformational HRO deals are to prove successful over the long term.

Finally, there is the HR profession itself. HRO is invariably accompanied by the transfer of some HR staff to the service provider. Such a transfer will be a challenge for many HR professionals, but an opportunity for others, depending on their allegiances.

For those HR professionals that remain with the end-user organisation, there may well be a greater opportunity to have an input at a strategic level. For those operating in the HRO service suppliers market, new skills will be required. HR professionals will benefit from business and change management expertise, process expertise, as well as subject matter expertise in a specific area of HR, such as compensation, benefits, training, or recruitment.

And, with greater opportunity comes greater competition, as the boundaries are blurred between the scope of the HR professional's job and that of lawyers, consultants, and other HRO advisory services.

As our research shows, HRO is likely to affect many more firms than it does today. Organisations and individuals should be planning for change already. Potential end-users should be thinking about how best to approach HRO in a way that allows them to transform their HR processes for the benefit of the business as a whole; HR professionals should be thinking about which side of the HRO divide they want to operate on, and what skills they will need in order to do that.

introduction: the BPO market

1 The rise of Business Process Outsourcing

The growth of the Business Process Outsourcing (BPO) appears unstoppable. In 2004, *HRO Today* magazine concluded that, at the start of 2004, the three most frightening letters in the English language, next to WMD, were BPO. Despite these anxieties, the BPO market grew in 2004 to an estimated £126 billion.

Since then analysts have made a variety of growth predictions: that the market will continue to grow at eight percent over the next five years, reaching $181.5 billion in 2009, for example. The common element in these predictions is for continued strong growth. This is a result of organisations shifting their internal spending on sales, general and administrative activities, into investments with external providers. BPO providers enable organisations to delegate IT-intensive business activities. In turn the provider owns, administrates and manages the processes, based on measurable performance metrics.

The growth pattern is not the same across the outsourcing market, which can be divided into two distinct segments. Currently, most activity is in the high volume commodity BPO space, which accounts for 80 percent of the market. This segment is heavily *transactional*, focused on automating previously labour intensive processes. It is characterised by standardised solutions that can be replicated for different clients with little need for customisation. Lack of customisation means thin margins, as there is little opportunity for vendors to outperform competitors. The main motivation for purchasing is short-term cost reduction.

Buyers are looking for increased efficiency and effectiveness, and ultimately business value.

A second emerging segment is Business Transformation Outsourcing (BTO), a *transformational* strategy, focused on improving the effectiveness of an entire corporate function such as HR. It is a high value-added market, involved in outsourcing end-to-end corporate functions. Buyers are looking for increased efficiency and effectiveness, and ultimately business value. The rationale for BTO is to outsource administrative tasks and thus leave time for the retained organisation to focus on strategy formulation using their core competencies.

Analysts predict that in the next five years the transformational segment will grow more strongly than the transactional. Some analysts have predicted that the proportion of BTO in the total BPO market will increase from 19 percent in 2004 to 31 percent in 2009.

2 To HRO or not to HRO?

...the entire market remains fragmented due to the extensive range of skills that suppliers need to serve a process like HR.

Within BPO, human resource outsourcing (HRO) may seem a counter-intuitive strategy. There is an increasing realisation on the part of managers that, as a result of the cost cutting strategies that accompanied the economic downturn, they have been cutting back their core asset – their employees.

Impelled by an improving economic and competitive environment, some organisations are beginning to build a longer-term strategic view. On the one hand, outsourcing strategies are prone to go beyond externalising non-core processes to an expert service provider. But if human capital is a core asset, and a source of sustainable competitive advantage, how far can firms outsource HR without endangering the future of the business?

Other reasons for the reluctance to outsource HR include the detrimental effect it could have on client service. For instance, without a secure data protection system in place, sensitive employee information might be misused or misappropriated.

There is also a great deal of consolidation currently taking place in the HRO market, and some clients are waiting to see which providers build a sustainable business in HRO. They do not want to risk outsourcing their human resource management to a company which may not exist in six months time, as this would have a negative impact on customer service.

Another argument against HRO is that outsourcing is a restructuring strategy, and it is during restructuring that organisations rely most on their HR departments.

Others reluctant to adopt HRO argue that in comparison to other functions, the potential savings are relatively small. All of these concerns are amplified by the general fear around outsourcing, and the negative association it has with offshoring.

Despite all these concerns, HRO accounts for 65 percent of the wider back office outsourcing market. It is predicted to grow at eight percent over the next four years, from $23 billion in 2005 to $31.7 billion in 2009. While the growth in HR BPO will remain relatively flat, the transformational HRO market will grow at 21%, increasing from an estimated $3.920 billion in 2004 to $8.510 billion in 2009. (See Figure 1 for projected growth).

Figure 1: HR BPO Market Sizing Growth 2004-2008 US$

Source: IBM Global Market View Data. Utilised average of consulting CAGRs:
Kennedy Consulting 4.5 percent; IDC 11 percent; Nelson Hall 8 percent; Yankee 12 percent

Like the rest of BPO, HRO is not a homogenous market. It includes sub-processes as diverse as payroll processing, benefits administration, personnel administration, training and education, expatriate administration, employee communication, HR information systems, compensation design, succession planning, and hiring and recruiting. Single process outsourcing, such as payroll and benefits administration, is a relatively mature market. However, the entire market remains fragmented due to the extensive range of skills that suppliers need to serve a process like HR. This is in contrast to the case of IT outsourcing, in which vendors have been able to provide a 'one-stop shop' package of services from the start.

This briefing looks at a number of important issues regarding this rapidly growing segment of the business process outsourcing sector. In particular it considers the following: What corporate strategies are driving HRO and in what way? What entry and growth strategies are the HRO service providers adopting? What are the characteristics of HRO contracts that facilitate successful outsourcing relationships? What is the impact of the growth of HRO on the HR profession and third-party advisory network involving consultants and lawyers?

The answers to these four questions shed light on the future of the HR profession as well as the sustainability or otherwise of the rapid growth in HRO projected by market analysts.

outsourcing as corporate restructuring for strategic focus

The traditional 'make or buy' decision faced by organisations is not just relevant in relation to the inputs that go into the firm's final products, but also to the processes that take place within the various functional areas of an organisation. This raises important questions: should organisations outsource business processes and if so how far can firms outsource their functions without putting the existence of the firm at risk?

To help answer this question it is important to look at corporate restructuring and, in particular, to understand how decisions are made about corporate restructuring through the unbundling of corporate functions.

Corporate restructuring comes in different forms, for example, there is a distinction between 'vertical disintegration' and 'corporate function unbundling'.

Business service outsourcing is as much about corporate function unbundling as vertical disintegration. Major organisations are restructuring by doing both at the same time, for instance by outsourcing 'modules' or 'components' that cross both the vertical value chain and a corporate function. The distinction between the two, therefore, has implications for the distribution of capabilities in the business service industry, as new entrants and incumbents vie to expand their business.

1 Vertical disintegration of value-adding processes

When looking at corporate restructuring someone with a manufacturing perspective will often focus on vertical disintegration, such as the separation of component suppliers from manufacturers in the PC or motor car industry.

Outsourcing of component manufacturing and assembly is facilitated by modular design and open product architecture. Suppliers are less likely to remain captive to a specific customer company, as the opportunity presents itself to exploit economies of scale across a broad customer base.

First-tier suppliers become global, but are likely to specialise in a specific industry. For example, key suppliers for the automobile industry remain distinct from those in the aerospace industry, although both are assembly-based sectors with a significant overlap in their base technologies. Similarly, in business services, providers of legal services, patent filing, for example, are distinct and separate from providers of medical diagnostic services, although both may involve an element of document preparation. The extent of specialisation and economies of scale are therefore confined to a specific business service sector.

Growth for these suppliers in vertical markets is based on developing new capabilities to be able to take on higher value-added processes in the supply chain. Over time, suppliers are likely to engage in an invasive strategy to go upstream and downstream, in direct competition with the client companies' business. For example, a supplier may start with simple assembly, but develop capability to manufacture the components it assembles, and eventually undertake design and development.

2 Unbundling and rebundling of corporate functions

A different type of outsourcing deal happens when a corporation unbundles its functions rather than its supply chain. Many different corporate functions may be downsized, restructured, and sold to service providers, including human resources, finance and accounting, procurement, and logistics.

In business services, some of the largest outsourcing deals are of this type, such as the $600 million seven-year contracts between BP and Exult and the $400 million ten-year deal between Procter & Gamble and IBM Business Consulting Services.

When outsourcing is about the unbundling of a corporate function, such as the HR function, providers of business services have specific know-how that can be applied to clients in a broad range of industrial sectors. Thus, suppliers can grow very rapidly by exploiting economies of scale and cross-sectoral learning. This gives an advantage to large global players in this field.

The nature of competition between the buyer and the supplier is quite different in the two cases. Vertical disintegration enables buyers to exercise monopoly power to negotiate prices. By contrast, corporate function unbundling does not, as suppliers and buyers are essentially in unrelated markets.

A different type of outsourcing deal happens when a corporation unbundles its functions rather than its supply chain.

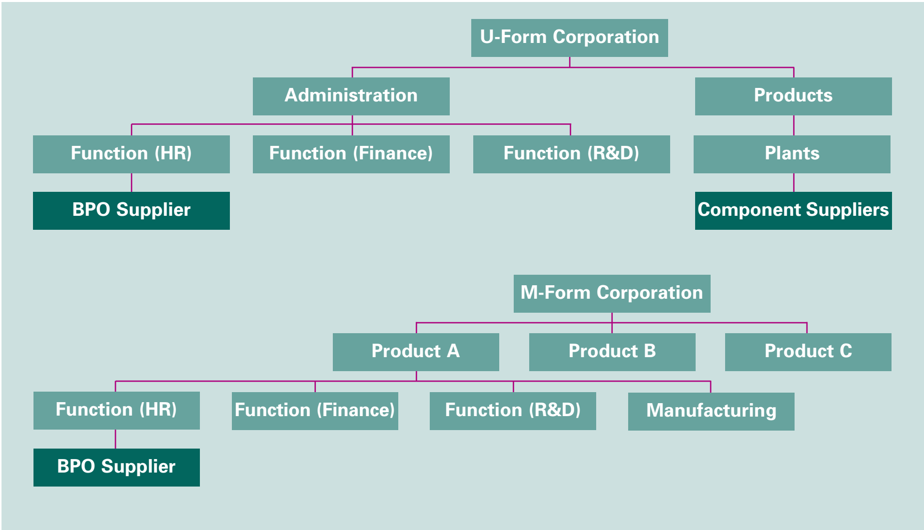
Moreover, suppliers have incentives to grow in different directions. In vertical markets, suppliers grow by deepening industry-specific knowledge and moving into higher value-added activities upstream and downstream, in direct competition with their client firms. Corporate function unbundling, by contrast, leads to suppliers developing expertise in a functional area beyond a specific industry.

To understand the importance of corporate function unbundling, see Figure 2.
In a U-Form Corporation, to use US business historian Alfred Chandler's terminology, a corporation has a single set of administrative functions at the HQ, to support the production of a good, or a service. In the most extreme cases, a company may buy all inputs and materials and even outsource the final assembly of the product so that it becomes a brand owner and a manufacturer without factories, like Dell or Nike.

Apart from buying material inputs and outsourcing final assembly, a corporation may also outsource business processes specific to an administrative function such as Human Resources.

As corporations grew, many adopted a multidivisional structure (M-Form), where each product division had its own set of administrative functions.

Figure 2: Scope for Rationalisation by BPO Suppliers is Bigger in M-Forum than in U-Forum Corporate Structure



With much greater autonomy the product divisions developed their own processes and, as a result, there was some inevitable duplication of some tasks. It then became clear that greater efficiency could be achieved through standardisation and centralisation. To cut costs and improve the quality of service delivery, the same functions in different divisions were bundled together in a shared service centre.

Some organisations that set up shared services centres in the 1990s, have even turned them into a commercial offering. J P Morgan Chase's 'Treasury Services', for instance, competes with outside vendors to provide a service to the bank's operating units.

Other firms are experiencing a levelling off in the benefits of shared services and are looking to a third party outsourcing solution to provide the next step towards transformation. Both BT and Procter & Gamble implemented shared services, but have since opted for third parties to drive further transformation.

Thus, the outsourcing of business services is not about vertical disintegration in its conventional sense, but about the rebundling of an administrative process or function, to be carried out by a third party.

3 Outsourcing: which type?

Outsourcing deals are, therefore, likely to accompany any restructuring of corporate functions. Which functions and processes are outsourced depends partly on a corporation's decision-making structure.

There is an important distinction between 'strategic outsourcing' and 'tactical outsourcing'. For example, analysts tend to consider tactical outsourcing as involving cost cutting, whilst 'strategic outsourcing' is reserved for making transformational improvements.

The strategic focus is due to both thinking more long term about the knowledge aspect of outsourcing – can you outsource tasks without outsourcing and eroding the underlying knowledge; and also subjecting the administrative functions, and not just inputs to production, to outsourcing scrutiny.

In this way, outsourcing has become a board-level decision within the purview of the CEO, peeling away at the administrative support structure of professional managers.

4 Evidence from HRO Deals

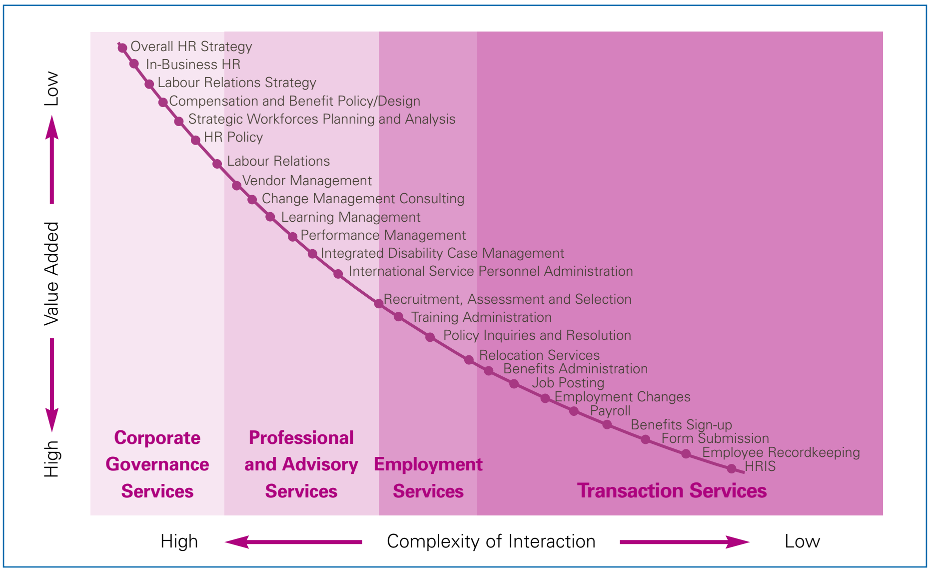
One way of analysing what is happening in the HRO market sector and, in this case in HRO, is to examine the evidence from HRO deals.

Single-process HRO transactions, such as in payroll administration, have been taking place for over 15 years when the use of IT, and in particular, ERP systems, became affordable for most business. Multi-process HRO deals are, however, much more recent.

HR processes can be distinguished as follows:

- HR strategy formulation which is retained by end-user firms;
- Process management and operations which is usually taken on by the outsourcing supplier – within this category there are a complex range of HR processes and operations which can be outsourced (see Figure 3);
- HR information systems which tend to be managed by the outsourcing supplier;
- Data centre infrastructure and network administration which can be managed by either the client or the supplier.

Figure 3: HR Curve



Source: TPI: http://www.tpi.net/solutions/hr.aspx

The majority of HRO activity to date has been in the lower right hand of the curve, but vendors are increasingly trying to move to the top of the curve.

Moving to multi-process HRO

Table 1 (p26-33) lists 114 multi-process deals greater than $25m which were signed between April 2000 and March 2005.

Of the 59 outsourcing buyers, just 19 are in the Fortune 500, which indicates that there are many larger firms still to outsource their HR function. The gap helps to explain the analysts' prediction for growth, as large global firms are more likely to have complex multi-divisional and regional structures, which may be subjected to rationalisation through the centralisation of the HR function.

Multi-nationals are also trading in and between an increasing number of countries, so the level of complexity involved in their HR systems and administration is increasing. HRO, as compared to the outsourcing of other processes, tends to be affected by each country's national laws, making country-by-country rollout a common occurrence. Rather than handling this complexity themselves, large organisations are outsourcing to a third party provider, who has global coverage.

These companies also tend to be concentrated in specific sectors that have experienced deep sector-wide restructuring, such as financial services – Bank of America, Deutsche Bank, regulated utilities – AT&T, BT, and airlines – Air Canada, Finnair. Table 1 also demonstrates that all industries are involved in the HRO market.

Companies also use HRO as a way of rationalising processes when they merge with, or acquire, new companies, as was the case with BP's acquisition of Amoco.

Some processes, such as payroll, are more commonly outsourced than others, like recruitment. Plus, some processes may bundle together better than others, based on the overlap of technology and data. One example of bundling of processes would be core process management, including payroll, benefits, payments and procurement. Another is workforce management, which includes workforce administration, leave management, global mobility, domestic relocation and compensation administration.

As compared to these bundles, recruitment of temporary staff by placement agencies appears to be largely separable from other processes.

5 Paths to transforming and outsourcing business processes

While one-time immediate cost savings are realised by most companies through HRO contracts, transforming the business beyond this is much more challenging. A firm cannot transform its HR function through outsourcing alone, as eliminating the transactional element is only one element of the transformational process.

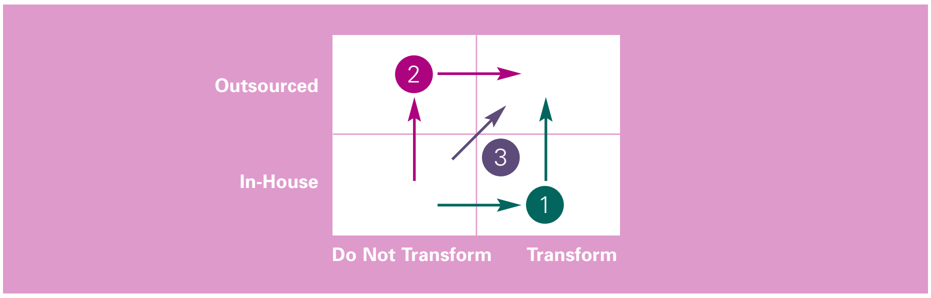
Transformational HRO demands changes in HR's fundamental role, and it requires employees in both the acquired and the retained organisation to behave differently. There is a growing recognition that in order to implement successful HRO, clients should address the changing roles of HR generalists and technical specialists (see page 21 for more on this).

Moreover, the ability to make the transition from transactional to transformational outsourcing depends in part on the exact path followed in multi-process HRO.

As Figure 4 demonstrates, there are three possible paths to outsourcing shared business services to a third party, each with advantages and disadvantages, leading to a different distribution of capabilities between the buyer and supplier firms.

…the ability to make the transition from transactional to transformational outsourcing depends in part on the exact path followed in multi-process HRO.

Figure 4: Three paths to transforming and outsourcing business processes



(i) A company makes process improvements by creating a shared services centre (SSC) before it outsources the ownership and management of the SSC

In this case, the company is able to benchmark the cost of service delivery more accurately. It can also retain in-house know-how of service provision and process improvements. Both these factors strengthen the company's bargaining power during contract negotiation with suppliers. However, this path has the disadvantage of a large resource commitment by the end-user. Moreover, the end-user may not have a service delivery culture necessary to make the in-house SSC a success. Procter & Gamble, for example, followed this path, but considered outsourcing its SSC to IBM a necessary step to achieve full effectiveness.

(ii) A company outsources the existing processes first to a vendor, who in turn makes process improvements

In this case, the vendor takes a lead in providing the technology and the know-how to transform specific processes, whilst the end-user is likely to be in a weaker position to provide an input into redesigning processes. This path provides a more organic way of outsourcing processes, starting with transactional processes.

(iii) A company undertakes to outsource and transform HR processes at once, in a 'big bang' approach

This is done with an expectation of quick returns, and the initial resource requirement to make this happen may be very large. In order to keep the cost of ownership as low as possible, the end-user may engage in full asset outsourcing, as was the case when Exult created a new shared services centre for BP. The end-user has the advantage of creating a SSC without much capital tied up.

However, without much accumulation of know-how in transforming processes in-house, the end-user is likely to become heavily dependent on a specific vendor in this path. This fear, combined with prospect of growth, might lead to an alternative asset ownership arrangement in the joint venture.

strategies of business service providers

Evidence from the HRO market shows that HRO providers adopt a variety of strategies in their attempt to enter, grow and survive in the HRO market.

1 A transforming market

According to the traditional 'make or buy' decision framework, the fundamental value proposition behind BPO is cost reduction. The recent economic downturn forced HR departments to do more with less. Many HR organisations were asked to increase the scope of their capabilities without increasing overall headcount. As a result, some organisations viewed outsourcing as a 'prop for the lame and sickly.'

In 2004 the BPO market started to shift, and buyers began focusing on the total cost of HR programmes.

This phrase refers to the strategy of outsourcing to address short-term financial performance issues through the financial engineering associated with large outsourcing deals. Outsourcing vendors can reduce costs for end-users through labour arbitrage, the implementation of self-service technologies, and taking on the development costs for the technology.

On the more strategic side, vendors can take on the fixed capital costs, enabling buyers to invest in other areas of the business. Service providers can also inject capital and specialist skills to give a much needed boost.

Recent research by business analysts the Yankee Group found that HRO can have a significant impact on the bottom line. The research showed that the average annual running cost for HR BPO providers is between $1,500 and $2,000 per supported employee. This is in contrast to the $5,000 many companies spend per employee per year in total HR costs. For a company with 20,000 employees, a 15 percent reduction in workforce costs and a five percent increase in revenue will have a financial impact in excess of $1 billion.

In 2004 the BPO market started to shift, and buyers began focusing on the total cost of HR programmes. This led to market consolidation, as vendors acquired capabilities across the entire HR value chain in order to create a more integrated approach, and leverage economies of scale.

To succeed in this price competitive market, vendors need to increase economies of scale and decrease infrastructure costs. One strategy that firms such as Procter & Gamble, IBM, and Motorola are adopting, is to move from local to global delivery models, so they can benefit from labour arbitrage and 24/7 service delivery.

The HRO market is not standing still. Clients are looking further than a cost reduction strategy. They are looking for vendors who will transform their HR function. As a result vendors are focusing on value-add solutions. They are bundling HR consulting and systems integration with outsourcing, and introducing gain sharing associated with total HR spend versus transactional fees for delivery. Exactly what counts as 'transformation' is a matter of debate amongst clients and vendors, but a transformational deal would include at least one process from the upper half of the curve in Figure 3 (p13).

Transformational outsourcing claims to support the raised aspirations of HR organisations rather than threaten them. HRO suppliers claim that they can provide sustainable competitive advantage by aligning human capital strategies with business objectives through robust measurement systems and analytics. Prior to outsourcing, many HR organisations 'had been laws unto themselves', with ill-defined metrics and lacking timely accurate reports.

HRO providers believe they can increase transparency, and provide a more complete picture of the HR performance and how this is contributing to overall business performance. Thus, providers and analysts argue that HRO can act as a mechanism for moving towards a more accountable culture.

2 Market entry strategies

Within this broad and evolving landscape, there are four market entry points.

(i) Deep domain expertise in one corporate function

'Pure play' firms competing in the HRO landscape include SynHRG, Xchanging and Exult, before its acquisition by Hewitt.

Private equity firms such as General Atlantic Partners, for example, sometimes create these firms from scratch around an anchor client. These anchor clients are typically brownfield operations in large corporations. Exult and Xchanging are both examples of entrepreneurial start-ups aimed purely at exploiting the market opportunity in HRO, and funded by General Atlantic Partners.

(ii) A single end-to-end process such as payroll or benefits administration

In HRO, the single process segment is dominated by large players such as Ceridian, Paychex and ADP for payroll; Hewitt, Fidelity, and Towers Perrin for benefits administration; and Manpower, Adecco and Spherion for staffing.

(iii) Technology

Firms such as IBM and HP are leveraging their technology expertise to build asset based models for outsourcing.

(iv) Consulting

It includes firms such as Accenture, ARINSO, and PwC Consulting prior to their acquisition by IBM. Both consulting firms and IT specialists often specialise in more than one horizontal function, such as HR, Supply Chain and Customer Relationship Management. These multi-process providers compete in a much more fragmented landscape than the single process firms.

3 Growth strategies

Once a supplier is in the market, various growth strategies are available.

While payroll and benefits administration are currently the largest market segments in HRO, Figure 1 illustrates that multi-process solutions is the fastest growing. This is due to the nascent multi-process market and the high penetration of the single process segment.

For the single process providers there is therefore an opportunity to extend the scope of their processes and expand their client base through mergers and acquisitions.

Hewitt and Exult deal

In 2004, Hewitt built on its own benefits administration by purchasing multi-process capabilities and clients from Exult, the pure play HR outsourcer. Through this acquisition Hewitt gained number one market share (30 percent) based on total contract value and the number of clients with more than 10,000 employees. The acquisition enabled Hewitt to amass dominant market share positions in HR consulting, and multi-process HR, which complements its previous single process HR expertise.

Being acquired by Hewitt strengthened Exult's resources for delivering mega deals and handling large client employee transfers. The profit margins are also expected to improve because Hewitt is now able to offer most services on a direct basis, whereas about half of Exult's historical revenues came from third party providers with a minimal profit margin. Another example of consolidation was Manpower's acquisition of Right Management Consultants in December 2003. Similar to the Hewitt/Exult tie-up, this acquisition enabled Manpower to expand its HR delivery capability to include HR consulting as well as staffing.

A second growth strategy is to extend geographical coverage in order to achieve global presence and enter new markets. When Hewitt acquired Exult it significantly extended its global footprint, and, as a result, was called back in to the deal with Sun Microsystems, which it eventually won. Overnight Hewitt acquired on-the-ground facilities and HR professionals in 45 countries outside the United States.

Mergers and acquisitions activity is also driven by a desire to benefit from economies of scale. While each segment has a distinct revenue and profit model, they all fundamentally depend on economies of scale.

Economies of scale are also important in multi-process BPO because the revenue model is based on customised contracts for each client.

With the exception of HR consulting, the other HR processes have a limited number of profit leaders. For a single process such as benefit administration or payroll processing, providers are paid based on the number of transactions. The ability to leverage a single, highly automated platform is therefore a key driver of profit. This requires a long term investment in technology in order to build a robust and scalable platform.

Hewitt and Fidelity are profit leaders in benefits administration as they have a cost advantage based on lower technology and infrastructure costs (fixed costs) amortised over a much bigger base. In payroll, the profit leaders are Ceridian, Paychex, and ADP.

For staffing providers, the revenue model is based on fee per contract signed, usually based as a percentage of candidate's first year's compensation. For lower end staffing firms (e.g. Monster) automated technology platforms are key for profitability. The technology expands the market for both employers and prospective employees, and it speeds up the cycle time.

Economies of scale are also important in multi-process BPO because the revenue model is based on customised contracts for each client. Multi-process BPO is much more labour intensive than single process BPO. This is because it includes systems integration, low-end consulting, and, in the BTO market, less transactional processes which are not as amenable to self-service. Consequently, global resourcing is a key driver of profitability and vendors are seeking high quality low cost alternatives for call centre delivery and transactional processes.

The consolidation trend is not always mirrored in buyers' strategies. Some analysts are noticing a move away from single-source transactions in favour of a more selective approach with multiple vendors. This approach has been adopted by both Procter & Gamble, which uses both IBM and HP, and General Motors.

While this could lead to further fragmentation, it does provide buyers with the flexibility to pick and choose those vendors who can best serve each sub-process. In the single process segment, first mover advantage through the setting of industry standards is a key differentiator. Pioneers in the HRO market are taking out intellectual property rights on their tools and methods in order to protect this advantage.

towards relational contracts

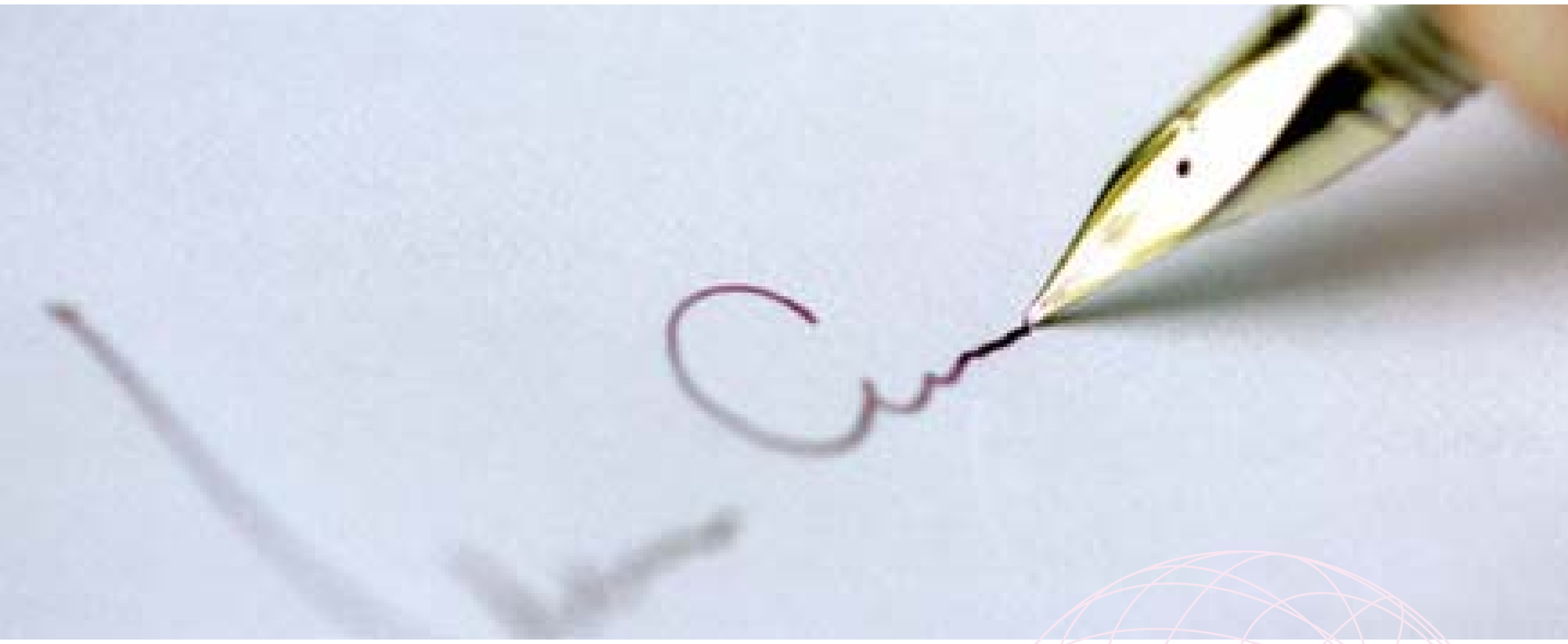
From transactional to transformational outsourcing

Business service outsourcing is usually governed by a contract. The contract consists of a master vendor agreement with general terms, and then a more detailed service level agreement (SLA) that defines the level of service the vendor is committed to provide for each process.

Examining the changing nature of these agreements sheds light on the shift of emphasis in the HRO market from a transactional to transformational approach.

Business contracts are often incomplete; they do not cover every imaginable scenario. This incompleteness can be an advantage as it allows firms to avoid wasteful negotiation costs following the signing of a contract. For example, one firm might attempt to enforce a strict interpretation of the contract according to the 'letter of the contract' rather than the 'spirit of the contract'.

If contracts are incomplete, careful thought needs to be given to what contractual terms should be included, and what should be left out in order to retain some flexibility in the relationship.



It is also common practice to use 'relational contracts', that is, an informal understanding which would not be adjudicated by a court. These are commonly used in combination with formal contracts that would be enforced in a court.

Such relational contracts are self-enforcing to the extent that partners in relationships have their reputation in the industry to consider. If one party to a relational contract reneges on an implicit contractual understanding, the other may threaten to terminate the business relationship. This self-enforcement mechanism works because of the fear that a terminated contract will damage the reputation of the party who failed to perform its side of the bargain.

Evidence

There was a lot of evidence from the research we carried out of the willingness to use informal agreements in HRO, alongside formal instruments, such as formal contracts. This willingness was clear from the statements of HRO providers, such as: "if the relationship is right, the contract should sort itself out." The vendor went on to say that: "Trust and understanding are key. Begin with a general rationale for doing business, and then turn that into something legal, but not until right at the very end. Then keep the lawyers reined in."

Another interviewee working in HRO consulting considered a meeting of minds and the alignment of expectations as key determinants of success in outsourcing relationships. His phrase: "Don't put the contract in a drawer, but don't bludgeon it either" sums up the importance of combining formal and informal agreements.

1 Drivers for a relational contract

There are at least three reasons to believe that HRO relationships would have to rely increasingly on relational contracts; otherwise, formal contracts are likely to become more and more a source of rigidity and wasteful renegotiation.

(i) More complex

HRO deals grow more complex as their scope becomes greater, both in terms of the number of processes included, and also the geographical coverage.

The more complex the HR deal is the more difficult it becomes to specify terms in advance. The deal needs to be flexible enough to allow for the operation to scale up and for continuous improvement in the processes covered.

In reality, even if the scope of processes is specified, vendors may end up providing a growing range of services without an agreed price. In these cases, lawyers would have to be called in to deal with a backlog of unresolved and unpaid transactions before any contract could be renewed. Without the willingness to resolve the backlog in the 'spirit of the contract', rather than the 'letter of the contract', the growth of global multi-process HRO is not sustainable.

(ii) Transformational

In the future, HRO deals are likely to be transformational and not merely transactional. End-users are asking vendors not only to provide services against an agreed detailed process of delivery, but also to transform the existing processes into something better. In a manufacturing analogy, this would be a move from supply to a detailed specification, towards a 'black box' development contract.

Transformational deals are much more difficult to scope out. For example, benchmarking and baseline cost data are not easily available. The inability to cost such a deal makes such transformational HRO deals less likely in the absence of an informal relational contract.

(iii) Longer

Because of the above reasons, HRO deals must become longer to be financially viable. Generally, the cost of initial investment by a vendor is bigger the greater the scope of HRO processes and the more transformational the deal.

HRO deals normally take 18 months before they start generating revenue. Vendors prefer a longer contract to facilitate a longer payback period to spread the larger cost of upfront investment.

Table 1 lists deals ranging from three to 15 years, with a median of ten years. A lot can change in a decade. The longer the contract, the more likely that vendors and end-users will want to retain contractual flexibility.

2 Managing expectations

The message from interviewees we spoke to during our research is that the essence of a successful outsourcing relationship is the alignment of expectations and incentives between the two parties.

Vendors must be careful not to oversell the deal, raising expectations that they cannot meet. Nor should they be so keen to win new deals that they undercut competitors with unrealistic quotes hoping to make it up later once the business is secured.

At the same time, whilst careful thought might go into aligning incentives between the end-user and the vendor, end-users' internal incentives may not be so well aligned at the time requests for quotation (RFQ) go out.

Some interviewees mentioned a tendency among end-users' to rush into RFQs, in order to meet the cost saving targets specified by their CFO, and thus obtain bonuses.

This means that there is a tension between the rush with which some end-users wish to proceed with large-scale HRO, and the time that is required to roll-out the transformation and migration of processes to the vendor.

3 Choices

It is clear that, as with component purchasing in manufacturing, HRO end-users have a choice between contracting standardised processes to vendors at arms-length or developing relational contracts involving a dense exchange of information and know-how.

Although the types of processes being outsourced in HRO appear to demand the latter, various factors, such as the internal incentives of the decision makers within the end-user companies, mean that a move towards relational contracts is by no means automatic.

It has been suggested that half of HR professionals will be working for outsourcers by 2007. If this is true what then are the consequences for the HR profession?

1 HRO: opportunity or threat?

HRO has an immediate impact on administrative tasks which account for two-thirds of HR activity in most organisations. This in turn results in a trimming of HR staff, often regarded as an overhead.

When downsizing, end-users aim to reduce costs, partly by off-loading HR managers to the vendor's shared services centre. For example, 800 employees were transferred in the Procter & Gamble – IBM deal. Such transfers are sensitive events; mishandled, they can lead to high attrition of staff, and add to the cost of outsourcing.

One issue is the identity of the transferred employees. For example, employees that identify strongly with the company that they worked for prior to a transfer, would object more than those who identify more closely with the HR profession or with a dynamic service delivery business. Thus an ex-Procter & Gamble employee who transferred to IBM viewed it as becoming a central part of the new HRO business, rather than being identified as an overhead in the end-user organisation.

2 A new breed of HR professional

For some time now, in the Anglo-American corporate world at least, human resource managers have been criticised for not being strategic enough, for not rubbing shoulders with board-level directors in order to make hard-nosed decisions as a business partner.

Outsourcing may be about separating out the administrative part of the HR profession from the strategic component, but the HR profession is also being transformed in a more complex manner.

Traditionally, HR professionals were generalists who would train in a number of specialist areas, such as recruitment, compensation, and job design, before promotion to head up an HR department. With the training grounds vanishing as they become outsourced or offshored, and with retained HR managers sandwiched between the CFO, who exerts financial pressures, and line managers, to whom HR matters are delegated, what is there left for HR managers to do?

Not everyone associated with the HR industry has a pessimistic view of the future, however. One vendor, for example, interviewed during the research argued that 'there has never been greater opportunity and more careers available for the HR profession than now.'

The basis of such optimism lies in a fundamental redefinition of the skill set that HR professionals require. As business partners, HR professionals have to possess business and change management expertise. In addition they may focus on developing process expertise by working in shared services centres, as well as subject matter expertise in a specific area of HR, such as compensation, benefits, training, or recruitment.

Consequently, points of entry into an HR career will be more specialised and varied, attracting non-traditional entrants with a background in operational efficiency, procurement, or financial management. Above all, the HR profession with this broadened scope of capabilities would have more data and tools at their disposal, enabling them to drive the agenda in an organisation and carry influence at board level.

3 The future

Of the HR professionals that remain in end-user companies, half are likely to focus more on strategic decision-making and policy implementation, less distracted by managing transactional processes. The other half of the HR profession will be based at specialist HRO vendor firms, and have the opportunity to demonstrate, as process experts or area specialists, that they are assets that can generate revenue for their firms and not just another overhead.

Above all, the HR profession with this broadened scope of capabilities would have more data and tools at their disposal…

The latter group, however, will face competition in their role, from consultants and lawyers who are also part of the advisory network that has developed to support the process of HRO. HRO advisory firms and lawyers may be suspicious of HRO providers that also provide consultancy services because of the vested interest the latter has in winning contracts.

A shift from transactional to transformational outsourcing, however, will require a closer link – even the blurring of the boundaries – between consultancy advice and process improvements.

Table 1: HRO Multi Process Deals < $25m (2000-2005)

HRO User	HRO Provider	Date of Contract	Contract Length (years)	Contract Value ($m)
Air Canada	Exult	26/04/2004	7	280
American Express	Mellon Human Resources & Investor Solutions	01/06/2002	10	350
Apparel Manufacturer	Accenture	08/04/2004	7	50
AT&T	Aon Consulting	29/05/2002	7	150
Australian Department of Employment and Workplace	Maximus	14/08/2003	3	31.5
Bank of America	Exult	01/11/2000	10	1600
Bank of America	Exult	30/06/2004	5.5	50
Bank of America	Fidelity Employer Services	12/04/2004	7	300
Bath & North East Somerset Council	Hyder Business Services	03/02/2003	10	110
Best Buy Inc	Accenture	31/01/2004	7	400
BMO Financial Group	Exult	23/04/2003	10	500
Borden Chemical, Inc.	Accenture	08/01/2003	5	30
BP	Exult		5	600
BT	Accenture	02/02/2005	10	459

Processes outsourced initially (processes outsourced later)	Industry Sector	Number employees covered
Core administrative and transactional HR services, Technology and operational tools	Transportation	30,000
HR administration and record keeping, Learning services administration, Compensation planning, Payroll administration	Financial Services	
Compensation and benefits services, Customer contact services, Information services, Learning services, Performance management services, Relocation services, Resourcing services, HR technology services	Manufacturing	
Payroll services, HR administration and transaction services, Oversight of existing benefit plan providers, Provision of HR functionality	Telecoms	70,000
Employment services including: Job placement, Job search support, Customised assistance	Government	
Includes the predominance of the bank's back office HR and affiliated financial processes and regional staffing and recruiting functions	Financial Services	
Recruiting, Temporary staffing, Travel and expense management, Accounts payable, Fixed assets	Financial Services	
HR administration and workforce effectiveness services, Health and welfare services, 401(k) administration services, Payroll services, Defined benefit administration services, Employee stock plan services, Supplier management of third parties that offer Work/Life programmes	Financial Services	250,000
HR administration and payroll services, Business Improvement Service that will provide access to HBS' skills, systems and processes through a dedicated team of analysts	Government	
HR systems support, Payroll, Compensation and benefits, Staffing and recruiting, Corporate HR generalists, HR operations and technology, (call/service centre for employee inquiries, an employee Web portal, a staffing system to facilitate the internal and external recruiting of employees, and an employee-centric data warehouse that centralises all data about individual employees)	Retail	90,000
Payroll and benefits administration, HR call centre management, Employee record administration	Financial Services	
Benefits administration services, Claims processing, Payroll processing, HR information technology management	Manufacturing	
Payroll, Recruiting, Expatriation, Records management, Vendor management, Global e-learning services, Relocation services	Manufacturing	63,000
Expansion of previous HR outsourcing deal	Telecoms	Expansion of previous to cover an additional 10,000 employees

Table 1: HRO Multi Process Deals < $25m (2000-2005) continued

HRO User	HRO Provider	Date of Contract	Contract Length (years)	Contract Value ($m)
Canadian Imperial Bank of Commerce	EDS	17/11/2003	3	71
Canadian Imperial Bank of Commerce.	EDS		7	156
Capgemini	Hewitt	27/10/2004	10	100
Celanese	Arinso	10/01/2002	7	30
Circuit City Stores, Inc.	Exult	10/11/2003	7	350
City of Copenhagen	Accenture	29/07/2003	5.7	43
Dana Corporation	IBM Business Consulting Services	01/04/2005	10	500
Delta Air Lines	ACS	14/02/2005	7	120
Department of Energy	CSC	08/01/2004	10	96
Department of Labor	ACS	03/07/2002	5	45
Electronics Manufacturing Company	Convergys	31/03/2005	10	100
Fifth Third Bancorp	Convergys	20/10/2003	5	50
Gateway	ACS	01/10/2003	0.75	42

Processes outsourced initially (processes outsourced later)	Industry Sector	Number employees covered
3 year extension to existing HR outsourcing contract	Financial Services	
Payroll, Pension, Benefits administration, Contact centre, Project-management support for several bank departments including human resources, health and occupational services, program and financial reconciliation and management	Financial Services	
Full-scale HR BPO contract including: Workforce administration, Benefits, Compensation, Recruiting, Payroll services	Business Services	
HR administration, Payroll administration, Welfare and benefits administration, Application support for SAP-HR	Manufacturing	
Payroll, Benefits administration, Compensation, Employee contact centre services	Retail	38,000
Payroll services, Basic HR services, Development of a new HR system incorporating self-service facilities, Reengineering of pensions and payroll processes	Government	
Payroll services, Benefits administration, Recruitment and training administration, Relocation and expatriate processing services, Employee care	Manufacturing	70,000
Compensation and benefits administration, Relocation services, Recruiting, Learning services, Payroll, HR Information Services, Employee call centre services	Transportation	
Occupational health services including: Medical surveillance, Employee counselling and health promotion, Emergency and disaster preparedness, Monitoring of legacy health issues	Government	11,000
Medical bill processing services initially covering centralised processing for claims (Division of Coal Mine Workers' Compensation program, Energy Employees Occupational Illness Compensation program, Longshore and Harbor Workers' Compensation program)	Government	
Global HR administration, Recruiting and staffing, Training administration, Compensation administration, Performance management administration, Stock option plan support, Benefits administration (not in the U.S.), Business transformation services	Manufacturing	57,000
Payroll administration and processing, Compensation administration, Performance management support, Knowledge management services, Benefits administration, Time and attendance management, Implementation of recruitment technology and a self-service web portal	Financial Services	20,000
Multi service BPO and IT. BPO services include a mixture of HR services and F&A outsourcing. Within HR, ACS will support the following activities: Payroll services and expense processing, Employee benefits processing, Recruiting, Training, Operation of a Gateway employee service centre where the company's employees can call to have their questions answered. Specific finance and accounting services to be provided by ACS will include: Accounts payable, Accounts receivable. Specific IT outsourcing services to be provided include: Midrange computing services, Desktop operations, Helpdesk and field services, Network management, Application development and maintenance	Manufacturing	

Table 1: HRO Multi Process Deals < $25m (2000-2005) continued

HRO User	HRO Provider	Date of Contract	Contract Length (years)	Contract Value ($m)
General Motors	Arinso	04/11/2003	5	90
General Motors Europe	ACS	04/11/2003	10	500
Gissings	Liberata	30/06/2004	15	150
Goodyear	ACS	02/02/2004	10	200
Grupo Semco	Exult	21/09/2004	5	50
IBM	Fidelity Employer Services	02/07/2002	10	150
Infineon Technologies AG	EDS	16/10/2003	10	35
International Paper	Exult	18/03/2003	8	85
Marriott International	Hewitt	14/02/2005	7	150
McKesson Corporation	Exult	06/08/2003	5	50
Metropolitan Police Authority	LogicaCMG	12/04/2005	7	47
Motorola	ACS	19/12/2002	10	650
Office Depot	Convergys	12/02/2003	5	25
PepsiCo	Hewitt	12/04/2005	10	150

Processes outsourced initially (processes outsourced later)	Industry Sector	Number employees covered
Support for deployment of PeopleSoft HR and SAP payroll, Assistence in processing payroll and personnel administration	Manufacturing	
Recruitment, Personnel administration, Time keeping and payroll, Expatriate payroll, Travel and expenses, Training, Reporting, Data archiving	Manufacturing	75,000 active, 35,000 inactive employees
Pensions administration including: Pension and flexible benefits administration, Pension contact centre services, Pension enquiries, Information changes, Quality assurance, Pension fund accounting, Banking, Payroll services, Pension and flexible benefits administration solutions	Business Services	
Payroll, Medical benefits, Call centre, Training, Recruiting and staffing Support services	Manufacturing	40,000
F&A services, covering Accounts payable, Accounts receivable, and taxation services, HR outsourcing services, covering Payroll, benefits administration, Recruiting and Training and development administration services	Business Services	
Pension, Health, Welfare plan administration along with other HR services	Manufacturing	
Payroll administration, major elements of the recruiting function in Germany and Austria	Manufacturing	
Learning Administration Services including: Training administration, eLearning, Call centre support for training activities, Learning Management System licensing, Third party management	Manufacturing	
Workforce administration, Benefits administration, Compensation services, Recruitment, Domestic relocation, Learning and development services	Retail	133,000
Recruiting administration services, Learning services, HR contact centre services	Business Services	
Payroll and Pensions services	Government	46,000
HR information systems expertise, Benefits administration, Global relocation, Global employee assistance program, HR selection and assessment, Learning services, Access to global employee call and transaction centres, HR core process redesign/portal, Some compensation, Staffing and performance management systems and processes	Manufacturing	
Health and welfare benefits administration, Leave of Absence administration, Multi-channel contact centre services, Introduction of web-based self service technology	Retail	37,000
Workforce administration, Payroll administration, Benefits administration, Employee contact centre support	Manufacturing	106,000

Table 1: HRO Multi Process Deals < $25m (2000-2005) continued

HRO User	HRO Provider	Date of Contract	Contract Length (years)	Contract Value ($m)
Procter & Gamble Company	IBM Business Consulting Services	09/09/2003	10	400
Prudential Financial Inc.	Exult	17/01/2002	10	700
R.R. Donnelly	Convergys	05/02/2003	5	25
Ritz-Carlton Hotel Company	Convergys	13/03/2002	7	25
Rockwell Automation	Hewitt	13/01/2005	15	50
Rohm and Haas	ACS	23/06/2004	7	100
Sandvik	Accenture	16/11/2004	10	180
Sony	Hewitt	10/10/2002	5	100
State of Florida	Convergys	20/08/2002	7	280
State of Texas Health and Human Services Commission	Convergys	07/06/2004	5	200
Sun Microsystems	Hewitt Associates	10/2004	5	100
Thomson Corporation	Hewitt	04/02/2005	5	50
Transportation Security Administration	Accenture	20/03/2003	5	214.8
Warner Music Group	Exult	21/09/2004	5	30
Williams Companies	IBM	07/2004	7.5	320

Processes outsourced initially (processes outsourced later)	Industry Sector	Number employees covered
Payroll processing, Benefits administration, Compensation planning, Expatriate and relocation services, Travel and expense management, Human resources data management	Manufacturing	98,000
Payroll services, Benefits administration, HR call centre management, Employee records management, Training, Staffing	Financial Services	
Operation of a multi-channel HR service centre, General HR query resolution, Staffing, Leave processing, Support for an HR website	Business Services	25,000
Health and welfare administration, Insurance payment processing, Employee stock ownership administration, Implementation of necessary software solutions to support employee care solutions	Retail	16,000
Workforce administration, Payroll administration, Health and welfare and defined benefit services	Business Services	15,000
Human resource technology and infrastructure services, including administration of the company's human resource information technology platforms and employee and manager self-service tools, Technology to support compensation planning, performance management and leadership development, Payroll services, recruitment support, and relocation services in North America, Payroll services in France	Manufacturing	
Administrative services to support: Resourcing, Employee support, Competence development, Performance management, Reward and recognition. Accenture will establish a new service centre in Sandviken and will oversee Sandvik's HR operations in: Finland, United States, Sweden. (Operations in France, Germany, United Kingdom, South Africa, India, and Australia will be added at a later stage)	Manufacturing	
General HR	Manufacturing	
Recruitment, Training, Benefits Administration, Payroll Administration	Government	189,000
Payroll administration, Benefits administration, HR administration, Employee support services	Government	46,000
Workforce administration, Recruiting and staffing, Compensation administration, Performance management, Training and learning	Manufacturing	>30,000
Compensation services, Payroll administration, Learning and development services, Recruitment	Business Services	28,000
Executive level HR administration, Employee orientation, General HR records administration, Benefits administration, Core compensation services, Payroll administration	Government	67,000
Benefits and payroll services	Media	
HRO, FAO, ITO	Utilities	NA

conclusions

Our research highlights some important trends and issues relating to the future of the HRO industry, and the strategies of end-users and vendors of HRO. Trends and issues that have implications for both end-users and HRO service suppliers.

1 Rapid growth

There is likely to be rapid growth in HRO, with transformational outsourcing occupying a larger proportion of the total than transactional outsourcing over the next four to five years.

The reasons behind the projected rapid growth lie on both the demand side and the supply side of the market.

On the demand side, end-users are using HRO as part of corporate restructuring – unbundling of corporate functions rather than vertical disintegration – to reduce their internal costs and to focus on their core competence. In the list of HRO deals, large Fortune 500 companies are prominent, but do not constitute the majority, indicating that there are still many untapped companies with on-going deep corporate restructuring.

On the supply side, HRO vendors are entering the market from various points, either as 'pure play' firms, providers of a single process such as payroll administration, consultants, or technology firms.

2 Vendor survival

Nearly all vendors believe that their survival depends on growth in the scope of expertise and economies of scale, fuelling recent M&A and alliance activities.

There might be a space for niche HRO providers and sourcing advisory firms that remain small and profitable. But, on the whole, providers with scale and scope, who can bring capital and technology to the table, are more likely to survive and prosper. This is because much of the entry work being done is transactional, and transition to transformational work (BTO) is not automatic.

Also, whilst possessing relational and customised aspects, most deals gain initially from standardising and integrating processes.

Lastly, since required processes in HRO are not industry-specific, HRO vendors have an enormous opportunity to exploit economies of scale, potentially for any organisation in any sector of the economy.

3 Expect deals to become longer and more flexible

Theory and evidence presented in this paper also shed light on the sustainability of rapid growth in HRO.

Two issues were discussed. First, as HRO deals become more multi-process and more transformational, contracts, currently with a median of 10 year duration, are likely to become longer. As flexibility has to be built into more complex and difficult-to-price HRO deals, there is every pressure to build outsourcing relationships over time so that parties can rely more on 'relational contracts' – i.e. informal understanding not enforceable in courts – to supplement their formal contracts. However, a move towards more relational contracts is not automatic, given end-users' internal financial incentive to rush into large-scale HRO deals.

4 The changing profession

A successful future for the HR profession depends on whether the HR profession can adjust, to a business landscape where HRO is widespread and at a strategic level. A move from transactional to transformational outsourcing is blurring jurisdictional boundaries between HR professionals and those people involved in associated professions such as consultants and lawyers.

The ability of the HR profession to redefine its professional jurisdiction and stake out new boundaries depends on its ability to attract managers with new skills in process design, procurement, project management, and financial management.

AIM – The UK's research initiative on management

If you are interested in working with AIM Research, require further information or to access the following:

- Full UK programme of AIM workshops, conferences and event listings
- Fellows' profiles and full research project details
- AIM quarterly Newsletter and press releases
- Research papers and AIM publications available as downloads
- Information for the media

please visit AIM's website **www.aimresearch.org**

Advanced Institute of Management Research

For all enquiries please contact:
Advanced Institute of Management Research (AIM)

Tel: +44 (0)870 734 3000
Fax: +44 (0)870 734 3001
Email: aim@london.edu
Web: www.aimresearch.org

The Advanced Institute of Management Research (AIM) was founded in October 2002. It is a multi council initiative of the UK's Economic and Social Research Council (ESRC) and Engineering and Physical Sciences Research Council (EPSRC) – with activities at over 30 institutions in the UK and overseas.

ISBN 978-1-906087-02-9