HR Outsourcing in manufacturing Companies in India: An Overview

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“HR Outsourcing as a concept is now where IT Outsourcing was in the early 1990s. The innovators and pioneers have laid out the ground and the next wave will be the pragmatists and later adopters who will only follow a trend after it is well established.”

HR DIRECTOR, FT 100 COMPANY

Abstract

Human resources are the most significant resources of any organization as the organization's success lies in their hands. But in order to make sure that its employees remain satisfied, the company has to have a specialized human resources department that most of time proves to be a costly affair. That is why, most of the companies are offloading their HR functions to external outsourcing agencies. Moreover, it is no longer the privilege of big Multinational corporations but even public sector undertakings and medium/small size organizations have started outsourcing their HR-related activities. In the present study, a sample of 30 manufacturing organizations have been taken from NCR, India. This research study focuses on reasons for HR outsourcing and the problems in implementing HR outsourcing decisions.

Keywords: Outsourcing, multi-process services, third-party, bargaining, vendor

Introduction

Rapidly changing market dynamics and pressures of global competition have caused organizations to spend more time focusing on their core business. Organizations, predominantly manufacturing ones, have always developed contracts with outside organizations to provide goods and services. Any activity in which a company lacks internal expertise and confidentiality and requires an unbiased opinion on human resources, can be outsourced. Outsourcing is just the form of subcontracting, used to describe the practice whereby work formerly performed within an organization is “contracted out” to an external agency. It is the transferring of an internal business function, or group of related activities and assets, to an external supplier or service provider or third party who is prepared to offer a defined service for a specific period of time and at an agreed price. The use of external third parties by companies to provide services that had previously been applied internally is not a new trend.

Right from early 1970s, the HR function has progressively more looked to outsource some of its functions or activities so that work can be carried out more efficiently at less cost.

HR functions like pension and compensation services, transfer and employee motivation programmes, and the execution of training and development activities, are just a few examples of activities that have an established history of successful outsourcing. There has been a considerable transformation in thoughts of HR folks over the last ten years relating to outsource repetitive activities and concentrate more on strategy and policy.

The definition of outsourcing as per Wikipedia “Outsourcing is subcontracting a process, such as product design or manufacturing, to a third-party company.” Brown and Wilson (2005) define outsourcing as “the act of obtaining services from an external source.” Linder (2004) writes that outsourcing is “purchasing ongoing services from an outside company that a company currently provides, or most organizations normally provide, for themselves.” Lei and Hitt (1995) provide a much broader definition for outsourcing, as “the reliance on external sources for the manufacturing of components and other value-adding activities.” Mol (2007) summarizes the attempt to define outsourcing by providing three descriptions of outsourcing:

- “1. Outsourcing refers to those activities that are undertaken by outside suppliers.
2. Outsourcing refers to the transfer of activities and possibly assets from a firm to an outside supplier.
3. Outsourcing refers to those activities that are undertaken by outside suppliers but could also be undertaken by the firm.”

According to McIvor (2005), “Outsourcing involves the sourcing of goods and services previously produced internally within the sourcing organization from external suppliers.”

Kotabe and Mol (2006) state outsourcing as “a range of actions within a clearly identifiable time-frame that lead to the transfer to outside suppliers of activities, possibly involving the transfer of assets including people, as well, that were previously performed in-house or procured from other units within the corporate system.”

The Harvard Business review mentioned that ‘outsourcing’ is one of the most important management ideas to evolve in the last 75 years. It is nothing but transferring select functions or services and delegating their day to day management to a third party called the ‘supplier’ or ‘vendor’. It is merely a way of getting something done by a third party. It may involve transfer of internal operations, including perhaps, its existing staff, to a company supplying the outsource services. Outsourcing is a long term commitment on behalf of the company delivering the service to the outsourcing company.

HR Outsourcing is defined as the performance, by a third-party service provider on a continuous basis, of an activity that would have otherwise been carried out internally (Glaister, 2014; Delmotte and Sels, 2008).

HR Outsourcing is an activity in which a company lacks internal expertise and confidentiality and requires an unbiased opinion on human resources can be outsourced.

HR Outsourcing (HRO) is the application of different business models and techniques to new forms of activities - or processes – and radically redesigning them to create outputs of value

for end users such as customers or employees. HRO can be traced back to the definitive work of Michael Hammer and Jim Champy in Re-engineering the Corporation. This spawned the business process re-engineering (BPR) industry in the 1990s. Business process outsourcing (BPO) is based on the principles of reengineering, but also combines them with the ownership and management of processes on behalf of management by an outside vendor.

Greer et al. (1999) described HR outsourcing as 'the performance, by outside parties on a recurring basis, of HR tasks that would otherwise be performed in-house'.

HR outsourcing is a process in which a company uses the services of a third party to take care of its HR functions. A company may outsource a few or all of its HR related activities to a single or combination of service providers located in offshore destinations. HR outsourcing service providing firms or hr outsourcing company can be divided into four categories depending on the services they offer as, PEOs (professional employer organization), BPOs (business process organization), ASPs (application service providers), or e-services. In these categories the PEOs are the ones that assume full responsibility of a company's hr functions where as others such a BPOs, ASPs and e services provide web based hr solutions like database maintenance, HR data warehousing, maintaining records, developing and maintaining hr software's etc.

Evolution of Outsourcing

Outsourcing has moved on substantially since 1989 when the concept was first uttered by Eastman Kodak's CEO. He announced the outsourcing of the company's computer operations as "lock, stock and mainframe, and farming them out". BP followed, stretching the concept of IT outsourcing into its financial services by transferring accounting and settlement processing for off-shore oil rigs to the then Andersen Consulting. Consulting houses realized the potential of integrating the specific skills of re-engineering business processes with IT. By unbundling or scaling transactional processes in business activities, labor-intensive or 'back office' administrative tasks could be executed through sophisticated software systems written by IT experts working in firms such as Accenture, CSC, EDS, IBM, etc. (Corporate resource Forum, London, 2006)

Types of HR Outsourcing

- **Discrete services:** These are high – volume recurring tasks which are given to third party company. Example: employee verification.
- **Multi-process services:** This is also referred to as blended services. When an organization outsource more than one human resource service, it is known as multi-process services. Example: recruitment, payroll, HRIS, compensation and communications.
- **Total HR outsourcing:** When majority of HR services like recruitment & selection, training & development, payroll systems, employee benefits etc. are outsourced to vendors, total HR outsourcing takes place.

Advantages of Outsourcing

Domberger (1998) and Hendry (1995) list five advantages to outsourcing: lower production costs, cost avoidance, strategic focus, flexibility and relational rents. Burkholder (2006) lists ten advantages of outsourcing:

1. Acceleration of reengineering benefits

2. Access to world-class capabilities
3. Cash infusion
4. Freeing up resources for other purposes
5. Function difficult to manage or out of control
6. Improved company focus
7. Making capital funds available
8. Reducing operating costs
9. Reducing risk
10. Resources not available internally

Disadvantages of Outsourcing

Disadvantages of outsourcing that have been identified include: hollowing out, opportunistic behavior, transaction costs, reduced learning and innovation (Domberger, 1998; Hendry, 1995).

The other probable issues of concern are:

1. Effect on employee morale, which in turn will affect company culture.
2. Hard to quantify “soft” costs.
3. Loss of in-house expertise.
4. No or less HR people on floor at all times.
5. Spillover risks (putting company’s confidential matters in the hands of an outsider).
6. Requires the development of skills in third party account management which may not naturally exist within the company
7. Takes time for the retained HR function to adjust to having to focus on managing ‘outputs’ from the outsourcer rather than managing the process which delivers the outputs
8. A poorly designed scope of services and ill defined service levels can encourage inflexible responses from the outsource supplier if not carefully managed
9. The transfer of knowledge to the outsourcer requires effort and dedicated resources which is not always sufficiently costed in the business case.
10. There may be a perceived loss of control
11. When outsourcing contracts come to being renewed, the outsourcer is normally in a stronger bargaining position than the client organization because of the cost and effort required to either transfer or take the contract back in-house.
12. The signing of an outsourcing contract is the beginning, not the end, of the process. It takes dedicated effort to successfully manage the contract and the issues that will arise on a day-to-day basis as the relationship with the outsourcer beds in.
13. If an outsourcer has been driven down during negotiations to an unrealistically tight budget, then it will not be incentivized to put its best people on the contract. Service standards can be threatened if unrealistic prices have been agreed resulting in a lose: lose situation for all involved.
14. As the business environment and challenges change for the client organization the contract with the outsourcer will need to be revised to reflect new business priorities and realities. Unless properly set up, this change control process can be distracting for both sides of the deal.

Review of Literature

The outsourcing of human resources pertaining tasks play an important role within organizations and represent an important aspect of the way in which companies operate (Ruth et al., 2015).

Flora F.T. Chiang et al(2010)in their study explored the state of human resource outsourcing in the Asian context, a particularly important subject given its rapid proliferation in Europe and North America, the inconsistent and limited evidence from prior research, and its strategic importance to the human resource management (HRM) function. Drawing on both quantitative and qualitative data and the transaction cost, resource-based, and institutional perspectives, they found that although respondents were generally favourable towards outsourcing, that in practice its adoption and diffusion were in a nascent stage in Hong Kong. Decisions to outsource were, by and large, incremental and experimental and influenced by a range of contextual factors (e.g., availability of in-house expertise, skills and creativity, strategic priorities, legislation (coercive), availability of external service providers, and industry and peer (mimetic) influence). Despite considerable pressure to cut costs, instead of outsourcing in the first instance, firms placed greater emphasis on maximizing internal resource utilization (in sourcing).

Norman, T.J.(2009) in his thesis “Outsourcing Human Resource Activities: Measuring the Hidden Costs and Benefits”, has contributed to the literature on human resource management (HRM) and business process outsourcing (BPO) in three important ways. First, this is the first study to report on the level of human resource outsourcing (HRO) for 34 distinct human resource management activities. Second, this study examines the impact of HRO on organizational outcomes by attempting to detect an association between levels of outsourcing different types of HRM activities and three dependent variables: employee turnover, employee satisfaction, and customer satisfaction. Third, the study reports the assessments of several dozen expert raters as to the attributes of the 34 measured HRM activities and their suitability for outsourcing. The data set contains organizational data collected from multiple sources, including HR vicepresidents, CFOs, HR professionals, managers, organizational archives and publically available financial records. The evidence suggests that HRO levels vary along with the predictions of transaction cost economics.

Kabst and Giardini (2008) carried out a study in German to test whether or not RPO has negative effect on the perceptions and evaluations of job applicants. In an experimental study with 160 students they found that the satisfaction with the process, the attractiveness of the organization and intention to accept a job offer decreased with increasing levels of HRO.

Lieven and De Corte (2008) created a model of HR manager commitment in outsourcing relationships testing affective commitment and continuance commitment. They surveyed a stratified random sample of 478 firms in the Flemish part of Belgium and received usable responses from 186 HR professionals. This study found that affective commitment (desire for the relationship to continue) was related to the depth and frequency of HR outsourcing.

Cooke, Shen and McBride (2005) examined HR outsourcing as a competitive strategy. Their review state that the empirical evidence on the reasons for outsourcing HR and results of HRO are both fragmented and inconclusive. Their review also contrasts the dearth of empirical work with the large amount of prescriptive literature on the financial and strategic reasons for outsourcing.

Gilley, Greer and Rasheed (2004) analyzed HRO and organizational performance in manufacturing organizations. Their study included results of 94 firms and sought measures of financial and innovation performance. The findings concluded that outsourcing training and payroll was associated with measures of organizational performance.

Klass, McClendon and Gainey (2001) in their study investigated the relationship between a number of organizational characteristics and the decision to outsource HR. Determinants of the outsourcing of four categories of HR were examined: HR generalists activities (e.g., performance appraisal), transactional activities (e.g., payroll), human capital activities (e.g., training), and recruiting and selection. HR executives in 432 organizations provided data on outsourcing levels and organizational characteristics. Reliance on HR outsourcing was associated with idiosyncratic HR practices, strategic HR involvement, positive HR outcomes, promotional opportunities, demand uncertainty, and pay level. As predicted, however, the impact of organizational characteristics varied among the different types of HR activities outsourced.

Objectives of the study:-

1. To ascertain the HR functions outsourced.
2. To identify the factors influencing HR outsourcing.
3. To find the obstacles faced by organizations in making outsourcing decision.

Research Methodology

Data collection

An exploratory research work has been conducted based on both - primary and secondary data. The primary data was collected by personal interviews of HR managers with help of questionnaire. Secondary data was collected through company document, corporate websites, online journals, news papers, and research & survey reports.

Sampling

Sampling is the selection of a part of an aggregate material of population to represent the whole population. The part of the population selected is called a sample. Thus, in the sampling technique instead of every unit of the universe, only a part of the universe is studied and the conclusions are drawn on that basis for the entire universe.

Sample Size : 30(manufacturing companies)

Sample Design: Random sampling

Survey Method: Questionnaires and Personnel Interviews.

Scope of the study

This research study can be very valuable to the HR folks to realize the contemporary trends, happenings and challenges in relation to outsourcing of HR functions. They will be acquainted with advantages, disadvantages, which activities or functions to outsource to third party and which to be retained by the organization itself. Moreover, third party can also gauge expectations of the organizations.

Data analysis and interpretation

Table 1.

Outsourcing is quite prevalent amongst most of the manufacturing organizations. The HR managers of seventy percent (70%) of the manufacturing organizations stated that they use outsourcing for at least one of their HR functions, whereas ten percent (10%) of those who are not currently engaged in outsourcing reported that they have no plans to do so.

Outsourcing HR Functions by manufacturing organizations:

Among these companies, employee recruitment, training & staff development and payroll/compensation administration functions are the most frequently outsourced HR functions. In contrast, human resource management information system is outsourced thirty

percent (30%) and health care administration is outsourced for twenty percent (20%). Background checks are the least frequently outsourced (10 percent of companies).

Reasons for outsourcing:

Cost reduction was the most often mentioned reason for outsourcing which was cited by 93 percent of HR managers. The need to focus on strategy and core issues was cited second by 87 percent, while making up for lack of experience/expertise was the third reason to outsource with 80 percent. 40 percent indicated reducing HR employees/expenses as a reason for outsourcing. However, almost 33 percent listed improving compliance as a reason to outsource. Only 20 percent of the respondents listed compensating for staff reductions as a reason to outsource.

Obstacles when making outsourcing decision:

The fear of losing control over operations was the major obstacle to outsourcing given by 93 percent whereas 7% of the organization faced no obstacles at all. Lack of prior outsourcing experience in general accounted for 73 percent. Both fear of losing HR jobs and employee resistance in general were equal in percentage which is 50 percent. Locating quality vendors represented a problem for a relatively small number of companies which is 27 percent. Difficulty in finding vendors and resistance from senior management were also some of the obstacles given by 17%. Interestingly, only 10 percent of the respondents expressed resistance from HR as an obstacle.

Negative outcomes of outsourcing :

The study indicates that 60 percent of the organizations were unable to achieve operating cost savings, 37 percent experienced decrease in quality/service level and 17 percent were unable to effectively manage the relationship with vendors. Decrease in morale was cited by 13 percent of the companies whereas 7 percent lacked in-house expertise. Only 27 percent of the respondents had no negative outcomes through outsourcing.

Outsourcing of HR functions in future:

87 percent of the respondents expect their companies to increase outsourcing of HR functions in the future whereas 10 percent respondents expect HR outsourcing to remain the same during the next five years. Surprisingly, several respondents also marked the "don't know/not sure" option, indicating future uncertainty.

Reasons for not outsourcing:

23 percent of the companies indicated that outsourcing HR functions would be too expensive and 10% organizations don't have enough resources. Fear to lose control (7 percent), resistance from employees and senior management (7 percent) and preference to develop in-house expertise (7 percent) are other factors which made the companies decide not to outsource. Moreover, due to bad outsourcing experience, 3 percent of the companies don't want to outsource.

Limitations:

- The study is based on primary data collected from the respondents assuming that they have given their genuine preferences without hiding anything.
- The results of this study may not be generalized for all the regions as it is restricted to Delhi & NCR only.
- The present study is a study of sample. Alternatively, the complete universe would have been studied. This has not been done because of two reasons. First, it was not possible to

study the entire universe with the limited resources and time available at hand. Secondly, it is well established fact that the study of universe and representative sample would provide similar results. It is in this background that a sample study was opted. It is hoped that the results obtained would be appropriate for the strata studied as well as for the universe.

Conclusion

No organization can deny the fact that role of HR Outsourcing is going to augment in coming years. By outsourcing HR functions, organizations can concentrate on their significant core activities thereby enhancing the strategic role played by the HR department. Moreover, department of HR can concentrate more on the value added activities that add considerable value to the company's human capital, which has now become strategic differentiator for the organization.

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Appendice

	Table 1	Outsourcing Survey Results	
S.No.	Parameters	All companies(N=30)	Grand %
1	Does your company currently outsource ?		
a)	Yes	21	70
b)	No	9	30
c)	No, but plans in 3 years	6	20
d)	No, and does not have such plans	3	10
2	Which HRM function does your company outsource?		
a)	Payroll/compensation administration	19	63
b)	Employee background check	3	10
c)	Training & staff development	22	73
d)	Recruitment	28	93
e)	HRM Information Systems	9	30

f)	Healthcare benefits administration	6	20
g)	Strategic business planning in HR	0	0
3	Reasons for outsourcing		
a)	To better focus more on strategy/core business	26	87
b)	To save money	28	93
c)	To reduce the number of HR employees/related expenses	12	40
d)	To improve compliance with standards	10	33
e)	To make up for reduction in HR staff	6	20
f)	To make up for lack of experience/expertise	24	80
4	Obstacles when making outsourcing decision?		
a)	Difficulty finding vendors	5	17
b)	Fears of losing control	28	93
c)	Fears of losing HR jobs	15	50
d)	Lack of qualified vendors	8	27
e)	Lack of prior outsourcing experience in general	22	73
f)	Employee resistance in general	15	50
g)	Senior management Resistance	5	17
h)	HR Resistance	3	10
i)	No obstacles	2	7
5	Were there any negative outcomes?		
a)	Decrease in employee morale	4	13
b)	Loss of in-house talent/expertise	2	7
c)	Unable to achieve cost savings	18	60
d)	Unable to effectively manage the relationship with vendor	5	17
e)	Decreased quality/service level	11	37
f)	There have been no negative outcomes	8	27

6	In the next 5 years, will number of outsourced HR functions will increase, stay the same or decrease?		
a)	Increase	26	87
b)	Decrease	1	3
c)	Stay the same	3	10
7	Which factors made your company decide NOT to outsource?		
a)	Don't have enough resources	3	10
b)	Fear to lose control	2	7
c)	Employee resistance	2	7
d)	Resistance from senior management	2	7
e)	Would be too expensive	7	23
f)	Had bad outsourcing experience	1	3
g)	Prefer to develop expertise/technology in-house	2	7