



The State of Human Resources Outsourcing: 2004–2005

Survey Results

February 2005



Human Resources & Investor Solutions

Introduction

Increasingly, leading companies in the United States see the value in building a strong working partnership between the Human Resources (HR) and Finance functions. This partnership is driven by continuing pressure to streamline internal processes and procedures, as well as by the realization that human capital represents the single greatest cost — and asset — for many organizations.

Nowhere is this bipartisan effort more evident than when discussing the outsourcing of HR services, particularly in the administration and management of payroll and benefits, where HR and Finance have traditionally overlapped. Many companies in the survey reported that this administration has distracted attention from higher value activities. Companies indicated that outsourcing services enable Human Resources (HR) and Finance to focus on what really matters to the business.

Based on a recent survey of 375 WorldatWork and Financial Executives International (FEI) members, HR and Finance share similar, collaborative views of how to use HR outsourcing to drive value to the business. Conducted in Fall 2004 by WorldatWork, FEI, and Mellon's Human Resources & Investor Solutions, the survey is the first to look at how attitudes contrast between HR and Finance professionals regarding the outsourcing of HR functions and services.

The data collected in this survey support increased collaboration between HR and Finance in the outsourcing of HR services. Responses were very similar for members of FEI and WorldatWork across a wide array of outsourcing decision-making and management factors:

- Seventy-five percent of respondents indicated that HR was directly involved in the decision to outsource HR services. That role is increasingly being shared with Finance, however, with more than one-third of all respondents (and 72 percent of Finance respondents) indicating shared responsibility between the two groups.
- HR and Finance agree on the drivers of outsourcing: access to improved information, technology and service levels, and an ability to focus on higher value activities. Cost reduction and avoidance of capital investment were nearly as important, but dissatisfaction with current HR performance was the least significant factor in pursuing outsourcing.

- Benefits administration (401(k), health and welfare, defined benefits) remains the most commonly outsourced set of services within HR, followed closely by payroll and training.
- HR administration is the service area that appears most likely to grow, since nearly one-fifth of companies are currently considering it for outsourcing.
- HR and Finance report similar levels of outsourcing satisfaction: 73 percent of all respondents say the decision to outsource resulted in improved service to employees, while 70 percent suggested they were better able to focus on high value activities. Two-thirds report the decision to outsource resulted in reduced capital investment and cost savings.

Other similarities include a reluctance (by two-thirds of respondents) to use off-shoring as part of HR

outsourcing, as well as a similar view on the funding level for change management. Respondents were also similar in their focus on vendor quality and service as the most important drivers of success, followed by senior leadership understanding and buy-in.

Overall, HR and Finance seem aligned in their commitment and approaches to increasingly use HR outsourcing to add value.

HR Outsourcing is Maturing as a Field

As the use of HR outsourcing has become increasingly mainstream, companies have shifted their focus from implementation toward optimizing value from their outsourcing strategy. The question is not “Should I outsource?,” but rather “What scope of services, business drivers, and vendor strategies will provide the best business impact?”

Overall, two-thirds of survey respondents indicate they currently outsource one or more HR services, and the average company outsources 3.9 services. Outsourcing is more common for service areas that involve highly replicable transactional activities (e.g., 401(K) or health and welfare administration), although more complex processes are increasingly seen as future outsourcing candidates. (Figure 1)

Figure 2 shows the processes most considered for future outsourcing by companies that are currently performing these services themselves. As shown, nearly a third of companies not currently outsourcing are considering the possibility for health and welfare (31 percent), and one-fifth of companies not outsourcing may do so for their 401(k) and HR administration (20 percent each).

There appears to be little correlation between company size and the types of services outsourced. Generally speaking, smaller companies involved in outsourcing HR services tend to utilize outsourcing strategies in a pattern similar to those of larger companies. The notable exception to this, however, is the outsourcing of payroll services. In that case, small companies (fewer than 1,000 employees) are almost twice as likely to outsource the payroll function than are larger companies.

Figure 1: Current Status — HR Outsourcing Prevalence

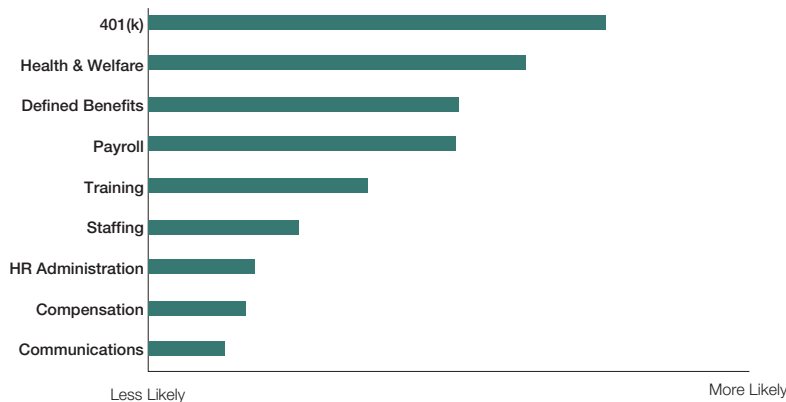
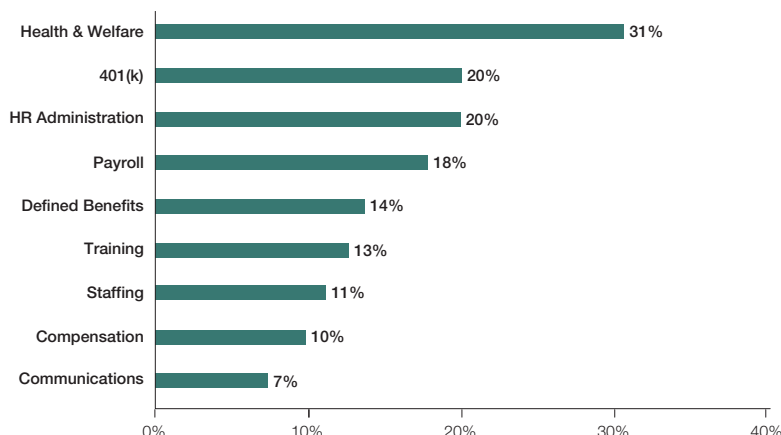


Figure 2: Companies Considering Outsourcing



Across all outsourced services, survey respondents gave an average satisfaction rating of 3.8 (on a “1 to 5” scale), indicating they were somewhat satisfied but also found room for improvement. Administration of 401(k) plans generated the highest level of satisfaction, followed by training. Satisfaction with outsourcing appears to be affected by several factors in combination: size of firm, number of services outsourced, and the complexity of the services outsourced. In general, the most satisfied companies were those in which there was a good match between the amount and complexity of outsourcing (the requirement) and the size and experience of the firm.

Only five percent of companies reported considering taking a previously outsourced function back in-house. Most respondents (63 percent) were content with their current level of outsourcing and had no plans to expand the initiative to include other HR-related functions. It is likely that the decision to outsource or expand outsourcing will continue to be made on a company-by-company basis, as the set of outsourced services and capabilities continues to mature and companies continue to define their core areas of focus.

Respondents recognize that the value they receive from outsourcing is heavily affected by both vendor and client organizational readiness. The vendor must be client focused with user-friendly products and technology. Yet the client needs its own leaders to provide organizational support and must deliver solid vendor management as well. More than half of the respondents said they devoted two percent or less of outsourcing budgets to change management; just 13 percent devoted more than five percent to managing change.

In general, these results clearly show that HR outsourcing is moving out of adolescence and into young adulthood. The field is broadening its service offerings while increasing performance levels, but still has significant room to improve. As a result, most

companies have grown more sophisticated in their use of outsourcing and are approaching their decision-making and management more strategically. In this type of environment, the survey data suggests the following points for consideration when implementing or reviewing an HR outsourcing decision:

- Ensure ownership and collaboration from both Human Resources and Finance for HR outsourcing strategy and implementation.
- Build a “roadmap” for your organization regarding the processes and timeline for HR outsourcing; tailor this roadmap to fit your organization’s maturity and needs.
- Strengthen operational readiness for outsourcing by preparing leaders and employees and by enhancing their ability to choose and manage vendor relationships.
- Prior to implementation, plan and budget for change and communication activities that increase the chances for outsourcing success.
- Use HR outsourcing not just to “handle administration,” but rather as a critical enabler of delivering better information and business value from HR.

Full Survey Findings and Conclusions

I. Methodology and Participant Demographics

This survey was commissioned by three leading organizations as the first large-scale effort to better understand the current state of HR outsourcing as viewed by both HR and Finance professionals. The three sponsoring organizations are:

- *WorldatWork*, the leading association for compensation, benefits and total rewards professionals
- *Financial Executives Research Foundation, Inc.*, the research affiliate of Financial Executives International (FEI)
- *Mellon's Human Resources & Investor Solutions*, a leading provider of HR services

As shown in Figures 3, 4, 5 and 6, about two-thirds of respondents were HR professionals and one-third were Finance professionals. Respondents were mostly from larger companies, with 14 percent working at organizations with more than 20,000 employees, and 27 percent at companies with between 10,000 and 20,000 employees.

II. Outsourcing Prevalence and Satisfaction — HR Services

Outsourcing is widely accepted as a legitimate option for doing business, with two-thirds of participants in the survey indicating that they outsource one or more HR functions. This commitment to outsourcing is evident regardless of the size of the company involved; a majority of respondents in

Figure 3: Respondents by Membership

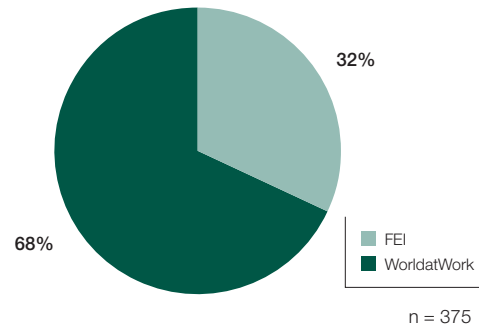


Figure 4: Respondents by Number of Employees

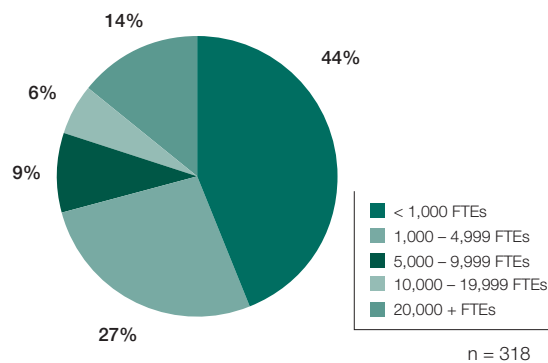


Figure 5: Respondents by Company Size

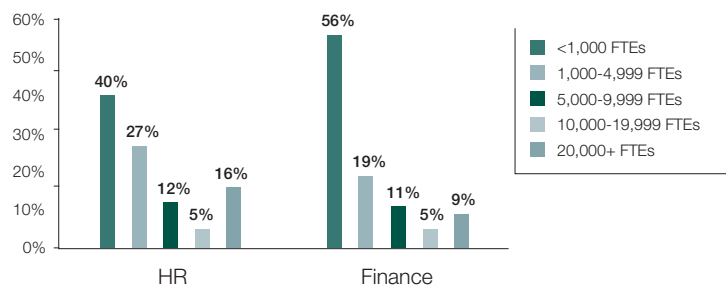
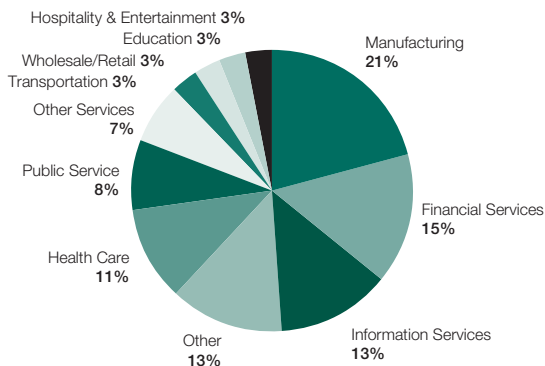


Figure 6: Respondents by Industry Type



each of four size groups (as defined by number of employees) report that they rely on outsourcing of HR services.

The survey also examined actual outsourcing patterns with regard to nine common HR functions, ranging from process-based activities (e.g., payroll, 401(k) administration) to those that require more tailoring to organizational factors (communications, compensation). In general, the more transactional an activity, the greater likelihood that it is outsourced. (Figure 7)

In general, respondents reported a level of satisfaction that, while not overwhelming, at least affirmed their decision to outsource. The average level of satisfaction across all outsourced functions was 3.8 (on a scale of 1 to 5, where 5 is very satisfied). (Figure 8)

Survey results show that overall satisfaction increases as the number of functions outsourced increase, suggesting both that familiarity and experience with outsourcing initiatives are key drivers in satisfaction and that the more satisfied respondents are with current outsourcing initiatives, the more likely they are to expand those initiatives in the future.

III. Outsourcing Decision-making

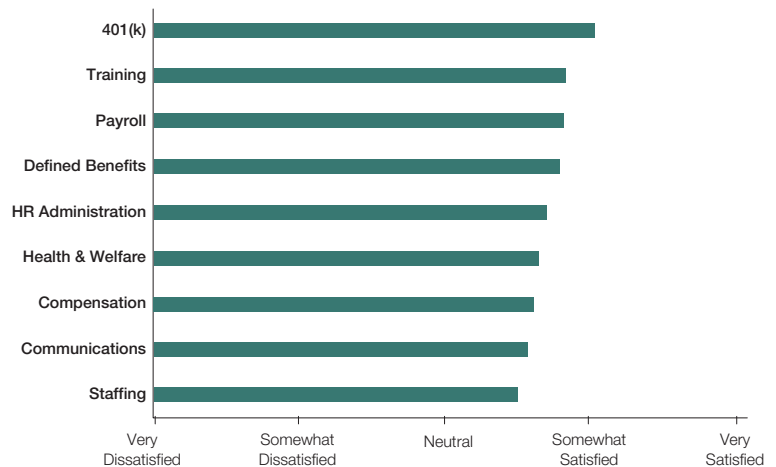
The survey also examined several different aspects of an organization's decision-making regarding outsourcing. These included:

- The respective roles of HR and Finance in making HR outsourcing decisions
- The “business drivers” prompting a decision to employ HR outsourcing

Figure 7: Current Status — HR Outsourcing

	Completely Outsourced	Partially Outsourced	Under Consideration	Not Outsourced	n
401(k)	48%	42%	2%	8%	241
Health & Welfare	24%	55%	6%	15%	233
Defined Benefits	24%	38%	5%	32%	196
Payroll	23%	39%	7%	31%	236
Training	6%	43%	6%	45%	232
Staffing	3%	29%	8%	60%	226
HR Administration	3%	13%	17%	67%	223
Compensation	3%	16%	8%	73%	227
Communications	2%	13%	6%	78%	223

Figure 8: Satisfaction Level — HR Outsourcing



- The “buying factors” most important when choosing an outsourcing vendor
- The strategies of organizations to expand or manage the future scope of outsourcing

Overall, 75 percent of survey respondents indicated that HR plays a primary or collaborative role when considering the outsourcing of HR services. Forty-three percent indicate that Finance plays a role as well, though the majority of respondents indicate that role is more collaborative than leading. (Figure 9)

Similarly, 59 percent of HR respondents report that HR is the primary lead in HR outsourcing decisions, with 41 percent indicating that responsibility is shared with Finance. By contrast, only 28 percent of Finance respondents believe Finance has primary responsibility, with 72 percent reporting that they share that role with their HR counterparts. (Figure 10)

What factors caused organizations to pursue HR outsourcing? Respondents identified the following as the most important business drivers (in order of importance):

- Access to leading-edge technology and capabilities
- Improved information
- Improved ability to focus on high value activities
- Improved service to employees and managers
- Reduced capital investment
- Cost reduction

Interestingly, dissatisfaction with current HR performance was *not* identified as a primary driver of the decision to outsource HR processes.

Figure 9: Internal Champions for HR Outsourcing

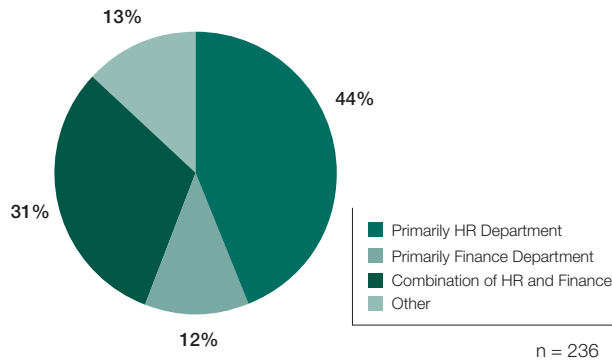
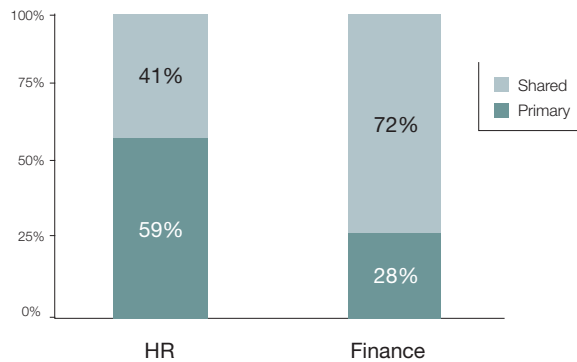


Figure 10: Varying Perceptions of HR Outsourcing Responsibility



Also, Finance respondents were less likely than their HR counterparts to report cost and capital investment as key drivers for HR outsourcing.

In terms of selecting an outsourcing provider, results show that customer service is the most important decision-making factor, followed by price and technical expertise. Respondents were given a list of 12 potential “buying criteria,” and were asked to pick the three most important. As shown in Figure 11, 80 percent chose customer service, 66 percent chose price, and 57 percent rated technical expertise as among their top three. Interestingly, factors such as long-term stability, experience, ease of transition, and partnership relationship were far less likely to be selected as among a buyer’s most important decision factors.

Once organizations have begun outsourcing, their decision-making turns to the future: should they expand the scope and level of integration for outsourcing, maintain the status quo, or take currently outsourced functions back in-house? Results show that almost no organizations want to return to performing the function themselves. Yet many are more likely to maintain their current level of outsourcing than to expand scope and pursue more integration across services.

This slow pace of moving toward scope expansion and integration is perhaps a reflection of the maturity of the HR outsourcing industry. Organizations often want the benefit of a fully integrated and broad scope HR outsourcing arrangement, but are not confident this can be delivered as effectively across the full Total Benefits or Human Resource Management domains. We expect this to increasingly

Figure 11: **Most Important Attributes When Selecting Outsourcing Partner**

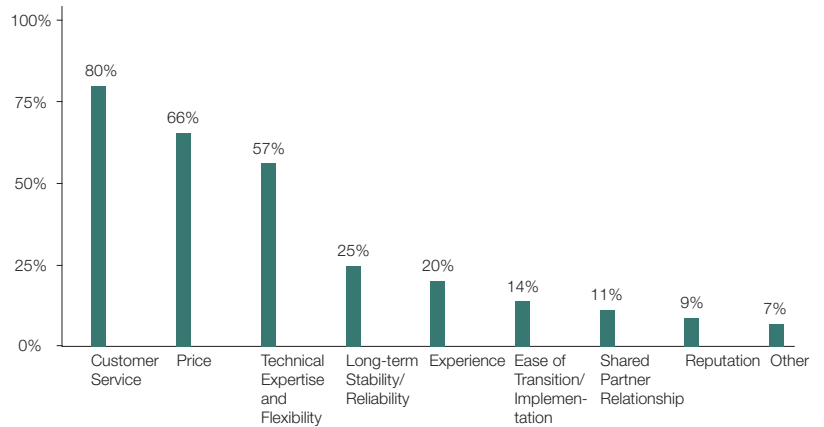
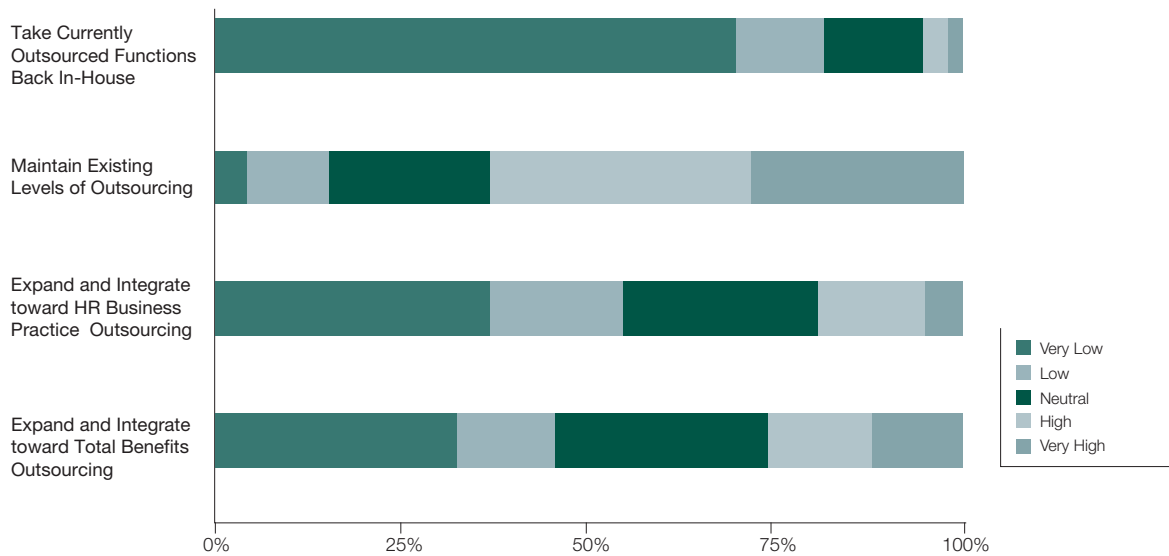


Figure 12: Likelihood of Action Within Next Two Years



shift, as there are more success stories and outsourcing vendors develop their full domain capabilities. (Figure 12)

IV. Maximizing Value from Outsourcing

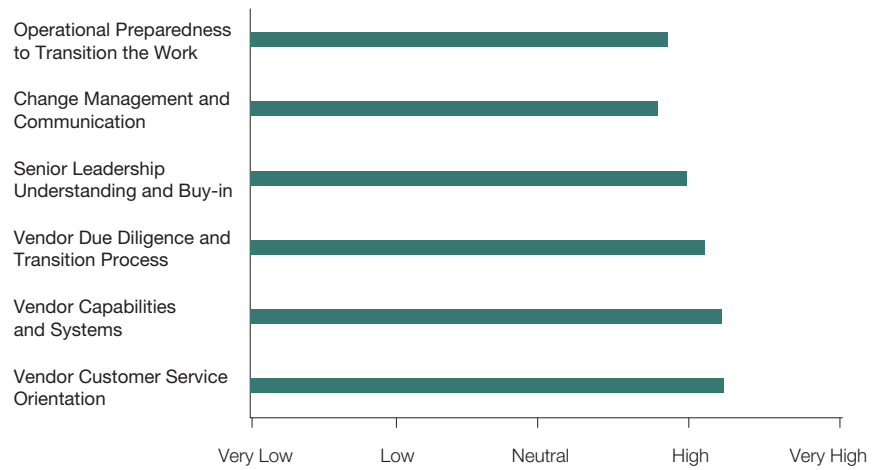
In this final section of the report, we provide insight into factors affecting the value that organizations are realizing from their outsourcing initiatives. Respondents provided their input in the following areas:

- The critical success factors and “organizational readiness” required to implement outsourcing
- Which HR processes are most important as part of an HRM BPO initiative
- Preference regarding off-shoring as part of outsourcing
- The impact on HR staffing levels of implementing outsourcing
- Funding levels for “change management” as part of outsourcing implementation

Regarding organizational readiness, respondents indicate that outsourcing success requires high levels of

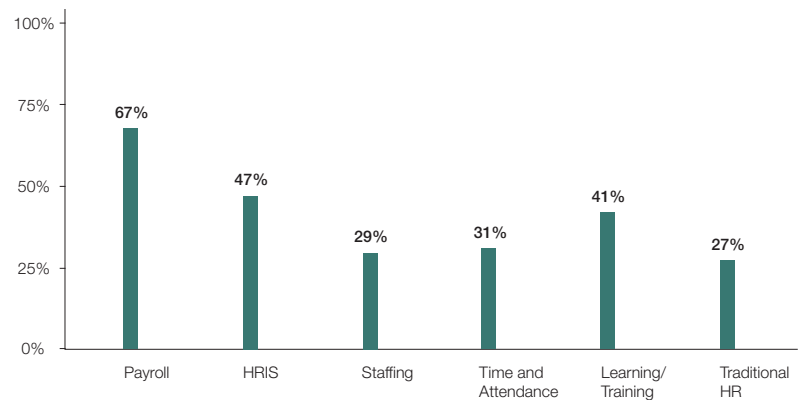
execution across a wide range of activities. The vendor's customer service orientation, capabilities and due diligence/transition processes are definitely critical. However, the client organization's internal performance is seen as almost equally critical: operational preparedness, change management efforts, and senior leadership understanding and buy-in. Thus, effective implementation requires building organizational readiness with critical requirements for both the client and the outsourced vendor. (Figure 13)

Figure 13: Importance of Various Factors in HR Outsourcing Success



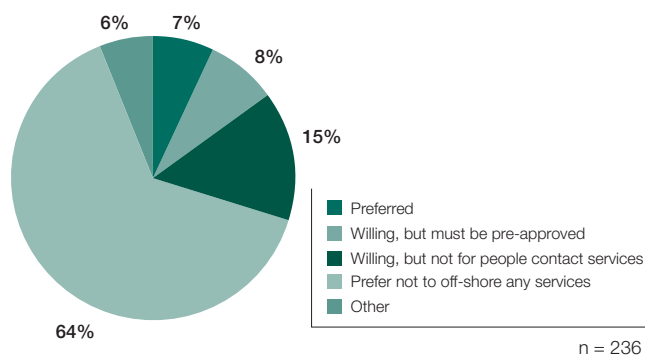
As organizations progress toward achieving greater value, they require a roadmap for the processes they want to include in their outsourcing initiative. Respondents indicated that beyond traditional benefits outsourcing, the most important processes to consider are payroll, HRIS, and learning/training. Two-thirds consider payroll to be part of a full HRM BPO outsourcing initiative, and nearly half of respondents see HRIS and learning also as important components. (Figure 14)

Figure 14: Important Components of HR Business Process Outsourcing



Given the amount of media attention that "off-shoring" has received of late, respondents had strong feelings on the topic. Nearly two-thirds of respondents indicated they preferred not to consider off-shoring of any outsourced service. A total of 29 percent would consider off-shoring under certain circumstances, and only seven percent said they preferred to use off-shoring as part of their outsourced arrangement. (Figure 15)

Figure 15: Attitudes Toward Off-shoring of HR Services



While HR outsourcing works to deliver new value, what is the impact on current HR staff? Survey results suggest the typical impact is to reduce staff, sometimes involving reassignment internally or to the outsourced vendor, but more often resulting in

displacement. As shown in Figure 16, respondents believe that perhaps one quarter of staff may be hired by the outsourcer, with the remainder being displaced or reassigned internally.

When respondents project changes in staffing levels during the next two years, just over half believe HR staffing levels will be flat. About a quarter expect growth in staffing levels to grow by more than five percent. (Figure 17)

Considering together both off-shoring and HR staff reductions, it seems clear organizations have concerns about the external perception of their outsourcing decisions. Organizations want to be seen as fair to their workforce and a good employer. These findings showcase the importance of an effective change and communication strategy with a set of key messages about the reasons for outsourcing and the manner in which it will be implemented.

Many organizations speak about the importance of change management in a successful outsourcing implementation, but how much do they "put their money where their mouth is?" In this survey, more than half of respondents indicate they devoted less than two percent of the outsourcing budget to change management, while a third spent between two and five percent on managing change. Just 13 percent devoted more than five percent of their budget to change management and communication. (Figure 18)

Figure 16: Employee Impact of Outsourcing Decision

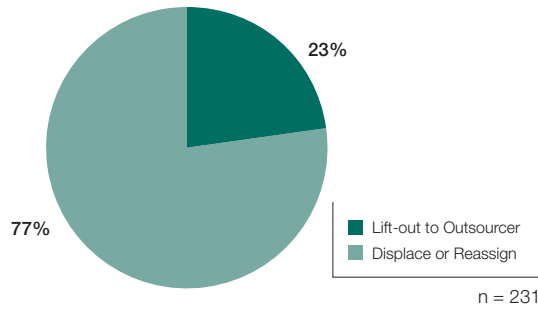


Figure 17: Projected Change in HR Staffing Levels: 2004 through 2006

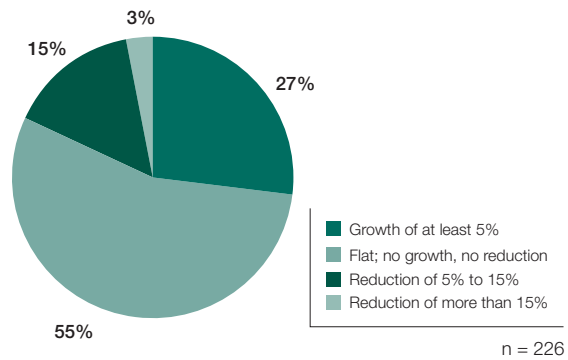
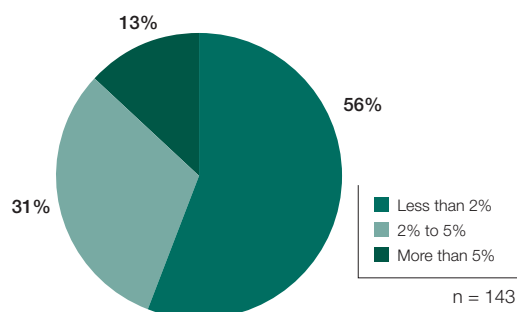


Figure 18: Share of Outsourcing Budget Devoted to Change Management and Communications



Conclusion

This report has provided a snapshot of HR outsourcing practices from the perspective of both HR and Finance professionals in a wide range of organizations. As stated in the Introduction, HR and Finance are increasingly aligned in promoting HR outsourcing — they have similar views across the full range of survey topics. The increasing partnership between HR and Finance is a critical enabler to achieving additional business value through HR outsourcing.

More broadly, this survey documents the continued maturation of the HR outsourcing industry: growing in satisfaction, sophistication and value. Both client and vendor organizations are getting smarter about how to make HR outsourcing deliver its promised business benefits.

But the survey also shows that this maturation requires improvement and growth. Outsourcing vendors need to focus on enhancing client satisfaction in order to “earn” the client’s confidence and expand their use of outsourcing to other more integrated services. Client organizations need to be more strategic, with a clearer roadmap for their use of outsourcing longer-term and to enhance their organizational readiness.

HR outsourcing remains a very exciting arena, with considerable business benefit already and significantly more opportunity ahead. Responses to this survey show that HR and Finance professionals expect — and are focused on — creating that next level of performance and value. Increasingly, outsourcing is becoming not a “one-off” activity to cut costs, but rather a critical enabler of a broader HR strategy to influence business success.

About the Author

Dr. Bruce Barge is the Western Region Human Resource Management leader for Mellon’s Human Resources & Investor Solutions, providing outsourcing and consulting services to help clients increase business impact from HR. Bruce has more than 20 years’ experience in HR service delivery, organization design and change, talent management, and related HR processes. He has led outsourcing and consulting engagements for a wide range of organizations across many industries.

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