

## What The Leader Needs To Know: Competitive Issues For The HRO Provider

Leo F. Flanagan, Jr., Ph.D.

A Service Of Flanagan Consultants, LLC

October 2004

### The Opportunity

This article is focused on the challenges faced by the leaders of Human Resources Outsourcing (HRO) providers.

According to Gartner<sup>1</sup>, the HRO market should top \$51B by the end of 2004. A compound annual growth rate of 12% is predicted for the next 3 to 4 years. It's an attractive market but one with particular risks.

Our review of HRO identified risks to HRO providers. The list is not exhaustive and not all will face all these risks. Still it's prudent to reflect on them if you're a leader of an HRO provider.

#### 1. Cost Reduction: The Basic Proposition

The clear number one reason for a company to outsource HR is to reduce costs<sup>2</sup>. Improved service is a distant second. There are two major problems with cost-reduction being the core proposition of HRO. First, many HRO providers are "stalking elephants". The high end of the market is seen as the most desirable. Here are some problems with this:

- Negotiating power – the telcos learned the hard way that big business accounts wield their power and crush margins.
- Transfer of infrastructure and employees is a core part of the deal with big accounts. Your margins rely on greater efficiency. Efficiency creates excess capacity. What do you do with it when clients expect you to pick up their resources?
- Low frequency – big deals equal long sales cycles. According to Business Week (October 4<sup>th</sup>, 2004) JPMorganChase's canceling of their BPO contract with IBM is going to make client's more skittish; likely driving even longer sales cycles.

Second, a focus on cost-reduction increases the next two problems.

#### 2. Low Cross-Selling

Prior to being acquired by Hewitt, Exult had difficulty selling additional, higher margin services<sup>3</sup>. If I brought you in to save money why are you asking for more?

#### 3. Commoditization

Recently of 70 HRO providers only 5 enjoyed consistent name recognition<sup>4</sup>. Two of those (including Exult) have been acquired since. There is no brand leader. Absent strong brands and focusing on cost-reduction this industry's margins will erode.

#### 4. A Talent Gap

A leading HR authority<sup>5</sup> recently found most HR professionals lack business acumen and skills. If you acquire these people in your deals – your talent pool may not be adequate to run an efficient business.

#### 5. Poor Execution

The selection, negotiating and transition processes are uniformly viewed by clients as chaotic and frustrating. Clients and experts consistently recommend the retaining of an HRO consultant to address this issue<sup>6</sup>.

### How To Leverage It

Here is what you need to successfully build an HRO provider.

#### 1. Change The Basic Proposition

Your offer should include the ability to directly accelerate your client's business results. That is not just saving expenses. The focus should be on providing concrete means to exceed solid financial measures. It's been proven that this is possible<sup>7</sup>. Repositioning your HRO business to deliver "profit maximization" would address the problems of commoditization and difficulty in cross-selling higher value services. Clients are unlikely to spend more to save more – but will spend more to make more. Imagine if your brand stood for "Using HR to maximize profit". A focus on such a hard financial measure has been suggested as what will make HR a truly strategic function<sup>8</sup>.

Short and long-term success in HRO can't be achieved on the current playing field with the current play book. In a competitive market the winner is often the one who changes the rules. Why not be the winner?

#### 2. Consider The Middle Market

Here's just a few reasons why you might want to focus on a market that consists of as many as 75 million employees – just in the US.

- Shorter sales cycles – you are more likely going to be able to deal directly with the decision-maker and they haven't got time to drag this out.
- Outstanding service – your platform and people are well beyond the scope and quality of what many middle market companies can or will invest in. There is real opportunity to outperform previous service levels.
- Utilizing capacity – particularly if you focus on growth companies in the middle market. They'll have a genuine need for the capacity that you've acquired from your larger clients.
- Less competition – your competitors are going after the "elephants". Let them fight it out for long-term, lower margin deals.
- Shorter contracts – a 10-year deal for a service you haven't perfected is high risk. An annual contract or a two-year deal should be much safer, with higher margins and generally more attractive to both provider and client.
- Partnership – is a more realistic possibility when your clients are "...not big enough to have teams dedicated to squeezing vendors or to employ sourcing advisors..."<sup>9</sup>

#### 3. Build Your Talent

If your talent consists predominately of HR professionals you've acquired from your clients why should they expect superior results? Especially

since HRO is a greater challenge than HR. HRO professionals have to manage client relationships, understand the client's business, manage a P&L, market, sell and do it all with greater efficiency than HR organizations that don't have these additional responsibilities.

Here are some investments you might consider.

- **Senior/Cross-functional Business Development Teams**  
 Consider teams of senior people with breadth and depth in the following areas: marketing & sales; customer service; relationship management; finance; operations; IT; and, of course, HR. This is a tall order. However, only senior, high caliber talent across these areas can quickly win contracts and efficiently and effectively handle the transition. Investments here will be well returned in improved close rates, cycle times and market reputation.
- **General Management**  
 The senior executive responsible for HRO engagements on an on-going basis needs to be a competent, seasoned general manager. They are responsible for running a business that delivers HR services – not for running an HR function. A critical distinction in selecting and developing talent. Many providers put senior consultants or HR executives into these roles. The competency set is not a fit.
- **Core HR Professional Competencies**  
 In addition to HR areas, your HR professionals should be competent in: understanding and aligning with the client's business strategy; influence; organizational change; and consulting.
- **Universal Customer Service Learning**  
 There is tremendous value in every member of your organization knowing what you promise to your clients and how to deliver against expectations on a consistent, reliable basis. Great damage is done by well meaning employees not skilled in this area.

#### 4. **Perfect Transition**

Make your company easy to do business with. Right now no one is perceived as getting transition right. Here's your opportunity: Be so exceptional at transition that you provide value from the moment your team introduces themselves to a prospect. For example, provide prospects with a framework for establishing the current real costs and real returns on their HR function. Go further and be able to provide them with hard dollar costs and returns – not estimates with disclaimers like "...estimates are based on our experience and the best available information..." Be so good at it that your team can do it quickly, flawlessly and for free.

In a situation where the prospect has employed a "sourcing consultant", provide outstanding value that surpasses the expectations of both the consultant and the prospect; "Here's the information you requested and three other analyses we thought would be helpful."

Be great negotiators. Have 3 – 4 solid frameworks that offer true win-win solutions. Know what you will and won't consider – and why - before you start. Be masters at plain language. This new industry is replete

with stories of transitions being stopped cold because providers and clients disagree on what was agreed to. Take lessons from retail when you are actually switching over from the client's platform to yours. When Home Depot or Lowe's opens a new store it's done against uncompromising standards, a hard timeline and with great speed. HRO transfers often feel and look like they are being made up as they go along. Resentment on both sides builds as costs and timelines continue to grow.

If you invest in these four areas you can begin building a premium brand, capturing market share and building margins.

<sup>1</sup> (2004) Lawler, Ed. E. III. HR on Top.

*Strategy+business* (35)

<sup>2</sup> (2004) Gartner. Outsourcing HR Business Processes: Key Trends and Success Factors. In: *Successful IT Outsourcing: Strategies, Tactics and Management Approaches*. Gartner Executive Report Series.

<sup>3</sup> (2003) Zimmerman, E. Exult's CEO, Now Turning a Profit Transitions to the Next Stage. *Workforce*

<sup>4</sup> (2004) Crespin, R.J. & Flom, B. The Battle of The Brands. *HRO Today Magazine*.

<sup>5</sup> See note 1, above.

<sup>6</sup> (2004) Dennison, Timothy. HR Outsourcing: *Conference Board Research Report R-1347-04-RR*

<sup>7</sup> (2002) Fields, Gary S. In There or Up Front? : An Introduction to Bottom-Line Human Resource Management. *Working Paper 02-07, Center for Advanced h\HR Studies, Cornell University*.

(1997) Huselid, M., Jackson, S., Schuler, R. Technical Strategic HR Management Effectiveness As Determinants Of Firm Performance. *Academy of Management Journal* (40:1), pp. 171 – 188.

<sup>8</sup> See Fields in note 7 above.

<sup>9</sup> (2004) Mehl, R. Follow The Money: Middle Market HRO. *HRO Today Magazine*.

#### About The Author

**Leo F. Flanagan, Jr., Ph.D.** is President of Flanagan Consultants, LLC. He has over 25 years experience in improving strategy execution across global industries. Flanagan Consultants, LLC helps leading companies formulate and execute their business, marketing and human resources strategies. They pride themselves not on providing advice rather on partnering with clients to rapidly achieve breakthrough results in business performance. Clients include leaders in financial services, technology, hospitality, pharmaceuticals, consumer products, government, and retailing. Leo can be reached directly at 203-321-8423 or [Leo@FlanaganConsultants.com](mailto:Leo@FlanaganConsultants.com). He welcomes your questions, thoughts and reactions.