Outsourcing and the 'New' Human Resource Management

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Executive Summary

Once believed to be strictly an administrative function low on management's priority list, the human resource function is increasingly involved in strategic management decisions. Intense competitive pressures are forcing it to reexamine its structure, the services it provides, and the competencies it requires. As a result, HR is looking at outsourcing as a way to reduce its workload and concentrate on strategic core functions. Interviews with nine HR executives reported in this study provide a snapshot of how Canadian organizations and their HR functions are changing to cope with the new economic environment. They reveal that outsourcing is increasingly seen in some organizations as a way for HR to shed parts of its administrative burden. But others are reluctant to transfer functions outside the HR department.

- Outsourcing has the potential to decrease the cost of service delivery, increase the quality of service, increase management flexibility, and provide access to the outside vendor's high level of expertise.

- On the other hand, decreased management control is a real danger when functions are transferred to an external vendor, and quality and service may suffer if outsourcing is not handled properly. The organization may lose strategic advantages if it becomes too dependent on an outside vendor.

- When considering outsourcing payroll and benefits administration, three organizations in this study found the services could be provided more cost effectively internally. Some commentators suggest organizations should let their own internal departments compete for potential outsourcing contracts, thereby pushing internal departments to become more efficient.

- In many cases, there will be a loss of productivity and low employee morale as a result of outsourcing. Middle managers will often build a strong case against outsourcing, fearing their jobs are at risk. Thus it is important to begin managing the human resource impact before the transition.

- In areas where the organization is highly vulnerable and the potential for competitive advantage is high, products and services should remain within the company. Where competitive advantage decreases, organizations may be better off to look to external vendors. Activities currently outsourced by organizations participating in this study include temporary staffing, benefits administration, recruitment, training and development, payroll, medical services, and pension administration.

- HR is generally unwilling to outsource what it sees as a strategic asset. For example, recruitment was not considered appropriate for outsourcing, since the organization might lose touch with potential candidates and fail to attract the best employees. There is a reluctance to outsource all of compensation, because it represents a large percentage of overall costs and organizations need to retain internal expertise to fully understand the impact of policy decisions.

The author concludes that in making outsourcing decisions, HR must carefully evaluate both the benefits, which can be significant, and the risks, to determine whether outsourcing a few or many functions is a good strategic decision.

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Introduction

Organizations in Canada today are faced with constant external pressures. Confronted with stiff competition due to globalization and international trade, they must become more efficient and productive if they are to remain serious contenders in the ever-expanding world market. Historically, organizations have competed through technological innovations, the availability of capital, and access to markets, but organizations must now use their people to achieve a competitive edge and take a serious look at how their HR policies and practices are contributing to the total business strategy, since the winning organizations of the future will be those that can best attract, retain, and motivate employees with the right skills (Lawler 1992; Benimadhu 1989).

HR is now required to be bottom-line oriented and play a key role in top management decision making. For most HR departments, this new role requires a change in mind-set and in the way they do business; managers must find ways to cut costs and increase service delivery. This study examines how the HR department is coping with the tumultuous environmental changes. It focuses on the role of outsourcing within an HR context and the role that outsourcing might play in dealing with the new challenges. The empirical data was gathered during one-hour interviews with HR executives/managers. (See Table 1 for a list of the organizations, the industries in which they operate, and the total number of employees.) Prior to the interview, each participant was provided with a copy of the interview guide. Further, participants were given the opportunity to review and correct the interview transcript to ensure that the data reported in the study accurately reflect the situation in their organizations.

Although the organizations participating in this study do not represent a random sample, it is believed that, taken together, they provide a snapshot of how Canadian organizations and their HR functions are changing to meet the new business and economic pressures.

Table 1 Organizations Interviewed

Organization	Industry	Work force
IBM US	Information technology	110,000
CN Rail	Transportation	25,000
CP Rail	Transportation	24,000
IBM Canada	Information technology	8,000
Dofasco	Steel	7,000
Avenor Inc.	Pulp and Paper	7,000
Procter & Gamble	Packaged Goods	3,000
Warner Lambert	Packaged Goods	1,400

The New Human Resource Function

Because the smaller, leaner businesses that emerge will count on high productivity from fewer people, human resources management will be at the forefront of organizational change. (Coates and Jarratt 1994, 1)

Once believed to be strictly an administrative function low on management's priority list, the HR function is shedding its 'administrative stigma' and becoming involved in top management decisions. HR is now required to provide a business case for new policies and practices and is increasingly being forced to make the choice between becoming bottom line-oriented and being completely eliminated (Benimadhu 1989, 7).

Services Provided; HR Competencies

Lawler (1992) found that when organizations were asked to identify which strategic issues were the responsibility of the HR department, the most common answer was 'none' (21 percent of the cases). But external pressures may force organizations to change quickly. Although the HR department will still need to deliver technical HR services and perform some traditional 'police' work, it will have to do so with a strategic mindset, ensuring that policies and practices are driven by the business strategy and business needs, and that functions such as HR planning, staffing, development, performance management, and rewards receive more attention, because they help to generate, reinforce, and sustain organizational competencies (Ulrich 1994). Thus, HR can no longer be a separate function with divergent activities (Dyer 1993).

If HR is to achieve its position as the right hand of strategy implementation, HR professionals must be able to act as consultants and partners to top and line management (Kesler 1995). HR professionals must know how to evaluate the business impact of policies and communicate all financial benefits and risks. They will also need to be effective agents of change if they are to provide guidance to line managers in dealing with pressures such as downsizing, restructuring, and implementing new technology. In addition, since human resources management (HRM) is focusing on increasing employee productivity, fostering and developing organizational effectiveness skills within the function will be critical (Benimadhu 1989). Table 2 provides a summary of the essential HR competencies required in the new environment.

Organizational Structure

Although a more strategic alignment between line management and HR will be required in the future, integrating the HR function within line management will require more than just linking HR to the business strategy. HR processes must be integrated with management processes, HR staff functions with line management, and HR measures with management measures—thus permitting the organization to quantify the business impact of HR practices (Walker 1994).

According to Walker (1994), the dilemma between centralization and decentralization of the HR function is at the centre of many HR decisions. Overall, operations have been decentralized

Table 2 HR Competencies

Performance Capabilities	HR Technical Know-How	Business Know-How
Catalytic influence	Organizational design	Competitive strategy
Diagnostic and fact-based analysis	Talent-pool management	Macro and micro economics
	Employee involvement	World class operations
Innovative process and structure	Training and education	Marketing/sales
Assuring standards	Recognition and rewards	Industry knowledge
Administration and services	Well-being and morale	
Problem solving	Communications	

Source: Kesler 1995, 248.

and a lot of power has shifted from corporate headquarters to business units. In the future, the number of HR staff at headquarters will diminish and more staff will be assigned to support the business units. But at the same time, to avoid duplication there is a movement towards centralizing certain activities that serve all areas of the business (Benimadhu 1989). The important question is where specific functions should be performed to best support the organization's needs. Walker uses the term 'unbundling' to describe the process of determining where HR activities should be placed within an organization. Unbundling is intended to integrate the HR function into the business in order to reduce overhead expense, eliminate duplication, and focus time and resources on value-added activities (for examples, see Table 3). Walker points out that many organizations keep all the services in the right-hand column of Table 3 within the HR department. However, they are also more than willing to contract out services for organizational change, quality improvement initiatives, and management development. But if change management and strategic orientation are to play a critical role in the future of HR, it would be logical to develop and retain these competencies inside the HR department while contracting out non-core functions.

Although HRM is moving towards a shared responsibility with line management, the responsibility for certain activities should not be equal (Towers Perrin 1992). For example, while line management should share the responsibility for policy formulation and the management of HR programs, HR professionals should bear the larger responsibility for program development and administration. Furthermore, it is believed that HR should report to the CEO if it is to play a strategic role within the organization; the CEO must recognize HR as a value-added function, and the link between the CEO and the head of HR must be perceived as real by the employees (Benimadhu 1989). A Towers Perrin study found that HR functions reported to the CEO in 74 percent of the organizations surveyed. Eighty-eight percent of respondents preferred this reporting structure for the future (1992, 44).

A Theoretical Model

Although HR is slowly moving from the basement to the boardroom, the new model of HRM is still more rhetoric than reality (Downie and Coates 1993; Betcherman et al. 1994).

Table 3 Unbundling HR Activities

Activities aligned with business units	Activities of overarching corporate interest	Activities that can be placed anywhere
Consulting on people-related business issues	Company-wide values, principles, and policies	Employee information, payroll Compensation and benefits Recruitment
Performance and organizational effectiveness	Executive compensation	Training design, technology, and delivery
Employee relations	Executive succession, staffing, and development	Compliance with labour law Diversity
Referral to needed technical or support services	These activities affect the organization as a whole. In addition, these services may be easier to coordinate in a centralized manner.	Labour relations
Usually staff share responsibility with line managers. These activities can easily be decentralized at the divisional or plant level.		Safety, occupational health Employee communication
		These activities can be performed anywhere or can be contracted to outside vendors.

Source: Kesler 1995, 248.

Martell and Carroll (1995) have found that HR still takes second place to other functions within the organization (see Table 4).

In many cases, the onus will be on the HR department to take charge and begin to act as a business partner. Table 5 compares the traditional model with the new model of the HR function that is necessary for long-term competitiveness.

Outsourcing

Although the HR function will be increasingly integrated within the overall organizational structure, HR will still be responsible for many nonstrategic activities. A recent study by the Bureau of National Affairs (1994, 4) indicated that in 85 percent of organizations surveyed, HR departments were responsible for outplacement counselling, insurance benefits, cafeteria management, employment equity legislation, HR record keeping and employee assistance programs (EAP), many of which can be classified as nonstrategic. In addition, there may be activities that the organization has neither the resources nor the capital to perform in-house. Thus, transferring these activities to external vendors may be a strategic option for the HR function.

Although some organizations are outsourcing HR functions such as recruitment, benefits-plan design, and retirement services, the most commonly outsourced functions are temporary placement, employee assistance programs, and relocation services (Labbs 1993a, 92). As the number of government regulations increase, companies that currently supply HR services are expecting a rise in demand because many organizations no longer have the expertise to handle all the necessary services internally in a cost-effective manner.

Loh and Venkatraman (1992) found two key determinants pushing organizations to outsource. First, the business- cost-structure plays a critical role. If costs are high, the organization may

Table 4 Importance of Functions in Strategy Implementation

Functional Area	Extremely Important (%)	Important (%)	Not Very Important (%)
Human Resource Management	37	46	18
Research & Development	58	24	15
Manufacturing	62	28	8
Marketing	73	23	2

Percentage of Respondents Strongly Agreeing with the Following Statements

Obtaining and preserving the necessary *human resources* is much more important than obtaining and preserving the necessary *financial resources*.	5.2
Obtaining and preserving the necessary *human resources* is much more important than obtaining and preserving the necessary *technological resources*.	7.0
Obtaining and preserving the necessary *human resources* is much more important than obtaining and preserving the necessary *marketing resources*.	8.0

Source: Martell and Carroll 1995, 259.

Table 5 The Traditional and the New HR Function

	Functional Specialist (traditional)	Business Partner (future)
Nature of HR program and function	Responsive Operational Internal	Proactive Strategic Societal
Creation of HR strategy and policy	HR function has full responsibility	HR function and line management share responsibility
Organization of the HR function	Employee advocate Functional structure Reporting to staff	Business partner Flexible structure Reporting to line
Profile of the HR professional	Career in HR Specialist Limited financial skills Current focus Monolingual National perspective	Rotation Generalist Financial expertise Focus on future Multilingual Global perspective

Source: Towers Perrin 1992, 6.

be more inclined to reevaluate the overall expenditure of the HR department and improve efficiency and productivity. Second, organizations with low economic returns on investments may be more inclined to outsource key functions. In these organizations, senior executives are under increased pressure to prove that they provide an essential, value-added service. This is particularly true of staff functions such as HR, which have been under extreme pressure to cut costs and increase efficiency. In most organizations, HR is still considered to be a cost centre, and its ability to contribute in a direct manner to the bottom line is limited (Benimadhu 1989).

Benefits

Core Competencies

Outsourcing allows an organization to focus on a set of 'core competencies,' which are the critical or fundamental functions that provide a competitive edge. Trying to establish what is 'core' within an organization is a difficult task, not easily understood by many senior executives. Quinn and Hilmer (1993, 44) recommend the following criteria:

- Core competencies should focus on skill sets, not product knowledge, since products are easily duplicated or outdated but skills can be transferred across the organization and infiltrate all functional areas.

- The skill sets identified should be flexible and able to adapt to changing business requirements. It is crucial that the core skills continue to be valued by customers and provide the organization with a competitive edge over the long run.

- Organizations should limit the number of core competencies. Most organizations value two or three essential activities. Since each skill is at the centre of the organization's competitive advantage, the investment in these skills should not be diluted.

- The skills should provide a unique source of leverage in the organization's value chain and fill a gap in the marketplace, where intellectual resources can provide the organization with specific advantages.

- Organizations should identify areas where they can dominate the market.

- Finally, core competencies should be embedded in an organization's systems to ensure that they outlive specific individuals.

From these recommendations it follows that activities with little strategic focus or activities for which the organization has little in-house capability are the ones that could be contracted out. For example, Apple computer outsourced seventy percent of its manufacturing costs and components and concentrated on such core competencies as the development of their operating system and specialized software (Quinn and Hilmer 1993, 43).

Increased Return on Investment

Not only does outsourcing allow the organization to gain maximum returns on investments in internal resources, it also allows it to benefit from the vendor's specialized capabilities, which may be expensive to develop internally. Many HR departments outsource functions because they are too time-consuming and their service delivery is too slow. For example, American Express outsourced its defined contribution plan administration to improve service and reduce turn-around time; their employees now have better access to information, and the HR staff has significantly reduced its work load and administrative overhead (Flatley 1992). A recent study conducted by Hewitt Associates (Laabs 1993a, 93) found that the most commonly cited reason (in 37 percent of their cases) for outsourcing the benefits function was to save time (see Table 6 for a summary of the advantages). Contracting out this function allows the organization to stay abreast of legal and tax changes without committing valuable resources to payroll management. Although organizations are still involved in the management of benefits, they can now focus their energies more directly on broader strategic HR issues and less on administrative tasks.

In some instances, it is unlikely that any organization can attain the vendor's efficiency level and economies of scale. For example, Olin Corporation outsourced its relocation-management function and discovered that through the savings achieved they were able to increase the level of service provided to their employees. According to the vendor, HHP Homequities, these savings were due to the negotiated fees they were able to obtain on behalf of their many clients (Corbett 1994).

Limiting Organizational Uncertainty

Outsourcing can transfer risk from one organization to another. In the case of a neglected function or process, it allows the outsourcing organization to realize the benefits of reengineering immediately, without assuming any of the risks of investing time and resources in a process which may not increase efficiency or reduce costs.

Table 6 Outsourcing Compensation and Benefits

Advantages	Percentage of Organizations
Saving time	37
Gaining expertise	18
Saving costs	14
Reducing staffing requirements	14
Minimizing hassles	13
Avoiding complexity	12
Improving service	11
Concentrating on core business	6

Source: Laabs 1993a, 92-3.

Better Cost Management

Outsourcing may promote better cost management. Organizations usually pay the vendor a negotiated fixed fee, and additional fees based on volume. Once the negotiated limit on the number of transactions has been reached, employees may have to reassess the urgency of their request for service. For example, when Continental Bank in the United States decided to outsource many non-core functions, such as cafeteria and legal services, they realized that many of these services were overused: they were perceived as 'just internal costs,' not 'real' costs. This perception has changed since the outsourcing push, and Continental has reduced overall costs while improving service levels (Huber 1993).

Many organizations also need to improve services without committing more human or financial resources. To satisfy increased government regulations, they are adjusting their staffing requirements by outsourcing temporary work to avoid high administrative costs. This allows the HR department greater flexibility in balancing their staffing requirements without making changes to their payroll system. According to the CEO of Career Horizons, 'Outsourcing is a natural outgrowth of the temporary-services concept of balanced staffing, whereby a flexible ring of temps is added to a basic core of permanent employees on an as-needed basis' (Laabs 1993a, 93).

Organizational Risks

Decrease in Management Control

Outsourcing requires managers to relinquish control of certain functions. In areas where the organization is highly vulnerable and the potential for a competitive advantage is high, products and services should remain within the company (Quinn and Hilmer 1993, 48). As organizational vulnerability and competitive advantage decrease, organizations may be better off to look for alternatives such as external vendors or buying a product off the shelf. Quinn and Hilmer (1993) suggest that at first it may be more advantageous for an organization to outsource less critical functions and gain experience in balancing the two priorities.

Activities such as EAP services, outplacement, and cafeteria services may be classified as HR activities with little strategic importance and a low strategic vulnerability. Areas of moderate control might include pension and benefits administration, training and development. They have some impact on competitiveness, since escalating costs can decrease profitability, and usually they must be tailored to specific needs of the organization. Areas of strategic control may place the company in a vulnerable position if they are contracted out. They must be performed internally to ensure that the organization is able to gain and maintain a competitive edge. Examples include compensation design, organizational effectiveness (OE), and daily dealings with employees: these activities have a significant impact not only on operating costs but also on the cultural fabric of the organization.

Managing the Vendor Relationship

Meshing the two corporate cultures is often one of the most difficult tasks in a vendor relationship, since it requires a good communication infrastructure—something most organizations do not have in place (Molloy 1993). Most of the literature indicates that buyer and vendor become strategic partners during outsourcing. However, Lacity and Hirschheim (1993)

disagree. Since profit motives in each organization are not shared (for example, when a customer's costs increase, the vendors profit increases) one should really look at the relationship as a client-vendor relationship rather than as a 'strategic partnership.'

Loss of Control to a Third Party

When outsourcing an activity, management does not abdicate responsibility, since organizations continue to have the ultimate responsibility for the services contracted out. In the United States, for example, Kyle Railways lost its case against a third party who administered their medical plan. The courts decided that Kyle itself was ultimately responsible for unpaid claims. Clearly, the HR function must maintain a close relationship with the vendor to monitor the outsourcing contract and avoid legal disasters (Laabs 1993a). Moreover, long-term contracts with suppliers may prove to be detrimental to the competitiveness of the organization if the vendor does not keep up with the latest technologies and innovations. Lacity, Willcocks, and Feeny (1995, 84) warn that the 'world is turbulent and unpredictable. Even so, many managers sign five- to ten-year contracts without considering that they often cannot predict how business conditions will change even in two years. Companies should therefore pursue short-term outsourcing contracts whenever they can.'

If the organization has not kept any in-house talent and if employees do not stay in touch with the technologies developed by the vendor, management flexibility may be limited, and the organization may suffer from dependence on the vendor. In some instances, vendors have developed such refined services that they have bypassed the buyer and entered the market as a competitor. For example, when Shwinn bicycles outsourced the manufacturing of bicycle frames to Giant manufacturing of Taiwan, they later found themselves in direct competition with Giant (Quinn and Hilmer1993).

Human Resource Impact

Since outsourcing will often displace employees across the organization and may reduce the overall number of staff, in many instances the organization will experience resistance to outsourcing, a loss of productivity, and low employee morale during and after the transition.

Middle management will often build a strong business case against outsourcing, since they frequently believe that their jobs are at risk (Laabs 1993c). Thus it is important to manage the human resource impact from the beginning.

Making the Decision to Outsource

Before deciding to outsource, it is crucial to conduct a comprehensive cost-benefit analysis which should include both internal costs and those associated with outsourcing. The organization should also consider hidden items such as time lost during the transition period, employee turnover, and training requirements. The internal costing should consider such factors as the anticipated resources needed to sustain the infrastructure, train the staff, and manage the function internally in the future. Internal departments can also be cost-effective, of course, and some commentators suggest that organizations should let their own internal departments compete for potential outsourcing contracts. This may provide the necessary push for the internal department to rationalize its operation and become an efficient service provider (Lacity, Willcocks, and Feeny 1995).

The organization must determine whether the vendor is offering any specific productivity gains; it should not simply transfer its own inefficient practice to an inefficient outside company. In addition, managers must avoid unrealistic expectations, which usually occur when organizations enter into outsourcing without the proper preparation and research (Foxman 1994).

Outsourcing is more than contracting for people and assets; it is contracting for results. An understanding regarding expected outcomes shared by the purchaser and the provider should determine the nature, terms, and conditions of the contract. . . . [Simply stated, arrangements should have] guarantees for service delivery, renegotiation conditions, and exit clauses. . . . Rule number one in outsourcing is to know exactly what you are buying and why. (Peisch 1995, 32, 34)

The Evidence from This Study

The Business and Economic Environment

All the organizations interviewed for this study have had to restructure their operations to become more cost-competitive (see Table 7). As the HR director at Dofasco put it,

In the past, Canadian organizations remained competitive in spite of themselves. Now we have no choice but to look at our cost structures and ensure that products and services are being produced in an efficient manner.

The current business climate has forced organizations to reevaluate their product lines, eliminate those which are no longer considered profitable, and concentrate on their core business. The consequent restructuring has resulted in major layoffs. With one exception, all organizations in

Table 7 Major Business Changes

Company	Major Business Changes
Warner Lambert	Globalization of business lines Restructuring and streamlining activities Decrease in number of hierarchical levels 10% reduction of the work force
CN	Privatization of business Restructuring and streamlining activities Decrease in number of hierarchical levels Work stoppages 33% reduction of the work force
CP	Restructuring and streamlining activities Consolidation of business lines Work stoppages Reduction of the work force
Avenor	Restructuring and streamlining activities Consolidation of business lines 33% reduction of the work force
IBM	Restructuring and streamlining activities Changes in business lines 40-50% reduction of the work force
Procter & Gamble	Restructuring and streamlining activities Changes in business lines
Dofasco	Restructuring and streamlining activities Consolidation of business lines 44% reduction of work force

this study have downsized their operations significantly over the past three years, from 10 percent to over 50 percent of the work force. Downsizing on a large scale began the process of eliminating the 'entitlement' mentality which existed in many organizations; gone are the days when job security is a pillar of the employment contract. Only one organization managed the downsizing on a voluntary basis. According to many of the executives interviewed, there are still layoffs anticipated in the future.

Unfortunately, in many cases, 'organizations downsized first and managed later.' Thus organizations are still trying to cope with the reduced work force and the pressure of doing more with less. Associated with the reduction in staff are extensive efforts to reengineer processes. These massive internal changes have resulted in a significant decrease in the number of hierarchical levels within the organizations. For example, at CN and Dofasco, efforts have been made to reduce the number of hierarchical levels between the CEO and first-line employees from twelve or thirteen to five or six. Organizations also realized that the implementation of high-performance work systems was a priority. According to one executive,

> The concept of these systems is to allow all employees to contribute to their full potential. This is achieved through very few lines of job demarcation, which provide people with the opportunity to do what is necessary to get the job done, and principles such as common objectives and continual learning and development. Thus, increasingly, organizations are empowering their employees and pushing the decision-making process down the line.

In the unionized sector, the impact of these forces on contract negotiations has been significant. Both CN and CP experienced work stoppages in 1995. At a time when organizations are pushing towards cooperative labour relations, economic forces have created a hostile environment for union-management cooperation. The interviewees noted that, ironically, economic forces are providing a unique opportunity for HR to prove its value to the organization, since in all change initiatives the HR impact is significant and must be skillfully managed.

Strategic HR Activities: Rhetoric or Reality

Most of the executives in this study defined a strategic HR activity as one that is fundamental to the execution of the business strategy and can take the organization where it needs to be in the future. However, discrepancies arose when the same executives were asked to provide examples of a strategic activity. For some, all HR activities are strategic, while for others, strategic activities go beyond the daily maintenance activities to include organizational design, business planning, labour relations, succession planning, compensation, process management, and the management of change. Simply put, being strategic is identifying opportunities and acting in a manner that will benefit the organization. For example, since Procter and Gamble has a recruit-from-within policy, recruiting is considered a strategic activity. At IBM, trying to influence the culture and instill a new way of thinking within the organization and change employee feelings of entitlement is an example of a strategic HR activity.

In general, the results of this study reveal that the HR function is not yet seen as a true strategic partner by the rest of the organization and 'in most cases, HR is still not always invited to the party.' The necessary transformation is slow, since HR has traditionally been viewed as the place where administrative work is performed. However, in some organizations

HR is viewed as an agent of change, particularly at the more senior level. According to the vice president of HR at CP Rail,

> The HR function is seen as a strategic partner by the top executives and by those departments coping with downsizing and reorganization. However, this perception of HR as a strategic partner is relatively new within the organization.

In organizations such as Avenor, which have significantly changed the HR function, the impact of a clear strategic direction for HR is being recognized by more than just the HR department. However, as stated eloquently by a vice president of HR,

> In many organizations, there is more hot air than substance. However, this is not universally the case. Good HR departments are able to contribute substantially to organization design and, on a more micro level, they are able to pull the required levers to have a substantial impact. Those who understand the concept of strategy execution grasp the role of HR.

It was the consensus of the interviewees that HR has to communicate what it does and how it contributes to the organization's goals and demonstrate its value to the line. Many HR executives also perceive that only if the HR function reports directly to the CEO can it become a true member of the executive team and achieve an equal status with the line function. In addition, as HR professionals are beginning to infiltrate the line functions, people are recognizing the capabilities and the value of the services provided by HR. For example, line functions might need help in establishing more effective work processes, and HR can introduce technologies to facilitate the change.

Still, in most organizations in the sample, the HR function is somewhat reactive. As the goals and strategies of the business are usually developed outside HR, the role of HR is to provide programs to support the business strategies. One vice president of HR commented that,

> This may not be that bad since the needs of the business with respect to HR are created out of the business not out of HR. I don't see the role of HR determining the direction of the business. However, HR must ensure that the organization has an optimal level of highly skilled and motivated employees to help it reach its objectives.

While the executives interviewed understood the concept of using people as a competitive advantage at an intellectual level, in times of crisis the actions taken by organizations often do not match this philosophy. Most organizations do not have the necessary mechanisms and procedures in place.

Changes in the HR Function

Overall, the HR function in the organizations interviewed has been transformed in some significant way. Economic pressures have forced HR to be smaller, more business-driven, and to provide value-added services. In addition, HR departments have been the target of many downsizing initiatives, and in most organizations, HR has been reduced significantly. At IBM, CN, and Avenor, the HR staff has been reduced by more than 50 percent. The reduction has resulted in the streamlining of activities, the increasing use of technology, and the outsourcing of nonstrategic activities.

Table 8 shows the total number of HR employees in the organizations interviewed and the ratios of HR staff per 100 employees, which range from 0.5 to 2.4. According to a recent survey conducted by the Bureau of National Affairs (1994, 9) in the United States, the median ratio of HR staff per 100 employees is 1.0.

Table 8 Relative Size of the HR Function

Company	Total Employees	Total HR Department	Ratio (HR staff/100 employees)
CN	25,000	300	1.2
CP	24,000	130	.5
IBM	8,000	42	.5
Dofasco	7,000	52	.7
Avenor	7,000	84	1.2
Procter & Gamble	3,000	50	1.6
Warner Lambert	1,400	34	2.4

It is interesting that HR staff levels relative to the work force (the median) have been virtually static at 1.0 for over two decades, ranging from 1.0 to 1.1 (Bureau of National Affairs 1994, 8). The BNA study also revealed that smaller firms have proportionally more HR staff because of reduced economies of scale. An earlier study by the Conference Board of Canada found a similar pattern (Benimadhu 1989, 21).

At Warner Lambert, CP Rail and Avenor, massive changes in HR were initiated by the introduction of a vice president of HR within the corporate ranks. While Warner Lambert introduced a vice president's position in 1986, CP and Avenor have had a vice president of HR only since 1992 and 1994 respectively. Before 1992, there was no HR department at CP; there was only a strong IR department and a personnel function with little strategic focus. Only recently has HR been perceived as having some critical value to the organization. At Dofasco, by contrast, the HR function reports through a senior vice president.

The Structure of the HR Function

The HR function in the companies interviewed was structured in a similar fashion. HR is generally composed of a central function at company headquarters and of HR generalists assigned to various business units across the organization to provide advice and guidance to line management. Headquarters provides the 'factory of HR services,' which may include functions such as training and succession planning, recruiting, compensation and benefits, pension administration, employee and labour relations, health and safety, legal compliance, HR policy, and organizational effectiveness. Although most HR departments provide the bulk of these services, each department is organized differently.

At CN eight different groups report to the vice president of human resources: HR generalists, training and development, HR planning, compensation and benefits management, health services, labour relations, quality and legal compliance, and official languages. At Warner Lambert, under the direction of the vice president of human resources, HR activities have been consolidated under three umbrellas: employee relations, organizational effectiveness, and HR generalists. Four positions in consumer complaints and community services also report to HR.

With the newly assigned vice president of human resources, Avenor has recently rearranged responsibilities within the HR department. The corporate HR function is responsible for strategic focus and integration (leadership development, training, succession planning), compensation and benefits design, employee and labour relations, health and safety, and HR policy and organizational development. The regions are responsible for providing input into and implementing HR policies and strategies, organizational effectiveness, career development and succession planning, and personnel services.

At Procter & Gamble, the HR department is divided into four areas: building operations, human resource information (payroll, benefits and compensation), employee relations (HR generalists in business units), and health services. All HR activities report to the director of HR. The HR department at CP is also divided into four areas: training and development, HR services, policy and planning, and organizational effectiveness. While the four areas report to the assistant vice president, the HR generalists in the three regions report to the vice president of HR.

At Dofasco, the HR department consists of compensation, claims management and occupational rehabilitation, employee relations, team development, business and HR planning, training and development, and divisional representatives. All functions report to a director of HR, who reports to the senior vice president of corporate administration. Finally, the HR department at IBM is divided into seven areas: employee relations, compensation and benefits, resources (staff resourcing and HR systems), medical services, HR operations (HR generalists providing support to line management), executive resources, and leadership development. Leadership development represents the engine of cultural change for the organization. This area also provides leadership development training for both managers and nonmanagers. All activities report to the director of HR services who reports in turn to the vice president of HR.

In three of the organizations interviewed (CN, IBM, and Procter & Gamble), the HR representatives report to the regional management they service. Prior to internal changes within the HR department, CP also had the HR groups in the regions reporting to the line functions. In the remaining six organizations, the HR representatives report centrally to corporate HR. Although most organizations provide the same HR services, they report to various different areas within the HR function. According to the interviewees, these differences may be attributable to the different business context and HR strategies in each organization.

Organizations are increasingly and actively pushing HR responsibility down to line managers. In all organizations interviewed, HR staff is assigned to the various line functions and business units to provide advice and guidance to line managers. However, the ability of HR to provide this service effectively depends on past practices. For example, as the vice president of HR at CP put it,

> The HR function has a lot of catching up to do, since it is trying to move HR from the 1940s to the 1970s. HR is a long way from institutionalizing the processes that most organizations have had in place for the past decade.

While the integration of HR within the line function is a future objective at CP, at IBM integration has been in place for the past seventy-five years. The remaining organizations interviewed fall somewhere between these two extremes.

In many organizations, the integration of HR has met with some resistance. Line managers often perceive HR as 'stepping on their turf.' However, line managers are increasingly being held accountable for HR activities and consulted in the development of policies and practices such as performance management, salary administration, and health and safety. At Dofasco, for example, to establish the credibility of HR generalists within the business units, headquarters' managers were the first representatives assigned. This move indicated that HR was committed to providing more than just administrative support, and it is believed that the acceptance of HR within the line function is largely due to the credibility of the HR staff. At Dofasco, line managers soon realized the benefits of having access to HR expertise and their attitudes swung from 'I don't need an HR representative' to 'I want an HR representative.' Avenor has recently assigned the responsibility for contract negotiations to the line function, and there is no longer a designated negotiator for the company. Each separate business must now negotiate collective agreements, and although there is still a key contact at headquarters for guidance and strategy planning, line managers have full ownership of the outcomes. Avenor is the only company interviewed that has done this, but it will be interesting to see if in the future IR responsibility is increasingly transferred to the individual business units in other organizations.

The integration of HR within business units is believed to be the model for the future. The acceptance of HR responsibility and ownership is not a choice for line managers; they must accept the changes and deal with people issues. However, as one vice president of HR warned, 'Given the choice, most line managers would be more than happy to relinquish all responsibilities back to the HR department.'

Key HR Competencies

As the function is currently transforming, the competencies required by people working within HR are changing significantly. In the traditional HR function, HR professionals were usually individuals who began in administrative positions and had twenty years of service. Simply stated, HR was seen as a place to 'park people.' This is no longer the case, since HR is becoming too important to business success. According to the executives interviewed for this study, organizations today are looking for specific skills from new HR professionals, skills that can be divided into three areas: soft skills, business skills, and HR-specific technical skills (see Table 9, which provides an aggregate list of all the interviewees' responses).

Soft Skills

Interviewees noted that HR has a unique role because, as in many staff roles, there is an absence of line authority, and consequently, the ability to build partnerships is crucial. Thus, HR personnel must possess strong communication, facilitation, and persuasion skills. Strategic 'selling' or 'influencing' is critical for the survival and growth of HR professionals because they must know how to direct their clients within their respective businesses on the solutions they have to offer. The implementation of these solutions must be conducted in a way to ensure that customers take ownership of the process and the results. According to the vice president of HR at Avenor,

> HR can no longer deliver a program to customers and expect it to fly—clients need to go through an awareness, involvement, and ownership process.

Table 9 Competencies Required by HR Professionals

Soft Skills	Business Skills	Technical Skills
Communication skills	Financial knowledge	HR administration skills
Interpersonal skills	Cross functional experience	Pension design skills
Resiliency, ability to deal with stress	Problem solving skills	Legal knowledge
Team building skills		Computer literacy
Stamina		Organizational effectiveness skills*
Versatility		Change management skills*
Influence ability		
Facilitation skills		
Project management skills		
Leadership skills		
Mentoring skills		

*These technical skills are highly valued by all organizations interviewed.

Business Skills

All the executives interviewed felt that to identify opportunities within the organization and assess the financial and organizational impact of a change, HR professionals need business acumen. Thus, cross-functional experience in line positions is a valuable asset which contributes to the credibility of the HR professional, since individuals who have spent their whole career in HR may have difficulties relating to line problems.

HR Technical Skills

Although HR staff need strong technical skills, traditional technical skills will no longer be enough. As one HR manager put it,

When HR is looking to fill new vacancies, it searches for people with strong business and interpersonal skills, since it is believed that technical skills are the easiest to acquire.

Several executives stated that clients now want their HR representatives to provide more than traditional HR services. HR generalists are now involved in facilitating processes such as the development of business strategies and operating plans; clients want more organizational effectiveness and fewer traditional HR people.

In general, the interviews revealed that HR is now required to work with managers on problems and be true participants in creating solutions to the organization's HR needs. HR professionals need to make that quantum leap from gatekeepers to change agents. This is a significant change for anyone who has worked in the old HR, which was characterized by 'rule setters.' According to one HR executive, 'This drastic shift in mindset was difficult for some of the existing HR staff since they had grown to accept their traditional role.'

As the organizations interviewed for this study have attempted to ensure that the HR department has the skills required, there has been much turnover within HR. HR has actively recruited to add much-needed depth and skills, and the remaining HR professionals have had to upgrade their skills or leave the organization.

Innovations Within HR

According to many executives, since HR is still a cost centre in most organizations, HR must be constantly looking at ways to reduce the cost of service delivery, to shed its administrative burden, and to become leaner and more focused on providing value-added services. Because the ability to quantify results brings credibility to the activities of the HR function, more and more organizations are using systems that look at measuring the 'people' outcome of policies such as retention and turnover.

Becoming leaner also implies increasingly pushing HR responsibilities to the line or to an outside supplier and expanding the role of technology within HR. Although technology has already decreased many administrative functions within the department, in the future it will have an impact on how services are delivered within the organization by creating links between all areas within HR. Sophisticated human resource information systems will no longer be a luxury. At IBM Canada the extensive use of technology has opened doors to new communication and training methods, and providing employees with personal computers has reduced the time required for the diffusion of information. For example, multi-media technology has decreased the resources required to communicate major changes, such as the introduction of flexible pay.

It is also believed that understanding the organization's core competencies and developing effective competency models will be essential for long-term survival and will provide a real strategic advantage to the organization. Thus, a database of all employee skills, experience, and availability will allow organizations to fill their critical resource needs at the right time and in the right place. With the increased focus on skill development, there is a push towards competency-based models of compensation such as skill-based pay. It is anticipated that areas of pensions and benefits will also come under close scrutiny in the future. Since the cost of these services is escalating, alternatives such as flexible benefits and pension premiums will be increasingly adopted.

The general conclusion is that the HR function will be truly innovative only when it moves beyond a service delivery model and embraces a model of organizational effectiveness that can determine what makes an organization profitable. As one vice president of HR put it:

> HR will have no choice but to increase their organizational effectiveness capabilities, as these are the critical skills which will be demanded by clients.

The following section provides a model of how one organization in this study radically changed the way HR services are being delivered. Although this example comes from the United States, it will be interesting to see in the future if this model will be adopted by organizations in Canada. What follows is based on an interview with the Director of Business Development for Workforce Solutions at IBM.

Workforce Solutions: A U.S. Example

A drastic change in the HR community took place in 1992 with the creation of Workforce Solutions at IBM in the United States. At the time, there were 2,200 employees in the HR department working in 38 different locations in the US organization. Workforce Solutions consolidated and centralized the HR services in two or three locations, took about 80 percent of the staff (1,700 employees) out of the business units, and moved the jobs into the new organization. The driving force behind Workforce Solutions was escalating costs. IBM had reached a point where something had to change: in 1991 the organization experienced the first loss in its history. Although cost-cutting was the main driver, IBM did not want to compromise the quality of HR services.

Workforce Solutions is a cost-recovery centre which bills internal IBM clients for services rendered and also provides services to external clients. Although Workforce Solutions operates much like a business, it has never been incorporated as a separate business entity. It is primarily responsible for the design and delivery of HR programs (e.g., benefits, compensation). Members of the HR staff who remain in the business units act as HR advisors/consultants and report to the general manager of the specific business units. The nature of the job in the business units has also changed significantly. Since many of the tactical and administrative tasks are no longer performed by the HR staff in these units and since many of the transactions are performed in one of the Workforce Solutions centres, HR professionals in the units can act more as business partners and advisors to the managers. It is important to note that although they are not part of Workforce Solutions, they are the key contact with the Workforce Solutions organization. They will contact Workforce Solutions if help is needed with any HR initiative.

One of the biggest changes within IBM is the extensive use of technology by Workforce Solutions. Before its creation, the use of technology in HR was inefficient. Now Workforce Solutions has its own technology staff to develop applications which are not available commercially, and technology is rated at the same proficiency level as other services provided (e.g., staffing, compensation). The implementation of Workforce Solutions has lowered the cost of delivering HR services at IBM by 56 percent. Technology has been identified as the key tool used to achieve these impressive results.

Outsourcing: An Option for the Function

Although the literature seems to indicate that outsourcing is widely used, the interviews conducted for this study revealed that this is not always the case. Some companies have embraced outsourcing as a method to ease their burden, while others are reluctant to transfer functions outside the HR department. The decision to out-source seems to be based on the perception and attitude of the head of the HR function. Table 10 provides a breakdown of HR activities currently outsourced by the organizations that participated in this study.

Table 10 Activities Outsourced

Activities	Warner Lambert	Dofasco	Proctor & Gamble	IBM	CP	CN	Avenor
Cafeteria Services	X						
Temporary Staffing	X						
Award Program	X						
Benefit Administration	X			X		Future	X
EAP	X						
Relocation Service	X			X			
Recruitment	X			X	X		
Outplacement					X		
OD/OE	X				X		
Training & Development		X*			X	Future	
Payroll				X			X
Medical Services		X*		X			
Actuarial Services			X	X			
Pension Administration				X		Future	X
Security			X				
Salary Survey				X			

* Dofasco outsources some of these services but the majority are provided in-house.

Benefits

Everyone interviewed indicated that the decision to outsource was intended to decrease operating costs (see Table 11). It was believed that an outside vendor can achieve economies of scale and deliver a product at a lower price, that the vendor's investment and specialized capabilities may be too expensive to develop internally, and that in some circumstances the quality of the service provided may be higher.

Interviewees believed that vendors can develop such a depth of expertise that it is unlikely any organization can attain their efficiency level, since the activity is not part of the core expertise of the organization.

At IBM, outsourcing administrative functions has allowed better cost management. If a service is performed internally, HR is expected to make minor changes to accommodate individual preferences. But when an outside supplier is used, minor changes are associated with high costs. Thus IBM and other organizations have been forced to assess the real costs and benefits of any changes desired, to recognize the explicit cost of trying to build too much complexity into their business and to do some implicit benchmarking, since the vendor may be quick to reveal that out of all its clients, the organization is the only one that insists on making those changes in the service.

Table 11 Perceived Benefits of Outsourcing

Perceived Benefits	Percentage of Respondents
Decrease in cost of service delivery	100
Increase in quality of service	55
Decrease in workload	44
Ability to concentrate on strategic activities	33
Access to high levels of technical expertise	33
Increase in management flexibility	22
Ability to reengineer the function	22

Organizations should take a long-term view of potential cost savings, since in some cases the savings will not occur until the third or fourth year of the contract. Although the interviewees believed that outsourcing will lower the cost of service delivery, several were skeptical about the actual savings, and, in general, it is still unclear if a cost advantage really does exist. In fact, higher costs were considered a real risk by some informants. For example, when investigating the possibility of outsourcing payroll and benefits administration, three organizations found that the services could be provided internally more cost effectively, and they have kept these functions in-house. However, as three executives noted:

> The decision to outsource should not be based solely on cost; it should be a strategic decision. Simply stated, the HR department needs to shed its administration burden so that HR professionals can start focusing on where the organization is heading in the future.

At Avenor, the design of the new compensation and benefits plan for all nonunion employees (approximately 900) was a massive undertaking since it consolidated employees previously covered under several different plans. The vice president of HR believes that this could not have been accomplished if the HR department had still been tied with the burden of the administration of the pension, payroll, and benefit plan. Avenor provides a concrete example of how outsourcing creates an opportunity to gain the maximum return on investment in internal resources: individuals within the organization are able to concentrate on what they do best and what adds the greatest value to the organization.

Increased management flexibility was also mentioned as a benefit of outsourcing a function. HR would be able to 'turn it off' like a tap, with few repercussions. One interviewee made this

point when referring to the training function. The interviews also revealed that outsourcing provides the opportunity to reengineer the function. One HR professional argued that

> Trying to reengineer the function without outsourcing would not be possible, since in many cases, people do not have the competencies and skills required to understand the reasons behind the new processes.

Organizational Risks

Not surprisingly, the most commonly cited risk of outsourcing was the loss of management control when certain functions are transferred to an external vendor (see Table 12). Organizations need, in fact, to maintain a degree of internal expertise to manage outsourcing contracts effectively. As we have seen, becoming too dependent on a specific vendor can cause major problems if the vendor makes mistakes or has a higher cost structure. However, it is believed that this problem can be minimized by going through a competitive bid process when contracts come up for renewal.

Table 12 Perceived Risks of Outsourcing

Perceived Risks	Percentage of Respondents
Decreased management control	67
Culture clash between two organizations	44
Decreased service quality	44
Increased cost of service delivery	33
Decreased employee contact	33
Loss of unique capabilities	33
Increased dependence on supplier	22

Since the vendor is now responsible for managing aspects of the business, there is a risk of culture clash between the two contracting parties. Organizations must therefore ensure that suppliers will support their corporate values, standards, and beliefs. Should the supplier not fully understand the overall strategy of the organization, clients such as line managers may receive conflicting messages.

As mentioned already, in many instances, the organization will experience a loss of productivity and low employee morale during the transition and after implementation. As one HR director put it, 'many clients still equate outsourcing with job loss.' Outsourcing will obviously affect internal employment, but as another HR executive pointed out,

> Job loss is not always necessary, since outsourcing may provide a better way to deliver services and allow the staff to concentrate on the firm's core competencies.

Are There HR Activities That Should Not Be Outsourced?

It is possible for an organization to outsource all HR activities, although a small corporate staff responsible for contract management would have to remain in place. However, judging from the interviews conducted for this study, moving all HR activities to a third party seems unlikely in the near future. One vice president of HR felt that

Although most functions could be outsourced, the question remains whether it is logical and desirable for the organization. One must also look at the role of the HR function within the organization. For example, if HR is a traditional function that provides activities such as hiring, firing, employment records, and training, it may be that the entire function could be contracted out. However, if the HR function is a strategic partner in large change management projects, this capability must stay within the organization to permit it to fully understand the implications of the initiatives suggested.

Another HR manager argued that

If organizations believe that people are an important asset, they should not out-source core HR activities that have a direct impact on the business strategy. Overall, outsourcing should be directed towards transactional and administrative processes. It is only organizations who have 'personnel' departments that are transaction-oriented and do not play a significant role in executive decisions who could outsource the whole function.

What HR considers to be a strategic service will have an impact on what it is willing to outsource. Some examples of HR activities not considered beneficial to outsource are

- The coordination of the skills inventory, since capital is now considered a key strategic asset.

- Activities requiring daily dealings with employees. In many situations, such as the firing of employees, line managers want an HR professional to help them through the process. Although, some organizations are outsourcing this type of advice and counselling role, the executives in this study believed that keeping this capability inside might be better for the organization in the long run.

- Recruiting, which is sometimes outsourced. It is feared that if recruiting is out-sourced, the organization will lose touch with the potential candidates; rapport between the candidate and the organization cannot be effectively developed; and the organization will not be able to attract the best candidates most suited to their organizational culture.

- There is also reluctance to outsource all of compensation, because it is such an integral part of the organization and represents such a large percentage of the overall costs. Organizations need the internal expertise to understand fully the impact of policy. Although compensation could be turned over to the finance department, the separation of duties between finance and HR works well: one is responsible for the well-being of the organization; the other, for the well-being of individuals. Simply stated, employee perceptions of fairness may be obscured if the finance department is determining the pay structure.

Finally, it is believed that organizations should not outsource the entire HR function, since they might lose the 'glue' that shapes the organizational culture and values. Although some organizations can operate without HR departments, they are usually small or have developed very sophisticated HR processes. In these organizations, line management accepts much of the HR responsibility and has the capability to manage the processes. But, they still need a company 'conscience' and an advocate for the employees.

Conclusion

The data collected through the interviews in this study reveal that the HR function is indeed changing, as the literature suggests. As it moves from a transaction-based and administrative function, HR is taking on a more strategic role. As the interviews indicated, making these changes is an uphill battle, since HR is often confronted with skepticism when implementing new policies and practices. Even though there is still a gap between the current HR function and the desired 'future state' of the theoretical model, environmental and business factors such as the aging work force, the potential skills shortage, and the present economic climate are facilitating the transition.

Although not all HR functions in the organizations interviewed were changing at the same pace, there were some commonalities across the board:

- As HR is forced to do more with less, it is streamlining, automating, or eliminating administrative processes and is increasingly pushing HR responsibility to the line. Increasingly, line management is being held accountable for HR activities such as recruiting and performance management. Although HR is still available to provide guidance and advice, line managers now have the final responsibility for some HR decisions impacting their employees.

- The competencies required by HR professionals are changing; gone are the days when HR can dictate the rules and policies and expect them to fly. HR staff must now form alliances with line managers and involve them in the development of HR practices. HR professionals must now be conversant with change management practices, organizational effectiveness, and other new methodologies. In addition, HR must have an in-depth understanding of the business. Thus, cross-functional experience is becoming a valuable asset to the HR professional. Nevertheless, HR must remain knowledgeable in the field of HR and have the expertise to deliver the 'factory of HR services.'

- Many respondents in this study believed outsourcing was the wave of the future for HR. Overall, the respondents felt that although some managers may resist the idea at first, they may not have any choice as HR continues to be under pressure to reduce costs and increase service levels. One HR executive felt that

    > Outsourcing is the wave of the future because it allows organizations to concentrate on their core competencies. It will become acceptable as a model . . . and in many major decisions, management can no longer ignore this issue. They must acknowledge outsourcing as an option. This has changed from three years ago.

However, skepticism was also raised regarding the long-term benefits of outsourcing. Cost savings are not always realized, and HR risks losing control of some important management functions. Therefore, in making the decision, HR must seriously evaluate both the benefits and risks and determine whether outsourcing a few or many functions is a good strategic decision.

Although the data collected from the interviews provides a snapshot of how the HR function in large Canadian organizations is adapting to today's economic and business realities, it is important to note that these organizations do not represent a random sample. Simply put, the data represent the views of nine executives in eight organizations. For more conclusive results, further research is needed. Furthermore, while the HR executives interviewed provided valuable insights, their views are the views of HR managers—which may, of course, be significantly different from the views of a CEO or a line manager.

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