

## Preparing for human resources business transformation outsourcing

*Risk mitigation strategies*



*An IBM Institute for Business Value executive brief*

IBM Business Consulting Services, through the IBM Institute for Business Value, develops fact-based strategic insights for senior business executives around critical industry-specific and cross-industry issues. This executive brief is based on an in-depth study by the Institute's research team. It is part of an ongoing commitment by IBM Business Consulting Services to provide analysis and viewpoints that help companies realize business value. You may contact the authors or send an e-mail to [iibv@us.ibm.com](mailto:iibv@us.ibm.com) for more information.

## Contents

1	Introduction
1	Understanding outsourcing risk
2	Mitigating HR BTO risk
20	Summary
21	About the authors
21	About IBM Business Consulting Services
21	References

## Introduction

Making the decision to outsource human resource processes is a major step for many organizations. Once a company has decided to outsource one or more human resource processes and has selected a vendor, the next major task is to implement an effective outsourcing arrangement. Transitioning to an outsourcing arrangement can pose a unique set of risks that must be proactively managed, given the complexities associated with transferring significant operational processes to a vendor while maintaining ongoing service to internal customers.

We believe that clients and vendors need to work together to establish strategies that reduce or limit potential risks in the management of what we call HR Business Transformation Outsourcing (HR BTO). Rather than simply handing over a process to an outside firm to operate, HR BTO focuses on transforming HR activities to improve efficiency and effectiveness, and create business value. Based on secondary research and interviews with outsourcing providers, consultants, academics and individuals responsible for outsourcing arrangements, we have identified four basic sets of activities that can be used to mitigate the risks inherent in outsourcing important human resources processes.

### *Understanding outsourcing risk*

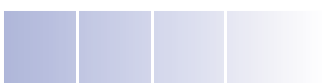
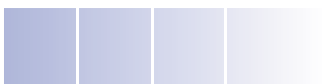
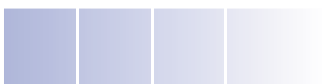
Jeanne Ross and George Westerman from the MIT Sloan School of Management describe a framework for understanding the risks inherent in entering outsourcing relationships. These risks can be broken down into four major categories:<sup>1</sup>

#### *Strategic risks*

- By outsourcing a particular HR process, the organization may be losing knowledge and capabilities that may gain additional importance in the future.
- Changes in the strategic direction of the organization must now be coordinated with one or several outside firms that may or may not be able to react with the same level of responsiveness.
- Outsourcing can limit the opportunities to attract/develop future human resource leaders in the organization.

#### *Relationship risks*

- Vendor and client are making long-term arrangements based on events that cannot be definitively predicted in the future, such as vendor viability, market conditions and legal/regulatory changes.



*Transition risks*

- Disruptions in service levels are possible due to a failure to adhere to, or adopt, new processes, tools and other work arrangements.
- Potential attrition or planned job loss can impact morale and organizational effectiveness, particularly with key staff.

*Operational/technical risks*

- New technologies, the introduction of third-party subcontractors and the financial health of a vendor can all impact the ability to deliver a particular service.
- Outsourcing can also increase the perception that sensitive employee information might be misused or misappropriated.

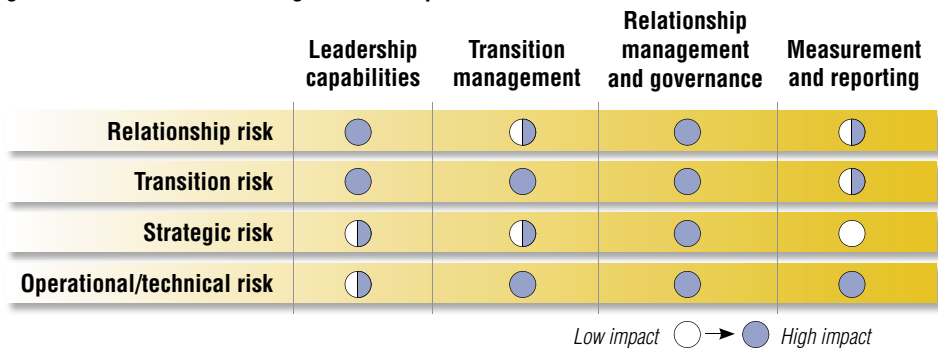
**Mitigating HR BTO risk**

Based on our research, we see four major sets of activities that can help reduce these risks:

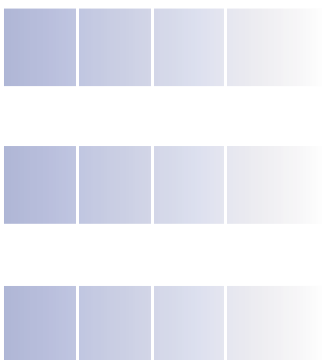
1. Identify the *leadership capabilities* required to oversee the overall outsourcing effort
2. Create an overall *transition management* plan that identifies all the activities required to transfer responsibility to the vendor
3. Develop an ongoing *governance and relationship management* structure to address conflicts and build an effective working relationship between the client and the vendor
4. Build a *measurement and reporting* framework that communicates how well the outsourcing arrangement is operating.

As illustrated by Figure 1, we believe that each of the different risk mitigation techniques addresses multiple risk factors.

**Figure 1. Risks versus risk mitigation techniques.**



Source: IBM Institute for Business Value analysis.



Identify the internal leadership capabilities required to oversee the overall outsourcing effort.

### 1. Leadership capabilities

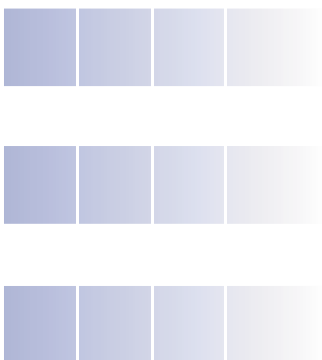
When talking to both HR BTO clients and vendors, one issue that becomes very clear is that leading an outsourcing arrangement is notably different from running a functional organization. In an outsourcing arrangement, the client does not necessarily have to worry about traditional issues associated with managing a large organization, such as hiring new employees, purchasing equipment or planning for additional office space. Instead, an entirely new set of responsibilities emerge, demanding skills that are not typically part of the traditional HR professional's skill set. As the VP of Service Delivery at a financial services company suggested, "You need a different [set of] skills to lead in an outsourcing environment – more focus on project management and metrics...fact-based outcomes, and less on people development and coaching."

In an article published in the *Sloan Management Review* in 2000, Michael Useem from the Wharton School of Business and Joseph Harder from the Darden School at the University of Virginia identified six key leadership capabilities that are valuable in outsourcing arrangements.<sup>2</sup> Though the context in which they were writing focused primarily on IT outsourcing, the six capabilities provide a relevant framework for the types of leadership skills needed by HR professionals as they take on outsourcing responsibilities.

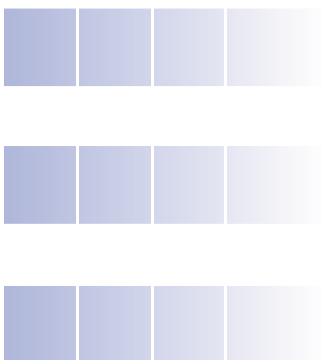
Figure 2. Key leadership capabilities in an outsourced environment.



Source: Useem, Michael and Joseph Harder, "Leading laterally in company outsourcing," *Sloan Management Review*, January, 2000.



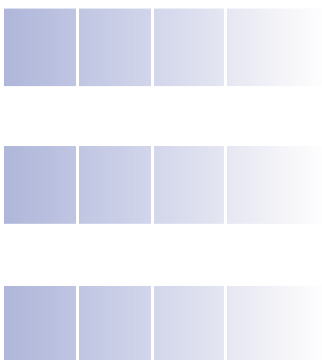
- *Strategic people vision* – HR professionals that lead outsourcing arrangements need to view the Human Resources function as a business *contributor*, not simply as a business *support* area. They must understand how strategic human capital management can provide competitive advantage to an organization, and how human capital can be managed through innovative and unique value propositions, programs and approaches. This will help determine how to best use the vendor to support their strategic activities *and* manage administrative, commodity-like work.
- *Analytic approach to problem solving* – One of the major differences between an outsourcing arrangement and internal HR management is the significant emphasis placed on metrics to measure whether the vendor is providing the appropriate level of client service. Prior to an outsourcing effort, many companies spend little time developing the appropriate metrics necessary to gauge the effectiveness of their HR processes and their impact on internal customers. Outsourcing efforts, because of their contractual nature, require a greater focus on these metrics. As such, leading an outsourcing relationship requires a strong “client service” perspective. Therefore, an individual leading an outsourcing effort needs to determine key effectiveness indicators early on in the contracting process and continue to evaluate these metrics for validity throughout the life of the relationship. After the contract is established, they need to be able to monitor and evaluate the results of service level agreements and determine the root cause of poor performance, adjusting measures as appropriate.
- *Deal making* – Part of leading an outsourcing effort is being able to evaluate and select vendors. This includes understanding the vendor marketplace to identify potential partners, evaluating multiple vendors and balancing the current and future needs of the client organization with the vendor’s cost and capabilities. While several of the individuals that we spoke with indicated that it was the responsibility of the client organizations’ legal and procurement teams to negotiate the terms of the final arrangement, the outsourcing leader needs to provide guidance to the negotiating team during the initial contracting process and throughout the life span of the contract.
- *Partnership governing* – Once the deal is negotiated, perhaps the biggest challenge facing the leader is the responsibility for managing a multi-million dollar business relationship. The leader needs the expertise to establish a series of formal governance procedures to identify issues, escalate problems to the appropriate level of the organization and recognize opportunities for mutual gain. Also, it is critically important that the leader has the ability to identify and cultivate key relationships in the partner organizations. Trusting relationships are more amenable to problem solving and issue resolution, and can reduce the need to go through the formal process. Several of those interviewed talked about the



importance of being able to manage “one step above the contract” and to settle small differences without having to go through additional legal changes and qualifications. (*Additional governance and relationship management issues are addressed later in this report.*)

- *Change management* – The leader of an outsourcing arrangement needs to be integrally involved in change management to successfully manage stakeholder expectations and perception. The outsourcing leader needs to be able to develop and articulate the rationale for the outsourcing decision, understand the drivers of resistance from various stakeholder groups and assure those key stakeholders that their concerns are understood and are being addressed. This is particularly true in situations where unions and works councils are being impacted by outsourcing changes. In addition, the outsourcing leader must be able to identify and leverage a host of internal champions and construct a communications infrastructure that not only sends and receives formal messages, but also is linked into the informal “grapevine.” Finally, the outsourcing leader must be willing to make decisions about the reduction and redeployment of existing staff – often a difficult task since outsourcing decisions can have a direct impact on employees’ jobs and careers.
- *Program management* – An outsourcing leader often needs to oversee a large and complex set of interrelated projects involving retained employees and vendors. The skills necessary for this task include the ability to track individual project progress, coordinate among different programs and projects, understand overlaps and synergies, monitor budgets and financial systems, and recognize when particular efforts face difficulties. Further, the outsourcing leader needs to serve as a liaison to the senior management of the company, communicating progress and anticipating and addressing areas of concern. Finally, the outsourcing leader should serve as an outsourcing champion, sharing good practices from these projects with other outsourcing efforts throughout the company, whether they are related to HR or another function.

In their research, Useem and Harder found that over two-thirds of hiring executives would pay at least a 6 percent premium for each of the above skills, while 40 percent would be willing to pay an 11 percent premium.<sup>3</sup> Though many companies would like to find one individual with all of these capabilities, often times, it is simply not possible. In many instances, outsourcing leaders will need to be supported by other individuals who are stronger in specific skill areas where the leader is less experienced.



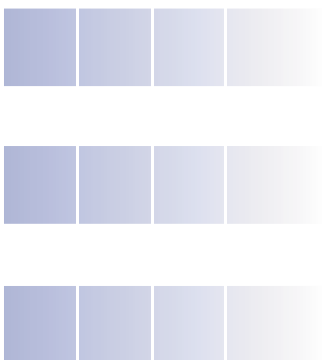
Compounding this challenge, many of the capabilities required to lead an outsourcing effort are often not found in the traditional skill sets of HR managers. While developing a strategic people vision and change management strategy might be skills that HR managers develop as part of their normal work experience, several of the other skills are more likely to be cultivated in other parts of the organization (see Figure 3). For example, an analytic approach to problem solving might be a skill developed as part of working in a call center environment, where large volumes of data are collected and analyzed on a daily basis. Similarly, deal making and partnership development skills may be more readily found in a business development or alliance management function. And program and project management capabilities might be more common in an IT department or central project office function. Because existing HR managers may not possess the full complement of skills required, companies should be open to supplementing with capabilities from outside HR when managing a large-scale outsourcing effort.

**Figure 3. Identifying key leadership capabilities within the organization.**



*Source: Useem, Michael and Joseph Harder, "Leading laterally in company outsourcing," Sloan Management Review, January, 2000; IBM Institute for Business Value analysis.*

**Create a transition management plan that identifies all the activities required to transfer responsibility to the vendor.**

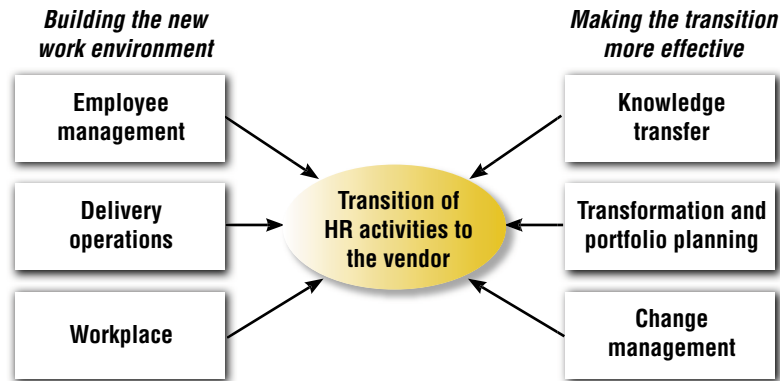


## **2. Transition management**

Perhaps there is no time during the outsourcing process that a client feels as vulnerable as during the transition of processes from the client to the vendor. Not only is the organization literally "handing over" its processes (and in some cases, its people and systems), but, at the same time, its success depends on everything working properly when the vendor begins operations. A mistake made during that time has the potential to interrupt service levels, destroy credibility and bring out legions of outsourcing critics. A well-orchestrated transition management process can play an important role in facilitating the exchange of resources (both physical and know-how) and improving the odds that operations will run smoothly once the transition is complete.

In developing an effective transition management process, organizations need to consider two major work streams: building a new work environment (i.e., defining the resources needed to make the processes work under the vendor's control) and making the transition more effective (i.e., improving the odds that the new environment will work properly once it is operational).

**Figure 4. Transition management focus areas.**

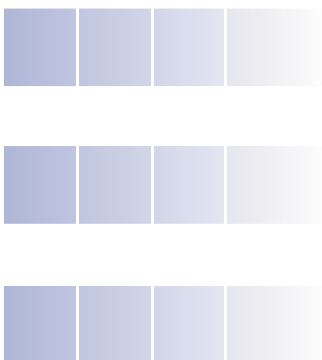


Source: IBM Institute for Business Value analysis.

When building the new work environment, three primary issues need to be tackled prior to the vendor taking control of the process:

- *Employee management* – In their planning, companies must consider three particular groups of employees directly affected by the outsourcing. First, there are employees that will be displaced when the vendor assumes full-scale operations. While eliminating employee positions is never an easy task, both the company and the vendor should work together, striving to treat displaced employees fairly throughout the process. This includes providing a comprehensive suite of severance packages, outplacement counseling, job-search assistance and retraining opportunities.

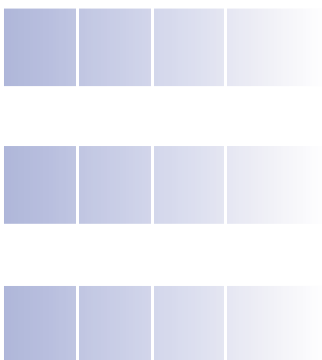
Second, for those that are being offered employment by the vendor organization, it is critical that the company advise those individuals of the terms and conditions of their job offers well in advance of their transition dates. As vendors prepare these offers, they need to work closely with clients to develop attractive compensation and benefits plans for these transitioning employees and address unique issues, such as expatriate benefits plans. In some situations, this will involve careful coordination with unions and works councils throughout the planning and execution of these new employment offers. It is especially important to retain



key resources through the initial years of the arrangement to avoid loss of tacit knowledge and facilitate a smoother transition. Therefore, the parties should agree on a retention strategy, including bonuses and other incentives, before the commencement of services.

Lastly, the company will retain a certain number of employees within their HR organization. However, in many situations, those employees' jobs will change significantly. For many in the HR function, their roles will be more focused on strategic and design activities, or will entail entirely new responsibilities managing the vendor relationship. These employees will most likely need training and coaching, not only in their new roles, but also in overall vendor relationship management techniques. Whereas, before the outsourcing arrangement, retained and transitioned employees worked together for the same organization, once outsourced, the relationship with service providers becomes more formal, and must be managed within agreed upon parameters. For some organizations, this may represent a significant change effort. Similar to retention efforts associated with those being offered employment in the vendor organization, it is important to develop a retention strategy and commensurate compensation packages for retained resources.

- *Delivery operations* – Key components of the delivery model should be clearly fleshed out prior to the launch of the new arrangement. In particular, the company should determine the appropriate operational service level metrics that will be used to evaluate vendor performance and develop a management reporting system to track key measures and issues. When the outsourcing arrangement involves the use of an employee contact center, the standard operational plan for the center should be shared and understood by the entire organization. Finally, the vendor should procure, install and test any client systems that have been outsourced, as well as any newly acquired third-party systems during this transition period. After all the key elements of the delivery operation have been transitioned, the ongoing operations of the newly transitioned tools should be tested to validate that the handoffs between the vendor and client were complete and no relevant activities were omitted.
- *Workplace infrastructure* – Experience has shown us that even the smallest technological details can quickly snarl the transition process. If the vendor is taking infrastructure previously owned by the client, both parties need to identify and provide the necessary computer equipment and network infrastructure to sustain day-to-day operations. They also need to build a plan to manage the transition of communications systems, such as phones, PBXs and e-mail systems

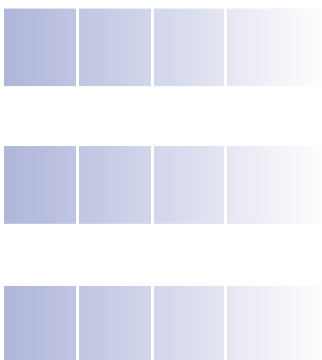


from the client to the vendor. The two parties need to establish the appropriate connectivity between the vendor and client networks, and provide employees with appropriate passwords and application access on both sides. During the transition period, both client and vendor personnel will need to have access to both old and new applications and infrastructure to validate that the cut-over from one system to another is complete. Finally, the vendor and client need to construct a business continuity plan to deliver services in the event of a large-scale business or technological failure.

Each of the previously outlined steps focuses on creating the new work environment for employees. Simultaneously, companies should address three key issues that will dictate the effectiveness of the overall transition process. These include:

- *Knowledge transfer* – One of the most important steps in the outsourcing process is the exchange of both explicit and experiential knowledge between client and vendor. As a VP of one technology company indicated, “A lot of people avoid this step because it brings ‘mortality’ closer and closer.” However, knowledge transfer is especially important to validate that formal documentation associated with contact center, processes and applications is accurate and up-to-date. Further, the knowledge of how to address various exception circumstances may be absolutely critical in maintaining the continuity of service delivery when the vendor becomes responsible for operations. Yet, the knowledge transfer process during an outsourcing transition is fraught with potential challenges.

For example, staff reductions can allow knowledge to “walk out the door” and result in a number of knowledge gaps. Working across large vendor and client organizations can make it difficult to identify and locate key experts, especially early in the outsourcing process when individuals are just learning about each other’s capabilities. Finally, as operations commence, a number of good practices and lessons learned will likely emerge that need to be shared, both across locations, and between client and vendor. These types of transfers can be hampered by differences in time zones, location, local culture and the amount of time and effort invested in identifying, capturing and sharing key lessons. Figure 5 provides an overview of the types of knowledge that need to be transferred during an HR BTO arrangement.

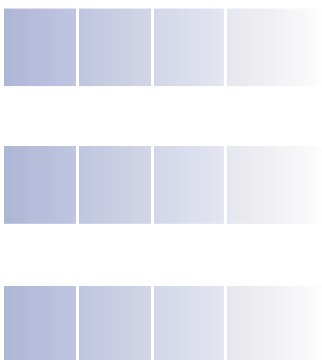


**Figure 5. Important knowledge categories to be addressed during transition.**

Knowledge categories	Description	Example
<b>Process knowledge</b>	<ul style="list-style-type: none"> <li>Knowledge about how routine activities and processes should be executed on a day-to-day basis</li> </ul>	<ul style="list-style-type: none"> <li>How do I approve a leave of absence request for an employee?</li> <li>How do I process a pay upgrade for a part-time employee?</li> </ul>
<b>Organizational knowledge</b>	<ul style="list-style-type: none"> <li>Knowledge of the key contacts and capabilities within the vendor/client organizations that can apply appropriate expertise to nonroutine questions</li> </ul>	<ul style="list-style-type: none"> <li>Who is the vendor subject matter expert on expatriate tax issues?</li> <li>Who is responsible for resolving employee grievances in Chile?</li> </ul>
<b>Systems knowledge</b>	<ul style="list-style-type: none"> <li>Knowledge about existing systems and how they have been modified over the years</li> </ul>	<ul style="list-style-type: none"> <li>What functionality do our current kiosks provide to our manufacturing population?</li> </ul>
<b>Program management knowledge</b>	<ul style="list-style-type: none"> <li>Knowledge about the progress and management of the overall transition process</li> </ul>	<ul style="list-style-type: none"> <li>Why do we have to obtain a special dispensation from both the local and national works councils before sending offer letters to transitioning employees?</li> </ul>
<b>Customer knowledge</b>	<ul style="list-style-type: none"> <li>Knowledge about the internal customer such as service expectations, cultural attributes, self-service capabilities and preferred information sources</li> </ul>	<ul style="list-style-type: none"> <li>What is the preferred channel for sales representatives to receive their commission statements?</li> </ul>

Source: IBM Institute for Business Value analysis.

Companies can use a number of techniques to facilitate knowledge exchange. Work shadowing, where an incumbent works side-by-side with an individual who will be taking over his activities, has been a traditional way for knowledge to be shared between client and vendor organizations. It can be a useful technique, as it enables the newcomer to ask questions and allows the incumbent to pass along experiential knowledge in the context of the actual work being performed. However, incumbents who are subject to job loss may be resistant to this approach if their resulting job loss is not compensated. Further, if this type of knowledge transfer is not done in conjunction with some form of explicit documentation, the company may be exposed if the newcomer leaves shortly after the transfer. There are a number of other ways that knowledge can be shared, ranging from documented subject matter expert interviews to simulations to collaborative environments designed to capture and organize relevant documents. Figure 6 provides a description of various knowledge transfer techniques.

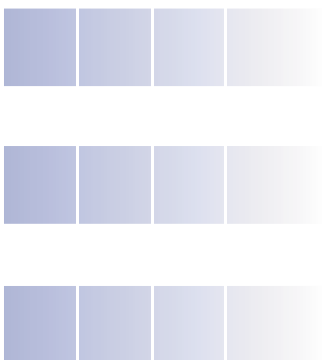


**Figure 6. Knowledge transfer techniques.**

Technique	Description	Strengths	Weaknesses
<b>Work shadowing</b>	Incumbent employee works side-by-side with individual who will be taking over his or her activities	<ul style="list-style-type: none"> <li>• Ability to ask questions and pass along experiential knowledge</li> <li>• Knowledge is passed along with the context of the operational environment</li> </ul>	<ul style="list-style-type: none"> <li>• Incumbents may be highly resistant to this approach if resulting job loss is not appropriately compensated</li> <li>• Knowledge transfer may not be explicitly documented, leaving the company open to risk if the newcomer leaves shortly after the transfer</li> </ul>
<b>Subject matter interviews (either one-on-one or in group format)</b>	Key subject matter experts are interviewed and their remarks captured in written/ audio/video format	<ul style="list-style-type: none"> <li>• Preserves critical knowledge that might otherwise be lost over time</li> <li>• Knowledge can be shared with many individuals</li> </ul>	<ul style="list-style-type: none"> <li>• Discussions might occur outside the context of performing work activities</li> <li>• Captured knowledge can quickly lose relevance without appropriate context</li> <li>• Ability to find/access materials over time</li> </ul>
<b>Documentation of work processes</b>	Work activities are written down in explicit detail and stored in a common location	<ul style="list-style-type: none"> <li>• Preserves critical knowledge that might otherwise be lost over time</li> <li>• Knowledge can be transferred to many individuals</li> </ul>	<ul style="list-style-type: none"> <li>• Documentation must be easy to locate and access</li> <li>• Documentation can lose relevance over time</li> <li>• Often does not include tacit knowledge of employees which is useful in addressing atypical situations</li> </ul>
<b>Simulations/ process walkthroughs/ parallel environments</b>	Creating an operational environment that gives employees an opportunity to practice using new systems and processes without the concerns of making errors in a production environment	<ul style="list-style-type: none"> <li>• Gives employees the opportunity to make mistakes in a protected environment</li> <li>• Reinforces classroom learning</li> <li>• Can be reused over time</li> </ul>	<ul style="list-style-type: none"> <li>• Can be expensive depending on the complexity of the process</li> <li>• Need to be maintained to remain accurate</li> </ul>
<b>Collaborative repositories</b>	Creating a virtual environment where individuals can organize and store relevant documents and search to find appropriate materials	<ul style="list-style-type: none"> <li>• Provides a standard location where individuals can find materials they need</li> <li>• Taxonomy makes it easier for individuals to find what they need</li> <li>• Can provide easier version control and ability to search</li> </ul>	<ul style="list-style-type: none"> <li>• Must be periodically maintained so that materials and taxonomy remain relevant</li> <li>• Must be linked to the original author so that individuals can go to the source of the original document</li> </ul>
<b>Expertise locators</b>	Leveraging processes and technologies for identifying and locating key vendor or client experts	<ul style="list-style-type: none"> <li>• Can significantly reduce the amount of time needed to locate experts</li> <li>• Increase percentage of questions answered appropriately</li> </ul>	<ul style="list-style-type: none"> <li>• Requires individuals to maintain their profiles and/or allow automatic profile software to develop profiles for them</li> <li>• Only useful in identifying individuals (not in retaining their expertise)</li> </ul>

Source: IBM Institute for Business Value analysis.

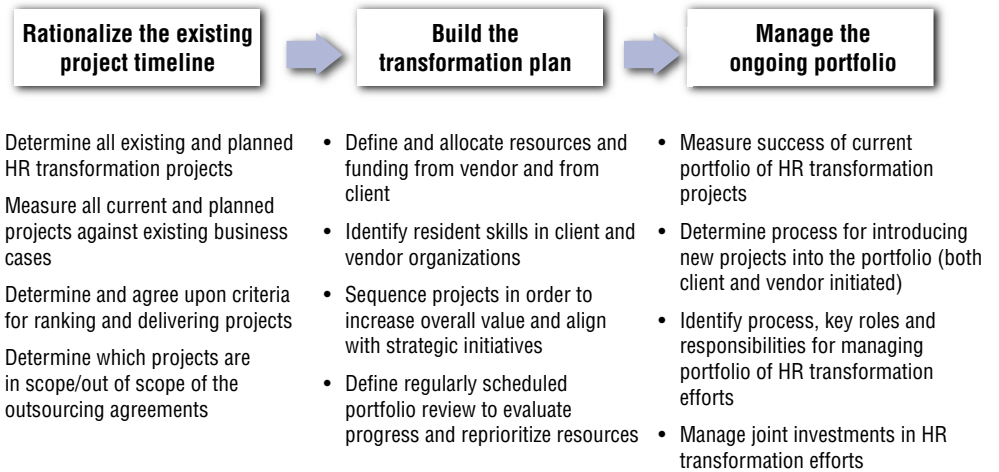
Often, knowledge transfer is most valuable when techniques for capturing explicit knowledge are combined with methods for sharing and applying more experiential types of knowledge. This can help ensure that knowledge, in whatever form it takes, is preserved and available to others in the future.



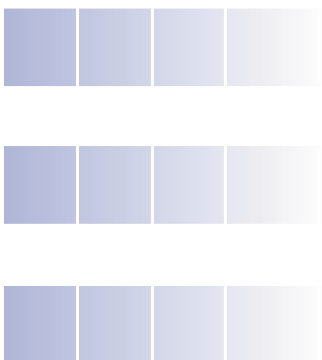
- **Portfolio management** – While transitioning HR processes to the vendor, a company may have a number of improvement efforts that are either ongoing, or need to be accomplished in the near future. For example, a company that has decided to outsource its HR contact center to a third-party vendor might also be reengineering its recruiting and staffing processes. Similarly, a vendor might spot an opportunity for joint cost savings in the learning management process that would involve a commitment of resources from both the client and the vendor organizations.

To facilitate close coordination between the client and vendor, the companies should create a joint portfolio management process to oversee all client HR improvement efforts. During the transition management phase, the client and the vendor should first rationalize the existing pipeline of improvement projects. This includes cataloging all relevant projects, reviewing them against intended business cases and determining which ones are in or out of scope for the outsourcing arrangement. Then, both parties should build a master plan which incorporates both transformation and transition activities, milestones and deliverables. This overall blueprint defines and allocates resources and funding from the vendor and client, identifies relevant skills for the projects, sequences the projects in order to increase their overall impact and spells out a series of timelines and milestones. Finally, both parties should manage and review these projects to prevent duplication of effort and enable value realization by both sides. Figure 7 highlights the key steps for undertaking this type of portfolio management.

**Figure 7. Developing a portfolio of HR transformation projects.**



Source: IBM Institute for Business Value analysis.



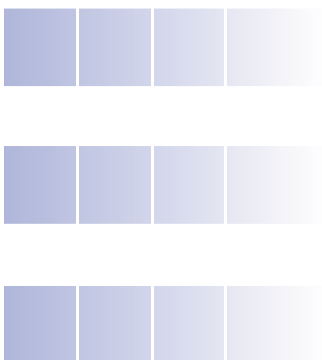
- *Change management* – “We did not have an adequate change management plan, nor did we dedicate enough resources to executing the plan.” This quote from one of the companies that we interviewed summarizes what many of our interviewees strongly believe: that despite all the best intentions, change management activities during an outsourcing arrangement launch are often not given the time, budget, attention and resources they need to be successful.

At the very least, two types of change management issues must be addressed within the client organization: those directly impacting individuals within the HR function itself, and those affecting employees in the larger organization. Earlier in the paper, we discussed the importance of providing transition support for individuals who are leaving the organization and for those who are moving on to work for the vendor organization. In addition to these two groups, a strong change management plan also needs to address those who remain in the client organization. For those individuals, the organization needs to address issues associated with “survivor guilt” and provide support as they adjust to their new roles and responsibilities.

At the organizational level, companies need to consider the change management implications that will affect the larger group of employees that use HR services. For example, individuals ranging from line of business leaders to front-line employees will likely have questions about why the company decided to outsource these HR services, how the new processes will operate, how the transition process is likely to occur and what types of new self-service tools will be introduced. Both the client and the vendor need to coordinate closely on identifying key stakeholders impacted by those changes and developing content that will both address their direct questions and provide them with a level of comfort that their service will not be significantly disrupted.

An important change management tool is a clear internal marketing and communication strategy. The marketing and communication approach should be developed jointly by the vendor and client, as illustrated by this quote, from one consultant we interviewed: “*Communicating the change process is absolutely critical...the vendor can provide advice and support but ultimately the client has to drive it, working closely with the affected business units.*”

Figure 8 highlights some of the key components of a successful communication strategy.



**Figure 8. Components of a communication strategy for an HR BTO arrangement.**

Communication strategy	Description
<b>Objectives</b>	Describes the overall rationale for developing and executing the communication strategy
<b>Guiding principles</b>	Provides the common values that will be reflected in the design, development and delivery of the communication strategy
<b>Audiences</b>	Highlights the key audiences, their information requirements, influential leaders, prior large scale change experiences
<b>Key content</b>	Identifies the key messages and information that the targeted audiences need
<b>Media</b>	Proposes the channels through which various forms of communication will be delivered and received
<b>Timing</b>	Indicates the milestones for the communication strategy's design and execution
<b>Responsibilities</b>	Highlights the appropriate individuals responsible for developing, reviewing and delivering components of the communication plan
<b>Measurements</b>	Identifies both the process and outcome measures that the client and vendor will use to evaluate the ongoing effectiveness of their communication techniques

Source: IBM Institute for Business Value analysis.

Develop an ongoing governance and relationship management structure to address conflicts and build an effective working relationship between the client and the vendor.

### 3. Governance and relationship management

An outsourcing relationship represents a long-term partnership between two parties. Like any relationship, both formal and informal guidelines influence how and when the parties interact, who takes responsibility for various items and how differences are settled. By setting up a formal relationship management structure that begins at contract signing and evolves during transition and commencement of delivery operations, both sides can clearly identify who has responsibility for making certain decisions, how those decisions will be made and how the results will be communicated to others. This helps reduce overall uncertainty and clarifies the accountability that individuals from both parties have in the relationship. In our research, we found that organizations typically have relationship management issues at three levels – strategic, program and operational.

**Figure 9. Key relationship management issues.**

- |                    |  |
|--------------------|--|
| <b>Strategic</b>   | <ul style="list-style-type: none"> <li>• How well is the overall relationship between our organizations operating?</li> <li>• To what extent do we have the right alignment of people between the two organizations?</li> <li>• What opportunities do we have to enhance our relationship?</li> </ul>  |
| <b>Program</b>     | <ul style="list-style-type: none"> <li>• How can the outsourcer support changes in the client's business strategy and processes to achieve that strategy?</li> <li>• How will we determine which new projects should be undertaken?</li> <li>• How can the client be confident that it has the most innovative, best-in-class solutions?</li> </ul>  |
| <b>Operational</b> | <ul style="list-style-type: none"> <li>• How do we manage change requests so that not every change requires alterations to the contract?</li> <li>• What do we do when there is no clear reason for dips below minimum service level agreements?</li> <li>• How do we communicate updates/changes/programs to retained service managers, outsourced service managers, employees and business units?</li> </ul> |

Source: IBM Institute for Business Value analysis.

To address these critical issues, the client and vendor must align their governance roles and activities at each level.

*Strategic level*

At the strategic level, individuals from the highest levels of the alliance are primarily focused on three important issues: how well the overall relationship is operating, the extent to which the right people from each company are interacting with one another and whether there are future opportunities to enhance the relationship.

Typically, at this level, a small group of individuals meet several times during the year to review the overall contract performance, delivery areas where measures are not consistently meeting targets, turnover or attrition issues that might impact service delivery and strategic changes which will have a visible impact on the outsourcing arrangement. In addition to these regular reviews, individuals involved at the strategic level meet every six months to review the overall outsourcing relationship. As part of these reviews, the key individuals responsible for the overall relationship focus on current performance against established and new objectives and how the two organizations could improve going forward.

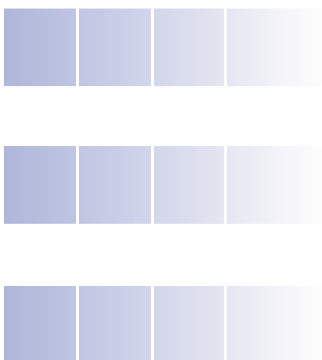
**Figure 10. Strategic governance roles.**

<b>Relationship management</b>	Manage overall outsourcing relationship, strategic partnership agreements and any broad, joint efforts with the external community
<b>Delivery management</b>	Manage delivery to provide appropriate service and quality levels across the entire outsourcing arrangement
<b>Governance management</b>	Validate that contractual obligations are met and that changes to the contract are aligned with the overall contract intent
<b>Global communications and stakeholder insight management</b>	Oversee the development and effectiveness of the overall change management strategy; Assess all changes for impact on the outsourcing agreements, prepare audiences through interaction across multiple channels and communicate other change management activities

*Source: IBM Institute for Business Value analysis.*

*Program level*

At the program level, individuals from both the client and vendor organizations come together to identify changes in the client's business strategy that will require vendor support, and determine which new projects the client and vendor should include in their portfolio of projects. Different HR BTO scenarios will involve a variety of transformation and program management needs depending on the level of redesign done prior to the outsourcing arrangement.



At this level, team members from both parties review the progress of ongoing transformation efforts, develop business cases for new improvement opportunities and identify how changes to ongoing business processes might impact existing service level agreements. Typically, a review of all transformational projects occurs quarterly, with specific project boards meeting more frequently as needed.

**Figure 11. Program governance roles.**

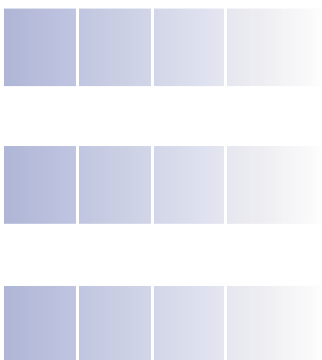
Role	Focus
<b>Overall transformation management</b>	<ul style="list-style-type: none"> <li>• Manage portfolio of vendor managed or involved HR transformation programs and projects to improve service delivery</li> <li>• Identify and plan for innovative solutions</li> <li>• Define and achieve business case</li> <li>• Apply consistent methodology to implement organizational, process and technological improvements</li> </ul>
<b>Portfolio management</b>	<ul style="list-style-type: none"> <li>• Develop and implement program management standards and tools</li> <li>• Manage project initiation and approval procedures</li> <li>• Oversee full portfolio of HR projects, within and outside transformation</li> </ul>
<b>Project management</b>	<ul style="list-style-type: none"> <li>• Oversee program delivery against contractual obligations</li> <li>• Manage activities and deliverables for each project with the program</li> <li>• Work with functional client counterparts to deliver on service area-specific projects</li> </ul>

*Source: IBM Institute for Business Value analysis.*

*Operational level*

The operational level is primarily focused on day-to-day interactions between client and vendor. These discussions center on managing (and potentially escalating) change requests, identifying root causes for problems and providing tactical communications to end users about potential changes in outsourced delivery.

Usually, operational level discussions happen relatively frequently (every one to two weeks or as needed) with larger monthly or quarterly reviews as required. Operational counterparts from both organizations participate regularly in these discussions, but will occasionally involve specialists from contracts, finance, risk and audit functions to assist them in coming to agreement on necessary changes.



**Figure 12. Operational governance roles.**

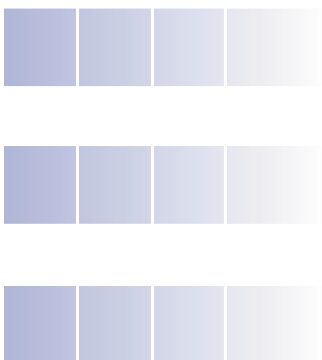
Role	Focus
<b>Contract management</b>	<ul style="list-style-type: none"> <li>• Provide contract interpretation – spirit of contract versus letter</li> <li>• Draft and apply changes to contract with associated terms and conditions</li> </ul>
<b>Risk and audit management</b>	<ul style="list-style-type: none"> <li>• Assess overall account for security, delivery and transition risks</li> <li>• Coordinate client and vendor audit activity</li> </ul>
<b>Procurement management</b>	<ul style="list-style-type: none"> <li>• Negotiate and manage contracts with third-party vendors</li> </ul>
<b>Delivery management</b>	<ul style="list-style-type: none"> <li>• Manage delivery, design and transformation of HR function, globally</li> <li>• Manage service level agreements</li> <li>• Resolve escalated employee issues based on functional expertise</li> <li>• Analyze trends and assess service levels to identify opportunities for improvement</li> </ul>

Source: IBM Institute for Business Value analysis.

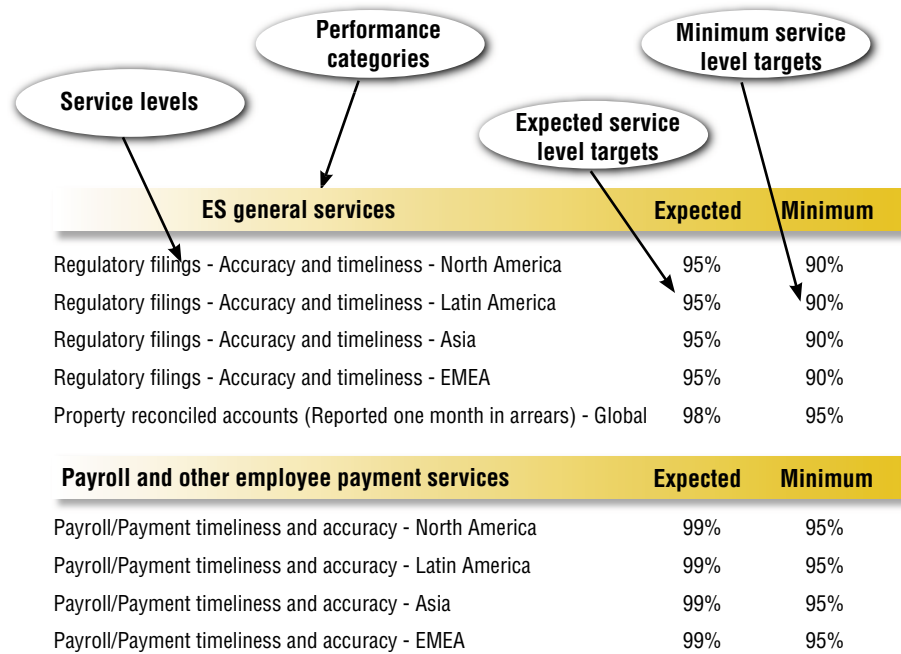
**Build a measurement and reporting framework that communicates how well the outsourcing arrangement is operating and how it can be modified.**

#### **4. Measurement and reporting**

When it comes to the topic of measurements and outsourcing, most attention is turned to service level agreements (SLAs). SLAs represent a contractual obligation related to the level of service the vendor provides to a client. Service level agreements are used to quantify objectively the performance to be provided to a client, report performance data to both the client and vendor in a consistent format, facilitate analysis of data across sites and regions and identify areas where improvements to service are necessary or possible. In many situations, the agreements outline financial implications for achieving or not achieving these service levels. In outsourcing arrangements, vendors are generally responsible for meeting SLAs even when they are dependent on other vendors or subcontractors. When developed and implemented effectively, SLAs can be a valuable tool to gauge vendor performance and communicate the effectiveness of the outsourcing arrangement back to the larger organization.



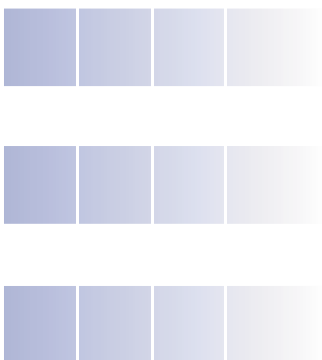
**Figure 13. Components of a service level agreement.**



Source: IBM Institute for Business Value analysis.

Companies can run into several challenges when developing service level agreements. Often, companies do not have adequate baseline measurements prior to entering into an outsourcing arrangement. While third-party providers can provide benchmarks and experiences from other client situations, companies should conduct an in-house analysis to identify accurate baselines before committing to a certain level of service. Also, before finalizing SLA standards, both the company and the vendor should agree on a “grace period” during the first several months of operations, where baseline measurements are validated and fine-tuned without the vendor being penalized for missing invalid or inappropriate targets.

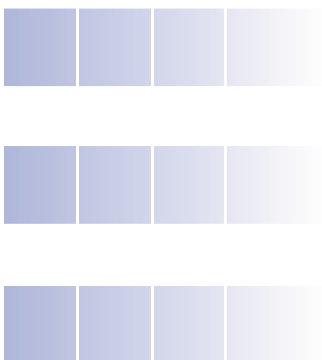
Even companies that are experienced in measuring HR process performance in-house may run into challenges in developing SLAs. Many of these organizations try to simply transfer their internal measurements over to the vendor. This can cause a number of problems. For instance, many measures traditionally developed by HR departments focus on measuring processes, rather than outcomes. Using the recruiting process as an example, an HR function might track how many resumes



were processed per day, or how many days it takes for a candidate to be contacted once they are selected for a potential job. What companies should focus on in developing service level agreements are outcome measures, since it is the *vendor* who is now responsible for delivering outcomes. For the recruiting process, this might mean measuring the number of days it takes the vendor to provide a list of suitable candidates once a job requisition is posted.

Once the SLAs have been decided on, both the client and vendor need to develop a process for reporting these measurements on a regular basis. Experience has shown that it is helpful to develop a common reporting template and collection infrastructure to reduce the amount of time it takes to produce the measurement. The report should use visual indicators, such as plus or minus symbols or colors (Red/Green/Yellow), so that individuals can quickly identify areas that need attention. Finally, a standard review and action process should be developed around these measurements, to allow the involved individuals the appropriate amount of time to obtain, review and provide feedback on the report.

While SLAs are often the primary focus for measuring the effectiveness of an HR BTO effort, another category of measures needs to be addressed. Organizations should consider the use of operating measures, or workforce analytics, to highlight the current “health” of the workforce across the organization. While these measures do not necessarily evaluate vendor performance, they do indicate the extent to which the HR organization is providing value to the larger organization. In many cases, the data needed to measure these types of outcome measures, such as voluntary turnover, promotion rates and performance ratings, is found in a combination of both vendor and client systems. Outsourcing vendors may be able to capture data and produce analysis that may have been previously unattainable. However, clients and vendors must work together closely to identify which outcome measures are critical to track and how to integrate their systems to make sure that the necessary data is captured and reported in a timely and accurate manner.



## Summary

To lower the risk associated with outsourcing HR activities, companies should consider the following questions:

- Leadership capabilities**
- Have you identified individuals who have demonstrated the key leadership characteristics needed to support an ongoing outsourcing relationship?
  - If one individual does not have all of these skills, are there other members of the ongoing outsourcing leadership team with complementary skill sets?
  - To what extent have you identified potential individuals in other areas of the organization whose skill sets could benefit the overall outsourcing relationship?

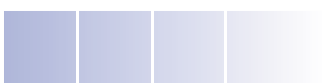
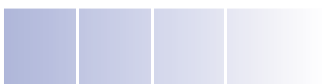
- Transition management**
- Are adequate resources available to develop plans for building the new environment?
    - Employee transition and redeployment management
    - Delivery operations
    - Workplace and infrastructure management
  - What level of emphasis has been placed on developing a knowledge transfer strategy and are the appropriate resources in place?
  - Has a structure been established to oversee the larger HR transformation effort that incorporates both client- and vendor-led projects?
  - How comprehensive is the change management strategy for this transition? And has the organization committed sufficient resources to execute it?

- Governance and relationship management**
- Has the organization identified the key roles and responsibilities for governance at all three levels – strategic, program and operational?
  - How collaboratively has the client worked with the vendor to assign clear governance roles and expectations?
  - What mechanisms have been put in place to encourage the development of trust among the governance teams of the outsourcing arrangement?

- Measurement and reporting**
- What process is the organization using to develop service level agreements and how are they reported to the various governing boards?
  - How is the organization validating that the measurements will be useful in making decisions throughout the lifetime of the arrangement?
  - How is the organization planning to collect the appropriate operating measures or workforce analytics that will allow it to make decisions about its workforce?

## Conclusion

Like many complex interactions between two companies, human resource outsourcing is not without risk. However, our research and experience have shown that identifying the right leadership skills, managing the transition effectively, developing governance and relationship management processes and creating a measurement system that provides useful insights to both the client and vendor can help improve the success of the outsourcing partnership and mitigate these risks. While these techniques involve some up-front investment in planning and design, they typically save resources and prevent conflict throughout the life of the relationship.



### ***About the authors***

Eric Lesser is an Associate Partner with the IBM Institute for Business Value. He is responsible for conducting research and developing thought leadership on a variety of human capital management topics. Eric is based in Cambridge, MA and can be reached at [elesser@us.ibm.com](mailto:elesser@us.ibm.com).

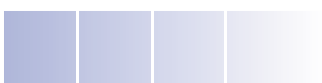
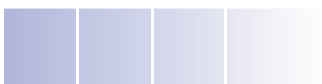
Joanne Stephane is a Managing Consultant in the IBM Human Capital Management practice. Her primary areas of focus include HR service delivery strategy, design and implementation, HR Business Transformation Outsourcing, and employee portal strategy. Joanne is based in Cambridge, MA and can be reached at [joanne.stephane@us.ibm.com](mailto:joanne.stephane@us.ibm.com).

### ***About IBM Business Consulting Services***

With consultants and professional staff in more than 160 countries globally, IBM Business Consulting Services provides clients with business process and industry expertise, a deep understanding of technology solutions that address specific industry issues, and the ability to design, build and run those solutions in a way that delivers bottom-line business value.

### ***References***

- <sup>1</sup> Ross, Jeanne and George Westerman, "Preparing for utility computing: The role of IT architecture and relationship management," *IBM Systems Journal*, Vol 31, No. 1, 2004.
- <sup>2</sup> Useem, Michael and Joseph Harder, "Leading laterally in company outsourcing," *Sloan Management Review*, January, 2000.
- <sup>3</sup> Ibid.





© Copyright IBM Corporation 2005

IBM Global Services  
Route 100  
Somers, NY 10589  
U.S.A.

Produced in the United States of America  
03-05  
All Rights Reserved

IBM and the IBM logo are trademarks or registered trademarks of International Business Machines Corporation in the United States, other countries, or both.

Other company, products and service names may be trademarks or service marks of others.

References in this publication to IBM products and services do not imply that IBM intends to make them available in all countries in which IBM operates.