



IBM Institute for Business Value Podcast

Human Resource Business Transformation Outsourcing

George Pohle and Eric Lesser - November 2005

POHLE: I'm George Pohle, global leader of IBM's Institute for Business Value, which is part of IBM Business Consulting Services. I'm here today with Eric Lesser, who is an associate partner in the IBV. Eric's responsible for conducting research and developing thought leadership on a variety of human capital management topics. Eric, thanks for joining me today.

LESSER: Thanks very much, George.

POHLE: From IBM's perspective, HR business transformation outsourcing is comprised of two things: first, outsourcing parts of the HR function to a third party; and, second, truly transforming the business processes to meet quality and cost targets. So, this is really about a fundamental change in performance. Is that right?

LESSER: Absolutely.

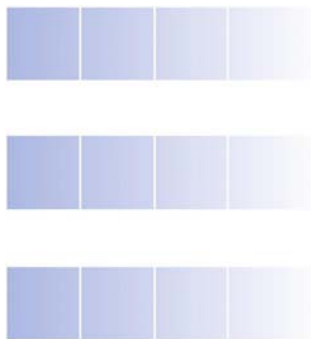
POHLE: So, what are the most relevant processes in HR that companies typically consider outsourcing?

LESSER: Well, what we've seen in the past is companies focusing on many of their administrative processes. So, things like benefits administration, pension administration, health and welfare. Those have been the typical processes that have been outsourced.

But typically what we're seeing now in many organizations are more multiprocess outsourcing arrangements, where we're seeing companies start to incorporate, I would say, more strategic components such as recruitment and selection, performance management and even learning.

POHLE: So, what are the drivers that are pushing companies to investigate different types of HR BTO?

LESSER: Well, I think there are a number of different conditions. First one clearly is around globalization. As companies are beginning to operate in more countries, they're finding it increasing difficult and costly to keep track of and manage the variety of benefits and regulatory requirements in each area.





So, give an example of a multinational organization that's been built over time from a series of acquisitions and buyouts, can find itself with a bewildering mix of compensation packages, pension plans, human resource management systems, HR guidelines and HR contact centers.

It's difficult for companies themselves to be able to rationalize all of these different components and therefore, many are turning to outsourcing as a way of both simplifying the administration and making it more effective.

Another major factor is simply cost, is that organizations under pressure to reduce their SG&A are finding it valuable, perhaps, to have companies that have greater specialization in HR administrative processes to essentially take over those processes for other companies.

POHLE: So, if you're an executive running an organization, how do you determine which parts of HR you might want to outsource?

LESSER: Well, you want to look at a number of different factors, I think. First of all, you want to look at to what extent is their dependency, are there specific assets that require dedicated facilities, equipment, capacity, training and investments.

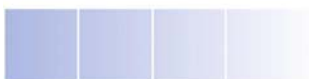
You want to look over spillover, is there something confidential, are there certain sorts of advantages that you don't want leaked to your competitors. If there were, you would certainly want to keep some of those activities in house.

There are issues around competence. Can a vendor have greater capability and process execution? Can that help lead to greater results? So, are there certain economies of scale or scope that can lead to a vendor being able to do this more effectively?

Is it a core capability? Is it something that is really going to differentiate an organization in the marketplace? If it is, it's probably something that an organization should keep in house but, otherwise, a third party may be able to do...to manage that process more effectively with better results.

POHLE: It sounds like this is a relatively complex set of issues that need to be considered. So, who needs to be involved in the decision like this, when a company is trying to decide if they should and how they should outsource?

LESSER: Well, ultimately within the HR organization it's the chief human resource officer or the person with the equivalent title in the organization that usually plays an active role in making the outsourcing decision.





Ultimately it's up to the CHRO to determine whether the outsourcing arrangement will enable the HR organization to provide the right types of cost-effective support for its internal clients, while at the same time support the organization's larger strategic objectives.

Typically the HR operations leader within the organization is very closely involved in developing the specifications of the outsourcing arrangement.

Now, while HR plays an important function, obviously, in putting together the specifications for these types of arrangements, oftentimes the chief financial officer will play a role in the decision-making process.

Often these arrangements require entering into a fairly long-term contract with an outsourcing vendor, that can have significant financial ramifications for the company. Also, the procurement organization plays a prominent role in terms of negotiating in contracting and leveraging its experience in developing terms and conditions that are favorable to the organization.

So, those are some of the key decision makers. In addition, you also have some influencers. So, for example, the information technology department is an important influencer because the systems that the vendor would run in terms of being able to manage the HR processes have to be at least in concert or be able to integrate with what the existing organization already has.

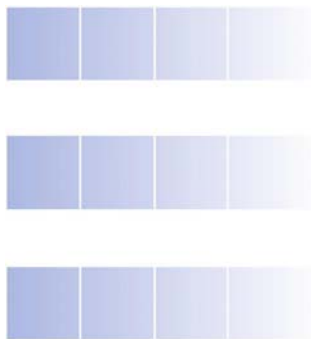
Also, the internal customers -- the leaders of the various business units that the HR department essentially supports -- also have a role because it's going to be the services that they are providing back to their employees that ultimately the third party is going to provide.

Lastly, from an approval process, for many organizations the CEO and the board of directors are responsible for the final approval of this type of large, multiprocess outsourcing arrangement in HR.

And for a number of reasons, obviously because this is a big commitment for companies but also because these types of efforts are fairly visible and the CEO needs to be able to articulate the rationale for undertaking these types of efforts. And also, how this is going to impact the overall organization strategic direction.

POHLE: So, given the nature of these types of decisions, how do you go about evaluating which vendors would be right to provide the services to you?

LESSER: I think that's an important question, and I think it's important to look at the right types of vendors because typically there are lots of vendors out there in the marketplace and being able to spend time with the right kind of vendors becomes very important in making your selection process.





So, typically what we see companies doing is, what they at least in the beginning stages, is going through what they call experience questionnaires: asking companies to document, if you will, experiences that they have already in the marketplace with customers, with existing customers that they have.

Oftentimes we'll find companies also undertaking a financial and credit review to make sure that the vendor is actually going to be in place and be able to deliver through the lifetime of the contract.

Undertaking a security and compliance review, given Sarbanes-Oxley and many of the other regulations out there, companies want to make sure that they are working with companies that are going to handle their data appropriately, that they're going to be providing the right kind of support for regulatory environments and things of that nature.

We also see companies going out and actually doing reference checks and site visits with other clients to see both how the process works and also the level of satisfaction the clients are having.

They will go out and visit processing or contact centers because these are going to be the public face back to their employees when their employees need assistance with a variety of HR processes.

And then also, meeting the potential delivery team leaders, understanding from the vendor side who are the people that you're going to be working with and are going to be entrusting your processes to.

POHLE: Right. If an organization thinks that HR BTO might be the right answer, what are some of the next steps that organizations can take to at least start to consider the options that they may have?

LESSER: Well, I think one thing that they need to do is to start assembling a team of HR experts to begin to understand what is the potential for HR outsourcing in their organization.

Oftentimes the people who are most needed in beginning to make some of those preliminary decisions are people who already have full-time plus day jobs. So, being able to secure their time and their effort to start to both develop the specifications for HR outsourcing, then to be able to examine potential vendors is something that people need to free up early in the process.

Also, being able to communicate through the HR organization, as soon as people are aware that there is the potential even, for HR outsourcing, people will become concerned. Putting a communication strategy in place to help people understand



what's going on, what's the rationale, and how people will be addressed throughout the transition is something that is going to be very important.

And lastly, the importance of gathering data on the current state of the HR organization. In many companies often they don't have a baseline in terms of what is their process performance, what are their actual costs in terms of delivery of HR services.

So really getting a handle on that data, both from an information technology perspective, from a data perspective, and being able to, if you will, put together the baseline business case so that they can then go and evaluate what vendors are producing and offering in the marketplace will give them a sense for whether the business case for HR outsourcing is right for them.

POHLE: How important is information management and information technology in achieving some of the benefits that HR BTO could provide to an organization?

LESSER: I think information technology plays an important role. And matter of fact, many companies begin their investigation of outsourcing, one of the major triggers is often the need to be able to upgrade some of their HR IS systems.

And companies not necessarily wanting to take on a major upgrade would rather have an outside vendor be able to manage that process, if you will, and to take on some of that HR IS responsibility.

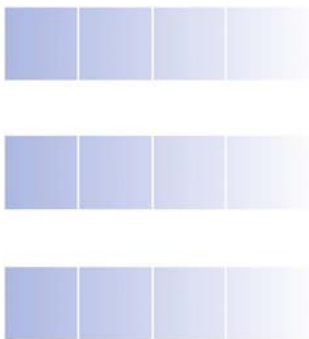
What we find, though, is the ability to offer sort of leading technologies in terms of employee self-service, increased employee decision support, are also one of the reasons that people are attracted to looking at HR outsourcing...

...recognizing that, perhaps, they couldn't take on that type of functionality on their own, having a third party vendor being able to provide a host of technology services, because that, essentially, is their core capability, is something that's very attractive to many companies.

POHLE: Beyond IT, what are some of the other critical success factors in HR BTO outsourcing deals?

LESSER: I think there are four important capabilities that organizations need to think about as they are going through this transition towards HR outsourcing. The first one is, is to have an effective leadership team in place.

One of the big differences in working in an outsourcing environment as opposed to leading a functional organization, is that the leadership styles need to be different. There are differences in terms of now being able to focus on how you manage a





vendor, and looking at key metrics and making sure that the vendor is providing the right level of service to the organization.

Those types of skills are actually very different from the skills in leading a functional department. So, understanding what the right leadership capabilities and competencies are I think are one critical success factor.

The second is around building a very smooth and comprehensive transition plan. When you outsource your HR processes, they are very visible to your employees. And as a result, there are lots of components of a transition plan that need to be addressed to make sure that that handoff goes smoothly.

POHLE: Right.

LESSER: So, whether it be dealing with some of the employee management issues that come out of the transformation, whether it deals with knowledge transfer issues, how you transfer knowledge between a vendor and an employer and back and forth...

Looking at issues such as, do I have the right facilities in place for the vendor to be able to provide their services, if I need to transition people from a client organization to a vendor organization, and dealing with a lot of the change management issues. All of those things are wrapped up into the larger transition plan, so establishing that important transition plan is a key step in the overall relationship.

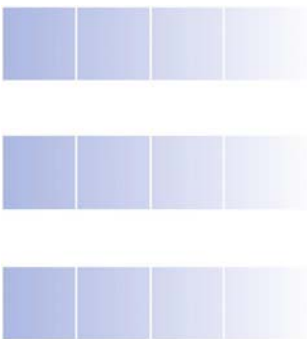
A third component is setting up a governance structure so that people know who to go to if there are difficulties or challenges along the way to make sure that there is a constant dialogue going on at the right levels between the vendor and the client.

And then, lastly, and again very important, is understanding the metric, setting up a system where people can actually measure, if you will, the performance of the vendor, that there is a clear way of being able to address shortcomings or being able to overcome challenges and being able to make those clear evaluations in a way that everybody understands what's expected of them and how they can deliver results.

POHLE: How important is security and privacy in the equation?

LESSER: Security and privacy are very important because you're dealing with employee data and that each country that you're going to be operating in will have its own security and privacy regulations.

So one thing that a vendor should do is have a fairly strong comprehensive viewpoint on how they're going to manage the security of that data and how they're doing to comply local regulations.





POHLE: And are the skills required to manage the strategic side versus the administrative side very different from one another?

LESSER: They are different. And one of the challenges that many organizations face is how they can retool or reskill their HR organizations to focus on some of those strategic issues, rather than just having to deal with the day-to-day administrative burdens.

POHLE: Eric, given that BTO is about both outsourcing and transformation, can companies transform themselves before they outsource?

LESSER: Absolutely.

And we've seen examples where companies have reinvented or reengineered their HR processes before turning over the operation of their process to vendors or in situations where they've actually let the vendor drive some of those transformation processes.

Where the research has shown that companies have difficulty is when they do it sort of partially, when there is a mixture, if you will, of processes that have been redesigned versus processes that have not been touched. And that makes it so much more difficult for companies to be able to see the benefits of their outsourcing arrangements.

POHLE: So you mean after they've gone through one or two waves of cost cutting, then deciding to do the outsourcing?

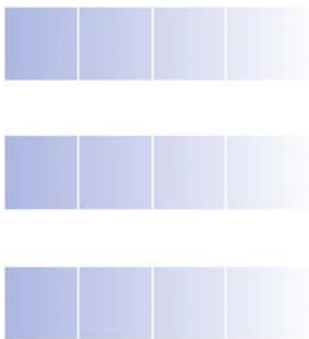
LESSER: Right.

We've seen examples where companies have made the migration, let's say, to a shared services environment, where they essentially will run a contact...HR contact center for multiple divisions within their organization and then have a vendor essentially run their contact center for them.

We've seen that in many situations, but we've seen situations where the outsourcer's come in and made those changes before they've actually been done in the company.

POHLE: Okay. Eric, thanks for coming by and talking to us today about HR BTO.

LESSER: Thanks very much, George.





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