MIT Sloan
Management Review

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REPRINT NUMBER 45112

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Outsourcing has become increasingly attractive for many organizations. In such relationships, a company contracts with a vendor that rents its skills, knowledge, technology, service and manpower for an agreed-upon price and period to perform functions the client no longer wants to do. Much attention has focused recently on the outsourcing of staffing, including temporary and contract workers, and IT professionals. A much less noticed, though growing, business has been that for human resources business-process outsourcing, or HR-BPO.[1] Starting with humble payroll processing, outsourcers now offer to take over virtually any HR activity - or even the entire function. In 2000, the HR outsourcing industry had revenues of $21.7 billion, accounting for more than 8% of total HR spending.[2]

Some observers see outsourcing as a key trend (perhaps even *the key* trend) shaping the future of HR They envision HR departments focused entirely on strategic activities, all performed with an in-house staff consisting of a small number of high-level contributors, perhaps only internal consultants, HR systems designers and HR executives - leaving all the transactional and administrative activities to vendors for which those processes are core.' But others doubt that the strategic and operational aspects of HR can be separated so cleanly. Ralph Kimmich, director of compensation and benefits at Southwest Airlines Co., for example, is skeptical about HR outsourcing. "It seems to me," he says, "that once you do that, you're abdicating your role as an employer to lead your people." Consequently, Southwest Airlines has instead been beefing up its in-house HR capabilities.'

Indeed, outsourcing any business activity creates potential risks as well as benefits: Companies can find themselves overly dependent on suppliers, and they can lose strength in strategically core competencies. Interestingly, given the importance of the outsourcing decision and the amount of

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Business-process outsourcing is a key trend shaping the future of human resources. Six factors can help companies determine which HR processes to outsource and which to retain.

Paul S. Adler

About the Research

This article is based on an extensive review and synthesis of the literature on outsourcing in general and HR-BPO in particular, including separate studies and surveys conducted by Gartner/Dataquest, International Data Corp. and Robert W. Baird & Co. Inc. The case study of the outsourcing agreement between BP Plc and Exult Inc. is based primarily on a series of interviews with two executives who helped implement the landmark $600 million deal.

academic and practitioner literature on it, there is surprisingly little consensus about the topic, probably because of the multiplicity and complexity of the factors involved. This article synthesizes the strongest of the available research and identifies the six key factors that companies should consider when making important outsourcing decisions. The framework, which helps assess the pros and cons of outsourcing, can be applied specifically to HR functions. In particular, it can help explicate the managerial issues of outsourcing agreements such as the recent landmark deal between BP Plc and Exult Inc. That $600 million, seven-year arrangement provides a window into the many opportunities — and complexities — of HR outsourcing.

A Changing Environment

Changes in the broader business environment are affecting nearly every aspect of how companies manage their human resources, altering the balance of pros and cons for outsourcing HR business processes.

First, conflicting pressures in the labor market have brought the role of HR to the fore. On the one hand, the 1990s brought the so-called war for talent. Looking forward, demographers predict a long-term tightening of the U.S. labor market. On the other hand, intensifying competitive pressures have forced companies to be more aggressive in cutting costs, often by reducing head count. HR functions have had to manage such downsizings, while also trying to be innovative in attracting and retaining valuable employees. HR may not be considered a core competence, but its interdependence with strategic factors is growing.

Second, HR departments themselves have become the target for belt-tightening efforts, and they must now find ways to provide more value at lower cost. Many have argued that the key is to focus on activities that are essential and outsource the rest.

Third, the legal environment of HR has grown increasingly complex, and HR managers have struggled to keep up with the regulatory changes, particularly in the areas of health care, stock-related compensation, overtime-pay calculations, pension reform, benefits eligibility for contingent workers and the marriage tax penalty. This has driven the demand for outsourced employee services from vendors that are subject-matter experts.

Fourth, mergers and acquisitions have become increasingly frequent, creating huge HR challenges. Often, HR is charged with the simultaneous tasks of integrating large numbers of employees, managing layoffs from staff consolidations and helping to blend dissimilar corporate cultures. Companies confronted with the challenge of merging heterogeneous HR systems frequently find outsourcing appealing because the specialized personnel required for the task will often be superfluous after completion of the project.[5] Globalization poses a comparable challenge, requiring HR departments to address the needs of employees in, and moving between, different countries.

Finally, of the various forces affecting HR, the development of technology is perhaps the most significant. The Internet and new generations of software have revolutionized HR information systems, significantly improving HR productivity, increasing control of employee benefits, streamlining compliance efforts, facilitating the management of payroll functions and lowering the cost of recruiting. The information from such systems is easier to modularize than that from paper-based systems, making outsourcing more attractive. New technology has also led to Web-based HR portals that provide employees with 24-hour access to information from a variety of sources, including insurance carriers, health providers and asset managers, in addition to up-to-date company information (such as policies and procedures manuals), employee data (allowing individuals, for example, to change their address or tax exemptions online) and management tools (such as performance-evaluation forms). Many companies, however, view the technical challenges of building and operating such systems as a costly distraction, providing neither a competitive advantage nor the prospect of a sustainable lead. For them, outsourcing is an appealing alternative.

A Segmented Industry

As outsourcing HR business processes has become commonplace, three main industry segments have emerged: consultants, administrative-service providers and technology enablers. HR consultants provide expertise on issues such as compensation, stock-option-plan design, employee benefits and workplace diversity. This industry segment includes large organizations such as Hewitt Associates, Towers Perrin, Mercer Human Resource Consulting and Watson Wyatt Worldwide, as well as a number of smaller, more specialized firms.

Administrative-service providers handle payroll and benefits processing and will themselves sometimes outsource certain niche activities such as the management of workers' compensation and COBRA. This industry segment includes both back-end processing-centric vendors such as Automatic Data Processing Inc. (ADP) and front-end Web-centric firms such as eBenefits Inc. Interestingly, administrative-services providers that began in payroll, including ADP, Ceridian Corp., Paychex Inc. and ProBusiness Services Inc., have been expanding into benefits outsourcing and other areas.

Technology enablers help companies that want to continue managing their back-office HR processes in-house (perhaps after purchasing either customized or packaged HR software) but need assistance to do so. This industry segment includes vendors such as USinternetworking Inc. and Corio Inc., which charge a monthly fee for Web solutions that use PeopleSoft software. In such arrangements, the technology enabler is responsible for the implementation, software maintenance, data management, network access and round-the-clock support, and the client provides the functional HR professionals necessary to use the system. Technology enablers also include traditional IT consultants that have formed partnerships to gain access to HR capabilities (for example, Unisys Corp. with Exult and IBM with Synhrgy HR Technologies).

Three main HR-outsourcing industry segments have emerged: consultants, administrative-service providers and technology enablers.

Within each of the three segments, some vendors are specialists while others are generalists. Among administrative-service providers, for example, specialists include Gelco Information Network Inc., the largest outsourcer of travel-expense management, and RewardsPlus, which provides optional benefits to the employees of clients. Generalists include firms such as Exult, Employease Inc., e-peopleserve (now part of Accenture) and Synhrgy, which can integrate the whole spectrum of HR processes.

The vendors also differ in the number of primary segments they compete in. For instance, IBM's PricewaterhouseCoopers is a vertically integrated generalist, offering a full range of HR services that spans consulting, administrative services and technology. By contrast, PayChex, a specialist in payroll and tax processing for small businesses, does not build systems for clients, nor does it offer consulting services.

Trends in Outsourcing HR Business Processes

Because HR processes differ across organizations, developing solutions that are custom-tailored to individual companies can be prohibitively expensive. Thus many vendors have adopted a strategy of mass customization. For example, when working with the Phoenix Suns, ProBusiness provides payroll-tax solutions that account for the different tax-withholding laws in every state so that the pro-basketball team is covered when it travels to play across the country. ProBusiness has found that the only cost-effective way to handle such variety is to standardize a set of basic modules and equip them with simple switches that accommodate a range of situations.

Another trend is that toward integration and consolidation. Gartner/Dataquest estimates that in 2002 only 10% of HR outsourcing in the United States was for integrated solutions, but that percentage is expected to grow as companies find greater appeal in obtaining complete servicing from one vendor. Accordingly, many of the key process-centric outsourcers such as ADP, ProBusiness and Ceridian are now providing solutions with greater breadth and higher levels of integration. By selling extra services to clients, those providers can take advantage of large economies of scope, increasing their revenue per employee and spreading overhead costs over more service lines. This suggests that some consolidation of outsourcing contracts is likely through aggressive cross-selling by dominant players, with industry concentration a likely result. A potential risk is that fees might rise and solutions could become too standardized and inflexible. Already, many companies are cautious about entrusting their entire HR systems to a single provider. In fact, businesses currently use an average of 4.5 outsourcers to fulfill their HR requirements.[6]

On a related note, alliances are another likely trend. If an outsourcer lacks strong capabilities in a given area, it can gain access to them through partnerships with other vendors. A possible scenario is the growth of intermediaries that develop alliances or joint ventures with specialized vendors to provide clients with a broad range of services. Alliances also offer vendors a way to strengthen their sales channels. According to a 2000 report, about 55% of ADP's small-business clients come through referrals from trusted business advisers and more than 30% of Paychex's new sales come from partners, mostly CPAs.[7]

When To Outsource and When Not

The outsourcing of HR functions has several potential benefits: It frees the internal HR staff to focus on strategic activities that add more value than transactional, administrative tasks; it enables decentralized structures that support higher rates of innovation and flexibility; it alleviates the bureaucratic burden of centralized HR administration; it enables the HR department to play its part in overall corporate downsizing efforts; and it facilitates access to new ideas and approaches outside the organization.[8]

But there are risks and hurdles. A survey of 125 medium- and large-sized companies in 2000 found that the most frequently mentioned factors discouraging HR outsourcing were perceived higher cost and lower quality — and fear of losing control.[9] Another study of 150 companies in 2001 found that the most common problems of HR outsourcing were poor service, costs higher than promised, contractors with insufficient knowledge about the client and unanticipated resources required to manage the relationship.[10]

These pros and cons play out differently for firms of various sizes with respect to different HR processes. Of the total market for HR outsourcing, large clients (more than $500 million in revenue) account for 55%, midsize organizations ($50 million to $500 million) for 17% and small companies (less than $50 million) for the remaining 28%. In general, large corporations are the main customers for integrated HR services, whereas smaller firms tend to outsource only the payroll function.[11]

How, then, should a company decide what and when to outsource? An extensive review of the literature has identified six important factors:[12]

1. Dependency risks. If a company has to adapt its operations to do business with a supplier, it might then find itself dependent on that vendor. However, if the supplier has to tailor its operations to the needs of a particular client, it could find itself dependent on that customer. In some circumstances, both parties are vulnerable to such risks; in other words, the dependency can be bilateral. Dependency risks increase (thus discouraging outsourcing) when the outsourced activity requires the co-location of facilities, specialized equipment, dedicated capacity or specialized training. A key determinant here is the interdependence of the outsourced process with other activities in the organization.[13] Specifically, if the supplier fails to perform the outsourced function, how will that disrupt other processes? But note that interdependencies can also have an upside: economies of scale from a reliance on common systems, routines or R&D. Thus, when activities are highly interdependent, a company might be reluctant to outsource any of them separately but might instead want to outsource them altogether.

2. Spillover risks. Contracting with a supplier can expose a company to the possibility that confidential information might leak, perhaps even to competitors. The risk is heightened when the outsourced activity involves technology that is novel in some competitively significant way and when the protection for it (for example, patent laws) is weak or unclear and the innovation is easy to imitate. Interdependencies are also of concern: Spillover risks are exacerbated when the interface between the outsourced activity and other internal functions is complex, requiring a company to reveal proprietary information to ensure a good fit between the two.

3. Trust. To protect against dependency and spillover risks, a company can rely on detailed legal contracts with vendors. But such documents are time-consuming and expensive to negotiate, and enforcement is uncertain and costly, thus discouraging outsourcing.[14] Instead, outsourcing is greatly facilitated by trust between the two parties, particularly when both organizations are keen on maintaining their reputations as trustworthy partners. However, given the possibility of divergent business interests, trust between independent firms is, by nature, conditional.[15] Note too that the trustworthiness of external partners should be compared with that of internal suppliers, which sometimes rate poorly.[16]

4. Relative proficiency. Outsourcers can take advantage of economies of scale and scope by aggregating the needs of several clients. In doing so, they can offer great variety and quality at low cost. Furthermore, in knowledge-intensive activities, specialized providers might be better positioned to recruit and retain scarce technical experts. But companies need to examine their proficiency relative to that of vendors on a case-by-case basis. Particularly among large corporations that have sufficient scale, clients may be very efficient. Even then, though, a company might decide that the activity is not sufficiently strategic. Another consideration is whether the client organization is adept at managing suppliers — an issue that is often an unexpected sticking point.[17]

5. Strategic capabilities. A company should not outsource any activity that directly contributes to its strategic, competitive advantage. In addition to such *core* capabilities, organizations should also think twice about outsourcing any *critical* activities — ones that provide no direct competitive advantage but are highly interdependent with those that do. If a company believes it can build a sustainable lead in an activity that offers long-term competitive advantage, then it should refrain from outsourcing that function and instead devote efforts to building superior capability even if its current relative proficiency is modest and other factors make outsourcing attractive. However, if a company doesn't believe it can build a sustainable lead, then it might be better off outsourcing the activity even if its current relative proficiency is high and other factors discourage outsourcing.

6. Commitment versus flexibility. Irreversible commitments (to a core activity, for instance) can be a powerful weapon for a company to signal to competitors its intent to defend its advantage. But strategic flexibility has considerable value, too. For example, a company might be inclined to outsource a function when there is great uncertainty about the future value of that activity's output. Furthermore, uncertainty about the future trajectory of a technology might make a company less inclined to outsource a process that relies on that technology if the activity is core or critical but more inclined to if it is neither.[18]

The relative importance of the six factors varies across situations, and companies need to weigh each accordingly to form an overall assessment. Of the different factors, the first four (dependency, spillover, trust and relative proficiency) can be thought of as short-term or operational. They hinge in part on the assessment of current relational and technical conditions. The last two factors (strategic capabilities and commitment versus flexibility) can be considered long-term or strategic. They hinge on future prospects, involving consideration of long-term changes that a company can strategically influence (and those it cannot).

With respect to HR, an activity such as payroll processing is frequently outsourced because the dependency and spillover risks are low; trustworthy vendors are available; those vendors have accumulated considerable expertise; the payroll function offers little competitive advantage; and clients can switch vendors without excessive difficulty. In contrast, an activity such as HR planning is rarely outsourced because it involves high dependency risks, considerable strategic importance and great interdependency with other key processes.

The six factors help explain why companies of different sizes tend to outsource different HR activities. For instance, small and midsize firms (as compared with large corporations) are considerably more likely to outsource payroll, because they lack the economies of scale to perform that function efficiently. Conversely, large companies are more likely to outsource benefits processing because they typically offer a broader range of benefits, which reduces the economies of scale for handling that activity in-house.

A Case in Point: The BP-Exult Deal

The six factors of outsourcing were major considerations in a landmark outsourcing deal that BP signed with Exult Inc. in December 1999. Through the arrangement, then the biggest HR-outsourcing contract on record, BP agreed to pay Exult \$600 million to take over all its HR services beginning in mid-2000. The seven-year contract called for Exult to assume management, ownership and accountability for all of BP's global HR administrative and transactional processes.[19]

One of BP's precedents for outsourcing as a strategic choice goes back to the 1980s when BP Exploration began to outsource its IT operations selectively. Later, after a series of mergers in the late 1990s, BP was seeking ways to minimize costs and gain efficiencies, and one area that came under scrutiny was human resources. Through its rapid growth, the company had found itself with 100,000 new employees and a proliferation of incompatible systems — for example, literally dozens of different compensation and appraisal systems. According to Nick Starritt, then group vice president for HR, "Our cost of delivering HR activities was uncompetitive, and the quality of delivery was uncertain. Further, the burden of administration on the HR departments in the business units was preventing the function from performing effectively in the more strategic HR services."[20]

To address such issues, BP executives specifically looked for ways to transform HR from a fixed cost to a variable one that the business units would then pay for. In principle, BP could coordinate and streamline the HR systems by creating a large, shared-services group. In practice, though, that approach would be difficult, both politically and financially. Thus the search for an outsourcing partner began in earnest in 1998.

Enter Exult. Based in Irvine, California, Exult takes responsibility for all or part of a client's existing HR staff, processes, technologies and existing outsourcing relationships with other third-party vendors. Exult provides Web-based software that ties the client into a network that operates from four off-site client-service centers. The outsourcer targets companies that have operations in more than five countries, at least 25,000 employees and more than \$10 billion in annual revenue. Typical cost savings reportedly range from 10% to 20% per year.

"The range of HR practices within the organization was mind-boggling," recalls BP's Nick Starritt. "The list seemed to go on and on."

The BP-Exult deal specified that the outsourcer would handle the administrative elements of compensation, benefits, payroll, organizational development, performance management, employee development, training, recruitment and relocation. That left BP responsible for HR policy, strategy, professional resources and labor relations. As management put it, BP retained "only the things that require judgment and policy." According to one estimate, the deal would allow BP to cut perhaps 40% of its HR staff.[21] Not surprisingly, the decision to go with Exult was a subject of considerable debate, and much of the discussion involved the six factors of outsourcing.

Dependency risks. The bilateral dependency risks of the deal were obviously considerable. To minimize them, the two parties worked hard from the outset to establish a bond of trust. According to Starritt, "In many outsourcing deals, the client simply presents the overall process cost and asks potential suppliers if they can beat that cost. ... By contrast, we had an open-book approach to Exult — we called it the 'crystal barrel.' Our view was that the partnership had to begin on Day One. We needed to show them our detailed cost data, and they needed to show us how they would improve on them and the margins they would earn in the process."

A big concern for BP was whether Exult could handle such a large project because the contractor was merely a startup. On the other hand, Exult's founders and staff had considerable expertise, and BP was not impressed by proposals from some of the bigger, more established players. Another issue was BP's exit strategy should Exult or the deal fail. BP ran several risk-management workshops with Exult to talk that issue through. Internally, line managers at BP questioned whether the new arrangement would improve — and not degrade — HR service levels. In response, BP created a governance structure for the outsourcing process that involved representatives of senior line management.

Spillover risks. BP did not anticipate spillover risks to be much of a problem. But Exult discovered that in Germany — BP's third-largest location, with more than 10,000 employees — privacy laws made it difficult to process personnel information outside the country. As a result, BP and Exult had to revise their plans to handle all of BP's needs through Exult's Glasgow and Houston service centers, and they had to scale back the integration of BP's non-U.K. European units.[22]

Trust. In addition to the trust-building efforts described earlier, BP became an investor in Exult. "Our investment in Exult was mainly a sign of good faith," says Starritt. "BP has less than 8% ownership."

Relative proficiency. For BP, one of the key attractions in working with Exult was the outsourcer's Web expertise. As BP envisioned it, the new HR system would be Internet-enabled, eventually allowing all employees access to HR services and information from their personal computers. In the past, for example, someone considering an assignment overseas might have waited up to 12 days to get all the necessary information from the HR department. The new Web system would allow employees to obtain that data by themselves within minutes. And not only would the new system improve response time and reduce costs, it would free HR professionals to answer more-complex questions and to design policy improvements on the basis of employee feedback. The Web technology has also enabled BP to accommodate new functionality easily. For instance, the company worked with Exult to create a software agent that takes information from employees looking for another position within BP and then automatically searches the posted openings daily for any possible fits.

Strategic capabilities. Some BP managers questioned whether the company should be outsourcing HR, because employees were, after all, one of BP's key sources of competitive advantage. In response, Starritt and his colleagues argued that processes like payroll were hardly a competitive differentiator. "We needed to focus on more important things," he says, "such as a worldwide diversity program to attract more diverse talent."

In its analysis, BP broke the HR function down into specific activities and considered the strategic significance of each. Through that assessment, BP decided to retain several key processes entirely in-house, including HR policy, strategy, professional resources and labor relations. Moreover, in outsourcing other processes, BP chose to remain actively involved in their high-level design, leaving Exult with responsibility for their detailed design and execution.

A key lesson here was the importance — and difficulty — of carefully analyzing all the various interdependencies. In retaining the high-level design and outsourcing the detailed design and execution of certain processes, BP bet that these two sets of activities would prove to be sufficiently independent. Conversely, with its decision to outsource a broad spectrum of HR processes, BP also bet that, by allowing Exult to internalize the interdependencies among those processes, not only could Exult then be held responsible for them, but the two partners would also be able to share the benefits of the resulting economies of scope and scale. So far, these bets appear to be paying off handsomely.

Commitment versus flexibility. BP's deal with Exult highlights the importance of strategic flexibility. A major motivation for outsourcing was BP's huge challenge — mainly a one-time effort — to harmonize its HR processes across a large number of newly acquired business units. Because the management of HR is highly interdependent with that of other business units, any effort to reconcile different HR systems throughout the company would require tremendous negotiation. Consequently, once BP had concluded that the bulk of its HR activities was not core, such an investment was clearly counterindicated, and flexibility through outsourcing became appealing.

Implementing the partnership was a tremendous challenge. Not only did BP and Exult have to integrate diverse HR systems across BP, they also had to support BP's line businesses, which were themselves undergoing restructuring. "The range of HR practices existing within the new organization was at times mind-boggling: the multiplicity of payrolls, employee appraisal processes, contracts of employment, salary structures — the list seemed to go on and on," recalls Starritt. Because of that complexity, BP decided to focus initially on just its operations in the United States and United Kingdom, its two largest concentrations of staff. The company formed joint project teams with Exult, and overall project governance was the responsibility of a special steering group, with senior representation from both BP and Exult, and with line and function management from within BP.

Inevitably, a project of this magnitude has its share of problems. Because relatively few BP staff relocated to the new Exult service centers, the transfer of knowledge between the two organizations was less than smooth. Complicating matters was the fact that the BP systems had not always been properly maintained, and in some cases the documentation was missing. So, for instance, payroll processing had a few glitches. "On at least one occasion," recalls Starritt, "Exult had to send paychecks by personal courier to ensure that our staff in one location was paid on time."

Such problems were beneficial, however, in that they helped

BP and Exult uncover the internal workings of the various systems. "We discovered more about the 'string and sealing wax' which had been used to bind the previous systems and processes together, more than I suspect we would ever have known if we had just kept everything in-house after the various mergers," says Starritt. Indeed, he adds, "The outsourcing contract forced us to confront the multiple and inefficient instances we had of just about every core HR process."

The benefits have been tangible. Two years into its deal with Exult, BP says that the payroll accuracy is higher; global employee-appraisal systems have been simplified into just one Web-enabled procedure; the number of different employment contracts has decreased significantly; a new learning-management system has been implemented; and employees have gained vast new functionality through a Web portal. All of that has improved BP's bottom line. "Could we have achieved all these things without a third party?" asks Starritt. "Personally, I doubt it — certainly not at the cost incurred."

Exult and the Future of HR Outsourcing

Exult's experience helps illuminate the various issues and challenges of HR outsourcers, providing clues to the future of that industry. In addition to its contract with BP, Exult has signed several other major deals: Unisys (seven-year contract for $200 million), Bank of America Corp. (10-year contract for $1.1 billion), International Paper Co. (10-year contract for $600 million) and Prudential Financial (10-year contract for $700 million).

The various megadeals have been crucial. "Economies of scale are the key to our business model," notes Bruce Ferguson, Exult vice president and chief people officer. "To give you an example, we recently took over one function for a client and found that we could replace their staff of over 90 by adding only 15 people to our existing group because we could leverage our existing infrastructure." But achieving that kind of efficiency requires Exult to avoid excessive customization of its services. "Our value proposition assumes we can standardize around 80% and only adjust — rather than fully customize — the remaining 20% to give our processes an acceptable look and feel," says Ferguson.

Like its clients, Exult itself has resorted to outsourcing. In some cases, such as for expatriate administration, Exult merely uses tools provided by partner firms.[23] In other instances, such as in the benefits area, the partners provide the HR service. Exult's role is to aggregate the needs of clients and assure them of access to particular services. In this way, Exult can earn a share of the cost savings that come from the resulting economies of scale.[24] "Overall, we see our competitive advantage coming mainly through hard work — excellence in execution — and through the scale advantage we can establish by being there first — building enough transaction volume to drive down price and enough of a client and partnership network that followers will have a hard time breaking in," says Ferguson.

Interestingly, in deciding what activities to outsource and what to retain, Exult often goes through the same kind of decision-making process that its clients do. "We outsource some processes, like benefits, where there are already strong providers," says Ferguson. "So far, our rule of thumb has been to keep in-house and treat as core processes ones where there are low barriers to our entry and where we can establish scale advantages."

Through the outsourcing of HR business processes, support functions for companies such as BP have become a core business for Exult. The end result, Ferguson notes, is this: "There's an amazing culture change between in-house and outsourced HR. When payroll, for example, goes from the back office to the front office, when the top executives of the firm are visiting the department frequently, when that department is revenue-creating rather than just overhead, it creates an extraordinary sense of empowerment. Everyone starts contributing improvement ideas. The whole mood of the place changes drastically."

ACKNOWLEDGMENTS

The author is grateful for the time and help of Nick Starritt, former group vice president for HR for BP, and Bruce Ferguson, vice president and chief people officer for Exult. Research assistance was provided by Jill Benner, Maryann Gonzalez, Natasha Jones, Jason McFarland, Koji Takano and Michelle Sippl. Invaluable comments on early drafts of this article were offered by Nick Argyres, Bob Hayes, Sue Helper, Ed Lawler, Arturs Kalnins and Kyle Mayer. Gartner/Dataquest, International Data Corp. and Robert W. Baird & Co. Inc. were generous with their data and time.

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12. This framework integrates ideas from industrial-economics analysis of the value chain (M.E. Porter, "Competitive Advantage: Creating and Sustaining Superior Performance" [New York: Free Press, 1985]) and transaction-cost economics (O.E. Williamson, "Markets and Hierarchies: Analysis and Antitrust Implications" [New York: Free Press, 1975] and "The Economic Institutions of Capitalism" [New York: Free Press, 1985]) with three other strands of theory: social exchange theory, organization theory and business strategy. On social exchange theory, see, for example, T. Kern and L. Willcocks, "The Relationship Advantage: Information Technologies, Sourcing and Management" (New York: Oxford University Press, 2001), chap. 2. On organizational theory, see, for example, J. Baron and D. Kreps, "Strategic Human Resources: Frameworks for General Managers" (New York: John Wiley & Sons, 1999), chap. 18. On business strategy, see, for example, J. Barney, "Gaining and Sustaining Competitive Advantage," 2nd ed. (Upper Saddle River, New Jersey: Prentice Hall, 2002), chap. 6; R. Hayes, S. Wheelwright and G. Pisano, "Vertical Integration and Supply Chain Strategies," working paper, Harvard Business School, Boston, 2002; J.B. Quinn and F. Hilmer, "Strategic Outsourcing," Sloan Management Review 35 (summer 1994): 43-55; and J.B. Quinn, "Strategic Outsourcing: Leveraging Knowledge Capabilities," Sloan Management Review 40 (summer 1999): 9-21. The decision criteria presented in this article also reflect concerns actually encountered in industry practice. On HR outsourcing, see M. Cook, "Outsourcing Human Resource Functions" (New York: AMACOM, 1998); T. Gainey and B. Klaas, "The Outsourcing of Training and Development: Factors Impacting Client Satisfaction," Journal of Management 29, no. 2 (2003): 207-229. On IT outsourcing, see Kern, "The Relationship Advantage"; L. Willcocks and M. Lacity, eds., "Strategic Sourcing of Information Systems: Perspectives and Practices" (New York: John Wiley & Sons, 1999); M. Greaver, "Strategic Outsourcing: A Structured Approach to Outsourcing Decisions and Initiatives" (New York: AMACOM, 1999); M. Lacity and R. Hirschheim, "Information Systems Outsourcing: Myths, Metaphors and Realities" (New York: John Wiley & Sons, 1995); R. Klepper and W. Jones, "Outsourcing Information Technology, Systems and Services" (Englewood Cliffs, New Jersey: Prentice Hall, 1997); F. McFarlan and R. Nolan, "How To Manage an IT Outsourcing Alliance," Sloan Management Review 36 (winter 1995): 9-23; K. Ripin and L. Sayles, "Insider Strategies for Outsourcing Information Systems: Building Productive Partnerships, Avoiding Seductive Traps" (New York: Oxford University Press, 1999); C. Saunders, M. Gebelt and Q. Hu, "Achieving Success in Information Systems Outsourcing," California Management Review 39 (winter 1997): 63-79; and L. Poppo and T. Zenger, "Testing Alternative Theories of the Firm: Transaction Cost, Knowledge-Based, and Measurement Explanations for Make-or-Buy Decisions in Information Services," Strategic Management Journal (1998): 853-877.

13. A. Afuah, "Redefining Firm Boundaries in the Face of the Internet: Are Firms Really Shrinking?" Academy of Management Review 28, no. 1 (2003): 34-53; K. Mayer, "Managing Buyer-Supplier Relationships in High Technology Industries" (Ph.D. diss., University of California, Berkeley, 1999); and K. Mayer and J. Nickerson, "Antecedents and Performance Implications of Contracting for Knowledge Workers: Evidence From Information Technology Services," unpublished, 2002.

14. J. Barthélemy, "The Hidden Costs of IT Outsourcing," MIT Sloan Management Review 42 (spring 2001): 60-69.

15. K. Artz and T. Brush, "Asset Specificity, Uncertainty, and Relational Norms: An Examination of Coordination Costs in Collaborative Strategic Alliances," Journal of Economic Behavior and Organization 41, no. 4 (2000): 337-362.

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17. Gainey, "The Outsourcing of Training and Development."

18. P. Ghemawat, "Commitment: The Dynamic of Strategy" (New York: Free Press, 1991); D. Besanko, D. Dranove and M. Shanley, "Economics of Strategy," 2nd ed. (New York: John Wiley & Sons, 2000); and T.A. Luehrman, "Strategy as a Portfolio of Real Options," Harvard Business Review 76 (September-October 1998): 89-98.

19. In November of that same year, BP signed a $1.1 billion agreement with PricewaterhouseCoopers to outsource all its finance, accounting and MIS-applications work in the United States. See F. Hansen, "Global BPO: Reshaping Credit Management," Business Credit 102 (April 2000): 18-20.

20. Unless otherwise indicated, quotations and descriptive material are drawn from interviews conducted by the author in spring 2002.

21. G. Donnelly, "Do It Yourself: Browser-Based Technology Gives Rise to True Self-Service HR," CFOEurope, April 15, 2000, http://www.cfoeurope.com/displayStory.cfm/1741270.

22. See A. Maitland, "Giant Leap for Human Resources," Financial Times, March 27, 2002, p. 12.

23. See B.E. Rosenthal, "Strategic Alliance Provides Missing Piece," http://www.outsourcing-hr.com/strategic.html, for a description of Exult's partnership with Deloitte & Touche (now Deloitte-ToucheTohmatsu) to integrate Deloitte's GlobalAdvantage expatriate-administration software into its suite.

24. Exult does not merely contract with the client to manage existing HR-BPO vendor services. Instead, Exult becomes the party responsible for providing those services, and Exult's providers are paid by Exult rather than by the client.

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