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HR outsourcing

An overview of HR outsourcing, its use within organisations and its alternatives

Introduction

Outsourcing any activity to an external provider can offer benefits, such as increased efficiency and access to expertise. But it can also present challenges, such as loss of local knowledge and processes, and fragmentation of the service provided. Payroll is the most commonly outsourced HR activity, followed by providing advice on complex specialist topics.

This factsheet introduces HR outsourcing and its use by organisations, outlining some of the alternatives, such as shared services, employee self-service, and buying-in consultancy services. It highlights the need to consider the business case for outsourcing HR work and the questions to ask in deciding whether outsourcing is the most appropriate solution. Finally, the factsheet offers guidance on selecting a provider and sets out some issues to consider when managing the move from in-house to a third-party service.

What is HR outsourcing?

The practice of outsourcing involves buying one or more business services from an external provider. This could include HR and/or other services such as IT. The specific processes included within any HR outsourcing arrangement will vary from organisation to organisation – some may outsource virtually all their HR processes while others select specific components such as payroll or recruitment.

Our [People profession in 2020 survey](#) found that outsourcing models are used mainly by SMEs. Compared to larger organisations payroll was more commonly outsourced in SMEs compared with those larger firms surveyed. Complex case loads are also more frequently outsourced in SMEs compared with larger firms.

Alternatives to HR outsourcing

HR outsourcing isn't the only solution that organisations could consider if they want to change the way their HR service operates. Other options that can work either as an alternative to, or in conjunction with, outsourcing.

There's no single model for delivering HR that's suited to all organisations. An organisation should structure its HR activities based upon its organisational strategy, wider organisational structure and current business needs.

Shared services

The term 'shared service' refers to the creation of an internal 'hub' for the delivery of HR services that are shared across an organisation (or sometimes, a range of organisations).

Currently, more organisations appear to prefer setting up internal shared service centres than adopting a full-scale outsourcing approach. See more in our [HR shared services](#) factsheet.

Offshoring

Offshoring may sometimes relate to outsourcing, and the two terms are often, but incorrectly, used interchangeably. Offshoring is the process of outsourcing business activities or services to a third party overseas and/or moving business activities or services to another country as a direct or indirect employer. So offshoring does not necessarily involve the services of an external provider. 'Nearshoring' is a term sometimes used when services are moved to countries close to or bordering the country of operations.

Adopting offshoring arrangements is likely to be driven by cost considerations. Some commentators believe that offshoring may be most appropriate for process transactions rather than more personal services such as call centres.

Self-service systems

Increasingly, some organisations are using technology to introduce comprehensive HR self-service systems that allow employees and managers to carry out some HR-related activities themselves via a portal or intranet.

In an employee self-service system, individuals may be able to update their own personal details when their circumstances alter, while in a manager self-service system, managers

might review absence records, manage leave or record development activities for all their staff.

Buying in consultancy services

External consultants might be used to advise on specific HR issues or on implementing particular HR processes (for example, the introduction of flexible benefits). Typically, consultants do not manage or deliver these services once implemented – this is taken on by the internal HR team.

Benefits and challenges of HR outsourcing

Creating a business case for HR outsourcing is an important initial step for any organisation considering such a move. The organisation must ask at the outset why it needs to change the way it's HR function currently operates. What aspects of the existing service are unsatisfactory or would benefit from improvements? By probing such issues, HR can focus on the scale and type of changes required before moving on to consider whether HR outsourcing might be an appropriate response (as opposed to the types of alternatives detailed above).

A number of potential benefits and challenges are associated with HR outsourcing.

Potential benefits

When organisations put forward a business case for HR outsourcing, the potential benefits are frequently cited. In practice, these benefits are not necessarily mutually exclusive, while conversely they might be achieved through some alternative solution rather than via outsourcing.

Commonly mentioned benefits include:

- Reduced costs.
- Increased efficiency.
- Access to improved HR IT systems without capital outlay.
- Improved people management information (including people analytics).
- Access to HR expertise that is not available internally.
- Increased flexibility and speed of response to HR problems.

- Ability to support or fit well with an overall strategy (for example where the organisation is outsourcing a number of its support functions, of which HR is just one part).
- Reduced risk, as it is possible to scale up and down more efficiently.
- Capacity for HR to operate more strategically.

Potential challenges

Potential challenges to bear in mind when considering outsourcing include:

- 'Don't outsource what you don't understand'. The outsourcing provider will only have to subsequently solve the problem (at a cost) and the provider's solution might not be most suitable from the organisation's perspective.
- Outsourcing does not absolve the organisation of good people management practices nor of overall responsibility for the provision of HR services.
- Increasingly, outsourcing arrangements are long term (five to ten year contracts are not unusual). An understanding of the organisation's current and future business strategy and potential changing business profile (and hence risk) by the outsourcing provider is crucial before entering into any contractual arrangement. This helps to avoid being tied into unfavourable contractual arrangements.
- Loss of local knowledge and processes which instead reside with the outsource provider.
- Standardisation of processes in line with the preferences of the outsourcing provider rather than the organisation.
- Fragmentation of the service provided meaning that day-to-day operations are split from strategy and policy direction.
- The need to constantly review the success of the outsourcing arrangement against specified metrics. The rationale for outsourcing services may change as the business environment changes, and there are instances of services being brought back in-house.

Selecting a provider and managing the transition

Selecting a provider

A number of actions and decisions must be taken when selecting a suitable HR outsourcing provider. Many are similar to those taken when entering into any contractual arrangement with a third party. For example:

- Understanding the existing HR service provision including the cost base, responsibilities and level of service, as these all provide useful baseline information when comparing provider offerings and costs.
- Understanding the organisation's own future requirements in terms of level and type of service.
- Establishing a shortlist of preferred suppliers.
- Communicating with other organisations who currently use the outsourcing providers to establish how satisfied they are with the service.
- Considering 'fit' with provider organisation, which will include cultural as well as geographical factors.
- Identifying who will be the key relationship manager.
- Determining preferred contract length.
- Building in contractual flexibility where possible.
- Staying involved in the contracting process. Particularly in some larger organisations there might be a procurement function that normally takes responsibility for all contracts. It's important not to abdicate everything to such a function as it's unlikely to have the necessary expertise in HR matters.
- Identifying metrics, including benchmarks of acceptable and unacceptable ranges, to be included as part of any service level agreement.
- Ensuring a clear 'statement of work' is produced that clearly sets out the responsibilities of the service provider.
- Defining a clear governance process, so that the impact on the outsourced service is considered when any internal decisions are made and there is a clear decision making process with the outsourcer where required.

Managing the transition to HR outsourcing

Managing the transition from in-house to third-party service will need similar considerations to managing any large-scale organisational change.

In addition, there will be significant changes to existing HR processes, maybe including HR self-service systems and/or formalised HR call centre provision for staff and managers. It's therefore crucial to make sure sufficient HR leadership and expertise remains internally to manage the change as well as providing ongoing strategic direction.

Clarity over who is accountable for resolving problems during the transition is also key - is it the outsource provider or the outsourcing organisation? The outsourcing organisation's HR leaders cannot simply delegate to the provide clear understanding by both parties of what's involved will also mean misunderstandings are minimised. An open dialogue is needed between the outsourcing company and the provider.

Finally, it's possible that changes will be needed to the roles and skill sets required of the remaining HR staff as well as other employees and managers. This could involve re-deploying certain staff as well as providing additional training to many others. Recognising that these processes take time to introduce needs to be factored into any change programme. Open and ongoing communication to staff about the whole process is vital for success.

Further reading

Books and reports

INCOMES DATA SERVICES. (2011) *Outsourcing HR*. HR Studies. London: IDS.

REILLY, P. and WOLFE, H. (2004) *HR outsourcing in the UK*. Brighton: Institute for Employment Studies.

SCOTT-JACKSON, W., NEWHAM, T. and GURNEY, M. (2005) *HR outsourcing: the key decisions*. Executive briefing. London: Chartered Institute of Personnel and Development.

Journal articles

GLAISTER, A. (2014) HR outsourcing: the impact on HR role, competency development and relationships. *Human Resource Management Journal*. Vol 24, No 2, April. pp211-226.

LEWIS, D. (2018) The pros and cons of outsourcing HR. *People Management* (online). 25 September.

REICHEL, A. and LAZAROVA, M. (2013) The effects of outsourcing and devolvement on the

strategic position of HR departments. *Human Resource Management*. Vol 52, No 6, November/December. pp923-946.

ROPER, J. (2016) HR's hokey-kokey. *Human Resources*. March. pp26-31.

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This factsheet was last updated by Steve George.