

point of view

February 2011

HR Outsourcing 2.0 — Revising outsourcing contracts to reflect lessons learned

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Highlights

- As the first wave of HR BPO contracts expire, HR leaders are being forced to decide whether to renegotiate—or retire—existing outsourcing agreements.
- Early, proactive assessment of an existing outsourcing arrangement is critical to achieve maximum value when negotiating a new deal.
- HR leaders must understand gaps in current outsourcing processes and performance—and be prepared to provide metrics for negotiation.
- HR should identify improvements that must be implemented in new agreements in order to drive business value and HR efficiency.

New opportunities in the second generation of Business Process Outsourcing (BPO)

The expiration of a multi-process BPO agreement, which typically outsources three or more HR functions, presents a strategic opportunity to negotiate a new agreement that will improve outsourcing processes, efficiencies and business value. These gains can free HR to pursue more strategic, value-adding activities.

Understanding the fast-changing outsourcing industry

The outsourcing landscape has changed dramatically over the past seven years. HR leaders must ensure that they understand new technologies, processes and suppliers before they begin to renegotiate an outsourcing deal.

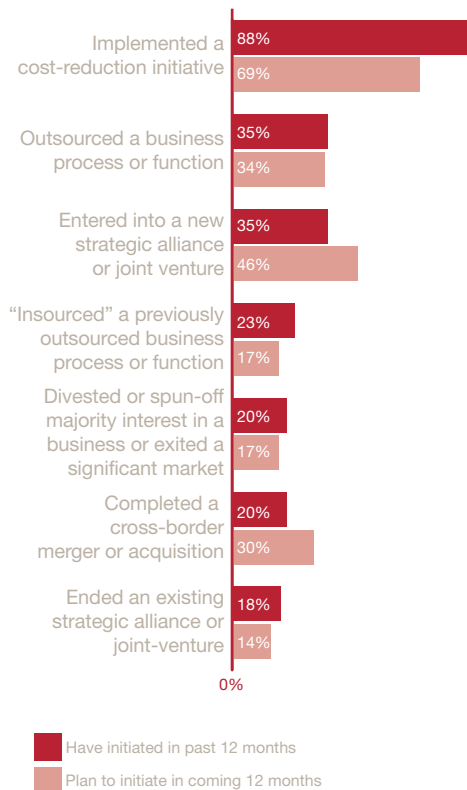
Engagement of pivotal talent is increasingly critical

Changing demographics will soon put businesses in the grips of an unprecedented talent squeeze. Effective outsourcing of transactional tasks can enable HR departments to better explore new policies, practices and technologies to help engage and retain those in pivotal roles.

Background

Understanding today's outsourcing landscape

Outsourcing remains key to cutting costs



Source: PwC 13th Global CEO Survey

As the smoke from the global economic meltdown begins to clear, it is apparent that one thing has not changed: Companies will continue to seek ways to do more with less.

PwC's 13th Annual Global CEO Survey found that 69% of respondents intend to implement cost-reduction initiatives in the next 12 months. Outsourcing remains one of the most effective—and enduring—responses to the “more with less” mandate. In our CEO survey, 35% of respondents said they plan to outsource a business process or function in the coming year.

The appeal of outsourcing is undeniable. Many HR areas—payroll, benefit administration and retirement plans, for instance—are full of time-consuming, transaction-based tasks that rob HR of its ability to innovate. In fact, our research shows that more than 75% of HR work hours are spent on transactional tasks. And 73% of respondents to a recent Towers Watson survey said eliminating this administrative clutter is a primary goal of HR outsourcing¹.

Transferring these tasks to an outside service provider can help boost an organization's productivity, standardize processes, reduce shadow (or indirect) HR activities, cut costs and improve compliance with regulatory mandates. Outsourcing can also free HR to refocus on a broader strategy that delivers value and better focuses on helping the company achieve its overall business goals.

Preparing for the future of HR outsourcing

Outsourcing is nothing new, of course. Many HR departments caught the first wave of HR Business Process Outsourcing as it began to swell seven (or more) years ago. Today those agreements, which typically range from five to seven-plus years, are beginning to expire in very big numbers. More than 110 outsourcing deals with a combined contract value of about \$6 billion will near their end-of-term between 2010 and 2012, according to the Everest Research Institute².

And that leaves HR leaders with a new challenge: They must decide whether to renew, revise or terminate an existing outsourcing agreement.

For many, it's unfamiliar territory. Continuing advances in technology and improvements in processes, as well as an avalanche of new suppliers and new variations in ways to procure services, have created an outsourcing environment that may be all but unrecognizable to companies that entered deals years ago.

This can put HR in the untenable position of having to blindly evaluate the performance, costs and efficiencies of its existing agreement vis-à-vis those of other providers. In other words, the HR leader risks committing to the next seven years of service without fully understanding the previous seven years of progress.

It's not that HR has been asleep at the wheel. Outsourcing vendors may have promised results that were never delivered, and performance shortcomings may have compounded over the years, resulting in a failure to realize promised value. Attention was often focused on the underperforming vendor, leaving the HR leader unaware of advances in the outsourcing industry.

That's not to say outsourcing vendors shoulder all the blame, however. To achieve maximum value and effectiveness from an outsourcing deal, HR must participate as an engaged, committed partner to the outsourcer. Doing so requires that HR adopt the vendor's leading practices and challenge itself to standardize its procedures. It also is critical that HR establish a governance model that can manage the supplier partnership, monitor service delivery performance and help resolve operational issues. Simply put, HR leaders must approach BPO as a partnership, not as a lopsided service arrangement.

Too often we have seen contracts renewed with an incumbent out of simple inertia. Effective negotiation of second-generation outsourcing will help define the success of the HR function, but it requires very careful planning.

¹ Achieving Effectiveness in HR Outsourcing, Towers Watson, 2009

² End of Term Market in HRO, Everest Research, 2009

Analysis

Taking the right steps toward contract renegotiation

Three choices: Pros and cons

HR leaders deciding whether to renew or end an HR outsourcing agreement have three basic options to choose from. Each has its advantages and drawbacks.

1. **Renew the agreement ‘as is’.** The company renews its contract with an incumbent vendor because it has a workable relationship that is providing acceptable service. An ‘as is’ renewal may be fast and simple, but it often provides a false economy because it will not help the organization maximize efficiencies or lower costs. Nor will it help the HR function evolve and progress.
2. **Opt for a ‘hybrid status quo’.** The organization retains the existing outsourcing vendor but mandates key performance and service improvements. This approach may not add significant value, however, because it yields only marginal changes in performance.
3. **Hire a new outsourcing supplier.** The company assesses the field of appropriate vendors and engages one that can provide better services at lower costs. This tactic offers the potential of transformative business improvements, but it also requires a potentially costly and disruptive change management effort.

Negotiating an outsourcing agreement, whether with an incumbent vendor or a new provider, represents a powerful opportunity to achieve new efficiencies in costs and processes. Yet it is fraught with potential missteps that can adversely impact the organization’s operations for years to come.

The decision comes down to three options: Renew, revise or replace. And in the fast-changing HR outsourcing industry, it’s not an easy choice.

Nor is there a one-size-fits-all process to arrive at an answer. We believe the best approach is to rigorously assess business needs and strategies, then develop a disciplined outsourcing renewal plan that delivers value and minimizes impact to users and stakeholders. HR leaders should:

1. Review agreements early.

Those responsible for HR service delivery should begin reviewing outsourcing agreements 18 months before the contract is due to expire. This will allow time to gain a detailed understanding of current and future business needs and then build consensus among the right stakeholders, including the CFO, CIO and appropriate business-unit leaders. HR should follow two parallel processes, one with the current provider and another to identify whether other viable vendors could improve service and/or costs.

2. Understand existing shortcomings.

Before an HR leader begins discussions with an incumbent outsourcer or new provider, it is critical to investigate and understand any shortcomings in the existing relationship. Determine what needs have been met by the agreement and understand any gaps that exist in service delivery. Be prepared to hand over quantitative and qualitative metrics to support your assessment. It is also important to review the governance in place for managing the vendor performance and relationship—and make changes if necessary.

3. Identify improvements.

Working with the provider, HR leaders should identify improvements to current processes and technologies that will drive efficiencies and value during the upcoming stage of outsourcing. These improvements should always be evaluated in the context of how the outsourcing agreement can help the HR organization contribute to the success of the business and innovate—today and over the life of the next contract. The scope of these improvements should drive the scope of the analysis with other viable providers.

4. Build checkpoints into the process.

When formulating an outsourcing strategy, it is critical to include checkpoints for assessing the quality and performance of the implementation. For instance, at the user acceptance phase HR leaders should carefully evaluate the effectiveness of the implementation. Next, when going live and transitioning to a “stabilization period” of operation, HR must communicate, collaborate and resolve all issues. The stabilization period typically lasts three to six months, although the quality of the outsourcing service is more critical than the duration of the phase, since the stabilization period prefigures the relationship with the vendor for the term of the contract. HR should assess its relationship with the supplier to ensure that the deal maintains the agreed-upon partnership and transparency.

5. Know when it’s time to let go.

Once an acceptable steady state has been reached, HR leaders should ensure that the retained governance and HR teams no longer be involved in the transactional activities that have been outsourced. This will free HR to pursue strategic, value-adding activities that can elevate the department’s effectiveness and influence within the business. Only then will business stakeholders recognize that the governance and retained HR team are strategic partners in helping build the company’s future.

HR leaders need great servicing solutions, rightsized HR functions and workforce metrics if they hope to engage employees in pivotal roles

Key metrics for assessment of employee engagement

| Talent acquisition metrics | |
|---|---|
| Internal management hiring rate | Percent of management requisitions filled by internal candidates |
| New hire performance rate | Relationship between new hire performance and overall performance ratings |
| Talent development metrics | |
| Average time to promotion | The average number of months required for promotion |
| Career path ratio | Percentage of upward employee movement |
| Talent retention metrics | |
| High performer separation rate | Percentage of high performers that left the organization (voluntarily or involuntarily) during the period |
| Low performer separation rate | Percentage of low performers that left the organization (voluntarily or involuntarily) during the period |
| Succession management metric | |
| One-through-three candidate succession planning depth | Percentage of key roles that have a succession pool of one-through-three unique candidates |

HRS International Conference, Orlando, November 2010

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Q&A

Q: Why are some HR departments bringing outsourced functions back in house?

A: In some cases, HR organizations have found that their unique needs have not been met by providers' standardized solutions. In other situations, HR has reviewed its outsourcing initiative and decided to bring certain core competencies in-house. Recruiting, for instance, is a function that many HR leaders are renewing some or all components for in-sourcing because they want to take ownership of the cultural relationship with incoming employees. Regardless of reason, in-sourcing requires that HR rebuild its infrastructure, processes and staff. Accordingly, HR should begin planning at least 18 months before the outsourcing deal expires.

Q: Are there new alternatives to HR BPO?

A: Some HR organizations are adopting new on-site technologies that enable them to effectively achieve results without end-to-end outsourcing. For instance, Software-as-a-Service (SaaS) can provide a configurable model that can be employed in-house to gain better control over the function. Other HR departments are adopting a hybrid model in which they may retain key HR functions while outsourcing select processes, such as background checks.

Q: Why is the need for talent management escalating?

A: Despite the shaky economic recovery, demographic shifts, increasing global

mobility and skill shortages in critical areas point to a future talent shortage³. Anticipating talent needs and retaining highly skilled employees is critical for the future growth. Yet HR also must be prepared to swiftly reallocate talent to better align people strategy with business strategy to meet the needs of the organization over the term of the contract.

Q: How can HR better measure talent and predict future staffing needs?

A: HR must employ fact-based metrics to ensure the organization retains high-value employees. Yesterday's baseline metrics—such as new hire, staff cost and turnover rates—won't do the job. Effective analytics requires both data repository and business intelligence tools, plus at least five years of meaningful employee data, to help prevent the loss of high-value employees. Measurements such as PwC's Saratoga metrics enable a firm to benchmark itself against companies in similar industries and of similar size. Ensure your outsourcing provider is well-equipped to provide access to and analytical analysis of this type of data. The ability to leverage meaningful workforce data will be a key driver to enabling your HR organization to speak with impact to business leaders.

Q: How should HR rightsize its retained organization?

A: As the size and scope of BPO contracts expands, HR must rightsize itself to take full advantage of the partnership. HR leaders should eliminate in-house activities and positions that are redundant to the outsource provider, while adding positions that bring new capabilities to the department. The ability of the HR and Talent functions to effectively manage and complement the services of the outsource provider will enable the organization to more effectively align the outsourcing relationship with its strategic needs.

³ Managing tomorrow's people, PwC, 2009