# Administration and Payroll: Essentials of Shared Services and Outsourcing

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## Contents



**Abstract**

In this chapter business process outsourcing is defined not as a one-dimensional cost-cutting approach but rather as a complex change process that simultaneously targets efficiency potentials and ensures high service quality. The chapter shows that efficiency potentials will only be realized if – prior to implementing the

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outsourcing approach – all relevant parameters are correctly captured in a business case calculation. This case should not only include implementation and monthly running costs but should also at least partially foresee the cost for necessary future process and system enhancements. The chapter further illustrates cornerstones for a sustainable business process outsourcing, namely, a diligent process and requirement documentation, stringent performance measurements, and an established continuous improvement process. All of these factors ensure a successful collaboration model between the client in the respective HR department and the business process outsourcing provider. If the four areas of potential risk – system capability, system automation, skill set, and documentation – are also continuously monitored, outsourcing initiatives can lead to a better process handling and higher service quality than in an in-house environment.

**Keywords**
Business case • Change request • Deliverable • KPI • Quality of service • Standard (ed/ization)

## Introduction and Overview: What is Outsourcing?

According to *Collins English Dictionary* (HarperCollins 2003), outsourcing in commerce means "1 . . . to subcontract (work) to another company and 2 . . . to buy in components (for a product) rather than manufacture them." The *American Heritage Dictionary of the English Language* (Houghton Mifflin 2000) enhances this definition by including one, if not the presumably major, intention of all business process outsourcing activities in its definition: "To send out (work for example) to an outside provider or manufacturer in order to cut costs."

Outsourcing developed as a formal business strategy in the 1980s and the 1990s and saw a first wave of outsourcing as companies began to focus on the implementation of cost-saving measures. U.S. companies that outsourced business processes not only clearly dominated the industry in 1990s and the early years of the new millennium with the ". . . biggest 'lever' of attractiveness [being] wage arbitrage to India . . ." but also clearly continue to be the pioneers of outsourcing, whereas ". . . large-scale European enterprises are far less experienced when it comes to outsourcing and offshoring . . . and many offer a less mature 'just get it done' attitude" and countries in Asia with its diverse economic landscape "are less enticed by cost-reduction . . . because low cost labor is already available locally. . ." (Horses for Sources 2013).

Still, during the financial crisis, economies across the globe and all kinds of industries suffered tremendously. Almost everywhere, sales were down to an all-time low, and companies were struggling to survive. Drastic cost cuts were the rule of the day, and all parts of the business were asked to contribute their share. In fact, the share allotted to HR often equalled a budget cut in half. Reduction targets of these dimensions could not simply be accomplished by some superficial cost cutting measures.

Rather, HR teams had to deal with the challenge of headcount reductions. And this meant HR had to find answers to two crucial questions: Can all services required by the business still be delivered in an appropriate manner? And for those HR processes that would remain inside the HR portfolio, how must work be restructured to ensure that with reduced capacity high-quality results can still be achieved?

In alignment with Dave Ulrich's HR Operating Model (Ulrich 1996; Ulrich and Brockbank 2005) many companies therefore decided to restructure the HR world and committed to an operational model with three basic functions: (1) HR Business partners are in direct contact with their customers in the business and provide the strategic HR support that is needed to enable the business to be successful – today and in the future. (2) HR Centers of Excellence bundle HR expertise regarding HR's governance role e.g., when it comes to guidelines and policies for compensation and benefits. (3) HR Shared Service Centers are established in which high-volume transactional HR administration tasks are bundled.

Following the decision for this HR Operating Model all core HR processes need to be analyzed and then allocated in one of the three basic functions. Payroll (which according to external benchmark analyses requires up to 40 % of the available capacity in decentralized HR teams) is a prime candidate for a reallocation and bundling of all payroll activities within Shared Services. Other HR processes such as HR Administration and Recruiting as well as Training Administration were also allotted to the list of processes that can be bundled.

## People Perspective

As quickly outlined above, the decision to bundle certain HR processes and source them either in house in Shared Service Centers or outsource them to an external provider, is usually taken on the basis of economic necessity with the clear intention of relieving a (financial) stress level that the company or more particular the HR department may be experiencing. In order to reap the potential cost benefits as soon as possible, more often than not quick actions are taken that range from a spreadsheet **business case** approach to a speedy vendor selection and an ambitious implementation approach.

But any outsourcing initiative is much more than a cost-efficiency program – it is a major change process which will at least impact the existing company culture and potentially – in the case of offshoring –grows into a huge intercultural change management project. And quite a lot of people tend not to embrace change eagerly but rather see obstacles when steered away from the trodden path of how things were done for years.

How this change process will be perceived by the various affected departments and employees is unfortunately largely left out of consideration. What looks like an attractive economic option from a management perspective can be seen as a downright existential threat if employees translate the figures in the **business case** into losing their jobs. This fear needs to be addressed properly, openly, and in a timely manner with very clear indications regarding future options for the employees whose jobs will be allocated differently. It is essential that the management respects and appraises the work that has been done in the past and in parallel explains the necessity for change – i.e., the decision to outsource – with all possible consequences. The attempt to sugarcoat the decision to outsource by insisting that jobs with a higher competency profile would of course be retained within the organization and that the affected employees would be considered for these positions has a high probability to backfire because there are neither enough of these jobs available nor do people who have very often spent a lot of years as reliable employees handling the bulk of transactional work tend to fall for this kind of career development rhetoric.

From a management perspective, it is essential to avoid the pitfalls of failed communication because – although the affected employees may not be members of the HR organization after the business outsourcing activities have been completed – they are one cornerstone for the success of any outsourcing implementation project. Unclear, vague, and potentially misleading communication from the top management regarding the consequences of a business process outsourcing will almost inevitably trigger one or more of the following reactions from the affected employees with a negative impact on the outsourcing initiative as such:

1. People go into rescue mode, start looking for new opportunities, and leave their old jobs as quickly as possible.
   This premature drainage of internal resources and expertise potentially leads to an incomplete or partially even incorrect transfer of processes into the responsibility of the new provider.
2. Staff members who do not jump ship immediately are faced with the burden of having to compensate the capacity and expertise already lost. Simultaneously a significant dip in motivation and commitment to the company, the HR department, and the current job is experienced.
   As a result the **quality of service** delivery while still in house may suffer leading to dissatisfaction of the business regarding the HR performance in the process in question.

Whereas it may be possible from a management perspective to argue that lower performance levels due to the abovementioned changes in the HR community are acceptable for a limited period of time, one key activity must not be underestimated in order to avoid serious and long-lasting challenges regarding the management and steering of the external service delivery.

HR departments who wish to outsource one or more processes need to tackle two tasks to enable the provider to be successful:

(a) Retained workforce in the HR department needs to be defined to facilitate the collaboration with the vendor. Focus activities include, e.g., provision of high-quality input from internal systems or regular updates regarding internal changes such as policy and guideline adjustments which have to be taken into consideration by the external provider.

(b) A sustainable governance function needs to be established to ensure a stringent vendor monitoring via regular **KPI** measurements, a structured **change request** management, and a vendor development targeting to establish a continuous improvement process.

Whenever an HR department decides to outsource one or more processes, the business – management and staff alike – also need to be involved in the communication process regarding this change. As customer of HR, the business will not be impressed by the potential to realize cost reductions within HR. In fact, the key question to be answered positively by the business will not be "Is this outsourcing initiative beneficial for HR?" but rather "Is this outsourcing initiative beneficial for the business?"

An Employee Self Service (ESS) or Manager Self Service (MSS) functionality that is implemented in the course of an outsourcing project may serve as an example in this context. Naturally, this functionality will relieve the HR team of a substantial burden of manual work – thus, these tools are highly welcomed. But if ESS or MSS only serve to burden the business with work that is no longer done in HR, the implementation will not be well received. But if these functionalities come with additional, user-friendly features, employees in the business can see benefits for themselves, while simultaneously HR can establish more efficient workflows.

One more factor needs to be acknowledged to round off the people perspective when talking about outsourcing: the people perspective cannot be limited to the internal community of employees – in HR and in the business, on staff and on management level. Rather, in order to ensure that the outsourced processes are seamlessly interfaced with internal process steps, the people perspective has to include the external provider as an integral and essential part of a joint success story.

The collaboration with the business process outsourcing provider (BPO) is, of course, regulated by contractual agreements, Service Level Agreements (SLAs), and relevant Key Perfomance Indicators (**KPI**s). But the best legal framework will not ensure success unless both parties involved in the process – client and provider – manage in parallel to develop a cooperative team spirit and a joint dedication to establish HR processes that work as smoothly as a well-oiled machine. SLAs and **KPI**s alone are adequate tools to steer a well-functioning process. But when mistakes occur a team spirit is needed to work on a continuous improvement process rather than focus on finger-pointing and penalties based on failed **KPI**s.

## Economic Perspective

If a company decides to undergo a major change process this is always motivated by two factors:

- A desire to significantly improve the quality of processes, results, and products
- The need to reduce costs which in a nonproductive environment often also equals headcount

Frequently, these two factors are not seen as equally important elements in an equation for business success. Actually, since the significant change processes are usually only pushed by the management and more or less accepted by the staff level if the overall situation of the company is in critical shape, more often than not the quality aspect is pushed into the background and cost reduction targets take center stage (Sullivan 2005). This potentially dangerous imbalance can result in damaging effects which will be further explained in the subchapter Risk Perspective.

If the focus is on cost reduction or – in more positive terms – an increase in efficiencies, the starting point for all Shared Services activities including business process outsourcing initiatives is the creation of the **business case**. In order to come up with a valid **business case**, the following steps need to be taken:

1. The scope of the outsourcing initiative needs to be described as clearly as possible. To name only two relevant considerations – which process steps should be bundled and/or outsourced and which countries or legal entities will participate in the initiative.
2. How is the process handled today? Relevant aspects here may include what is done manually, which systems are in use, and where are necessary interfaces to other systems, functions, departments? In order to get a detailed insight into this process handling, especially if the scope of the initiative covers multiple locations, on-site visits and descriptions of the as-is situation are required.
3. How many Full Time Equivalents are involved in which parts of the process? What is the labor cost for these employees? Again, there may be a wide range of different costs and cost levels depending on the scope of the initiative.
4. How many employees in the business are served by the HR employees who are currently responsible for the process? Based on this service ratio the maturity of a process can be assessed, i.e., a high service ratio indicates a high maturity level.
5. In case some parts of the process in scope are handled by a third party, what are the costs for the services received from this third party?
6. In case IT systems are in use to facilitate the as-is process, what are the costs for these systems? There may be a breakdown available, e.g., cost per employee serviced per month, but a careful analysis also has to specify whether these costs include hardware, software, and – very often rather hard to specify – licence and maintenance.
7. What are the G&A costs currently invested in this process and the people who run it? Usually, facility costs with all different aspects ranging from rent to infrastructure need to be captured here.

Unfortunately, another dimension is very often not documented, because it does not directly contribute to a calculation of the cost reduction dimension which is taken as most relevant for the economic perspective.

This dimension covers all costs for further system developments and solution enhancements once the process has been outsourced to an external provider. On the one hand, costs listed from 1 to 7 usually can be captured quite accurately with the support of the HR, FC, and IT departments and are calculated against the costs for implementation as well as service delivery provided in the vendor proposal. On the other hand, costs for so-called **change requests** are much harder to define. Therefore, these costs are frequently not fully considered in the **business case** calculation.

What may fall into the category of chargeable **change requests**?

Naturally, the outsourced business process will also have to go through system maintenance, updates, and new release periods which come at a certain cost. The potential range of these costs should ideally already be outlined in the vendor proposal as future one-time implementation efforts. Alternatively, these costs can be reflected as part of the monthly service delivery fee.

Also, the client – i.e., the HR department, the business, and the management of the company – over time may ask for solution enhancements and system changes that were not built into the original solution framework offered by the provider during the period of implementation. Although these requirements can never be fully known and captured in advance, accomplished providers of business process outsourcing solutions should be able to provide a catalogue of frequent or known **change requests** including a realistic price range needed to realize changes of that kind. This catalogue can be factored into the calculation of the **business case**. And, maybe even more important, the catalogue can serve as a means of orientation for the planning of the HR budget once the business process outsourcing has been completed.

In fact, if the potential price for a **change request** is known in advance, this may even lead HR, business, and management teams alike to consider the following questions very early on in the **change request** process: "Is the solution enhancement really needed? And, if so, has the budget needed for the enhancement been included in the budget planning?" Needless to say that the price catalogue for **change requests** may trigger some reluctance to change the solution framework too frequently – especially if the requested change falls into the category of "nice to have."

Another positive side effect of this cost discipline should also not go unmentioned: the fewer **change requests** from the client are implemented, the easier it will be to safeguard the overall level of **standard**ization that has been achieved with the business process outsourcing.

Ideally the decision-making process for a **change request** should always cover three steps:

1. Is this **change request** legally required?
   If this is the case, immediate implementation is required and should be part of the duties of the BPO provider – thus free of charge.
2. Is this **change request** a business requirement from which all service recipients (e.g., all legal entities in scope of the outsourcing approach) will benefit?
   If this is the case, the **change request** should be implemented as the new, enhanced **standard** process and paid for by the client according to the contractually agreed price range.
3. Is this **change request** a business requirement from which a limited group of people (e.g., only one legal entity) will benefit?
   If this is the case, implementation should be critically assessed in terms of necessity. This helps to avoid too many customizations which may – at the

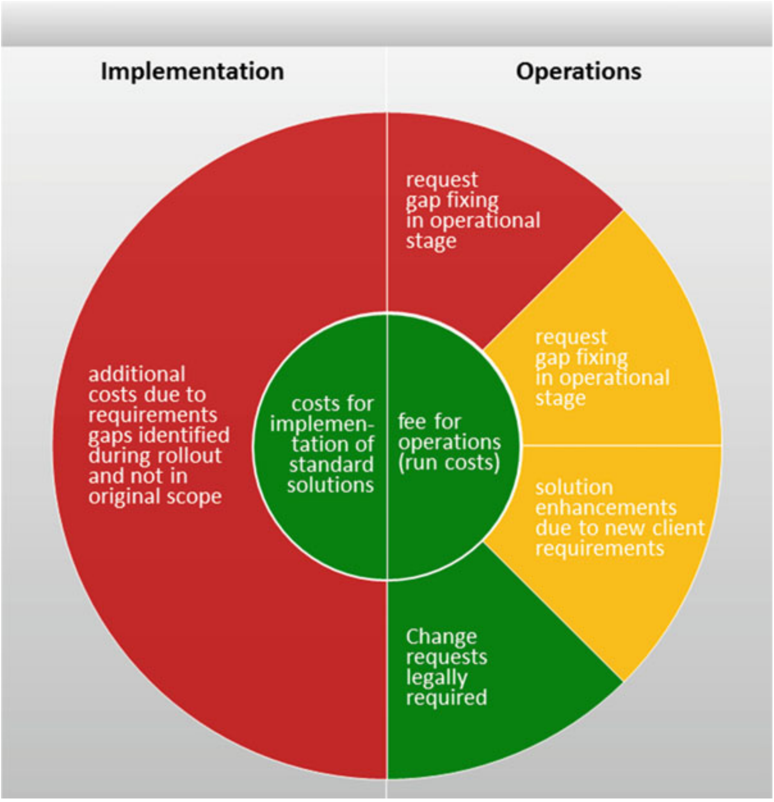


**Fig. 1** The vicious circle of change requests

end – have an impact on the quality of the service delivery because the level of **standard**ization is gradually diluted. And the very same people who initially requested the customizations in are likely to be the first who complain about the decline in **quality of service** received from the provider (Fig. 1).

## Risk Perspective

There is one basic truth that management teams and HR departments should keep in mind before they select a provider for the business process they want to outsource. This can be phrased as follows: systems and processes can be outsourced, but the risks that lie in the field of outsourcing can never be outsourced. In addition, the responsibility to mitigate these risks should they materialize remains with the outsourcer and will not be taken over by the BPO provider (Protiviti Independent Risk Consulting 2004).

In fact, each and every potential benefit seen in the field of outsourcing can – in principle – also turn into a potential risk. Known risk areas are an increase in cost, quality issues, a need to establish process control and coordination effort to monitor high-quality results, regulatory risks should the external partner not comply with regulatory requirements, dependency on the provider, loss of internal know-how, lack of internal support (management and employees) resulting – in a worst case scenario – in legal conflicts, and a potential reputational loss of the HR department internally or of the company as such externally.

The most frequent risks encountered in the BPO business are always connected to the quality of the service delivery that the chosen provider is expected to deliver. Without exception, this expectation regarding the service delivery can be summarized as follows: it should be at least on the level of quality reached in-house before the decision to outsource was taken, but ideally the client expects service delivery above the in-house level of quality.

Unfortunately, this level of expectation very often remains the implicit undercurrent during the selection and negotiation phase with the future provider, when full focus is put on the commercials in terms of implementation and operations. Of course, once the contracting has been completed and all players involved enter the implementation and operations phase of the outsourcing approach, expectation and expectation management quickly come to the surface. In fact, both tend to take center stage and are perceived as key areas of conflict.

However, in the initial contact phases (i.e., during the proposal and bidding process), providers competing to get the deal and win over a new client may not be fully aware of all complexities that need to be handled to provide the requested quality in service delivery. In fact, one can also assume that in the throng of this "beauty contest" with other BPO providers, some may even consciously choose to disregard a couple of these complexities to keep the proposal submitted on a very attractive price level. Regardless of the motivation in the background, the risk can be defined as hidden costs for **change requests**. These **change requests** may occur during implementation or in the actual operations phase, because the required solution goes beyond the scope of the solution framework originally contracted. Needless to say that these costs have a severe, negative impact on the **business case**. In a worst-case scenario, this may even lead to the belated insight that developing the provider to the expected quality level made outsourcing more expensive than handling the respective business process in-house.

The risks caused by insufficient investment in the outsourcing of a business process can be attributed to four focus areas: (a) system capability, (b) level of system automation, (c) skill set, and (d) documentation (Fig. 2).

(a) The solution framework offered cannot cover all complexities and interdependencies needed to process accurate results as expected. This may – for example – occur in the field of payroll outsourcing where statutory requirements of the respective tax legislation and internal policies and procedures need to be reflected to trigger accurate calculation results. The **standard** solution in some instances may simply not be advanced enough to reflect all possible scenarios

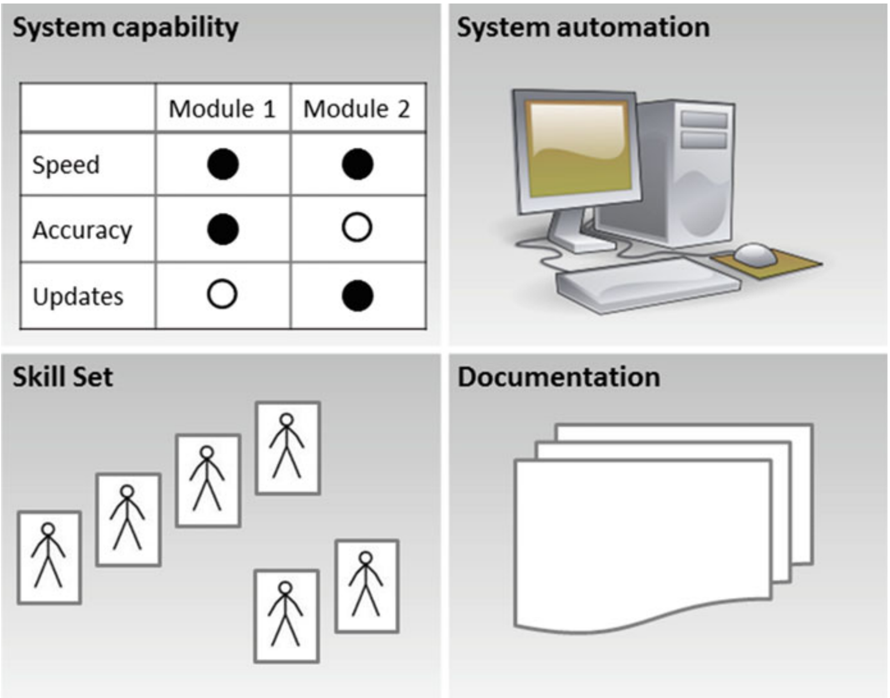


**Fig. 2** Focus areas for risks encountered during outsourcing initiatives

that go beyond the country-specific general tax legislation to cover, for example, special tariff solutions or collective agreements.

(b) The solution framework offered may require frequent manual intervention to cater to the complexities as described under (a). The result of any manual intervention signals a potential increase in mistakes and failure rates. These mistakes, of course, do not happen at the moment of intervention which actually targets error prevention. But manual data input occurs outside of automated system updates and uploads, and may, therefore, lead to jeopardized data integrity and data quality at a later point in time. In payroll this may, for example, lead to a critical situation during the year-end process. A high level of system automation is, therefore, crucial to maintain data integrity and thus high-quality results.

(c) If the skill set of people on the part of the provider are not readily available – both in terms of quality and quantity – the business process outsourcing solution as such is in jeopardy.

Payroll, to mention another example, rarely shows seasonal peaks. Rather it constitutes a constant time-, capacity-, and cost-consuming activity. This is the case for two main reasons. First, it is highly transactional and repetitive in nature with at least 12 payouts to every employee in the company. Second, it is extremely complex and sensitive because it must reflect laws and regulations accurately. Local tax legislation, social security contributions, and pension payments as well as banking regulations require a highly qualified skill set in the responsible payroll team provided by the external partner. Any deviation from the rules exposes companies to serious tax and compliance risks and will potentially trigger internal or external audit activities with critical findings followed by a very strict remediation plan to eliminate risks.

Take the example of recruiting: An outsourced solution may specifically help fast-growing companies or companies whose recruiting demands show a seasonal fluctuation pattern where periods of intense hiring and short-term onboarding alternate with periods of little if any changes in the labor force. It is essential that the selected external provider can balance out these peaks, because most companies find it difficult to handle intensive recruiting periods with enough qualified staff to ensure the onboarding success.

(d) Business process outsourcing providers with their comparatively low labor costs are known to suffer from relatively high attrition rates. With every skilled staff member moving on to new, better-paid professional tasks, expertise regarding the client profile and processes serviced by this staff member is potentially lost. This risk increases dramatically if the provider is located in a country where notice periods are extremely short and there is little if any opportunity to realize a transfer of know-how between the former and the new staff member. For this reason, it is extremely necessary that – apart from a high level of **standard**ization and automation – all processes, policies, rules, and exceptions to these rules are documented in detail and are updated on a regular basis. If this documentation is missing, incomplete, or out of date, the new employee taking over the client in question is largely left without guidance and will most certainly make unnecessary mistakes or repeat mistakes that have happened before. In fact, for lack of a transition period between old and new job holder, the client himself may be burdened with the task to instruct the new staff member regarding the handling of the process in question. Without doubt, the client will lose patience rather quickly if this happens more frequently – depending on the frequency of staff changes on the provider side.

Apart from the service quality risks outlined above, which may occur in any field of business process outsourcing – from administrative tasks in various areas, customer support across functions, IT services to accounting – outsourcing specifically in the field of HR also needs to pay special attention to the requirements of data security and data protection since HR handles highly confidential personal data. In fact, prior to a transfer of data, HR departments need to verify in alignment with data protection legislation if each employee's individual "explicit consent" is required to process his or her data in an outsourcing environment. This would, of course, make any outsourcing impractical, if people refuse to grant this consent. In order to avoid conflicts on employee-by-employee level, a close cooperation between HR, the works' council, and the legal department is necessary to find a compliant solution for the handling of HR data in a BPO environment.

With regard to the requirements that the BPO provider has to fulfil in order to obtain approval regarding the handling of HR data, rules and regulations may vary from country to country, but – in principle – guidelines can be summarized in the following checklist:

- BPO Server/data/IT Center: Is the BPO provider able to prove that measures against external attacks or damages can be taken effectively? Is there a plan for disaster recovery in place? Has the IT Center been certified by an independent auditor?
- BPO staff: Has the staff been adequately trained and qualified including a documentation of this training? Have all employees signed a data confidentiality agreement?
- Data transfer: How does the BPO provider guarantee a secure, encrypted transfer of data between client and provider? Which measures are in place to ensure that BPO employees not involved in the service delivery for a specific client cannot access confidential data of this client? How does the BPO provider ensure that data of different clients are strictly kept apart? Which processes for secure data storage and data deletion at specified time intervals are in place?

If any of the requirements listed above show major deficiencies, the complete outsourcing approach is at stake. Immediate and effective action needs to be taken to avoid serious risks for the company and its employees.

And last but not least, any decision to outsource a business process needs to take into account that there is a mutual risk of dependency involved which may lead one or both parties – outsourcer or BPO provider – into a critical situation. From a company's point of view, one rule of thumb should be acknowledged clearly: It may be difficult to outsource a business process to an external provider, but it is much more difficult to reclaim this process and re-establish it as an in-house service.

One reason for this is that over time, internal know-how regarding the process has been lost and needs to be built up again internally on the client side. This naturally requires some time. But usually, time is the commodity that is in short supply or almost not available should the collaboration between client and BPO provider take a turn for the worse. A BPO provider with valid reason to believe that contracts will not be extended will limit efforts regarding **quality of service** delivery and customer satisfaction. In fact, this provider may feel an economic necessity to quickly reallocate focus and capacity with the target to retain other clients in the portfolio or to win over new clients.

Of course, all data processed on behalf of a client constitute this client's property and have to be transferred back to the client in the event that the collaboration comes to an end and the contract expires. However, the system solution built and configured by the BPO provider and in the BPO environment to process these data (hardware and software) is part of the intellectual property of the provider and will not be returned or handed over to the client. Business continuity thus may become a serious challenge if the client has to take over responsibility for the formerly outsourced business process without adequate preparation for this change in roles and responsibilities.

In order to ensure a long-lasting, productive, and effective collaboration model between client and BPO provider, it is essential to build up this collaboration model on the basis of a contract that defines tasks and responsibilities as precisely as possible (including Service Level Agreements, **KPI**s, and penalties for failure to meet the expected **deliverables**). In addition a well-functioning risk management needs to be established during the initial stages of the cooperation. This risk management function should also not cease to exist once the implementation or project phase has been finalized. Instead, an effective quality control system and risk management is one of the pillars that will ensure success once the stage of ongoing operations has been reached.

## Operational Perspective

Once the decision has been taken by the management team to outsource a business process, and this decision is the result of both a conscious strategic decision and a valid **business case** which attempts to capture all relevant parameters (see section "Economic Perspective"), preparation for the actual outsourcing activities can begin.

A dedicated project team needs to be established which should ideally consist of different types of people: process experts who have all the relevant and detailed experience regarding the business process which will be outsourced, project management experts with some outsourcing experience if available, and a project leader who coordinates the communication to and involvement of all relevant stakeholders and is responsible for the political engineering necessary to overcome the obstacles against outsourcing within the company. In an HR context, the functional background of the project group should go well beyond the scope of HR and cover experts from IT as well as Finance and Controlling (e.g., in the case of payroll) or Marketing (e.g., in the case of Recruiting).

### Creation of Scope Document

In order to identify the right BPO provider, it is first of all necessary to describe the scope of outsourcing as precisely as possible. Questions that need to be answered and documented contain such aspects as: Which process steps will bes outsourced, and which steps potentially remain in house? Where are the respective interfaces and how can they be managed? What are the **deliverables** resulting from this process? How often does this process run, and how much time does it take to complete the process? Are there further interfaces to other HR processes or processes outside of HR, and what needs to be done to manage these interfaces? Which IT systems are currently in use and what kind of data do they capture? What is the internal setup of roles and responsibilities, and which responsibilities will be shifted to the external partner?

During this initial documentation process it may become apparent that the internal process is not **standard**ized, e.g., across legal entities, for all functions and divisions or – for that matter – for all employee groups. Prior to initiating any outsourcing activities these differences in handling should be critically assessed, and the process should be harmonized as much as possible. This ensures that the actual implementation can proceed more smoothly.

If available, existing internal Service Level Agreements as well as the respective success/failure rates should also be captured. If these measurements are not used internally, the Service Level Agreements planned for implementation with the BPO provider should be tested in the in-house environment. Once the business process has been outsourced the documented actual performance levels can serve as a reference point for the service delivery quality provided by the external partner. In addition, these facts and figures can potentially be used to argue against those voices who claim – post go-live of the outsourced solution – that the former process handled in-house achieved better results than the new solution framework.

## Vendor Selection Process

Based on the detailed documentation of all aspects of the internal process handling, a scoping document can be designed and sent out to a group of BPO providers who are known to offer BPO services in this field. The scoping document should specify the targets to be achieved via the outsourcing approach. It should describe both, the as-is process and the requirements for the future process solution highlighting, e.g., potentials to improve quality, increase efficiency, and further enhance a compliant framework.

Depending on the number of initial proposals received, a first selection process based on predefined criteria should take place. Criteria frequently used in a selection process include BPO company profile (location, organization, ownership structure), economic performance/stability, proposed solution framework including the IT platform, available people and skill set, as well as ranking in BPO market analyses and an initial insight into the client portfolio including references. Apart from defining these selection criteria in terms of content, the different content areas also need to be weighted to ensure that the most relevant aspects are reflected accurately (Fig. 3).

Once these criteria have been applied and the number of potential providers has been reduced to three to five, these finalists can also ask questions to further specify their proposal including commercials and timelines for a realization of the business process outsourcing. During a bidding day these providers are given the opportunity to explain their proposals further.

Although the project team should, of course, partake in the final decision-making process, Procurement and Legal should be in the lead. In addition, it is essential to include stakeholders from the business and representatives of the departments that will be affected by the outsourcing initiative. This further ensures commitment regarding the outsourcing initiative and emphasizes the joint responsibility for the selection of the best BPO partner.

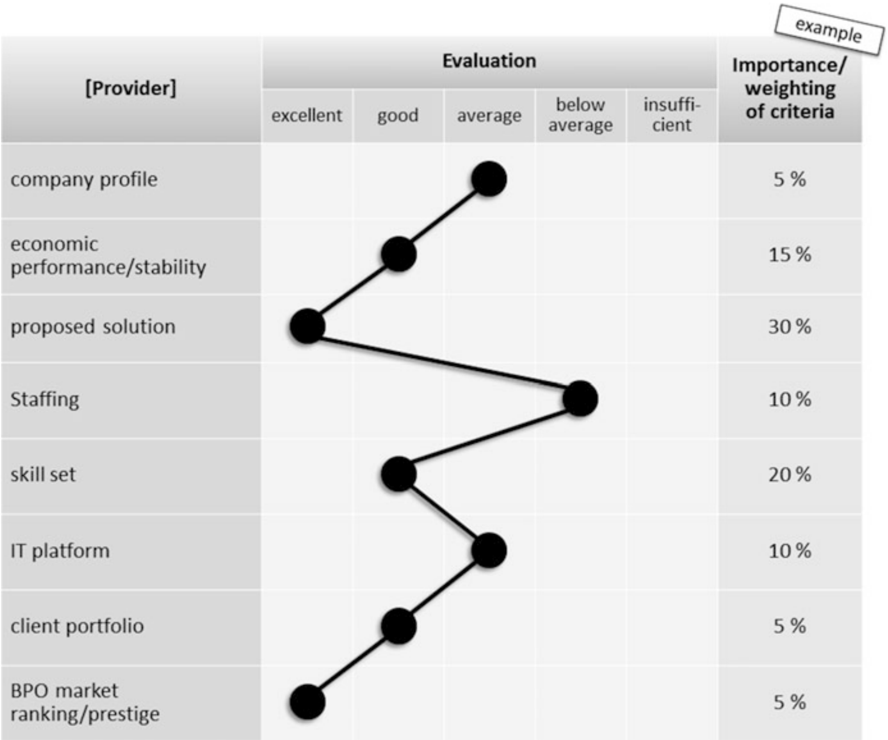


**Fig. 3** Criteria for vendor selection

## Contracting

Once the decision for a BPO partner has been taken, the contracting phase begins. The contract should include the implementation and the operations phase. It should contain a clear definition of tasks and responsibilities. All **deliverables** in terms of time and quality should be measurable and the payment terms (including incentives and penalties) leave no room for discussion (see section "Risk Perspective"). In order to protect the company against damage that may be caused by the failure of the BPO partner to deliver the services as requested, an adequate liability frame needs to be included into the contract.

## Implementation

The outsourcing of a business process is a highly complex endeavor. Risks, delays, and obstacles of various and sometimes unforeseeable nature will happen. In order to maintain the necessary management support during the entire implementation period it is necessary to define a project sponsor and a steering committee. Both are informed in appropriate intervals about the progress of the implementation and can intervene in case serious challenges put the implementation at risk.

For this reason, it is absolutely necessary to agree on a project management tool or method which helps to document the progress of the implementation in detail. The tool also highlights potential risks in a timely manner so that countermeasures can be taken to avoid further escalation. Or, to put it more simply, the project leader needs to know at any stage of the implementation process WHO does WHAT until WHEN and HOW.

For this the implementation approach needs to include defined phases, clear roles and responsibilities, and consistent measurable quality gates. In order to ensure high-quality results at the point of go live, all parties must agree on these clear measurements which indicate without a doubt that all requirements to pass a quality gate have been accomplished. If requirements are not met by one party (internally or on the side of the BPO provider) this can, e.g., trigger delays in the overall implementation plan since most activities are interdependent. Delays will need to be compensated according to the penalty structure established in the contract.

During the first stage of the implementation, the blueprint which describes the setup of the to-be process and the as-is process are discussed and compared with each other. These fit-gap approaches determine the amount of adjustments that need to be done to ensure that the **standard**ized new process (blueprint) can be implemented successfully. It goes without saying that the majority of adjustments should occur in the as-is environment to safeguard the **standard** solution. If processes have already been somewhat harmonized internally prior to the actual implementation, the need for further adjustments will be limited. Of course, the solution framework proposed by the BPO partner should also allow for some flexibility to cater to some well-founded exceptions from the **standard** approach. This combination will certainly help to reduce frustration on the part of the former process owners within HR and will smooth out this initial period of cooperation between BPO provider and HR (Fig. 4).

It is essential (a) that the agreed-upon solution, the to-be process, covers all requirements that HR and the customers of HR may have and (b) that these requirements are documented in all necessary detail. In fact, all parties involved in the implementation officially need to approve of this documentation before the actual configuration of a system solution should start. The documentation and the alignment on the details captured are time consuming and may seem tedious, but this investment early on in the implementation process will pay off during the testing phases post system configuration. Wrong or incomplete process documentation will result in a partially faulty system solution, and necessary fixes will most certainly take more time than the compilation of all requirements in written form. In fact, if the outsourcing company, i.e., the HR department, provided a sign-off on requirement documentation that turns out to be incomplete, the BPO provider may contractually be justified to consider such fixes as a first instance of chargeable **change requests**. In other words, detail orientation in the documentation phase can help to avoid unforeseen increases in the agreed-upon implementation cost.

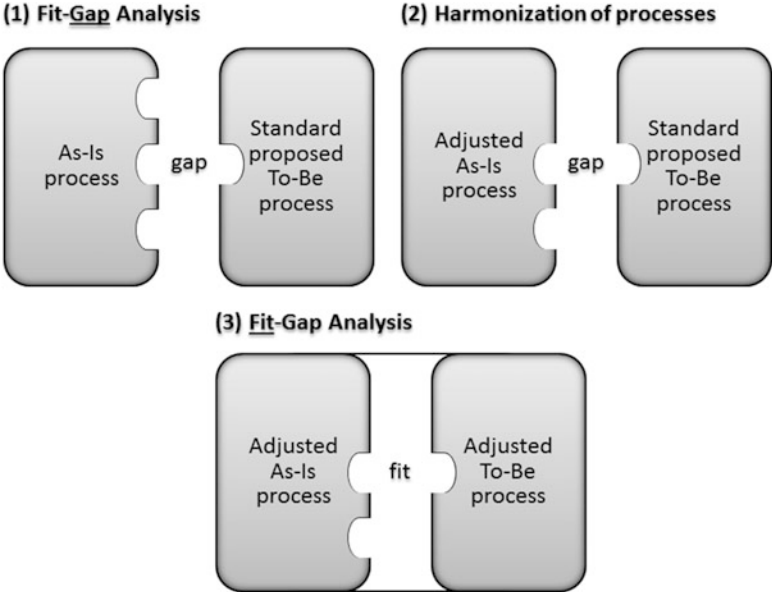


**Fig. 4** Principal stages of a fit-gap analysis

Post the documentation and configuration phase, the IT solution provided by the BPO provider needs to be tested. In an initial test stage, these tests may be limited to a specified set of scenarios populated with dummy data to ensure that the overall framework captures client requirements. Ultimately, the external provider has to conduct a full component testing to ensure consistent and complete system capability. Also, the interfaces to other systems used by the client need to be tested.

Once the system is set up as such, all relevant HR data needed for processing has to be migrated into the BPO IT systems. In order to ensure a complete and correct transfer of data, a template approach defining mandatory and optional data fields is put to use. Once all data conflicts have been clarified and the mapping of the data has been finalized, the actual process can be tested.

In this next test stage a complete set of historical data, e.g., the payroll of a past month, may be reprocessed by the BPO provider. Usually, the predefined pass rate in the first round of testing (quality gate) will not be 100 %, since certain variances can be expected between the historical system solution and the future system solution. Of course, any variance detected is only acceptable if it can be explained based on the requirement documentation and is accepted by the client in HR. The number of variances should be consequently reduced with the number of test runs conducted, and all known complexities (e.g., bonus runs) should be tested. As the go-live date in the implementation approaches, a mock or parallel run to the actual month processed in the internal systems is conducted to ensure maximum compatibility. As a rule, documentation of all testing activities should be a contractual obligation on the part of the provider, and the preagreed number of test runs or pass/failure rates should never be compromised to avoid serious quality issues post go-live.

## Project Controlling

All stages of the implementation process should be covered by a stringent controlling of the targets achieved or missed. The project controlling should consist of a few manageable **KPI**s, such as implementation cost, time, and quality. If major deviations from the targeted **KPI**s occur, the project sponsor and steering committee need to be informed, and corrective action needs to be taken.

If an implementation approach covers several legal entities, different locations, or different countries and is, therefore, set up in implementation waves, experience gathered during the initial wave should be used to assess if the implementation approach needs to be adjusted. Controlling data collected during this initial wave should be the basis for any potential changes in time or approach. Thus, project controlling and the lessons learned at an early point in the overall implementation can help to enhance the approach as such which in return will avoid an increase of frustration for all parties involved in the implementation.

## Postimplementation Phase

"The project is not over till it's over." Although a successful go-live marks the end of the implementation phase, the project team – internally as well as on the external BPO partner side – cannot or should not immediately transition responsibility for the outsourced process handling to Operations. Rather, this handover should be managed in a 3- to maximum 6-month time frame after go-live. Activities to be conducted during this period include a close monitoring of the results that the new system solution provides as well as a capturing and potential fixing of any additional system variances should they occur.

Yet, the transitioning of process responsibility to the BPO operations team is the most important thing to be accomplished during this stage. The team has to develop system and client expertise in a comparatively short time span. This means. BPO staff members need to familiarize themselves with all system adjustments that had to be configured upon request of the client. In addition, they need to know the intricacies of all process steps that need to be followed in order to meet customer expectations. This includes a detailed checklist approach to ensure proper timing and sequencing if necessary. Ideally the checklists that are being implemented at this stage are also shared with the client. Approval of these checklists ensures a joint understanding of the required process handling.

In fact, the postimplementation phase can also be seen as the time during which the collaboration model between the remaining internal HR staff and the BPO operations team is established. A stringent and efficient buildup of client expertise is essential to establish confidence in the outsourced process solution as quickly as possible.

## Operations Phase

Once the responsibility for process operations had been handed over to the BPO operations team, a regular performance monitoring based on contractually agreed upon **KPI**s begins.

If a well-functioning BPO solution has been installed, the collaboration model is working, and the skill set of the operations team meets client expectations, **KPI** measurements are part of a monthly routine. In this stable environment, all parties involved will most likely also acknowledge that mistakes may occur once in a while. In such cases, a content client will probably also not insist on a zero-tolerance approach. Based on the good cooperation, HR and the BPO provider are rather more likely to find a joint, pragmatic solution to the issue encountered.

This mindset changes dramatically, if mistakes occur more frequently, and especially if the same issues occur again and again, putting a sustainable **quality of service** delivery at risk. If the BPO performance ranks below the measurable expectation level, fines can be used to penalize this performance dent. Ideally, any missed **KPI** followed by a penalty fee should initiate corrective action on the part of the provider. Since quality issues cannot be tolerated over an extended period of time, penalties usually increase with each month the performance ranks below the expected quality level. As economic pressure rises, the BPO management will speed up the process to bring **quality of service** delivery back to a sustainable level.

The gratification some internal players opposed to outsourcing may feel, if the BPO provider is to blame for significant quality issues, will most certainly be short lived – the reason being that at the end of the day, all parties involved will be held responsible for success or failure by the affected employees. Therefore – despite all the understandable frustration on the part of HR – the BPO provider will need the continued support of HR and the management to bring performance back on track.

## Operations Controlling

Apart from the regular performance controlling, these efforts should be tracked by Operations controlling – a continuation of project controlling during the implementation phase.

Operations controlling is used to ensure that the strategic outsourcing targets as well as the **business case** targets are met once the process has been fully outsourced. Ongoing operational challenges put cost and capacity reductions as well as a targeted increase in quality and efficiency at serious risk.

In fact, should all efforts to develop the BPO partner to the expected quality level fail to trigger the desired results, the management may ultimately have to reassess its decision for the BPO partner. In this context, vendor management and controlling would have to develop two alternative scenarios: transitioning the outsourced business process to a new provider and reversing the outsourcing process to bring the process back in-house (Al-Ahmed and Al-Oqaili 2013).

Both alternatives would come with considerable risk and cost and without valid guarantee that the strategic targets defined would be achieved.

## Do's and Don'ts

### Do's

Do address all consequences of an outsourcing initiative in a timely, open, and transparent manner. This will help you to avoid an unnecessary increase of insecurity within the staff affected by the initiative and ensures that the employees who need to drive this initiative do not lose their project commitment.

Do acknowledge that quality expectations regarding the handling of outsourced business processes can only be met if the pricing allows the provider to set up the respective infrastructure (systems and skill sets).

Do ensure that all legal requirements connected to the handling of HR data by a third party are clarified prior to outsourcing the respective HR process to avoid regulatory risks.

Do build up a sustainable in-house governance function for a stringent monitoring of the outsourcing provider by using regular performance measurements of predefined Key Performance Indicators (KPIs).

Do establish a structured change request management to establish a continuous improvement process and simultaneously safeguard the level of process standardization achieved through outsourcing.

### Don'ts

Do not only treat outsourcing as a cost-efficiency program but define it as a major change process that needs highest management attention and commitment.

Do not initiate a business process outsourcing project unless a sustainable business case – including cost and quality aspects – has been calculated and accepted by the management.

Do not make the attractive pricing included in a vendor proposal the one decisive aspect for your choice of outsourcing provider, and always keep in mind that you can outsource processes but you cannot outsource the risks that come with a failed outsourcing approach.

Do not rush into an outsourcing implementation phase, but rather take care to document all complexities of the current process in all necessary detail to avoid configuration gaps that lead to mistakes in the process handling by the outsourcing provider.

Do not underestimate the mutual dependency of HR client and outsourcing provider and establish a joint team spirit and sense of responsibility, because it is much easier to outsource a process than to reclaim it should the outsourcing initiative fail.

## Final Comments and Outlook

Although there are quite a few stories out there that portray outsourcing approaches in general as risky business, and although there are quite a few examples where outsourcing initiatives indeed failed and that at considerable cost, outsourcing can be very successful if some parameters are kept in mind.

It is very difficult to save an outsourcing approach once serious operational difficulties have been encountered. But outsourcing is never doomed in the operations phase – the journey toward failure begins much earlier: during implementation or even in the preimplementation phase.

A clear management support is needed during the decision-making phase but more importantly throughout implementation and in the operational phase. This support needs to be communicated consistently and continuously internally and toward the vendor. Strategic targets to be achieved with business process outsourcing should go beyond short-term cost reduction and need to be realistic in terms of realization timeline. Expectations regarding a successful business process outsourcing need to be made clear to all potential vendors, and the selected external partner should be capable to meet the targeted improvements. This capability should be verified as much as possible in an extensive selection process. In terms of commitment and collaboration culture the selected external partner should be a good fit with the client. The contract should be comprehensive and cover all areas and stages of cooperation including measurable success criteria. Internal processes should be harmonized as much as possible prior to outsourcing, and the **standardized** outsourced business process should not be exposed to extensive customization. During implementation all requirements have to be captured in detail and accurately, and the highest quality expectations need to be realized and verified during implementation.

If these guidelines are kept in mind and strictly adhered to, potential risks can be resolved in a timely manner, turning dreaded failure into a sustainable success story for both client and external BPO partner.

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