The Generic Theoretical Frameworks on Human Resource Outsourcing Decision

MohdFitri bin Mansor, Noor Hidayah bt Abu, Atikah Nor bt Johari, Hussen bin Nasir

Abstract

Human Resource Outsourcing is one of the most powerful trends and these activities conducted for many reasons. It is referring to handing over the whole or part of human resource activities outside the core capabilities of organizations by an agreement to a third party or supplier which is expert in their field. Thus, the aim of the current study is to analyze and examine the previous studies particularly on Human Resource Outsourcing framework. Meanwhile, the objectives of the studies to investigate several variables such as cost efficiency, economics of scale, knowledge level and competencies level that really give significant impact and could lead the organization whether to engage human resource activities internally or externally. Finally, the study will propose the theoretical framework based on past studies conducted as well as to conclude the overall study in terms of human resource outsourcing scenarios.

Keywords: Human resource outsourcing, frameworks, theories and decision.

Article history:
Received  4 September 2014
Received in revised form 24 November 2014
Accepted 8 December 2014
Available online 16 December 2014

Introduction

Outsourcing is one of the most powerful trends in Human Resource Management (HRM). The growth in this, specifically Human Resource Management (HRM) outsourcing, has promoted research into the optimal strategic conditions for externalization of HRM activities [26,27,47]. Outsourcing refers to a contractual relationship for the provision of business service by an external provider or in simple words a company pays another company to do some work for it [7]. It occurs when the organization contracts with another organization to provide service or products whether core or non-core activities. The works are traditionally done internally is shifted to an external provider and the employees of the said organization are sometime be transferred to the service provider. However, transfer of the employees in the current organization to the service provider cannot be guaranteed and failure to do so will subject to the redundancy and liable for the retrenchment or layoff benefits.

Human Resource Management (HRM) outsourcing has grown popularly since early 1990s, particularly in the USA and Europe. It is up to 90% of the companies outsource some HRM activities [5,6,12]. HRM outsourcing means having a third party service provider (vendor) furnish, an ongoing basis, the administration of an HRM activity that would normally be performed in house [12]. Based on previous study by Galanaki&Papalexandris, [23], the positive implication of the company implement the HR outsourcing such as more efficient, economics of scale, provide knowledge and competencies do not exist in house and reduce cost compared than hiring staff to handle these HR activities. Again, HR outsourcing is gaining specialized HR expertise, achieving flexibility, reducing risks and enhancing access to advanced technology [7,29,44]. Again, the benefits of human resource outsourcing is also supported by Davidson, [16] where every organization entered in human resource outsourcing reported that they significantly reduced HR costs through greater economies of scale, lower technology-investment costs, efficient HR processes and headcount reductions. However, there are some issue and debate on HR outsourcing where it is seen as a threat that synonymous with downsizing or reductions in manpower lead to generate little value to the core competence of the organization [15]. It is a danger in outsourcing some HR tasks while keeping others in-house. Major organizational change become more difficult to achieve if part or whole of HR functions are outsourced, create rigidity, low morale and greater frustration among the employees that could leads to higher staff turnover [45].
The survey conducted by Gurchiek, [24] shown that nearly all organizations have outsourced parts of their HR functions. For example, IBM outsourced its entire HR department, so called Workforce Solutions, a profit center that produced gains in flexibility, accountability, competitiveness and profitability. In 2003, Delta Airlines outsourced 1000 jobs to India, but the USD 25 million in saving allowed the company to add 1200 reservation and sales positions within the US [17]. Again, Microsoft and Oracle among the large software companies have simultaneously increased outsourcing and their domestic payrolls function.

Intriguing facts some see outsourcing as a way of maintaining or increasing company competitiveness. However, many other view outsourcing in more negative light, focusing on job lost [52]. Failure to manage the human resource outsourcing subject the risk to the organization such as reduces the organization capability for cross functional synergies and creativity. This risks and limitations, it is estimated between 1% to 20% of outsourced HR functions have been brought back in house [24]. Organizations who outsource due to trends or “everybody is doing it” possibly faced by unexpected costs and complications. Based on previous studies by Lutchen, [30] about one-half of the outsourcing arrangements entered into end up being terminated for various reasons. Some new vendors encounter financial difficulties or acquired by other firms with different procedures and priorities. For example Indian operations in business processing such as call centers and office handling payroll, accounting and human resource functions often lose 15-20% of their workforces each year but the software programming skills are plenty, managerial experience is in very short supply [37]. In view of that, it becomes dilemmas to the organization to decide on the decision on “make” or “buy” that is referring whether to perform internally or externally particularly on human resource activities. Failure to make a wrong decision on the Human Resource Outsourcing (HRO) definitely will subject on negative implications to the organization. In view of the above, a careful decision should be made properly in order to avoid negative consequences. By having this study, a generic theoretical framework on human resource outsourcing decision is essential and can be developed based on the previous study. In developing this framework would help the organization, human resource practitioners particularly to determine the most effective and efficient determinant factors contributing the positive light in deciding or engaging human resource outsourcing activities in to the organizations.

Therefore, the aim of the current study is to analyze and examine the previous studies particularly on previous Human Resource Outsourcing framework. The aim of the study is to generic theoretical framework on human resource outsourcing decision. Specifically, the objectives of the studies are to investigate several variables such as cost efficiency, economics of scale, knowledge level and competencies level that really give significant to the organization in engaging human resource outsourcing. Finally, the study will propose the theoretical framework on human resource outsourcing decision based on past studies conducted as well as to conclude the overall scenarios.

**Human Resource Outsourcing Theories:**

The studies on outsourcing strategy have been constructed from many theories found in different disciplines. The outsourcing process is a complicated structure consisting of plentiful activities and sub activities, holding a lot of managerial dilemmas [21]. The analysis of the relevant human resource outsourcing theories is necessary to come out and to propose a framework of the current study. The related theories are discussed as follows:-

**Transaction Cost Economics Theory:**

Transaction Cost Economics Theory (TCE) is a main theory in the field of strategy. It states a few question on why firm exist, how they implement to govern operations and how firms define theirs limitation. This theory was introduced by Ronald Coase, [13] in his paper entitled “The Nature of the Firm” where he try to discuss about the concept of transaction costs [13]. On other side, transaction cost theory based on economic view of the costs of conducting business transaction [50]. Williamson expanded this theory become widen, firstly he started with an explicitly behavioral assumption of human behavior. Second, he identified that transacting parties sometimes come out with an opportunity and take advantage from counterparties. Finally he identifies features of transactions that cause markets down. TCE has been applicable in the reconsideration phase because of the concept of switching costs applied by an organization in studying the structure and contents of outsourcing contracts, and related preparation and contract management activities.

**Theory of Core Competencies:**

Next theory is theory of core competencies. This theory was developed by Gary Hamel and CK Prahalad in 1990 [42] to deliver the advantage in sustainable competitive. The concept of core competences has been developed on the basis of the resource. Core competencies by their definition is any business organization cannot acquired the ordinary skills owned by other organizations around the world easily. A long period of time will use to build these bundles of skills and competencies. According to the Prahalad and Hamel [42], core competencies can be define on how to coordinate diverse production skills and integrate multiple streams technologies. Learning and communication premises made theory was applicable in managing relationship and
reconsideration phases. The diversified of corporation look alike a big tree, grows from roots as basic things by provide nourishment, sustenance and stability is the core competence. The trunk like core products, the smaller branches as business units and the leaves, fruit, flowers as end product. The corporation will miss the strength of a tree if focus toward only it leaves and miss the strength of competitors by looking only at their end product as presented in Figure 1 below:

![Figure 1: Competencies: The Roots of Competitiveness Source: Prahalad C.K. & Hamel, 1990.](image)

**Knowledge –Based View Theory:**

The knowledge –based view (e.g., [22]) introduce the ideas on the existence and nature of the firm emphasized the role of knowledge vary in their transferability. An explicitly knowledge can be articulated and easily communicated between individuals. While the tacit knowledge such as skills, know-how and contextual knowledge is manifest only in its application and transferring it from one individual to another one is costly and slow [25,40]. This theory used in the outsourcing research to show proves that knowledge sharing in the managing relationship phase is positively bonded to the success of an outsourcing arrangement. Both competence and knowledge -based views are often seen as a continuation of the resource-based view theory [10,53].

**The Resource-Based Theory of Competitive Advantage:**

The Resource-based theory was developed by Robert M. Grant [22]. This theory is on inside-out process of strategy formulation by looking to the resource available and assesses its potential for value generation. Finally it will end up by determine strategy to generate maximum value in a sustainable way [22] that can be illustrated in Figure 2 below. This theory consists of five stages: analyze resources, appraise capabilities, analyze competitive advantage, select strategy, and identify resource gaps. This process of strategy is implemented by reference to existing U.S firms such as Xerox, IBM, Harley-Davidson and 3M. This process uses capabilities and resources as a basic thing for a firm’s long term strategy because its show the flow for firm strategy and become as a primary source to generate profit to firm. Capabilities are determined as the quantity for a group or team of resource to perform some activity or task. Resources are explained as the inputs include the skill of employees and items of capital equipment into the production process. Similarly, the resource-based theory demonstrated to the different between resources and capabilities of entire firms, which these differences can be perfect combination [9]. The competitive advantage can be created when resource and capabilities are deployed and mixed in a proper way. The Resource–based view can seek for an external provider in order to overcome the weakness by outsourcing builds from a proposition that an organization that lacks valuable, rare, inimitable and organized resources and capabilities.

**Determinants on Human Resource Outsourcing:**

Based on previous studies, there are many benefits or determinant factors contributing to the human resource outsourcing by the organization. However, this study will be focusing on a several variables that significantly effect on the human resource outsourcing decision that will be discussed as following below:-
Fig. 2: A Resource-Based Approach to Strategy Analysis: A Practical framework Source: Robert M. Grant, 1991 & Barney J.B., 1996

Cost Efficiency:

Nevertheless, the discussion whether to outsource HR function still occur and focusing in benefits and costs of outsourcing HR needs versus creating internal programs [19]. According to Tom Kosnik, 2006 [49], still has authentic fact about the advantage and disadvantage outsourcing HR activities. Starting from a few decades ago, the popularity of outsourcing becomes more spread around the world. Outsourcing seems to be more a cost cutting tactic for employers. Based on Table 1, Reasons on Human Resource Outsourcing surveyed by SHRM, the majority of respondents agreed outsourcing will save money and reduce operating cost that representing 56%. Besides that, to control legal risks and improve compliance, to gain access to vendor talent as well as to streamline human resource management operation that represents 55%, 47% and 45% respectively.

<table>
<thead>
<tr>
<th>Reasons</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Save money/reduce operating cost</td>
<td>56%</td>
</tr>
<tr>
<td>To control legal risks and improve compliance</td>
<td>55%</td>
</tr>
<tr>
<td>To gain access to vendor talent</td>
<td>47%</td>
</tr>
<tr>
<td>To streamline human resource management operations</td>
<td>45%</td>
</tr>
</tbody>
</table>


For example in the year 2004, Singapore Airlines (SIA) fired 130 of its IT staffs and another 70 from its finance department. The IT employees were from its Data Centre, End User Computer Support, and the Help Desk. These people were contracted out to IBM to whom SIA has outsourced its IT infrastructure maintenance. SIA would write off $10 million in one-off costs associated with the staff redundancy exercise, but would benefit from expected cost savings of about $15 million a year [32].

According to Roberts, [44], outsourcing can substantially lower costs and risks, while greatly expanding organizational flexibility, innovative capabilities, and opportunities for creating value-added stakeholder return. Outsourcing also look like as a cutting cost strategy, by outsourcing non-core competencies without overlooked on customer service or else. It can increase the competitive advantage [48]. For example in labour cost by having employees in organisations means paying them the wages, benefits for labour, healthcare and everything related to human right. Therefore, cost efficiency can be hypothesised as follow:-

H$_{1}^{1}$: The cost efficiency level has relationship by practicing human resource outsourcing.

Economic of Scale:

The study carried out amongst the 51 publicly traded firm in US among 1990 until 2002 were applied outsourcing in their operations. Based on their finding, the outsourcing can improve a firm’s cost-efficiency, improved their productivity and profitability [11]. It also supported by M. Lindsay, [33] in her studied has shown decision to outsource activities to third party can generate more productivity in businesses. The important objectives of human resource outsourcing are to cut cost, enhancing productivity, improved time lead as well as to gain economic of scale on the production volume. Again, according to Gilley, [20] has highlight the need to outsourcing can provide cost reduction to firm and Malhotra, [34] found that factors affect by outsourcing decisions are sharing risk on technology investment, operating cost reduction, access to specialized expertise, fixed cost due the contract, and perception of efficiency. In addition, [8] examined that the reasons why firm adapting the human resource outsourcing are due to increased capacity, higher quality of product and service...
and economy of scale in term of reduced cost of output. In view of that, the economy of scale can be hypothesized as following below:

\[ H_2^* : \text{The economics of scale benefit has gain by adapting human resource outsourcing} \]

**Knowledge Level:**

Based on Andersen, [4], human resource outsourcing raising over the last decade ago and growing until now. His studied showed that 67% of the respondents outsourced one or more HR functions. Another study, called “The Cranet Survey” conducted by Cooke, 2005 [12] showed a 97% use of external providers at least one HR functions. Furthermore, Stroh, [47] examined comparison between Russian and U.S Practices about outsourcing HRM. They concluded that 68% of the organizations outsourced recruitment, 61% human resource information, 56% training and 49% benefits administration. The knowledge level about HR outsourcing in Asia Pacific still under categorize of new trend. Most of the reasons behind those activities have been outsourced are to gain new knowledge, better ideas as well as new technology advancement [1]. This study presented comprehensive review in a country like Malaysia, practicing outsourcing become more common and service providers has probably grown significantly in recent year. Finally, the said variable can be hypothesized as below:

\[ H_3^* : \text{The knowledge level will increase by adapting human resource outsourcing} \]

**Competencies Level:**

Outsourcing human resource activities can give manager give fully commitment to focus on their core business rather than spend time to create new HR policies and activities that are becoming more advanced and complexity [12]. Other else, outsourcing also can reduce the work load existing for HR staff and it can give valuable time for staff to focus on their core competencies [31]. Currently, many organisations implement the outsourcing strategy toward some non-core competencies activities in order them to focus and enhancing the core competencies level in their organization.

Nowadays, firms around the world compete with each other’s to sustain their business in market. Firms are forced to create a new ways to generate value. The phenomenon of outsourcing provides alternative way to firm adaption in their business by the impact of positive value creating. Outsourcing will help them to expand into the other market [43]. According to Elmuti, [18] outsourcing can increase a firm’s access to innovation and improve their competencies. It happens when the firm can access new skill of personnel, ability to gain in market and increase firm competitiveness as well as provides opportunity to firm to increase their ability and to focus on their core competencies. Summarily, by focusing on the core competencies tied to increased productivity, capacity and improved organizational effectiveness. Thus, the competencies level can be hypothesized as below statement:

\[ H_4^* : \text{The competencies level will improve by adapting human resource outsourcing} \]

**Human Resource Outsourcing Frameworks:**

Based on previous studies, there are many human resources outsourcing frameworks available in the literatures. In order to gain better ideas on this, several selected human resource outsourcing frameworks will be analyzed and examined. The studied by Azhar, [5] examined the relationship between HR outsourcing and positive HR outcome as presented in Figure 3. The studied divided the HR outsourcing into four type; HR generalist activities, transactional activities, human capital activities, recruiting and selection. The dependent variables: cost reduction, competitive advantage, efficiency, achieving core competency and technology advancement.

![Human Resource Outsourcing Framework](Source: Azhar, 2003)

Furthermore, the studied conducted by Abdullah &Aykut, [3], had developed their human resource outsourcing framework based on the evaluation of resource dependency and transaction cost approaches to come out with their own research model. Resource dependency approach foresees that organizations cannot survive alone and the organization will required entering into a relationship with the environment for the
purchase of labour, raw materials, or equipment. This situation brings the organization to manage good relationships with other organizations [38]. Meanwhile, the transaction cost approach offer a powerful conceptual framework on the outsourcing [3]. These will reflect the outsourcing a choice whether organizations will perform the activities internal or external of organization. This selection is so called “make” or “buy” decision of the outsourcing activities [39] as illustrated in Figure 4 below.

![Outsourcing Model](image)

**Fig. 4: Research Model of Outsourcing** Source: Abdullah and Aykut, 2010

In addition, the studied by McIvor, [35] recognize four stages for evaluating the outsourcing decision. Starting with define the core activities of the business. Stage two to evaluate relevant value chain activities follow by total cost analysis of core activities. Lastly is relationship analysis. This framework attempts to integrate the key strands of the outsourcing decision making process and the impact of the company’s supply base on the decision. The framework try to overcome this problem by addressing on the key aspect of the outsourcing process such as value chain perspective, core competencies thinking and supply base influences. This framework can be illustrated in Figure 5.

![Outsourcing Stages](image)

**Fig. 5: A practical framework for evaluating the outsourcing decision** Source: McIvor, 2005

After reviewed on previous literature reviews, the following theoretical framework can be illustrated the relationship between cost efficiency, economic of scale, knowledge level and competencies level towards the human resource outsourcing decision. Thus, the theoretical of the study can be proposed as Figure 6 below:

![Theoretical Framework](image)

**Significant of Study:**

The study also will contribute positive contribution to both theoretical and practical benefits. In terms of theoretical impact, the current study will enrich the body of knowledge in the field of human resource outsourcing decision where many previous studies tends to focus on general outsourcing towards organizational performance. The findings of study will help the policy maker in updating and reviewing the manpower policy in the future. Again, it will inform and guide the policy maker in term of setting a new manpower policy by understanding opportunities and threats as well as the decision on ‘make or buy’ that is referring to whether to engaged human resource activities internally or externally. Finally, the future research can be extended by
testing the proposed framework on human resource outsourcing decision in the manufacturing, service industries or Government Link Company (GLC).

![Diagram of Proposed Theoretical Framework on Human Resource Outsourcing Decision]

Fig. 6: Proposed Theoretical Framework on Human Resource Outsourcing Decision.

**Conclusion:**

It is concluded that, Human Resource Outsourcing (HRO) is involving third parties to handle certain human resource activities. The works are traditionally done internally is shifted to an external provider and the employees of the said organization are sometime be transferred to the service provider. There are many underpinning theories available in the past studies in the context of outsourcing activities particularly on human resource outsourcing. Amongst the prominent theories are transaction cost economics theory, theory of core competencies, knowledge based-view theory, resource based-view theory and etc.

Furthermore, there are many determinants and benefits on the human resource outsourcing have been studied by the previous researcher. However, the current study focusing on several significant impacts towards the human resource outsourcing decision such as cost efficiency, economic of scale, knowledge level and competencies level. Generally, by conducting this study will contribute a better understanding and as precaution to the human resource practitioners in deciding whether to “make” or “buy” decision on the human resource outsourcing. Failure to decide correctly of these outsourcing activities will contribute a great negative impact to the overall organization. Finally, this theoretical framework can be tested in the future study particularly in the Government Link Companies (GLCs), Small Medium Enterprise (SME) or any others manufacturing in the context of Malaysia whether applicable or otherwise.

**REFERENCES**


