

# **HRO Innovation: Building Blocks to Derive Full Value**

Taking human resources outsourcing beyond lip service to the adoption of best practices and better use of technology.



**An exclusive report from BusinessWeek Research Services**

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## Executive Summary

- Although early customers of human resources outsourcing (HRO) are moderately satisfied, many are not achieving the benefits they expected from these deals. Among them are transforming HR into a strategic function, improving business results and enabling innovative process improvements.
- Some of the reasons for this dissatisfaction include a perceived lack of innovation by service providers, provider resource constraints, an immature business model, the complexities of global HRO and misaligned expectations.
- Learning from the experience of satisfied HRO customers, it's clear that improving the situation requires both buyers and service providers to view the relationship as a true partnership. They must come to a consensus regarding expectations and change management processes as well as building a better understanding of each other's constraints—be they financial, organizational or technical.
- Buyers also must thoroughly evaluate the service provider's relationship with the vendor that is providing the underlying technology, be willing to discuss adoption of the provider's standards and make the necessary internal and cultural process changes.
- Service providers must commit to innovating when possible, representing themselves accurately, ensuring that the customer's requirements are a good fit for their expertise, helping customers with change management and forging a close relationship with the provider of the software underlying their service offerings.

## Methodology

BusinessWeek Research Services (BWRS) launched a research program in late 2007 to determine the views of C-level managers—chief financial officers and HR executives—at large companies on how to improve the value derived from human resources outsourcing. Although many early customers of HR business process outsourcing (BPO) realized some cost savings from these partnerships, many others were disappointed with the overall performance of their service provider—especially modest or nonexistent HR process improvements and innovation. However, a new approach to HRO arrangements and implementations, based on the lessons learned from early experiences, offers to deliver on the unmet promises and more of the HR BPO concept.

This report is based on interviews with HRO practitioners, as well as forward-thinking consultants and industry analysts, who discussed the financial and strategic value that companies may achieve from HR BPO and—most important—what needs to be in place to reap those rewards. The organizations included in the research for this report are:

- |                                  |                    |
|----------------------------------|--------------------|
| ■ Automatic Data Processing Inc. | ■ Hospira Inc.     |
| ■ EquaTerra Europe               | ■ Motorola Brazil  |
| ■ Everest Research Institute     | ■ Northgate Arinso |

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## Introduction

Of all the business processes that companies outsource worldwide, human resources tops the list, capturing 18.2 percent of the entire BPO market in 2006 or more than US\$26 billion, according to Stamford, Conn.-based IT research and advisory firm Gartner Inc. in its November 30, 2007, report titled “Business Process Outsourcing Worldwide: Forecast Database” by Robert H. Brown and Kathryn Hale (see chart 1, “HR Leads the BPO Market,” below).

Although many clients who signed HRO deals in the early part of this decade are moderately satisfied with the resulting benefits—such as cost savings—the results of many of these deals have so far fallen short of initial expectations. The longer term and potentially more rewarding goals—like improving HR processes, transforming HR into a strategic function and deriving innovation from the service provider—are largely unmet.

HRO started out strong in 2006, with a worldwide market increase of 4.7 percent, but growth in 2007 slowed to 3.8 percent, according to Gartner. Analysts pose several explanations for the slowdown—including provider capacity constraints and global HRO complexity—but some of the diminished interest in enterprise HRO also is a result of the relative immaturity of some providers’ offerings and the unrealistic expectations of buyers. The result: higher than expected costs, oversold promises, poorly defined decision and success criteria, and poor change management processes.

Particularly in the early days of HRO, providers were promising capabilities that might not have been tested on multiple organizations and selling these capabilities as if they were, says Tim Palmer, HR practice lead at global independent outsourcing advisor EquaTerra Europe, based in London. “But I think we’re seeing the last of that in the established providers, because they have now been through the testing process with multiple clients,” he says.

But still, as recently as last year, a study by EquaTerra found that on a scale of 1 to 5, with 5 being “benefits fully achieved” and 1 being “benefits not at all achieved,” most ranked the benefits they received between 2.5 and 3—a somewhat mediocre result (see chart 2, “Success in Achieving HRO Benefits,” on page 6).

## Building Blocks to Longer Term Benefits

What’s clear is how important HR transformation is to organizations today. According to a 2006 EquaTerra study, 43 percent of respondents said transforming HR to make it more strategic and cost effective was “extremely important,” and two oft-cited ways of achieving this goal were outsourcing both HR processes and the underlying IT system. In many cases, companies want to lower the cost of providing HR services enough that the retained HR organization has more time and budget to do strategic work, says Stan Lepeak, EquaTerra’s managing director of research.

And in some cases, these types of benefits are being achieved. According to Lepeak, some HRO customers say they’ve improved retention of key employees, developed higher quality services and have better access to information.

Chart 1



Achieving these benefits, however, depends upon many factors. Most importantly, both provider and client must view the partnership as just that—a partnership—with both parties in sync regarding expectations, communication, governance and processes for critical activities like change management.

In addition, customers must focus on the following:

- Choosing a provider based on “what’s under the hood.” A provider’s ability to deliver also is strongly dependent on its relationship with the software vendor supplying its technology. Nontechnology executives need to know the questions to ask to differentiate among potential providers.
- Adopting the HRO provider’s standards, thus allowing the provider to leverage the knowledge, technologies, processes and best practices it has acquired.
- Making the required internal cultural and process changes.

In turn, service providers must be able to deliver on the following:

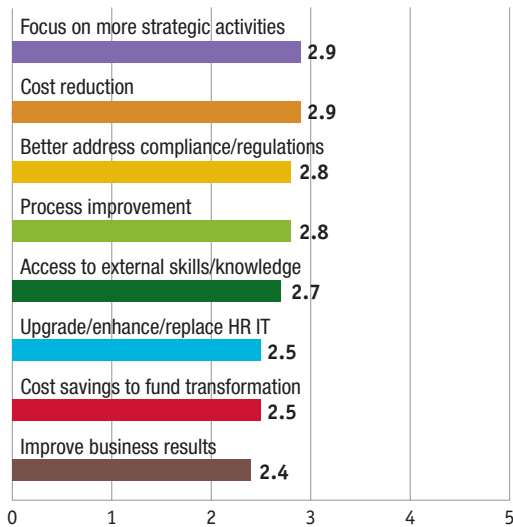
- Commit to innovating whenever possible.
- Leverage economies of scale, process optimization and labor arbitrage.
- Have an ironclad relationship with the critical software vendor that is underpinning service delivery.
- Refrain from overselling capabilities.
- Ensure that the customer requirements are a good fit for the provider’s expertise.
- Help customers with “change management.”

Achieving these fundamentals will enable the HRO provider to deliver more strategic value to the customer, in the form of improved and more innovative processes and practices. It also will provide customers with efficiencies and cost savings that enable them to focus on more strategic HR initiatives (see chart 3, “HRO Benefits and Problems: Who’s Responsible?” on page 7).

Chart 2

### Success in Achieving HRO Benefits

*Of all the expected benefits of HR BPO, none was given a satisfaction ranking higher than 3 on a scale of 1 to 5.*



Source: EquaTerra

## The Innovation Void

Lack of innovation on the part of the service provider is perhaps the biggest complaint of enterprise HRO customers. Buyers expect suppliers to devise new and innovative ways to perform various HR functions, such as recruitment and performance management.

One of the past failings of service providers that has inhibited innovation—but one that is rapidly changing—is the penchant for service providers to take over customers’ existing HR processes with the intent to innovate and build process improvements over time. Because service providers inherited entrenched and sometimes unwieldy legacy processes and systems—some very inefficient—a lack of innovation becomes something of a self-fulfilling prophecy.

On top of that, because HRO providers are still stabilizing their offerings, many don’t have the resources to engage in true innovation. “It’s very difficult for suppliers to put resources into innovation when, in many cases, they are still putting

resources into building their infrastructure and being able to deliver services they are contractually obligated to deliver,” says Monica Barron, who leads the HRO research efforts at Everest Research Institute, a leading outsourcing advisor in Dallas.

One part of the issue is misaligned expectations and a lack of clarity about the definition of innovation. One buyer may consider basic talent management to be innovative, while another might be looking for completely new offerings such as workforce analytics for talent management.

Another problem is that innovations that get discussed before the contract is signed—which are often theoretical in nature—don’t always become hardened into tangible contractual obligations, Lepeak adds. For instance, it’s easier to commit to a quantifiable contractual obligation like processing a certain number of transactions than something as nonspecific as “improving the recruiting process.” Therefore, if a certain type of innovation is important, it’s critical to spell it out, as well as how it will be measured, in the contract, he says.

When this is done, even small innovative changes can yield big results. At Motorola Brazil, the Jaguariuna, Brazil-based subsidiary of mobile handset manufacturer Motorola Inc. of Schaumburg, Ill., the enterprise HRO deal it struck in 2005 has resulted in a creative skills evaluation and training program implemented by its service provider, Milwaukee-based Manpower Inc. Manpower developed a simulation of Motorola Brazil’s internal operations, on which it trains potential employees for the jobs they will be performing. That way, they come to the company close to fully trained, instead of having to undergo weeks of training after being hired.

Manpower executes the majority of HR processes for Motorola Brazil’s 3,000 employees and 5,000 service providers, including compensation, benefits, personnel administration, labor relations issues, educational assistance and training, management of interns and mentors, and even selection and recruitment of some levels of personnel. Manpower also operates the supporting HR software.

Since 2005, Motorola Brazil has saved about 40 percent of annual HR costs as a result of its partnership with Manpower, according to Director of HR Eduardo Pellegrina. “With the focus on HR efficiencies and strategic business partnership, we were able to perform a team optimization on 75 percent of HR workforce personnel,” he says.

## The Prerequisite for Success—Standardization

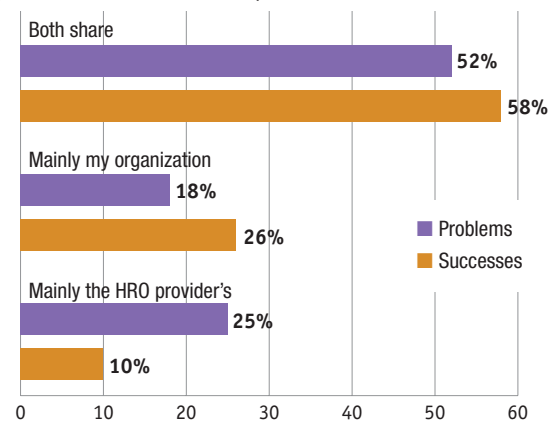
Enterprise HRO clients also need to become more aware of the economic model involved for outsourcers to provide innovation. One of the preconditions is standardization. Outsourcers simply can’t support a completely different process set and technology infrastructure for every customer they contract with and still expect to have resources to apply to innovation. Simply put, the more customers use standardized approaches and processes offered by service providers, the more innovation those customers will receive.

“We’ve found that by focusing our model on standardization, we don’t have the pressures of 10 or 12 different infrastructures, each from a different customer,” says Mike Capone, senior vice president at Automatic Data Processing Inc. (ADP), a Roseland, N.J.-based provider of business outsourcing solutions. Instead, the company uses one multitenant infrastructure with one core service delivery model. This enables ADP to present that innovation to each of its 70 customers simultaneously, Capone explained.

Chart 3

### HRO Benefits and Problems: Who’s Responsible?

Over half of HRO customers say they share the responsibility with their provider for HRO successes and problems.



Source: EquaTerra

Thankfully, standardization in the HRO arena is more prevalent than ever before—and that can only help the success rate, Everest Research Institute's Barron says (see chart 4, “The Shift Is Toward Configurable/Off-the-Shelf Solutions,” below).

In addition, standardizing the service delivery model worldwide can save significant money for companies. For example, standardized HRO services enable companies to recruit people the same way around the world, or regionally, depending on their needs. By standardizing these processes, it's easier to collect and analyze data that will allow executives to determine if goals

are being accomplished and processes are being performed effectively. More money to reinvest, and better access to better data are in themselves great foundational elements of innovation. “Without standardization, the model isn't sustainable,” Barron says.

However, there is give-and-take involved in standardization. At Hospira Inc., a Lake Forest, Ill.-based manufacturer of specialty injectable pharmaceuticals that moved to an HRO model in 2004, for example, the company didn't want to be forced to change all of its internal processes.

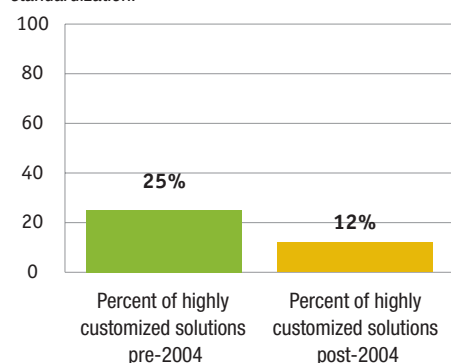
“We wanted more flexibility, and our service provider was willing to meet in the middle,” says Gail Denham, Hospira's vice president of compensation, benefits and employee compensation. The company contracted with HRO service provider Northgate Arinso, headquartered in Hemel Hempstead, United Kingdom, to provide payroll and benefits management, as well as management of its HR information system, when it spun off from its parent company, Chicago-based Abbott Laboratories.

On a scale of 1 to 10, with 1 being fully standardized and 10 being fully customized, Denham estimates that Hospira is currently at about a 4, but she expects HR processes to become even more standardized over time. “Coming from an environment that was 100 percent customized, we didn't want to go from one extreme to the other and shock our employees,” Denham says.

Chart 4

### The Shift Is Toward Configurable/Off-the-Shelf Solutions

The percentage of customized solutions has dropped significantly since 2004, showing a clear trend toward standardization.



Source: Everest Research Institute

## Looking Under the Service Provider's Hood

Another key to success is choosing an outsourcing provider that has a deep and ongoing relationship with the vendor supplying the technology that underlies its service offerings.

For instance, customers need to probe underneath the surface of the service provider's promised capabilities and research whether there is a formal partnership in place, whether the service provider implements all upgrades and whether it influences the vendor in terms of its development path.

“The relationship with the software provider is fundamental, because we have to make sure we have absolute access to their technical and application support so we are providing our clients with the latest versions and best possible support,” says Martin Mackay, global director of business development at Northgate Arinso. “And strategically, if we have a close relationship, we can work with them to understand where their product roadmap is going, what capabilities are coming to market and how to integrate them.”

That tight partnership works well for Hospira's Denham. She says HRO has allowed her to focus on areas like developing a new compensation strategy and assessing the benefit healthcare plans. What's more, because Northgate Arinso manages her company's entire HR system, Hospira's IT staff is relieved of the need to possess deep knowledge of the complex system.

## Culture Shock

An often-overlooked but important component to successful HRO is preparing for the inevitable shock that accompanies a change of this magnitude. That means effective change management. “Change management equates to execution,” EquaTerra’s Lepeak says. “You can pick a good service provider, have a great business case and have executive support, but if you drop the ball on execution, that’s where deals can fall down.”

For Motorola Brazil, changing the mindset of employees, especially those in the company’s internal HR department, was one of the most difficult challenges of all. “For our HR employees, this was an evolution in their career, from being accountable for executing things to being accountable for managing something that is being executed by others,” Pellegrina says. “It takes time and effort and persistence, and frankly, not everyone is ready for it.”

To ease the way, executives at Motorola Brazil spent months holding discussion sessions, helping employees determine how they should focus their careers, coaching and mentoring, and engaging in team-building activities both internally and with its service provider.

“You can have the greatest SLAs [service-level agreements] and greatest contracts, but if you don’t have the right governance structure and relationships at the senior level of the client organization, change management can be an issue,” ADP’s Capone added.

## Conclusion

Although there has been some disappointment on the part of enterprise HRO customers, others have proved that with the right process and service delivery design, underlying technology deployment, service provider and expectations, it’s possible to not only save money and increase efficiency but improve HR processes to the point of moving to the next level—creating strategic and competitive advantage that leads to better hiring and retention practices. The good news is that most clients think the current problems can be fixed, as evidenced by the very limited number of HRO contract terminations planned (see chart 5, “The Future of HRO,” at right).

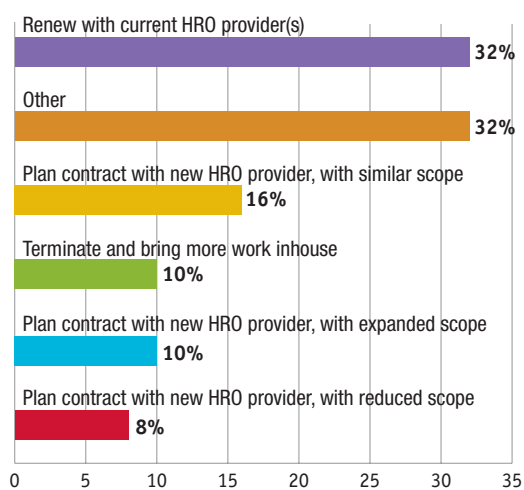
Indeed, despite myriad challenges, nobody is giving up on HRO—far from it. “The fundamental reason people outsource is still sound—to take critical operations that don’t need to be done internally with your own resources and give them to a supplier who can do it more efficiently and cheaply,” Everest Research Institute’s Barron says.

But there is more work to be done. As EquaTerra’s Palmer says, the true potential of HRO will be realized when organizations are able to look back on their journeys and understand that the access to data and methods they have achieved by working with an external partner are facilitating the talent, performance and cost management activities that they could only have dreamed of achieving before outsourcing. ■

Chart 5

### The Future of HRO

*Despite disappointment with benefits, when asked what they planned to do with HRO and their HRO deals, many companies said they are not terminating their deals.*



Source: EquaTerra

# Giving Innovation a Fair Chance

Some human resources outsourcing fundamentals are all too easily overlooked.

When it comes to human resources outsourcing (HRO), innovation comes in the form of advancements in service delivery processes and infrastructure to increase efficiency, enhance process quality and reduce process risk. Many times, these advancements are enabled by new or improved technologies. Examples are Web-based self-service delivery to users and business partners, electronic invoicing and electronic payment as complements to traditional billing and modern call center technology supporting personal handling of service requests.

At SAP, we are intimately aware of the challenges of delivering innovation in BPO by working “behind the curtains” with leading BPO providers and their clients. We notice that it is difficult to contract for innovation, because it is not easily defined in concrete terms in advance. Customers have leveraged incentives (e.g., gain-sharing) and stipulations (e.g., rate of continuous improvement or change of minimum performance level based on past over-achievements), but they are not effective in all situations.

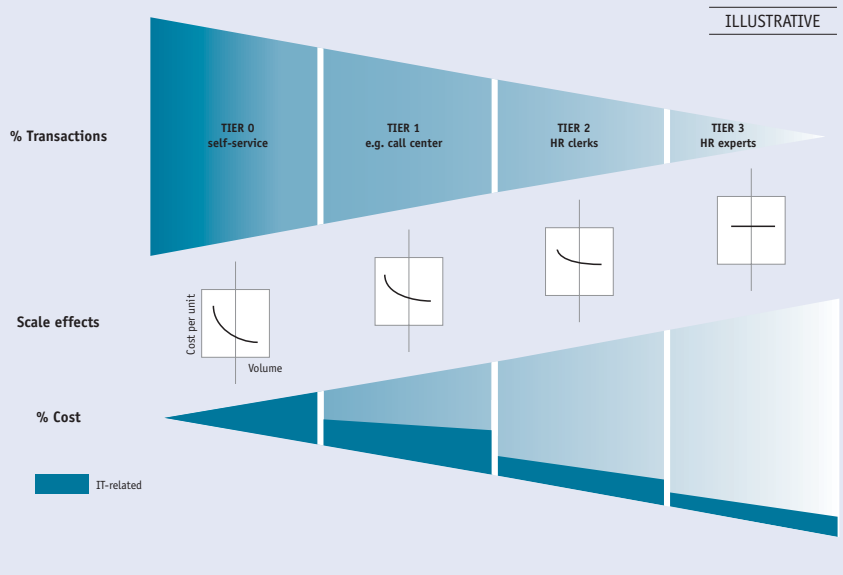
What always works is attention to the “fundamentals of innovation”: for example, ensuring that there are enough resources to invest in innovation and that the hurdles to innovation execution are low. In particular, financial resources are the scarcest and stem from the provider’s ability to effectively harness economies of scale, process optimization and labor arbitrage.

Some examples of these fundamentals include: a partnering attitude and mutual understanding of financial and organizational constraints; a technology platform that will keep pace and make new technologies available quickly and effectively; engraining innovation in governance mechanisms; and ensuring that the provider has a strong collaboration with the software vendor, ensuring a smooth design process, implementation and operation of applications.

Technology can support or hinder innovation—it is up to the customer and the provider to decide which is going to be their fate. The chosen technology providers must show a track record of integrating innovation quickly and effectively into systems—which is not necessarily being constantly on the “bleeding edge.” Examples are employee interaction centers (employing self-service and call center tools) natively integrated in HR applications, workflow integrated into the organizational model and self-service with intuitive user interfaces.

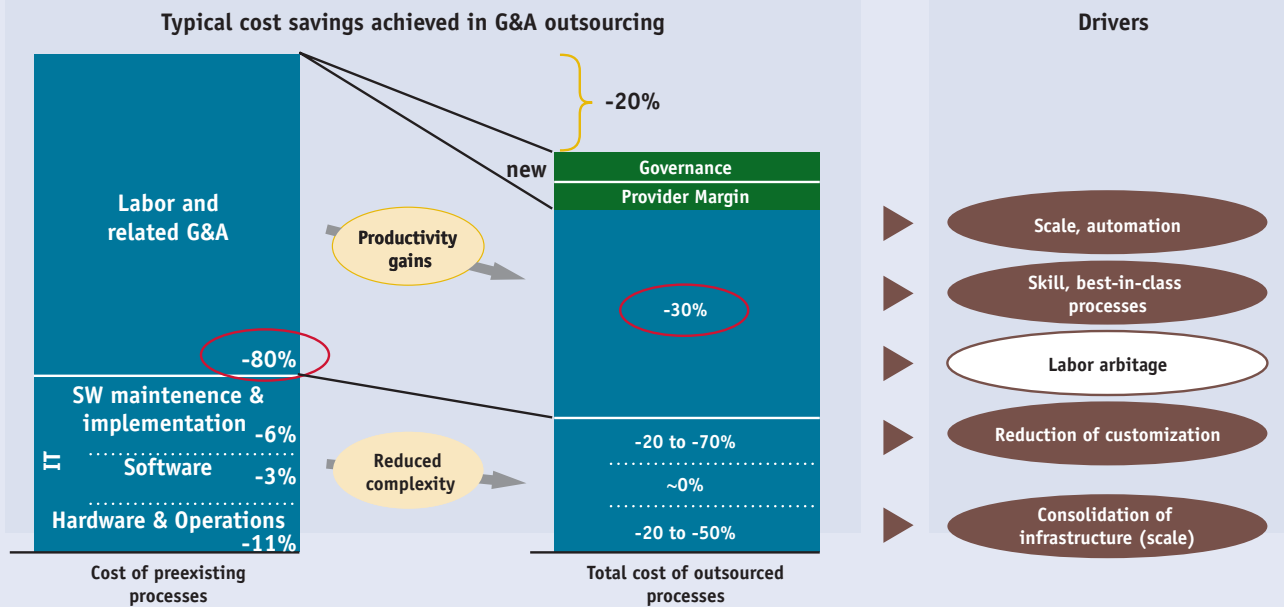
Customers and providers need to ensure through proactive oversight and agreement on documented standards that the platform can evolve with minimum customization to fully safeguard the innovation potential and related flexibil-

## Technology Is an Important Enabler of Scale



ity. The technology platform must ensure tight integration between the provider’s and the customer’s retained organization, because inflexibility and innovation pains often stem from the interface points. For instance, the maintenance of data integrity needs both ends to “move” when change is required, which in turn generates additional cost and effort.

## IT Drives Significant Cost Savings in BPO Engagements



We have sometimes witnessed client behaviors that stifle HRO innovation; for example, unwillingness to standardize on process and technology, unwillingness to accept change, uncooperative behavior between staff responsible for business requirements and those responsible for technology design and a tendency to decide on adoption of point solutions without full consideration of systemic and

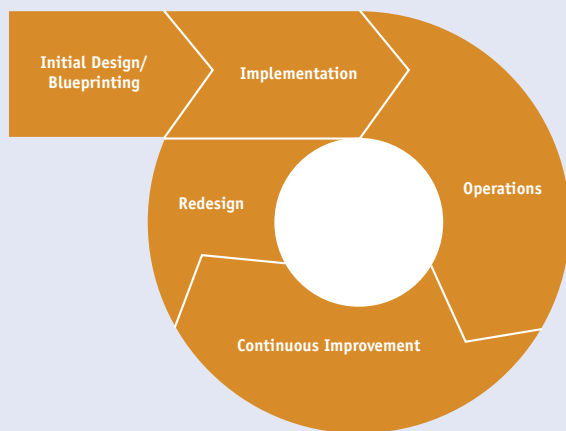
long-term effects. All of this must be addressed for innovation to stand a fair chance.

In particular, we are often asked what types of communication and change management practices we would recommend to encourage HRO innovation. The answer is clear: a strong collaborative mentality between provider and customer, and early involvement of experts with cross-functional (process/IT) experience.

All of this is possible—and for proof, it is sufficient to look at how BPO started as an innovation in itself.

Since 2004, SAP has deployed a very significant amount of dedicated resources with the intent of understanding the market better and improving it together with customers and partner service providers. In 2006, we named this “BPO 2.0.” Tellingly, the name has stuck, and BPO business practices have indeed started to mature. Innovation will become part of this maturation.

—Dr. Christian Baader, Vice President of BPO, SAP AG  
 —Gianni Giacomelli, Head of Global BPO Strategy and Marketing, SAP AG



More information can be found at <http://www.sap.com/services/hro>

