

## HUMAN RESOURCE OUTSOURCING

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## ABSTRACT

Outsourcing has gained a great impetus during the last some years. There are many reasons to outsource the goods and services. The concept of Human Resource Outsourcing facilitates a firm to rivet its attention to core business. It is also used to minimize the complexities to cope with human resource activities more precisely. In Pakistan, the concept of Human Resource outsourcing is in its inception stage as it is not very much in practice. Organizations are outsourcing Human Resource but only the activities and functions, which are very much essential to performed. Most of the organizations are unaware from the factual essence of this idea that it is very cost productive and helps to gain competitive advantage. Keeping these drawbacks, this study is carried out to discover the reasons of HR Outsourcing in the Pakistani business scenario.

## INTRODUCTION

Organizations have always outsourced goods and services with outside companies. There are many reasons to make or buy decision about the services. Harrison and Kelly (1993) defines outsourcing as “Outsourcing is one form of subcontracting and used to describe the practice whereby work previously performed in-house is ‘contracted out’.”

The trend of Outsourcing the Human Resource activities is increasing in today’s business scenario. Many professional and practitioner publications evident that there has been a significant increase in the development of HR outsourcing in last ten years. Currently, the concept of Human Resource outsourcing facilitates a firm to rivet its attention to core business and is also used to minimize the complexities to cope with human resource activities more precisely. HR outsourcing vendors meet the human resources requirements of a company according to its needs. Traditionally, HR functions have been performed internally. To release the in-house HR team for a more strategic role, many organizations outsource routine administrative HR functions to outside vendors. However, many other firms outsource their entire HR systems, including the design of HR systems. Outsourcing the whole HR system is likely to have a fundamental impact on the culture and performance of an organization.

This is one of the major issues in organizational decision making is that what types of HR activities should be outsourced and which activities should keep in-house. While making the decision of HR outsourcing, organizations requires analyzing and considering the impact of outsourcing these functions on the organization’s performance. For this purpose, Finn (1999) suggests that the organizations need to differentiate between “core” and “noncore” activities of HR function.

Some academic researchers have investigated empirically in which manner decisions of outsourcing are made, how these decisions are put into practice, how the effectiveness of the outsourcing is measured and the implication of these outsourcing decisions for the role of the HR function and for different groups in the organization. In general, there has been a lot of research done on outsourcing but there is a little academic-oriented research on issues related to HR outsourcing.

In Pakistan, the concept of HR Outsourcing is in its inception stage. Organizations know the concept of HR outsourcing but it is not very much in practice. Organizations are outsourcing Human Resource but only the activities and functions, which are very much essential to be performed. Most of the Organizations are unaware from the factual essence of this idea that it is very cost productive and helps to gain competitive advantage. Keeping these drawbacks, this study is carried out to discover the reasons of HR outsourcing in the Pakistani business environment.

Objective:

The objective of this thesis aims to study why organizations outsource Human Resource practices.

## Research Questions

1. What factors derive firms to outsource Human Resource activities?
2. Which activities of Human Resource is being outsourced and to what extent?
3. What effects Human Resource outsourcing has on cost?

## LITERATURE REVIEW

Trend of Outsourcing gained greater progress in the 1970s, as many large and diverse companies were underperforming at that point of time. This trend gained rapid growth in the early 1980s as the global recession was on its inception stage. In 1980s, there was a great change of direction in business approach and organizations have started thinking of outsourcing, but the main focus was on fewer activities. The activities that frequently outsourced are Cleaning, IT, catering and security. Adler (2003); Cook, (1999); Galanaki and Papalexandris, (2005); Lilly et al., (2005) has explained that the HR activities have been increasingly outsourced, and HR outsourcing is the fastest-growing segment over the past ten years.

Companies make the decision to outsource for a variety of reasons; cost reduction tends to be one of the primary reasons for outsourcing. However, many researchers argue that the cost reduction should not be the only factor considered while making the decision to outsource. For example, a study by Beaman (2004) shows “the real payoff from HR outsourcing is not in reduced costs, but in improved quality”. Belcourt, (2006); Lever, (1997); Scott-Jackson et al., (2005) have explain that the “ Other drivers of HR outsourcing are gaining specialized HR expertise, achieving flexibility, reducing risks and enhancing access to advanced technology” (cited in Klaas, B.S, 2003).

Outsourcing the information system and accounting, is most common organizational activities. There are lots of theoretical and empirical articles, but the academic literature on HR outsourcing is very few. The cost benefit analysis is the top and most important argument in the topic of human resource outsourcing. “Empirical data from government agencies outsourcing to private suppliers generated savings in the range of 20-30 % in production costs”. (Anderson et al, 1986; Greer et al, 1999; Gupta et al, 1992; Kakabadse et al, 2002; Lever, 1997, and Vining & Globerman 1999). But some researchers in their studies suggested that at the time of making the decision of outsourcing there should be other factors excluding cost which should be considered. The other reasons which are indicated in outsourcing by the researchers are specialized services, vendor-customer satisfaction, employee satisfaction and competitive advantage. Adler (2003) noted that a review by the Granter group identified six factors which are considerable in decisions of outsourcing: “dependency risk, spillover risk, trust, relative proficiency, strategic capabilities, and flexibility. The first four of these factors are short term factors, whereas the last two are considered more long term or strategic”. However, in

literature there is no defined procedure that identifies when outsourcing is most efficient and effective.

Once a firm has decided to outsource the particular functions, it needs to find out the best supplier for specialized services. A single supplier of services should be preferred to multiple suppliers for a number of reasons. Firstly, it is very easy to supervise one vendor as it will save time of the HR staff. Secondly, a single supplier better understands the needs of client and provides integrated solution across the company. Thirdly, it is great advantage when a number of solutions are being bought from one supplier which enables a firm to confer upon a better agreement.

Lieven and De Corte (2008) published the first study on the commitment of Human Resource managers to make the decision to continue an outsourcing partnership with the present supplier of the services. They formed a model of HR manager commitment, testing affective commitment and continuance commitment in outsourcing partnerships. This study found that affective commitment and the continuance of the outsourcing partnership was linked to frequency of HR outsourcing.

Brain S. Klaas, who has written a long theoretical study on the impact of HR outsourcing, found that organizations should be well aware of the prospective risks before selecting an HR vendor. He explained that the small and medium enterprises in particular, are rapidly going for HR Outsourcing. He further examined that there are the variables that can be affected by organizations and will vary from organizations to organizations, which are administration fees, staff time costs, HR outcomes and compensation costs. He suggested that if an organization is planning to outsource its HR functions, should fully research these variables to see which benefits can be obtained in contrast lowering the costs.

#### Arguments for Outsourcing:

In general, organizations think about using outsourcing for a number of apparent reasons. First, it permits them to concentrate on their “core” business functions, and can focus on the area where they have expertise and are likely to do best. Second, it allows the firms to obtain competitive advantage and gain profit from the expert service providers who may have specialized skill in the concerned areas. Third, it also allows companies with greater flexibility and efficiency to cater with fluctuating labor requirements with the help of subcontractors. Firms can save the direct costs by the on time provision of the human resource (e.g., reducing headcount and overtime working) and indirect costs (e.g., cutting administration and backup costs, saving recruitment and training costs, saving absenteeism costs, and reduced industrial relations problems). Fourth, outsourcing also minimizes the risk factor of uncertainty to the vendor. And lastly, outsourcing provides opportunities to firms to choose most competitive tender to keep the future costs down.

#### Arguments against Outsourcing:

HR outsourcing practice is not without drawbacks. One of the most important issues is maintain the continuous delivery of expertise delivery and the retention of knowledge and skill internally. Most of the organizations adopt outsourcing to save the training costs as they assume that the specialized service providers will deliver the key skills as per requirement. As Prahalad and Hamel (1990) point out, “outsourcing can provide a shortcut to a more competitive product, but it typically contributes little to building the people-embodied skills that are needed to sustain product leadership” (cited by Wray, G. N. 1999). Loss of quality is also another most important factor in outsourcing, especially for those firms which are operating in a very competitive business environment. Employees of the firm often assess the service quality by comparing the result of the service and expectations of the service under the proposed change.

#### HR Activities to Be Outsourced:

In outsourcing HR functions, the first and foremost issue is to make decision of which HR activities should be outsourced and which should be performed internally. While deciding about make or buy decision, firms require to consider that what would be the impact of outsourcing these activities on the firm’s performance. For better outcomes, organizations may need to classify the “core” and “noncore” activities. Finn (1999) suggests that “a basic distinction can be made between HR “core” and “noncore” activities. The core functions of the firm include top-level strategy, HR policies, and line management responsibilities (e.g., appraisal and discipline), while the non core functions include specialist activities (e.g., recruitment and outplacement), routine personnel administration (e.g., payroll and pension), and professional HR advice (e.g., legal advice related to employment regulations)”. Hall and Torrington (1998) found that “training and management development, recruitment and selection, outplacement, health and safety, quality initiatives, job evaluation, and reward strategies and systems were the likely HR functions to be outsourced, as they were considered noncore or because the organization lacked the expertise to perform these activities internally”. The literature is evident and listed some of the activities which are outsourced completely are employee training, payroll, healthcare benefits to employees, and pension benefits.

Regardless of this rapid progress in the outsourcing of Human Resource function, the empirical studies by Klaas, McClendon & Gainey, (2001), Gainey& Klaas, 2003; Klaas, 2003; Klaas, McClendon & Gainey, (1999) of Human Resource outsourcing concentrate on the issues like “the impact of organizational characteristics”, “the role of transaction costs”, “the relationship between HR department size and outsourcing activity”. However, the most important issue of outsourcing is when to outsource the HR functions, is not covered properly. Which factors allows firms to keep the activities in-house and which outside forces derive the firms to consider outsourcing. Although Klaas, McClendon & Gainey (1999) addressed this issue in their study of moderator variables in the relationship between amount of HR outsourcing and

perceived benefits from outsourcing. In a separate article by Klaas, McClendon and Gainey (2001) also analyze the certain organizational characteristics which derive organizations to outsource HR activities, but do not consider HR performance as a dependent variable.

There are very few empirical studies that examine the significance of performance while making the decision about HR outsourcing. As most of the researches seem to focus and explain the factors due to which organizations outsource, how to outsource, or the impact of outsourcing on the organization and its employees.

In the literature, the question of when outsourcing is most suitable and under what circumstances a company should outsource is not addressed properly or a very few work done on this issue. A considerable gap is identified as and when and under what business scenario does a firm should outsource which would add value to the firm's outcomes, what would be the impact on the firm's performance and how HR outsourcing mediates that relationship?

Reasons for Outsourcing:

Achieving competitive advantage:

Achieving competitive advantage is one of the most important reasons for the decision of Human Resource outsourcing. In different studies, the authors put stressed on the issue that Human Resource system can provide competitive advantage to the firm. In the case of HR outsourcing a firm is availing more specialized services probably from a different environment with different expertise and the knowledge proficiency can help an organization achieving a competitive advantage over it competitors.

Minimizing cost:

Minimizing costs is a second main reason of Human Resource outsourcing has been identified in literature. The activist, ( Roberts, 2001) campaigned for outsourcing as considerably lowering the costs and risk, increasing the organizational flexibility, innovative capabilities, and opportunities for creating value-added stakeholder returns. Obviously, many organizations preferred to outsource due to the cutting down cost of production. Nevertheless, these reasons are not without challenges. Some of the challenges have been listed as quality of HR services from vendors, insufficient employee preparation towards the jobs, and lack of proficiency to manage HR outsourcing.

Achieving Core Competency:

HR managers require to consider that all activities of outsourcing from maximizing resources and making service improvements, is to freeing up in-house staff to focus on more strategic staffing issues. The main issue is that Human Resource managers can perform more strategic roles by contributing to establish the company's future goals and plan to achieve them rather than spending time on staff payrolls or keep checks on absence records.

Technology Advancement:

The technology advancement is playing an important role in the issue of HR outsourcing. Due to technology advancement firms need to have the latest equipments and procedures. And firms

preferred to purchase of outsourcing services, which provides them the latest and accurate services. Most of these modern equipments and systems require specialized skills and experts to perform the functions. So consequently organizations in such need outsource the specified activities.

Generally, in the use of HR Outsourcing the researchers found considerable variations among organizations. More important, these variations appears to stand little relationship to the size, cost, or productivity of the function (Greer et al., 1999; Vernon et al., 2000), although Klaas et al. (2001) found that idiosyncratic HR practices, firm size, and cost pressures affected both the degree of outsourcing and the perceived benefits.

Existing literature on HR outsourcing appears to be limited in general. As it's a new phenomena which is in its inception, so that the research and practice in HR outsourcing is being in its early stages of growth and development. Many firms preferred to outsource the discretionary activities of HR (e.g., payroll, training, health and safety, legal advice), areas in which they consider a non-cost effective to develop and maintain internally and the lack of internal expertise.

Although some researchers remain cautious about the future growth of HR outsourcing but as per the existing evidence, HR outsourcing has augmented significantly over the last decade. Training and payroll listed as the most favorite areas of HR outsourcing. In addition, recruitment, taxation, and legal compliance are most common functions which are outsourced very often. However, employee relations, HR planning, career management, and performance appraisal are less likely to be outsourced, as these activities are considered to be the core competencies. Even so, there are no clear patterns of the types of HR activities that are outsourced.

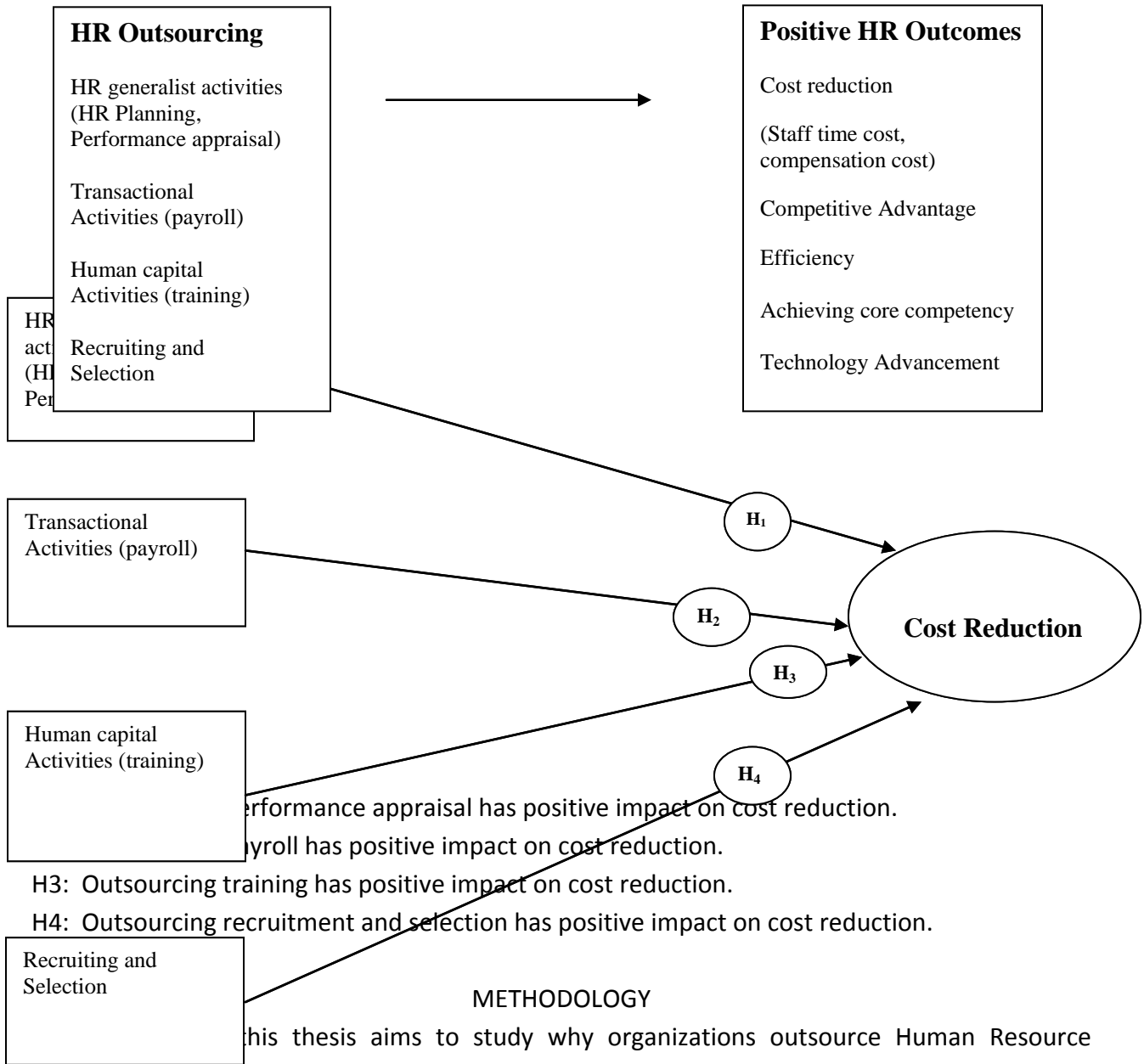
#### THEORETICAL FRAMEWORK

It is clear from the literature that outsourcing of the different Human Resource activities has positive impact on the organizational outcomes. In 2001, Klass, McClendon and Gainey examined the relationship between organizational characteristics and the decision to outsource Human Resource functions. They identified and divide Human Resource outsourcing activities into four categories: HR generalist activities, transactional activities, human capital activities and recruiting and selection activities.

The independent variables which are identified from the literature review are; First, Generalist activities in HR function which includes HR planning and performance evaluation. Second, the transactional activities such as payroll. Third, the Human Capital activities like training and development of employees. And lastly recruiting and staffing activity.

These activities have direct or indirect impact on the positive impact on Human Resource outcomes of the organization. The dependent variables which are identified in the literature are; Cost reduction (Staff time cost, compensation cost), Competitive Advantage, Efficiency,

Achieving core competency and Technology Advancement. These activities (independent variables) are directly related to positive HR outcomes (dependent variables).



Research Type:

The study would be an explanatory research as the primary goal of the study is to understand and explain the nature or mechanisms of the relationship between the independent and dependent variable.

Research Approach:

This study will employ both qualitative and quantitative methodology, which means that both numerical and non-numerical data and information will be used. By using quantitative method, it is easier to analyze the data and come up with the findings and results, consequently, conclusion and recommendation. On the other hand, qualitative method, as described by Denzin and Lincoln (2005), is “a situated activity that locates the observer in the world. It consists of a set of interpretive, material practices which make the world visible. These practices transform the world” (cited in Flick, 2008, 3). In addition, it also helps to focus on the process of describing, decoding and interpreting the meanings of the different events, situations and phenomena where in the normal social contexts happen (Fryer, 1991). With this, it can help to support the numerical data gathered by quantitative.

Quantitative research involves the process of counting and measuring events and phenomenon with the use of different statistical analyses of a body of numerical data. Therefore, by using this, the study assumes that object truths that are existing in this world are all measurable and can be explained by different scientific procedures. With this, its center on the thinking that measurements are all reliable, effective, valid, efficient and generalizable in its clear prediction of its cause as well as its effects (Cassell and Symon 1994).

In-depth interviews:

Walker (1985) describes it as an organized approach often over protracted period of time where the researcher is able to explore in-depth responses from respondents usually used to gain subjective information and more appropriate for a small number of respondents.

This study will be conducted through both the questionnaires and in-depth face to face interviews with the senior managers of the organizations which are outsourcing the whole HR function or one or two HR activities.

Population:

There would be no specifications of the industry. The sample has been restricted to Lahore, excluding all other major cities of Pakistan. Some of the companies which are practicing HR Outsourcing in Pakistan e.g. EMAAR, Pakistan International Airlines, PSO, Caltex, Virtual University, Supreme Court of Pakistan, Alcatel lucent Pakistan, Ufone Pakistan and Zong Pakistan. Population will be the manager or person responsible for strategic decision making.

Sampling Technique:

Non-probability sampling technique, convenience sampling and Snowball sampling will be used to reach the respondents. In this technique, respondents will be reached through references in such a way that one respondent will refer to the other respondent and a chain will be developed.

Sample Size:

Sample size will be 100 as the expected response rate is 50%; a total number of 50 responses will be collected. On the other hand, another set of respondents, (5) will be selected in order to undergo in-depth interview sessions from five different companies.

#### Data Collection:

This research will use both primary and secondary data. Primary data will be gathered by survey interviews and questionnaires from the respondents for the better understanding levels of HR outsourcing. The questionnaire consists of questions which focus on the different areas related to the current practices of HR outsourcing.

The survey interview and questionnaire instrument are designed with close-ended and open-ended questions. The main advantage of this type of question is that, it helps the respondents to express themselves, without limiting the answers which they can supply. With this, the data gathered using this question will be helpful in order to gather in-depth data or information, at the same time, help in order to support those data gathered using the close-ended one.

The snowballing sampling technique will be used to collect the required data. The selected respondents will be visited personally for the purpose of filling up questionnaires or survey forms will be sent through the e-mail as per convenience of the respondents. On the other hand, the secondary data will be collected from reputable journals and internet resources.

#### Measurement:

##### Dependent Variables:

The following scales will be included in the survey.

Cost Reduction will be measured using a five point instrument adapted from the previous studies (Klaas, Yang, Gainey, & McClendon, 2005). A five-point scale will be employed ranging from 1(strongly disagree) to 5 (strongly agree). This enables the respondents to express the level of the agreement and disagreement to a specific statement given in the questionnaire.

##### Independent Variables:

The following is a brief description of all independent variables. To assess measurement reliability, Cronbach's alpha value will be produced on all multi-item independent variables. It should not be any less than (0.7), which will be indicating a high level of internal consistency for all multi-item measures used.

All independent variables will be measured using an instrument developed by (Klaas, Yang, Gainey, & McClendon, 2005). A four item scale will be used to measure the extent to which outsourcing performance appraisal has impact on cost reduction. A four-point scale will be employed ranging from 1(never used) to 4 (most used). With the use of this scale, it is much easier to analyze, describe and present the result of the study.

### STATISTICAL ANALYSIS

The numerical data in the study will be analyzed with the use of statistical software SPSS. In line with this, frequency, percentage and weighted mean will be computed. Content analysis will be

used to analyze the data collected through interviews. As Coolican (1994, p. 108) pointed out: "The communications concerned were originally those already published, but some researchers conduct content analysis on materials which they ask people to produce, such as essays, answers to interview questions, diaries, and verbal protocols".

To check the internal consistency of scale, 15 questionnaires will be sent to the respondents and the value of Cronbach's alpha will be compared with the value of Cronbach's alpha of original scale.

To test the hypothesis H1 Linear regression analysis will be used by taking outsourcing performance appraisal as independent variable and cost reduction as dependent variable.

To test the hypothesis H2 Linear regression analysis will be used by taking outsourcing payroll as independent variable and cost reduction as dependent variable.

To test the hypothesis H3 Linear regression analysis will be used by taking outsourcing training as independent variable and cost reduction as dependent variable.

To test the hypothesis H4 Linear regression analysis will be used by taking outsourcing recruitment and selection as independent variable and cost reduction as dependent variable.

Limitation:

The main limitation of this study focus on the time spent in conducting the study. Another limitation is the small size population used in order to study the subject matter. The ethical issues will be considered in the study: informed consent and issues of confidentiality. The use of informed consent will be considered in the study in order to inform the respondents regarding the background of the study, including the importance of the data to be gathered from them. The researcher will ensure the respondents that all of the information in this study will be solely used in academic purposes only. In addition, the researcher also make sure that all of the responses from the sample will be given merit, whether the researcher agree or not to their individual responses.

The researcher will not disclose any personal information of the respondents, all of which will be explained in the conduction of the survey questionnaire and interview directly to the respondents. In addition, the researcher also pledge about these ethical principles towards the chosen companies.

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