

## HR Outsourcing is a Disruptive Innovation

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*Discuss the reaction of the organization's Human Resources department about innovations in business process or technologies.*

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Many managers will be familiar with Clayton's Christensen's theory of disruptive innovation described in *The Innovator's Dilemma*. The crux of the argument is that innovations in technology or business processes are often ignored by established companies because the market is too small, the innovation doesn't fit their business model, and it doesn't match their values. As a result, upstart competitors come in, get established and ultimately can take over a market.

I recently spoke to Erik Roth and Scott Anthony, co-authors of Dr. Christensen's latest book *Seeing What's Next*. We debated whether HR outsourcing vendors would have success as a disruptive competitor taking work away from HR departments.

The quick answer is, "Yes, it is disruptive and it will succeed." For one thing the employees who are HR customers are, to use Christensen's word, "overshot" by HR administrative services. That means the service HR offers is better than it really needs to be. HR departments are on-site, they know the company, customers can see them face-to-face, and they can customize administrative services to

the particular organization. These are nice-to-have, but not worth paying for. All that managers and employees really need for HR administration is an on-line system and access to a call centre. That is exactly what the outsourcing vendors are providing and as a result can provide a cheaper product that is good enough.

Secondly, the outsourcers have an advantage over individual HR departments in that they can get economies of scale by providing HR for many different companies. This is particularly relevant now that HR software has become so expensive.

Finally, HR leaders are not particularly interested in administration. They won't work hard to defend that part of the department against competition from outsourcers. They'd rather devote their attention to strategic HR.

This leads me to think that HR outsourcers will be successful in taking over a wide range of administrative tasks from HR departments. There are however two areas where it could come unstuck.

One area where outsourcers won't do well is where there is a need for customization. Outsourcing works best when the services being offered are standard. If a firm needs something unique then an internal HR department may be the best way to deliver it. But USC's Ed Lawler, whom I also spoke to about this, feels that you don't get competitive advantage from the administrative side of HR. It just needs to be cheap and reliable, something outsourcers can do well.

interested in providing outsourcing to extremely large firms. However, in a decade or so outsourcing is likely to affect many in-house HR departments.

HR managers who are good at the strategic HR, business partnership or organizational development will not be greatly affected. HR managers who are skilled at the administrative side should look for a career with the outsourcing firms rather than in an HR department.

**“HR departments ought to prepare for the time when outsourcers take over the administrative side of their business.”**

The other way outsourcing can get unstuck is in "invisible linkages". For example, if you really need to know what's going on in production to deliver HR administration then an outside provider will have a hard time being sufficiently in-the-know. Frankly, I don't think that invisible linkages will hurt the big outsourcers which provide an integrated set of HR services. Invisible linkages are more likely to be a problem for niche outsourcers such as people handling only performance management or only compensation. It is quite possible that linkages between compensation, performance management, succession planning and so on will make it difficult for a vendor to take on a single one of these areas.

What this means for HR departments is that they ought to prepare for the time when outsourcers take over the administrative side of their business. This will take some time, so far the leaders like Exult/Hewitt are only

It's interesting to speculate what happens once the outsourcers comfortably establish themselves on the administrative side. They will certainly attempt to move up-market offering more strategic, value-added services. There are a lot of areas where this will fail. An in-house HR team embedded in the specifics of the business will outperform anything a third party outsourcer will provide. However, there are probably areas we think of as being unique to the firm that may be susceptible to mass production. For example, it may be that staffing—an area where there already is a lot of outsourcing—can be done as a generic process. Similarly, I believe that by and large compensation can be standardized, and hence outsourcers could potentially take over essentially the entire compensation function, including setting up pay grades, merit schemes and tracking pay relative to the market.

Predictions about how an industry will unfold are always risky. However, Christensen's frameworks provide us with a useful way of thinking about the forces at work. HR managers would do well not just to read Christensen's books, but to take the time to ask, "What does this mean for HR?"

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**David Creelman** is a contributor editor to TerraForum Consultores.

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