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# Outsourcing and Human Resource Management

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# Outsourcing and Human Resource Management

**Abstract**
[Excerpt] Historically, outsourcing has always existed, as firms put out work to suppliers, contractors, and intermediaries to organize the production of goods and services (Doellgast and Gospel 2011). In recent years, however, outsourcing has increased in both scale (the volume of outsourcing) and scope (the number of activities outsourced). This has several related causes. First, the advent of new transportation systems, such as the growth of maritime, rail, and road logistics and the advent of new information and communications technologies (ICTs) have facilitated ordering, monitoring, and delivery of products and services. Second, as markets have extended and become more competitive, firms increasingly seek to save costs through focusing on their core value-maximizing activities, handing other activities over to suppliers. Third, the relaxation of trade barriers, emergence of new markets, and expansion of a more highly skilled labor force in Asia have increased the ease and cost savings of outsourcing to these regions. Fourth, in the public sector, organizations have been prompted by politicians to look to outsourcing as a way of cutting costs and introducing greater flexibilities. Finally, management fashion has played an important role in popularizing production and service models, as firms watch and imitate their competitors (IMF 2007; OECD 2007ab).

These trends have a number of implications for the management of human resources across firms' increasingly diverse (and often international) procurement and supply chains. Managers face choices concerning how to help employees adjust during worker transfer or downsizing following the decision to outsource work. Networked relationships across core firms and their subcontractors introduce new demands, in terms of resources and monitoring, as firms seek to coordinate practices and incentives across organizations. In addition, the human resource management (HRM) function itself is increasingly being outsourced to specialist organizations, often involving substantial restructuring and rationalization.

We first provide background on outsourcing trends and then discuss the HRM issues and choices associated with outsourcing. Throughout, we examine the ways in which national institutions affect the costs and benefits of different strategic choices by firms, as well as the particular challenges multinationals face as they seek to manage outsourcing contracts across national borders. We show that outsourcing is both driven by and used to facilitate globalization. However, outsourcing strategies and their impact on different stakeholder groups continue to be embedded in distinct national settings.

**Keywords**
call centers, Germany, outsourcing, telecommunications, trade unions, USA, works councils

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# Outsourcing and Human Resource Management

Virginia Doellgast

Howard Gospel

## Introduction

Historically, outsourcing has always existed, as firms put out work to suppliers, contractors, and intermediaries to organise the production of goods and services (Doellgast and Gospel 2011).* In recent years, however, outsourcing has increased in both scale (the volume of outsourcing) and scope (the number of activities outsourced). This has several related causes. First, the advent of new transportation systems, such as the growth of maritime, rail, and road logistics and the advent of new information and communications technologies (ICTs) have facilitated ordering, monitoring, and delivery of products and services. Second, as markets have extended and become more competitive, firms increasingly seek to save costs through focusing on their core value-maximising activities, handing other activities over to suppliers. Third, the relaxation of trade barriers, emergence of new markets, and expansion of a more highly skilled labour force in Asia have increased the ease and cost savings of outsourcing to these regions. Fourth, in the public sector, organisations have been prompted by politicians to look to outsourcing as a way of cutting costs and introducing greater flexibilities. Finally, management fashion has played an important role in popularising production and service models, as firms watch and imitate their competitors (IMF 2007; OECD 2007ab).

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*This chapter draws on and updates Doellgast, V. and Gospel, H. 2011: 'Outsourcing and International HRM' in T. Edwards and C. Rees *International Human Resource Management*, Harlow: Pearson. We would like to thank the previous two editors and Pearson.

and their subcontractors introduce new demands, in terms of resources and monitoring, as firms seek to coordinate practices and incentives across organisations. In addition, the human resource management (HRM) function itself is increasingly being outsourced to specialist organisations, often involving substantial restructuring and rationalisation.

We first provide background on outsourcing trends and then discuss the HRM issues and choices associated with outsourcing. Throughout, we examine the ways in which national institutions affect the costs and benefits of different strategic choices by firms, as well as the particular challenges multinationals face as they seek to manage outsourcing contracts across national borders. We show that outsourcing is both driven by and used to facilitate globalisation. However, outsourcing strategies and their impact on different stakeholder groups continue to be embedded in distinct national settings.

**Understanding Outsourcing and Related Activities**

There are several dimensions to the outsourcing of activities by an organisation. Here we consider the process, what may be outsourced, and to whom and where the outsourcing may take place. First, there is a decision as to whether or not to outsource. We deal with this below, but here we state that this involves a calculation of relative benefits and costs. Benefits may involve the ability to secure inputs more cheaply, to access new technologies, and to concentrate on core activities. It may also provide the opportunity to get around certain labour problems e.g. involving difficult trade union situations. Costs involve searching for a supplier, negotiating a deal, and then monitoring and enforcing that deal. It may be difficult and risky coordinating such activities and may potentially lead to a loss of control and ‘hold up by the supplier or provider. In these latter circumstances, it has also sometimes happened that firms which have outsourced decide later to bring activities back in-house again — or insource.

Second, outsourcing involves the decision to *carry out certain activities inside or outside the boundaries of the firm*. Economists have described this as the use of the ‘visible hand of management or the ‘invisible hand of the market, representing a choice between internal or external methods of coordination. They have also seen it in terms of ‘make or ‘buy’ decisions, or the decision either to make or do something oneself or to buy it in from others (Coase 1937; Williamson 1975). More recently, scholars have begun to refer to the ‘vanishing hand, as once highly integrated businesses and organisations are reducing coordination via internal mechanisms and are increasing coordination via market mechanisms (Langlois 2003). In practice, firms typically use a combination of internal and external arrangements, shifting the balance between in-house and outsourced production over time. In addition, some activities may lie in an area between the firm and the market — for example, where a company contracts with a supplier or subcontractor that it partly owns, or with an association of which it is a member. This first aspect of outsourcing can be seen in terms of a simple horizontal spectrum from *internal* to *external*, or *insourcing* to *outsourcing*.

Third, firms face decisions concerning *what to outsource*. Here a distinction may be made between *people* and *activities*. The firm can outsource workers who have previously been employed within the firm, transferring them to another firm on a permanent basis. The firm can also outsource activities, which can be further categorised as ‘*primary*’ and ‘*support*’ activities (Porter 1985). Primary activities are those that are integral to the firm’s value chain, such as components in a manufacturing company or accounts processing in a service organisation. Support activities are those processes that facilitate the firm’s value chain, such as IT, advertising, accounting and HRM.

Fourth, firms must decide on *the location of outsourced operations*, or to which regions, countries, or continents outsourcing will occur. Historically, outsourcing was largely domestic, to other firms or organisations in the near vicinity of the outsourcing firm. The geographical scope of outsourcing then extended to the national level as communications improved, transportation developed, and markets expanded. More recently, with further improvements in ICT, outsourcing has come to cross national boundaries and continents, with increased outsourcing by firms in developed countries to developing countries. The term *offshoring* is used to describe transactions that take place across international boundaries. We can distinguish further between *nearshoring*, in which work is moved to a neighbouring country (such as when a German firm shifts production to Poland) and *farshoring*, in which work is moved over a greater geographical distance (such as when a UK firm shifts production or service delivery to India).

Figure 15.1 shows the main distinctions made so far diagrammatically. The two entries on the right-hand side cover outsourcing. The bottom two entries cover offshoring. In this chapter, we are primarily concerned with the two entries to the right, or outsourcing that occurs domestically and internationally. Here, though, it should also be taken into account that what is outsourced at one point in time may be taken back into the firm later, as circumstances, incentives, and fashion change.

In the rest of this chapter, we examine the particular implications of outsourcing for the management of human resources. We focus on three themes: employment restructuring associated with outsourcing, especially where this involves transfers and/ or redundancy of workers; the challenges of coordinating HRM across organisational boundaries after outsourcing has occurred; and the particular case of the outsourcing of the HRM function itself.

Insert Fig. 15.1 about here

## Outsourcing and the Restructuring of Employment

One set of HRM challenges associated with outsourcing concerns the transfer or dismissal of current employees, following the decision to move the activities that they perform out of the core organisation. Companies typically choose among several organisational forms for a new outsourced operation. These include the following: the establishment of a *subsidiary* which remains under their direct control; the shifting of work to a *third-party subcontractor*; and the establishment of a joint venture with a third-party subcontractor. Subsequent to this, managers then face the decision either to dismiss the workforce performing the outsourced functions or to transfer a portion or all workers to the new organisation.

The decision to adopt a particular organisational and staffing strategy has important HRM implications. The retention of staff during outsourcing may be useful in transferring firm-specific knowledge, particularly for more complex business processes such as IT, research and development, or HRM. It also avoids costs associated with layoffs and new recruitment.

However, the transfer of existing workers may also conflict with plans to implement new working practices or reduce direct labour costs and is impractical when outsourcing is undertaken with the intention of shifting work to another region or country.

Viewed from an employee's perspective, the opportunity to transfer to a new employer is generally preferable to layoffs. There may be additional positive aspects of moving to a more specialist organisation, such as new opportunities for career development (Kessler *et al*. 1999). However, employees also often experience disruption associated with broken career ladders and changes in management practices and style, which may negatively affect motivation and commitment. For example, one study found that outsourced workers who were more satisfied in their jobs had more difficulty adjusting to a new employer compared to those with lower job satisfaction (Logan *et al*. 2004). The decision to adopt a more intermediate organisational form such as a wholly-owned subsidiary or joint venture can create more continuity in management and reduce disruption to employees, while allowing the core firm to retain additional control during the outsourcing process.

While employers face similar challenges in managing employee transfer or downsizing regardless of location, national contexts will influence the costs and benefits of different strategic choices. Two institutions at the national level are particularly important in this respect: legal regulation and industrial relations systems.

**Legal regulations**

Laws concerning employee rights during the so-called 'transfer of undertakings' affect the ease with which management can downsize the workforce or alter employment contracts when outsourcing work. In the European Union (EU), the *Acquired Rights Directive* seeks to safeguard employees' rights in the transfer of ownership of a business or part of a business, defined to include the transfer of employees between organisations. The directive specifies that the terms and conditions in a collective agreement must be observed until the agreement expires, the transfer of ownership does not constitute justifiable reason for dismissals and the status of existing employee representatives should be preserved (i.e. the new employer must continue to recognise and negotiate with existing unions or works councils). In addition, these representatives are entitled to be consulted as to the ‘likely or planned economic and social implications of the transfer ‘in good time’ before the transfer (Eurofound 2007). The European Court of Justice has broadly interpreted this to apply to the transfer of work associated with outsourcing, even when a contract is shifted from one outsourced firm to another and involves no transfer of ‘tangible or intangible assets’ (Justice 2002). Thus, the directive covers cases where services are outsourced, insourced, or assigned to a new contractor.

The implication of these rules is that staff transfers or downsizing associated with outsourcing are more strongly regulated in Europe compared to North America or Asia. For example, in the US, employment contracts are ‘at will’ unless otherwise agreed through individual contracts or collective bargaining agreements, meaning the employer can terminate the contract at any time without giving cause. There is thus no legal protection of contracts following the transfer of work through outsourcing, either to a third party or a subsidiary. In Japan the *Labour Contract Succession Law* was passed in 2000, giving the parent company the right to transfer its existing workforce employed in a line of business to a separate company (Sako 2006). Existing employment contracts and collective agreements are automatically transferred to a spin-off. However, this does not apply to transfer of undertakings associated with outsourcing to a third party (Araki 2005).

Despite overall stronger employment protection in Europe, there is also significant variation between EU member states in the terms of national regulations. In the UK, the *Transfer of Undertakings Protection of Employment* (TUPE) legislation safeguards, to a degree, the terms and conditions of employees affected by outsourcing. For instance, the 'transferee (the firm taking in the outsourced staff) takes on the liability for the key aspects of the contract of employment, while the 'transferor (the firm sending the outsourced staff) is obliged to undertake a 'full and meaningful' consultation process as early as is practical. However, some aspects of terms and conditions, such as pensions, are not fully protected in the transfer and the consultation process does not oblige management to negotiate.

In continental Europe, consultation requirements are substantially stronger. For example, in the Netherlands, management must inform works councils and union representatives of the decision to transfer part of the business, provide information on the likely impact and justification of its decision, and show that it has taken account of workers' interests. If works councils challenge the proposals, they must be postponed for a month, and the works council can subsequently go to a labour court to formally contest the decision. In addition, once the process of outsourcing has begun, the employer must consult with the works council on any contract changes with the subcontractor (Caprile and Llorens 2000). France, Italy and Spain also have additional regulations that make it difficult for employers to use subcontracting arrangements that do not involve the transfer of staff to terminate employment contracts or change working conditions, and that establish joint responsibility by the client and subcontractor for observing employment rights (Caprile and Llorens 2000). These different regulations affect the extent to which workers are able to have a say in the restructuring process, as well as the cost advantages of different organisational forms to employers.

**Industrial relations**

A second set of national-level institutions which can influence outsourcing decisions is the national industrial relations system. This can take a number of different forms, depending again, in part, on the law, but also on the arrangements established by employers and trade unions.

First, negotiation and consultation rights affect employees' ability to participate substantively in restructuring decisions — and thus may shape both the form that outsourcing takes and outcomes for employees. These rights can be important for the implementation of transfer of undertakings rules. In many continental European counties, employees have additional representation rights on corporate boards which allow them to have prior knowledge and to be consulted on restructuring decisions.

Second, the bargaining power of trade unions can influence their ability to negotiate job security provisions, which makes it difficult or costly to lay off workers, or to oppose outsourcing through strikes or other forms of industrial action. In countries where unions are weak, with lower bargaining coverage, membership density, and participation rights, such as the US and UK, workers are less likely to have these forms of leverage. For example, under the UK's TUPE regulations, an employer can dismiss workers if it can be demonstrated that it was undertaken for economic, technical, or organisational reasons; and employment contracts can be changed with the approval of individual employees. These conditions can be easy to meet, in the absence of strong unions or works councils to inform workers of their legal rights or to contest decisions. A study by Cooke *et al*. (2004), based on a series of UK case studies, showed that employers had broad discretion in reducing staff numbers and altering working practices following the transfer of workers, for example through dismissing employees for economic reasons and then re-hiring them under less favourable contracts.

Third, variation in bargaining coverage, or the number of workplaces covered by central collective agreements, may influence employers' ability to use outsourcing to reduce labour costs through varying employment terms and conditions. Companies may seek to use new organisational forms to escape or renegotiate strong collective agreements. This means that the ease of renegotiating agreements can influence employers' cost-benefit calculus. For example, in France, the government typically extends agreements negotiated between the major employers association and trade unions in a sector to all firms, while in Germany employers must agree to such an extension (which rarely occurs). France has sectoral collective agreements that cover all firms and subsidiaries in major industries like telecommunications and banking, as well as for the contractors that service these industries (Doellgast *et al*. 2009). In Germany, many subcontractors do not have agreements, and firms often form subsidiaries to move work out of stronger sectoral or company agreements (Doellgast and Greer 2007). For example, German banks have set up 'direct banks' for their call centres in order to transfer work to new companies not covered by the sectoral banking agreement. This has largely been uncontested following one unsuccessful strike by workers at Citibank facing redundancy (Holtgrewe 2001). Inclusive sectoral or national bargaining also exists in Austria, Denmark and Spain, among other countries, which may affect firms' ability to vary working conditions across their 'production chain' (Shire *et al*. 2009; Sorensen and Weinkopf 2009).

Finally, differences in union strategies may also affect outsourcing decisions. Worker representatives have distinct interests in keeping work in-house or maintaining a coherent framework of collective bargaining. Sako (2006: 4) argues that unions themselves choose to extend or contract their boundaries, and these decisions can then affect management's choice of a corporate structure. As representation rights regarding outsourcing are often weak, unions may draw on distinct forms of bargaining power in other areas to try to influence employment restructuring decisions. For example, in a comparison of call centre outsourcing strategies, Doellgast (2008) finds that US unions adopted strategic campaigns and strike tactics to extend agreements to new organisations and protect the working conditions of members, while German unions relied more on the co-determination rights of works councillors.

In some cases, unions have tried to organise subcontractors and extend legal regulations to these workplaces in countries or sectors where they are more poorly regulated — which may, in turn, affect the cost and/or skill differential between the in-house and subcontracted workforce. For example, in India a union was recently formed in India's call centre and business process outsourcing sector (Taylor *et al*. 2009). However, these efforts are often limited by the mobility of much subcontracted work and employer resistance in those sectors or activities where there is a perceived need to keep labour costs low as a source of competitive advantage.

International outsourcing within the EU — or nearshoring between EU countries — has created particular challenges for labour unions in recent years. Increasingly, transnational subcontractors in project-based industries employ 'posted workers' on a short-term basis, many of whom are migrants from eastern European countries with weaker labour market regulations. Following the terms of the European Union Posted Workers Directive, posted workers are entitled to the statutory minimum conditions of their host state or sending state, whichever is better from the worker's perspective. However, a series of legal decisions by the European Court of Justice has clarified that governments and unions cannot enforce standards that are not laid out explicitly in the directive and covered by national law. This means that where minimum pay and working conditions are typically set by collective agreement in a host country, these standards cannot legally be enforced. Lillie (2010; 2011ab) has argued that the result is a trend toward increasingly segmented labour markets in industries like construction and shipbuilding, where there is heavy use of posted workers: growing numbers of posted workers are competing with domestic workers who are paid higher wages and have more tightly regulated employment terms and conditions. This suggests that opportunities to ‘escape national regulations and industrial relations institutions through subcontracting can also be shaped by supranational forms of regulation.

**Institutions and strategic choice**

The above discussion raises the question of to what extent these national differences in institutions influence the strategic choices of firms. We focus here on staff transfers and layoffs associated with outsourcing, as well as the organisational form adopted.

The results of a survey by Kakabadse and Kakabadse (2002) suggest that the cross-national differences in outsourcing strategies between the more ‘liberal’ US and more ‘social’ Europe may not be as large as we might expect. They found that staff were transferred to a supplier following outsourcing in 38 per cent of US and 39 per cent of European companies surveyed; post-transfer redundancies occurred in 28 per cent of US and 24 per cent of European companies; while managers adopted new terms of employment for redeployed workers in 13 per cent of US and 10 per cent of European cases. Although the extent of employment change associated with outsourcing appears to be somewhat higher in the US, with more firms pursuing redundancies or changing HRM practices, these differences are relatively small.

Other studies find more substantial differences in outsourcing decisions within Europe. Barthelemy and Geyer (2001) conducted a survey of firms undertaking IT outsourcing and found that 69 per cent of these decisions involved personnel transfers and layoffs in France compared to 42 per cent in Germany. They argue this is explained by the greater power of German trade unions, which allows employees to oppose measures disruptive to employees. Grimshaw and Miozzo (2006) conducted a similar study of IT outsourcing in Germany and the UK, based on in-depth case studies of 13 outsourcing contracts. They show that all of these contracts involved some staff transfer through direct outsourcing, joint venture, or a captive market subsidiary. However, national differences in consultation rights and the period of protection against dismissal affected how the transfer was managed in each country. In Germany, management typically conducted six months of communications and negotiations with works councils, and demonstrated a stronger determination to win the 'hearts and minds of IT workers through designing a restructuring process that allowed staff to adjust to changes. In the UK, they found minimal consultation, little labour influence over the transfer, and, subsequently, substantial resistance — in one case resulting in a strike. These procedural differences also resulted in different organisational strategies: the German firms initially adopted joint ventures between client and supplier to transition workers to the subcontractor, because this was viewed as better for employees; while the UK firms all relied on direct outsourcing, with an immediate shift from in-house to externalised provision.

Thus, institutional factors which vary across countries, including legal systems and industrial relations arrangements, can influence employment restructuring decisions associated with outsourcing. Stronger laws protecting employee rights during the transfer of assets or people and more inclusive bargaining systems create constraints on strategic choice, encouraging consultation and discouraging the renegotiation of employment contracts at a lower level. While these constraints may represent short-term costs for firms, they also can have long-term advantages, in terms of higher levels of employee commitment and cooperation with restructuring plans. The Grimshaw and Miozzo (2006) study cited above found that German client firms were more satisfied with the HR practices and service quality of new supplier firms than those in the UK, which they attribute to the more extensive process of consultation in Germany.

## Coordination of HRM Across Organisational Boundaries

A further set of HRM challenges associated with outsourcing concerns the coordination of management decisions and processes between the relevant organisations. Here we refer to the firm that outsources work as the client and the firm that performs the outsourced work as the *subcontractor*. The following areas of HRM tend to be the focus of coordination efforts.

- *Employee selection and skill development*: Clients may seek to establish a common set of standards for employee qualifications and training across their subcontractors. This may be particularly important for higher-skilled jobs or services in which the subcontractors' workers are interacting with the clients' customers.
- *Performance management*: Clients may seek to harmonise incentives to promote shared goals, such as meeting sales or performance targets. Monitoring practices that track individual and group performance are often important for ensuring that standards are met.
- *Work design*: Clients may seek to encourage shared principles of work design, such as use of teams, participation or suggestion initiatives, and the use of shared procedures. This may be most important where employees work with each other across organisations, or in cases where a firm is strongly committed to particular principles of work organisation (such as lean production historically in Japan).

- *Scheduling and staffing*: Clients often demand a certain level of flexibility from subcontractors in adjusting the volume of goods or service production at short notice. This can have a direct effect on scheduling practices, with higher requirements for employees to be flexible with their own schedules, more use of part-time or temporary contracts, and lower job security.

Below we consider the conditions under which client firms are more likely to seek to influence or jointly manage subcontractors' HRM practices. We then discuss the challenges of coordinating HRM across organisational boundaries. Again, we show that national context can have an important influence on management strategy and outcomes, affecting the costs and benefits associated with coordination. In addition, the international character of many outsourcing contracts — and the internationalisation of subcontractors themselves — create distinct coordination challenges.

**The decision to coordinate or differentiate HRM practices**

It is not obvious that a client should seek to intervene in the HRM decisions of subcontractors or to coordinate these decisions in some way. Companies often outsource certain functions to reduce costs, concentrate on their core competencies, or rely on a specialist organisation's expertise — with the option of terminating the contract or switching providers if quality does not meet expectations. In other words, one of the attractions of outsourcing might be to differentiate HRM between occupational groups. However, there are certain conditions under which a client may have more of an interest in its subcontractors' HRM practices, depending on the nature of the contracted product or service, the extent of joint production carried out across organisations, and the national (or international) context of the contracting relationship.

First, where the product or service is more intangible or complex, contracting firms may take more interest in management practices used at the point of production. In settings such as business services or call centres, services are simultaneously produced and consumed, and thus the client is typically unable to rely on quality control mechanisms used in manufacturing at the point of delivery to prevent ‘defective’ products from getting to the customer. The reasons for outsourcing this work may also play a role: clients pursuing a business strategy focused on quality rather than cost reduction may be particularly concerned with ensuring that successful practices used in-house are extended to subcontractors, or that workers in the subcontracted firm develop a shared organisational identity with the client firm.

Second, where the outsourcing contract involves substantial collaboration or joint production with in-house staff, the client may encourage the coordination of practices to facilitate cooperation and harmonise incentives. Under so-called ‘relational contracting’, managers seek to encourage the development of social capital or collective goals across organisations (Dyer and Singh 1998). However, even in more transactional or mixed settings, there can be incentives for developing shared procedures and skills. For example, Rubery *et al.* (2003) show, in a case study of multi-agency subcontracting relationships in the airline industry, that a high level of interdependence between staff from different organisations meant that employees were subject to ‘multiple sources of control and evaluation as organisations attempted to ‘control staff employed by other organisations and through actions designed to encourage these staff members to increase identity with, and thus commitment to, the goals of the client ... organisation (285).

Third, as stated above, national context can influence strategy concerning HRM coordination. Geographical or cultural distance between the client and subcontractor(s) may have contradictory influences on the extent and goals of coordination. On the one hand, a client may be more likely to allow its subcontractors to adopt HRM practices that are consistent with the local conditions and business environment. Companies may also be more likely to offshore the production of products or services that are relatively standardised or easily codified, allowing them to engage in more arms-length contracting. On the other hand, cultural distance may increase uncertainty, leading firms to seek tighter control over HRM. In addition, firms with subcontractors in developing countries are increasingly concerned about the negative effects on their image associated with labour standard violations, and thus may establish codes of conduct with monitoring mechanisms to ensure that suppliers meet minimum terms and conditions.

Other national institutions of corporate governance, industrial relations, or traditions of corporate organisation may also influence the extent and nature of HRM coordination. For example, Japanese firms traditionally developed close, trust-based relational contracting with suppliers, based on the *Keiretsu* form of business organisation. Core firms sought to influence the promotion, training and work design practices of their subcontractors, even moving employees across firms to adjust to changing demand in different areas of the business. In Germany, strong industry-based unions have coordinated HRM to some extent across core firms and suppliers through sectoral agreements, while strong business associations serve to diffuse best practices and establish shared rules and acceptable behaviour of members. In contrast, US and UK firms have pursued more arms-length contracting relationships, explained in part by weaker organisation of employers, distinct traditions of law, and more decentralised or disorganised industrial relations institutions (Helper 1991; Lane and Bachmann 1997).

**Challenges of HRM Coordination**

Where firms do seek to coordinate HRM across organisational boundaries, a further set of issues concerns the particular challenges clients, subcontractors and employee representatives face in managing coordination and how these may be overcome.

A first set of challenges for client firms concerns the potentially high costs of enforcement or monitoring when seeking to promote a shared set of standards or practices across subcontractors, where they do not now have direct control over management. They thus often develop complex systems for ensuring compliance with contract terms; for example, through assigning special account managers to meet regularly with subcontractors or requiring detailed information on success in meeting training goals or quality targets. Third-party certification through consultants also plays an increasingly important role, with the growing popularity ofboth general certifications such as ISO 9000 and more targeted certification for particular industries or types of work.

A second set of challenges is faced by the subcontractors themselves, as they seek to adapt internal HRM practices to the demands of multiple clients. Contracts with different customers or clients may have widely varying terms concerning quality specifications and flexibility in adjusting the volume of goods or service production at short notice. This, in turn, affects the subcontractor’s ability to invest in training or to offer its employees predictable schedules and long-term contracts. In addition, clients may provide different variable incentives or offer contract terms that allow vendors to pay certain employees at a higher level. These difficulties are particularly pronounced in service settings, such as call centres or technical support, in which different groups of employees are ‘dedicated to a particular client. Under these conditions, managers face the potential problem of managing widely varying HRM practices within the firm (and often in one location), as well as dealing with possible negative effects on employee motivation of this internal variation. Grimshaw and Miozzo (2009) found that the global IT services firms EDS and IBM faced the challenge of managing multiple ‘employment subsystems’, as clients transferred groups of dedicated workers across subcontractors, while seeking to retain partial control over staff skill and expertise.

A third set of challenges exists for worker representatives, such as unions and works councils, which confront the question as to whether and how to coordinate collective bargaining across organisational boundaries. In many countries, HRM practices are regulated by collective agreements at the industry, firm, or establishment level. However, these structures are typically organised around traditional industry or firm boundaries, which may not fit the ‘networked firm model characteristic of outsourcing relationships. Different unions may be responsible for in-house and outsourced firms whose workers carry out similar functions, or, as discussed above, were formerly employed in the same organisation. Improving bargaining coordination between these unions and works councils at different organisations can be quite difficult due to conflicting interests and increased variation in pay and working conditions across in-house and outsourced firms (Doellgast and Greer 2007; Holtgrewe and Doellgast 2012).

These coordination issues usually have an important international dimension. Multinationals face distinctive challenges in coordinating HRM across international borders (see Chapter 5). This can be exacerbated by the fragmented ownership structures associated with subcontracting. Performance management and monitoring practices may be particularly important in helping to facilitate coordination, and thus there may be more focus on standardisation in a multinational setting. For example, Indian call centres have received a lot of attention in the media in recent years for their intensive monitoring practices, with workers’ calls often listened to by both internal managers and a series of additional quality control managers from client firms seeking to harmonise standards across subcontractors (Taylor and Bain 2004). A study by Batt *et al*. (2006) showed that subcontracted call centres in the US were more heavily monitored than in-house centres, but that monitoring was even more intensive in offshore settings such as India. In addition, subcontractors themselves are often multinationals, possibly serving other multinational clients. This poses multiple coordination issues as firms seek to provide a standardised service across national boundaries.

This additional focus on coordination and harmonisation can help to ensure a standardised product, but may also have costs, as local managers are constrained from adapting to local conditions. Case study research has shown that outsourced staff often experience reduced skill and discretion as their new employers intensify monitoring (Grugulis and Vincent 2005). The study by Batt *et al*. (2006) cited above found that higher monitoring rates were associated with high employee turnover, indicating possible negative implications in terms of employees' satisfaction and commitment of attempts to control performance management too closely. Yu and Levy (2010) found that radiology professionals working in the Indian offshore sector experienced a deskilling of their work, with negative effects on worker motivation. Another recent UK study found that increased internationalisation of the value chain for IT services contributed to a falling domestic demand for technical IT skills, with negative effects on career development and professionalisation in the sector (Donnelly *et al*. 2011).

The success of companies in responding to these challenges depends on a combination of management strategy and supportive institutions. Donnelly *et al*. (2011) show that collective social actors in the UK largely failed in their attempt to professionalise the workforce in the IT services sector through joint investment in training, due to weak coordination among the actors and marginal support from firms. In contrast, Kuruvilla and Ranganathan (2010) found that in the Indian business process outsourcing industry, high turnover rates among an increasingly mobile, middle-class workforce led companies to experiment with new HRM strategies aimed at improving recruitment, retention and training. These initiatives were complemented by those of actors outside of the firm: industry associations and the state and national governments in India adopted a range of policies aimed at overcoming persistent problems of skill shortages (Kuruvilla and Ranganathan 2008).

## The Outsourcing of the HR Function

The outsourcing of HR activities and even of a large part of the HR department is one specific form of outsourcing and offshoring that has very direct effects on HRM. Here we refer to the firm that performs the outsourced work as a service provider, consistent with the terminology used in this industry. As we noted in the introduction, firms have long outsourced support services, including HR activities such as recruitment or executive salary and benefit comparisons. In some countries, such as Germany and the Scandinavian countries, firms have also handed over aspects of their dealings with trade unions to employers' organisations, which is, in a way, a form of outsourcing. Here, however, we are primarily concerned with the relatively recent phenomenon of the outsourcing of a significant part of HR departments and HR activities.

Several factors have combined to facilitate the growth of HR outsourcing. These include the development of ICT platforms, pressures to reduce support costs, and the growth of provider companies. Adler (2003) describes several recent trends that have been particularly important: HR departments have been the target of ‘belt tightening as firms seek to focus on core activities; the HR legal environment has become increasingly complex, requiring subject matter experts (particularly for international firms); M&As create new challenges in managing the cross-border movement of employees; and improvements in HR information systems have made it easier to outsource information in areas such as payroll.

Responding to these trends, several segments of HR service providers have developed. First, specialised consultants supply a particular service, such as recruitment support, pensions planning, or wage and benefit surveys and systems. Second, technology providers supply specialist technological support services such as customised HR software. Third, a growing number of very large providers (such as IBM, Accenture, Exult and HP) provide a wide range of HR services and operate on a global scale. These often involve multi-billion pound deals lasting up to 10 years. Overall, it has been estimated that the global market for HR outsourcing is growing rapidly, and may rise from $30 billion in 2005 to $50 billion by 2010 (Sako and Tierney 2005; Gospel and Sako 2010).

The recent increase in the demand for such services started with a small number of large firms in the private sector in the US and UK. However, in more recent years demand has grown among smaller companies and public sector organisations across countries. National context again appears to have some effect on strategies: firms in countries such as Germany or Japan have preferred to keep more of their HR in-house, perhaps reflecting greater risk aversion and a willingness to continue to accept support services as a fixed cost. However, even in these countries, firms have recently shown a greater willingness to outsource support services. Despite some reversions to insourcing, it is likely that the outsourcing of many aspects of HR will continue (Adler 2003; Gospel and Sako 2010).

Firms face a number of considerations in managing the outsourcing of HR processes. Here we consider initial cost and benefit calculations and then more down-stream decisions about how and what to outsource. First, managers must evaluate the pros and cons of moving these activities to a provider. Advantages are similar to those of other forms of outsourcing, including lower costs through the reduction of overall headcount, the payment of lower salaries, the greater division oflabour, and access to better ICT systems, higher quality work with fewer mistakes, especially in routine areas, and the freeing up of internal staff to concentrate on more important strategic or operational matters. Estimates suggest the average annual HR cost per supported employee is between $1,500 and $2,000 when carried out by an outsourced HR service provider, compared to $5,000 in-house (Sako and Tierney 2005). However, there are also disadvantages and risks, such as reduction in morale both among transferred and retained staff, the risk of losing core competencies and control over activities, and the costs of administering what are often very lengthy contracts. Because ofthe sensitive nature ofthese contracts and because they often run for up to 10 years, there has been little research to date evaluating these costs and benefits.

Second, managers must decide which HR functions to outsource. For the most part, strategic and high value-added activities will be kept in-house. These usually include the management of senior managers, the development of HR strategy, and the development of HR policy. Sensitive issues such as dealings with works councils and trade unions will also typically be kept in-house. More transactional services are more often outsourced, including the running of HR information systems (including call centres), the administration of recruitment and exits, payroll processing, compensation and benefits, pensions administration, training administration, and expatriate and travel arrangements. Outsourcing the ‘transactional’ and retaining the ‘strategic activities has been a way in which HR professionals working in different functions have sought to improve their profile within their organisations.

In practice, there are a number of borderline or ‘grey areas where the advantages of outsourcing are more ambiguous. For example, an employee at a manufacturing plant might have a complaint about his or her level of pay. This may seem to be a simple individual issue, for which the facts are easily ascertained and where, if necessary, corrective action can be taken by the service provider. However, several employees may start to make similar complaints, contributing to a collective grievance and possible trade union involvement in an industrial dispute. If payroll is outsourced, it may be unclear who should spot this escalating problem and who should intervene at what stage. Such contingencies are usually set out in the service contract, with procedures for resolving disputes between the user and the provider about ‘who does what’. For the most part, however, the parties prefer to deal with these issues through personal contact and trust rather than on a purely contractual basis — and this may become more difficult when one or more service providers are involved. Overall, in deciding what to keep in-house and what to outsource, firms have to think through what aspects of HR add value, based on their core competencies or strategies. (Adler 2003; Gospel and Sako 2010).

Third, managers face the choice among different routes to outsourcing. One decision concerns whether to integrate and transform HR arrangements before handing them over to a provider or to first hand them over and let the provider transform systems (Sako and Tierney 2005). Large multinational companies typically have different HR arrangements that cover distinct product or service areas and geographical areas, which may be the legacy of mergers and acquisitions or a decentralised organisational structure. The decision to transform and integrate these HR systems before outsourcing may allow the firm to form a better opinion about what to outsource and what to keep in-house and to retain knowledge and capability in core areas. The firm will also pay a lower price for the service contract since much of the hard work of integrating and standardising HR will have already been done.

From the 1990s onwards, an increasingly popular strategy for transforming HR systems has been to create a Shared Services Centre (SSC) that brings together business processes shared across units within a company. A recent survey of MNCs in the UK revealed that around one-third of the companies operated an international SSC in the HR function (Edwards *et al*. 2007). A large multinational may establish a limited number of these centres in different parts of the world covering all its global activities. A related decision is then whether to outsource HR for a particular country or region or to do this worldwide. This latter decision will depend on factors that have been discussed elsewhere in this volume, such as how centralised the company already is and whether it has gone down the SSC route (Gospel and Sako 2010).

A final consideration relates to the effects of outsourcing on HR professionals. Here, two main groups should be considered *viz*. those who are transferred or hired by the service provider and those who stay within the firm. The first group are the HR managers who are transferred to or hired by the service provider. On the one hand, some of these employees will have to concentrate on rather narrow areas, losing their ability to perform generalist roles. On the other hand, they are able to move into an organisation specialising in their area, rather than working in a department that is an adjunct to the primary activity of the firm. They may, therefore, feel that their careers have been enhanced. One important consideration for the client is that, at first at least, sufficient ex-employees remain with the provider so as to be able to deliver a satisfactory level of service.

The second group of HR managers are those who stay within the firm. On the one hand, these employees can be freed up from more routine matters and allowed to become so-called ‘business partners’, where they may work as part of more value-adding line management teams. On the other hand, there may be a continuing need for some ‘experts’ who will have a more detailed knowledge of one particular area, such as the design of executive compensation plans. There will also be a need for a new class of managers whose job is to administer the contract with the service provider and deal with ‘seam issues when they arise. These include issues that are in grey areas, which have not been sufficiently thought through when the contract was negotiated, or that are new to the contract; for example, when an acquisition is made and new employee groups have to be integrated in the contract (Gospel and Sako 2010; Ulrich 1997).

## Conclusions

The management of outsourcing is increasingly important to the HRM strategies of both national and international firms. This chapter has presented a number of issues that managers face in deciding to outsource various aspects of production or service provision and in managing contracts with subcontractors. On the basis of this discussion, we can draw several broad conclusions concerning the role of national context and firm strategies in outsourcing decisions.

First, while management faces an increasing range of choices concerning the structure of outsourcing and activities outsourced, these choices are often influenced by distinctive institutional constraints. Transfer of undertakings rules, industrial relations institutions, and the strategies of trade unions and other worker representatives can affect the cost of outsourcing and its impact on employees. Continental Europe stands out as having stronger protections than those in most other parts of the world, including organised consultation mechanisms to ensure that employee interests are considered in outsourcing decisions.

Second, however, firms may increasingly be able to by-pass or circumvent these constraints. Outsourcing may weaken collective bargaining institutions; for example, by moving work outside of establishments covered by collective agreements or disrupting coordinated bargaining across a firm's production network. The threat of outsourcing or offshoring may allow firms to gain concessions from worker representatives. The HR function itself within large multinationals is increasingly shifted to SSCs, and then often transferred to outsourced providers. This drives standardisation and benchmarking of practices across countries, creating pressure to adopt a common HRM strategy across organisations or regions.

All of this suggests that outsourcing will remain a contentious (and contested) area of firm strategy. Consideration of this phenomenon has shed further light on the extent to which firms are embedded in distinct contexts, demonstrating that they have increasing scope to globalise their operations. We have also seen that as they do so, they face competing incentives to differentiate the way that different occupational groups are managed but also to achieve a degree of integration across them. Managing the process of outsourcing and its long-term effects on employees will be an increasingly important area for international HRM practitioners.

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Figure 15.1 Outsourcing and offshoring

| | | ***Internal v. External*** | |
|---|---|---|---|
| | | ***Internal*** | ***External*** |
| ***Geographical location*** | ***Domestic*** | *in-house production* | *domestic outsourcing* |
| | ***Overseas*** | *in-house offshoring* | *offshore outsourcing* |

Figure Captions

Fig. 15.1. Outsourcing and offshoring