

Vertical Integration of Human Resource Organizations

EVIDENCE FOR AN INTEGRATED HR MODEL FOR FINANCIAL SERVICES AND THE CROSS INDUSTRY SECTOR IN GERMANY, AUSTRIA, AND SWITZERLAND.

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Growing Market for HR Services

The decrease of vertical integration of HR organizations – in other words the outsourcing of HR services – seems to be a growing trend. The research company IDC estimates the HR services market worldwide to be USD 64,499 million in 2003 and projects it to grow to USD 104,684 million by 2008 (GAGR of 10.2 percent). Or – in other words – the HR outsourcing market is considerably large and is expected to grow at a low double digit growth rate. This impression of HR outsourcing as a major trend is further supported by the announcements of large deals in the past. The three largest announced HR outsourcing contracts for example are totaling USD 3,450 million in contract value to their service providers over the next ten years.

Research Framework

The basis of this paper is formed by the results of a detailed survey (more than 320 data points), analyzing structures, processes, and sourcing-practices of Human Resources departments. We analyzed companies in Austria, Germany, and Switzerland. We retrieved 42 analyzable que-

stionnaires, an acceptable return rate of 8.4 percent. 13 companies belong to the Financial Services sector and 29 companies belong to the Cross Industry sector. Our study aims to analyze structures and processes of tomorrow's HR organizations and the factors that determine the level of vertical integration using a standardized well-proven HR model (see Figure 1). The model uses an employee life-cycle approach and differentiates between eight HR activities or sub-processes.

Data Sample

The average number of total company staff is 15,203 full time equivalents (FTE). The HR organizations employed 107 FTE (average); on average 6 FTE act in a manager role within the HR organization. The HR budget averages EUR 26.5 million. The total assets of the analyzed companies average EUR 74.5 billion. The Return-on-Equity (RoE) of the analyzed companies averages 1.13 percent, with a median value of 10.85 percent. The role of the interview-partner within the HR organization is either first (C-level) or second management level of the HR organization.

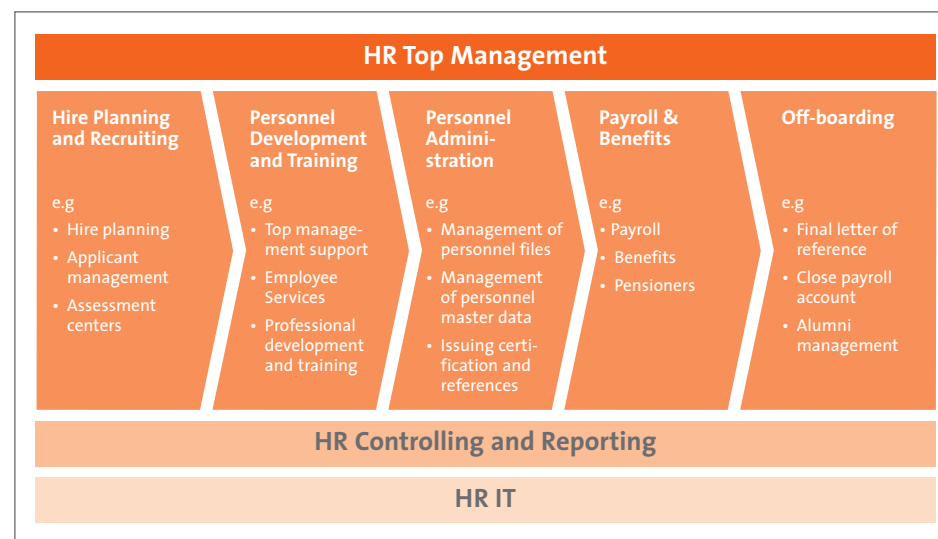


Figure 1: HR process model

Findings

High Vertical Integration

The participants categorized the degree of vertical integration of each HR process on a five-point-scale. The activity with the lowest vertical integration is 'Personnel Development and Training' (3.61), followed by 'HR IT' (3.83) and 'Payroll & Benefits' (4.33), the activities with the highest vertical integration are 'HR Top Management' (4.93) and 'HR Controlling and Reporting' (4.88), followed by 'Off-boarding' (4.83). The range between 3.61 and 4.93 indicates a considerable proportion of in-house production. Additionally, the results show that the companies from the Financial Services sector generally display lower means for vertical integration for all eight sub-processes compared to the companies from the Cross Industry sector. Further, for all activities the res-

pondents perceive their own level of vertical integration as higher than the industry average.

Performance Gap

The participants of the survey also categorized the performance (with respect to process efficiency and quality) of their HR organization and compare it against the perceived industry average and third party providers. The majority of the respondents believe that the capabilities of their own HR department are "very good" or "good" (average 3.96). The own performance is perceived as being much better than the industry average (average 3.50) or the performance of third party providers (average 3.41). The processes with the highest in-house performance are 'HR Top Management' (4.26) and 'Payroll & Benefits' (4.29), followed by

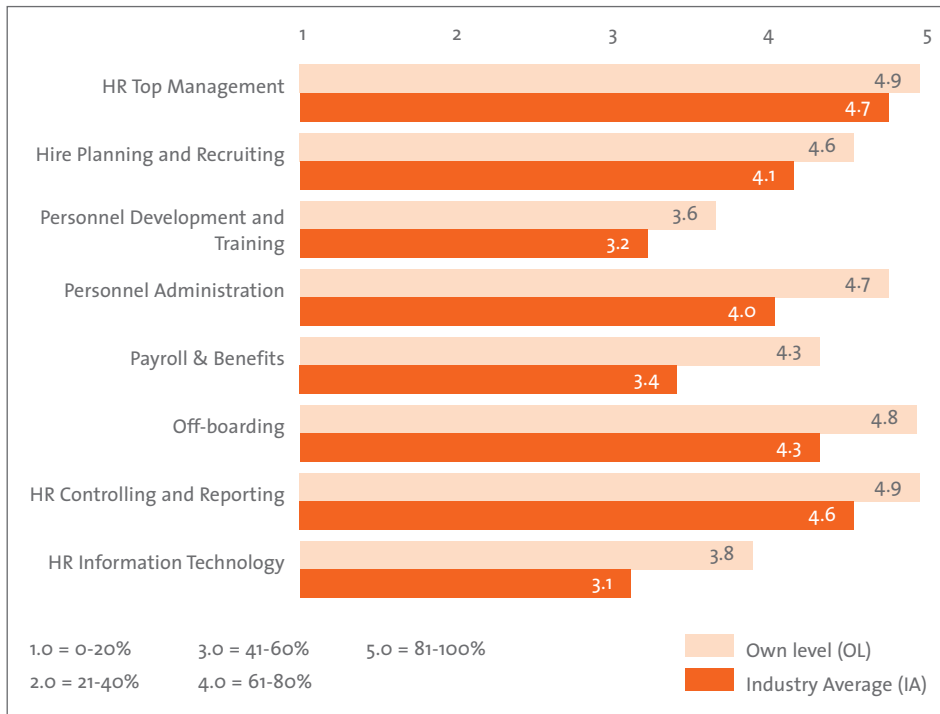


Figure 2: Vertical integration of HR process and perceived industry average

'Off-boarding' (4.17). The processes with the lowest in-house performance are 'HR Controlling and Reporting' (3.52), 'HR IT' (3.64) and 'Personnel Development and Training' (3.86). The high extent of in-house production seems justifiable by the perceived higher performance of the own HR organization. Respondents of the survey believe that their own organizational level of HR capabilities is outperforming the industry average as well as the services offered by external providers across all eight sub-processes. The activities with the highest performance gaps are 'Off-

boarding' (difference of 0.71 to industry average, difference of 0.84 to external service providers), 'HR Top Management' (difference of 0.54 to industry average, difference of 0.81 to external service providers'), and interestingly 'Payroll & Benefits' an activity that is deemed to be the major commodity process in human resources (difference of 0.49 to industry average, difference of 0.67 to external service providers). In general cross industry companies rate their own performance slightly higher than financial service providers.

Main Challenges

Despite the positive attitude toward the own capabilities most HR organizations face a high pressure to become more effective and – even more important – increase efficiency (85 per-

cent of all financial services companies and 79 percent of all cross industry firms stated a high pressure for change and rationalization). The efficiency potential seems to be high, because the portfolio of modern HR concepts is

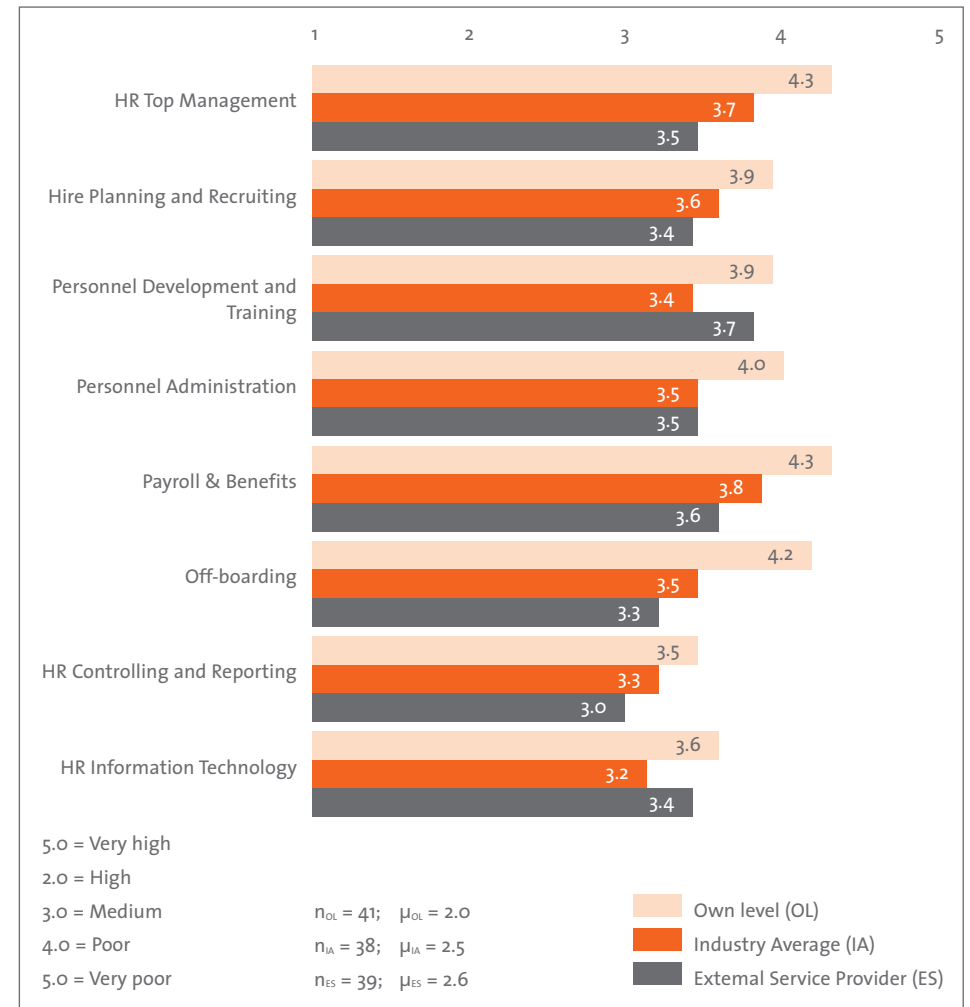


Figure 3: Process efficiency and quality – own processes, perceived industry average, and external providers

currently not utilized to its full potential. Indicators found in our analysis for this potential are (1) the low degree of process automation, (2) the low degree of process standardization, (3) limited use of employee and manager self services, (4) limited use of call center technologies, (5) limited use of modern management concepts, (6) limited use of service level agreements, and (7) limited integration of HR in the strategic decision-making.

Low degree of process automation – The proportion of manual work (in comparison to automated processing) is relatively high across all activities. On a five-point-scale with “1” representing a “very low” and “5” a “very high” proportion of manual work, the activities with the highest degree of automation are ‘Payroll & Benefits’ (2.20), ‘HR IT’ (2.69) and ‘HR Controlling and Reporting’ (2.81). The activities with the lowest degree of automation are ‘HR Top Management’ (4.19), ‘Off-boarding’ (3.90) and ‘Personnel Development and Training’ (3.52).

Low degree of process standardization – One reason for the relatively low degree of automation could be the poor level of standardization across all HR activities. On a five-point-scale with “1” representing a “very low” and “5” a “very high” level of standardization, the respondents state an average value of 3.30. Even services that should be relatively easy to harmonize have a rather low level of standardization: ‘Personnel Development and Training’ (3.19), ‘HR Controlling and Reporting’ (3.24), and ‘Hire Planning and Recruiting’ (3.31).

Limited use of employee and manager self services – Only a quarter of the HR organizations use Employee Self Services or Manager Self Services within their HR portal (24 percent, respectively 26 percent). In general most respondents stated that they currently use their HR portal to post static information (e.g., FAQs, HR policies) instead of offering transactional services

Limited use of call center technologies – Using a call center as a single point of contact can significantly increase the efficiency of an HR organization, but only 15 percent of all financial service providers respectively 17 percent of all cross industry firms have implemented such a technology to provide their HR services.

Limited use of modern management concepts (e.g. Balanced Scorecard) – The majority of all financial service providers (77 percent) does not use a Balanced Scorecard (or a comparable method) to manage their organization. Within the cross industry group this proportion is lower (54 percent), but still leaves enough potential for improvement. In addition nearly half of all respondents (40 percent) acknowledged that their organizations do not have any key performance indicators defined that could be reported regularly.

Limited use of service level agreements – Roughly two third of all companies (62 percent) do not use formal service level agreements between their HR department and the various business units of their company.

Organizations that do have such service level agreements (33 percent) often lack a formal process to align these contracts with the changing economic environment and business requirements (55 percent). Consequently, not even half of the respondents (48 percent) are satisfied with the quality (i.e., completeness, accuracy, and timeliness) of their service level agreements.

Limited integration of HR in the strategic decision-making – Still many HR organizations see their current focus not on strategic but on administrative tasks (38 percent). The comparison of the two industry groups reveals considerable differences: Financial service providers seem to have a stronger strategic focus (23 percent believe their focus is of administrative nature) than cross industry companies (45 percent believe their focus is of administrative nature). Nevertheless companies expect from their HR organization strategic support, 64 percent of all companies integrate HR in the strategic decision-making of their organizations.

Barriers for transformational change

Decision-makers seem to be unsatisfied with the current allocation of resources regarding the services provided by their HR organization. Still too many HR professionals are occupied by administrative, low value-adding tasks. If this should be changed in the future, HR must restructure its organizational setup. But exactly this change could prove to be very difficult for most HR departments.

Low discretionary spend – The majority of the HR organizations (80 percent) spend only 0 to 10 percent of its budget on discretionary investments. In other words over 90 percent of the total budget is spend to operate the HR department as is.

Skill gap of current HR workforce – Most of the HR workforce is occupied by administrative tasks and can not be allocated for large transformation projects.

Limited willingness to outsource – While today’s HR organizations accept the use of external service providers in nearly all processes, the scope of its usage is still limited. This could change in the near future, at least for specific processes (i.e., ‘Payroll & Benefits’, ‘Personnel Administration’, and ‘HR IT’). Nevertheless it seems that the magnitude of outsourcing needs to be increased significantly in order to facilitate substantial change.

Summary

It seems that even if HR top decision-makers are satisfied with the progress and performance achieved so far, they acknowledge that the environmental changes (e.g., regulatory changes, business unit demands) are forcing them to transform their organization on a larger scale. Many HR organizations seem to be ill-equipped for this transformational change. External service providers could be a viable solution to address some of the shortcomings in a cost and time effective way.