

# Is value from HR outsourcing truly sustainable for European organisations?

by Tim Palmer, HR Practice Lead, EquaTerra Europe

Europeans trying to make sense of the HR outsourcing (HRO) industry can get a false picture from what is happening in the United States; a more sophisticated interpretation is needed for these complex markets.

Central to the difference seem to be questions of sustainability. It might be fine for US corporations to conclude that the HRO market is mature and HRO is now a relatively safe course to take, but the practice is still developing in Europe. Any European HR Director contemplating outsourcing is challenged with questions such as:

- Will I have to shape my business around my provider's organisation?
- How reversible is it? Can I bring HR back in-house?
- With my junior HR people working for a provider, where will my HR business partners of tomorrow come from?
- What are the hidden challenges I'm likely to face nine months down the line? Will the provider staffing model deliver the right quality people at the right price?
- Can a provider really deliver the services we need across the 25+ countries that we operate in?
- Can I create a contract that will drive performance improvement and innovation?
- What will happen if my selected provider is acquired or if we sell part of our business?

Let's explore how HR Directors should approach such sustainability questions.

## 1. Understand Your Outsourcing Provider's Strategy

First, it is important to look at the strategies that the HRO service providers have adopted. You should not expect perfect answers to all questions; European capabilities are still relatively young. A service centre serving a single client is not going to be 'stress tested' and able to demonstrate how all of its multi-client processes will work. But you should see evidence that the provider has thought about and implemented a model that will enable it to build sustainable, profitable HRO business over the long term. Their philosophy and focus should be clear to you and they should be able to demonstrate their investment plans.

Industry observers often focus on the importance of technology strategies for the evolving HRO capabilities. They argue that providers who crack the technology question – to allow reuse of the same technology platforms for multiple clients – will win in the long term. Yet technology spend is typically between 10-15 percent of the total cost of an HR outsourcing contract. It is important, but it is not the only factor. The costs of the people delivering the service are typically closer to 50 percent, and the spend on implementing, sustaining and improving the processes that those people deliver is comparable with the technology costs.

So, part of the answer to the sustainability question lies in looking at each of these components. Here are points to check that can have material impact on sustainability:

### • Sustainability of People Strategies

People costs are significant in most outsourcing contracts. Providers should have a clear approach to people matters, and be able to demonstrate how:

- Staffing models for all service centres will work
- Foreseeable staffing issues will be addressed
- Staffing pyramids will be optimised over the term of the deal
- Reward levels will be determined and kept in line with the market
- Career management is in place, supporting the movement of people into and out of accounts and roles
- Motivation systems such as performance and talent management, and reward and training are integrated and how they operate in practice at a global and local level
- Poor performance is managed
- Succession planning is managed for key roles
- People will be treated toward the end of the contract
- **Sustainability of Process Strategies**  
Processes are the DNA of a well run operation. They need to operate in a seamless way across the boundary between a client and its provider(s). You should expect service providers to have firm positions on the:
  - Ownership of each business process and the mechanism for gaining sign-off for designs and any changes
  - Preferred template processes that will be used to deliver the services, including the roles, locations and assets required for process delivery
  - Controls that are embedded within the processes
  - Tools in which the ‘live’ processes will be stored and maintained
  - Way in which their processes will integrate with your processes and those of any other providers
  - Level of client-specific customisation and localisation that is possible within their model, along with the process and controls for applying those changes
- Approach to optimising the business processes over the term of the contract, including the use of formal quality processes, such as Six Sigma
- Way that all staff involved in the process, whether they work for the provider or the client, can initiate improvement actions
- Way in which innovations will be sought and introduced into the contract
- Methodology for introducing agreed and tested process changes into the live environment
- **Sustainability of Technology Strategies**  
Technology is important because it underpins and enables the efficient operation of the business processes. Service providers’ sustainable technology solutions should be able to demonstrate:
  - A clear and complete technology architecture
  - Identifiable proprietary software or configuration (as opposed to publicly available) that will be maintained for the duration of the contract
  - All interfaces are identified with clear responsibility for end-to-end creation and maintenance
  - Exit costs are understood and planned for – organisations should be seeking ‘smooth’ exit costs, yet repeatedly, HRO clients find that they face significant bills to leave an outsourcing relationship

## 2. Create and Manage the Right Commercial Relationship

If your preferred service provider’s strategies check out, you will then need to strike a commercial relationship that will deliver the desired outcomes to your organisation. The trick here is to share risk and reward with your service provider partner. The way that you do this can have a material impact on the business value that you achieve and, ultimately, the sustainability of the initiative. Here are some significant points:

- **Treatment of currency and wage inflation**  
Many outsourcing solutions involve the use of low-cost

labour in high inflation countries, which has a potential to destroy value if wage inflation gets out of control. It is not balanced to put all of this risk on to the outsourcing provider, but neither should your organisation take it all.

- **Benchmarking provisions**

As attractive as it may sound, it is unlikely that you will get agreement to automatic price adjustments as a result of benchmarking exercises in a European HR outsourcing contract. However, you should expect the right to have joint benchmarks of service cost and quality. You should ensure your provider can show how their improvement actions will help retain the market relevance of their pricing over the term.

- **Flexible SLA mechanisms**

One of the few de facto standards that we have in our industry is the mechanism for using SLAs and service credits as tools for clients to maintain control over the service that they receive. Your contract should give you the right to create new SLAs over time and to change the way that you apportion service credits to different parts of the service, as your priorities shift.

- **Exit provisions**

Contrary to real life, you must plan for divorce as you get married. You should pay particular attention to intellectual property rights, ensuring that you will have the means to continue the service at the end of the contract without facing an unreasonable fee. It is easy to discount this risk in the heady days of starting a contract, but a number of organisations have found heavy exit costs a real issue as they approach the end of the contracted term. Clearly, the intellectual property of the service provider must be protected from their competitors, but you should expect that you can have continued use of any proprietary software or processes for a transition period, and that any assets which you have paid to create should be free for you to use as required.

You can sign the right contract but you need to manage to it. Much has been written about outsourcing management and governance processes, because they are key to realising the expected and promised business value. At EquaTerra, we have found that outsourcing management processes in well-run BPO contracts cost 4-6 percent of the total contract value. This may seem high, but as outsourcing contracts get more

complex and global, and as organisations increasingly use multiple providers to deliver their HR services, the level of client involvement in these processes is shifting. Traditionally, governance has been provider-led, with clients having passive roles in a largely relationship management-focused activity. We are now starting to see client-led outsourcing management, with a focus on risk management and active use of the commercial hooks that were agreed upon in the contract.

### 3. Understand your Role in Achieving Sustainability

Buyers of outsourcing services have perhaps the biggest role of all in ensuring sustainability. There is no point in embarking on an HR outsourcing investigation without:

- **A clear mandate or end date to conclude**

It is important to do your homework and weigh the relative benefits of transformation through in-house versus outsourced shared services, but it is not sustainable to dip your toe in half heartedly. You should respect the investments that service providers make in providing you a bid. Only run competitive processes when you are serious about buying services, and limit the competitive period. It should be possible to select a provider with no more than three months of competitive activity – yet time after time we see selection processes taking six months or more. The more you test the market without committing, the less likely you are to get the attention of the best people in the best providers.

- **Being clear and realistic about what you intend to buy**

In your discussions with providers, you will almost certainly find that you cannot buy exactly what you want. You will need to make compromises, particularly if seeking to buy services in low-cost, but strategically important, locations such as Eastern Europe and China. This is normal, but set the objectives that you want to achieve, and ask your provider to help work through how they can be attained.

- **Adopting realism in your contracting process**

You should aim for a balanced contract that reflects your intentions. You should not seek to externalise all risks onto your provider. You need to allow your provider to make money. Outsourcing providers tend not to invest in 'Death Star' contracts that make no margin, and you want to do all that you can to prevent your contract from ending up this way.

- **Being prepared to invest in the active management of the contract**

You need to hold your provider to the commitments that they made and drive the change management necessary to ensure the correct behaviours and adoption rates within your organisation. The way that you start, your approach and drive in the first few months of the contract, will influence greatly how things pan out over the term, and, ultimately, the contract's long-term sustainability.

So, is outsourcing a safe and sustainable path for a European HR Director to take? 'Yes, if the conditions are right, and No, if they are not,' is the answer. For many organisations, outsourcing has proven to be the right choice. The positive precedents set by organisations such as Avaya, BT, GM, P&G and Sun Microsystems, show that sustained results can be achieved. And although all contracts have their challenges, there hasn't yet been the 'sharp intake of breath' disaster in HR outsourcing that some predicted. However many other organisations have weighed the options and have chosen to drive internal transformations instead. So this too must remain a valid option.

It is important to go into an outsourcing relationship with your eyes open, planning for the long term. And when making the decision about what to do, consider how many of the outsourcing sustainability questions raised here would also apply to an internally managed HR transformation project.

#### About the Author

Tim Palmer, HR Practice Lead, EquaTerra Europe  
E-mail: [tim.palmer@equaterra.com](mailto:tim.palmer@equaterra.com)

Tim Palmer was EquaTerra's lead advisor on Unilever's global HR outsourcing deal. He is also EquaTerra's HR practice lead in Europe and has 15 years of sourcing industry experience across the HR, F&A, procurement, logistics and IT functions. He has worked across Europe to help clients understand how to define and improve their HR processes and implement effective sourcing management processes.

#### About EquaTerra

EquaTerra sourcing advisors help clients achieve sustainable value in their business processes. With an average of more than 20 years of industry experience in over 600 global transformation and outsourcing projects, our advisors offer unmatched industry expertise. EquaTerra has deep functional knowledge in Finance and Accounting, HR, IT, Procurement and other critical business processes with advisors throughout North America, Europe and Asia Pacific. Our people are passionate about providing objective, conflict-free advice to our clients, which has fueled our exponential growth over the past three years. We help clients achieve significant cost savings and process improvement with outsourcing, internal transformation and shared services solutions. It is all we do.

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1 713 669 9292 (US) or 44 207 100 7766 (Europe).**