Investigating the antecedents of HR outsourcing
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ABSTRACT
This paper aims at defining a specific model on the decision to engage in HR outsourcing. There have been much deliberations that HR outsourcing as an organizational strategy has increased considerably over the last decade. Nevertheless, this trend has attracted little academic attention regarding the factors that influence the reliance on HR outsourcing. In this article, we provide a critical review on the contextual variables such as organizational size, strategic orientation, managers’ characteristics and environmental dynamism as primary determinants of the decision to outsource HR functions. This study adds to the present literature by explaining conceptually the linkages between these variables by applying both the resource-based view and transaction cost economics when making outsourcing decisions.

Introduction
Fierce competition resulting from globalisation requires organisations to reduce cost and improve quality to gain competitive advantage. The increasing demand for low cost and high-quality service levels has forced organisations to re-think the way they conduct their businesses. This has prompted the management to undertake corporate wide initiatives to radically restructure and improve the business posture of organizations. In fact, over the past decade, organisations have tried many tools and approaches, such as quality management, business process re-engineering, right-sizing and down-sizing to meet or exceed the organisational goals. While organisations find improvements in operations and processes, significant resources are still focused on the non core activities. Therefore, another strategic approach that is becoming popular is outsourcing the activities to the external vendors. This approach allows the management to re-focus the scarce resources on the core business activity, while increasing the customer’s perception of quality and reducing the cost of the outsourced functions (Marinaccio, 1994). In short, organisations strive to deploy more intelligently their limited resources and significantly improve its operations to function more effectively in a highly competitive and consumer-oriented market place (Insinga and Werle, 2000; Arbaugh, 2003; Lever, 1997).

Outsourcing is in reality a wonderful concept and a viable alternative to in-house management. Outsourcing is purchase from an external supplier of a value creating activity which could have been done in-house (Ehie, 2001; Gilley and Rasheed, 2000; Murray and Kotabe, 1999). Outsourcing is also referred to as contract services, partnership, out-tasking or co-sourcing. Whatever the phrase, the concept is still the same-trusting another organisation. This organisation will most likely be a professional service firm with qualified consultants who are continually updating their skills and knowledge in order to provide organisations with such a service. By allowing an outside firm to handle some of the issues the organisation may reap rewarding dividends in terms of saving time and cost. Thus, generally, outsourcing has been viewed as a form of pre-determined external provision with another enterprise for the delivery of goods and services which would have been previously offered in-house (Embleton and Wright, 1998; Delmotte and Sels, 2008).

The growing trend of outsourcing has recognised the outsourcing of HR as a major part of HR operations for the last few years (Shih et al. 2005; Fisher, et al. 2008). HR functions have traditionally been performed in-house; however, advocacy for the outsourcing of HR is increasing (Cooke et al. 2005). Some argue that the main motivation towards HR outsourcing is due to lower costs, to improve quality, to achieve greater economies of scale, to increase incentives and accountability for service providers, and above all to increase and gain access to experts in specialised areas (e.g. Lever, 1997; Cooke et al. 2005; Delmotte and Sels, 2008). However, others argue that outsourcing exposes the organisations to the opportunistic behaviour by the contractors, HR outsourcing will limit the ability of the organisations to develop distinctive competencies within its workforce, and the contractors are often unfamiliar with their clients’ strategy and culture which will create inefficiencies (e.g. Ulrich, 1996; Adler, 2003; Lieven and De Corte, 2008).

HR functions are also becoming a major corporate business function to be outsourced. Outsourcing activities initially encompassed only a small segment of human resource management (hereinafter referred to as HRM) such as payroll functions (Adler, 2003; Dickman and Tyson, 2005), but has gradually increased to comprise many HR functions such as recruitment, training, benefits administration and compensation (Lever, 1997; Stroh and Treeshuboff, 2003). HR outsourcing has become a major part of HR operations for the last few years. Smith et al. (2006) indicated that about 61% of organisations outsourced at least one aspect of the HR function. Out of that percentage, 68% of them outsourced recruitment, 61% outsourced human resource information system followed by training (56%) and benefit administration (49%). Similarly, a
2004 joint study carried out by the Society for HRM and the Bureau of National Affairs found that two-thirds of HR executives' surveyed mentioned that their HR department outsourced at least one HR activity. In addition, a study conducted by Ee and Ramayah (2010) in Malaysia, showed that the HR functions that are most commonly outsourced was training with 63.5%. The second most popular outsourced HR function was recruitment with 58.3% followed by operation/labor supply with 44.8% mainly. The least outsourced function was compensation and benefits with 16.7%.

Research has shown the importance of HR activities in the organisation’s performance (Becker & Gerhart, 1996; Huselid, 1995; Wright et al. 1995). However, there is much controversy about who should perform these activities (Lepak and Snell, 1998; Ordanini and Silvestri, 2008) and what are the factors that influence the decision to outsource HR activities (Lilley et al. 2005; Cooke et al. 2005). HR outsourcing can take many forms ranging from routine payroll administration to training programme delivery and to HR planning. While some HR outsourcing may involve routine administrative jobs, other functions may involve the design of HR systems, which are likely to have a fundamental influence on the organisation’s culture and performance. Given these distinctions among HR functions, various factors may impact the feasibility of outsourcing some forms of HR activities more than others, resulting in different determinants for various forms of HR outsourcing (Braun et al., 2010).

The decisions on which HR activities are potential candidates for outsourcing as well as the factors that lead to HR outsourcing remain inexplicable. Lepak et al. (2005) posit that an organisation’s core competencies should be a major determinant in the make or buy decision, and this, as mentioned earlier plays a central role in the HR outsourcing debate. Similarly, Stroh and Treehuboff (2003) asserted that organisations should keep the core activities in-house and outsource the non-core activities to external vendors. These authors believe that the HR activities that define an organisation’s competitive advantage may be too important to outsource.

Many researchers looking for reasons behind HR outsourcing support the view that this core and non core dichotomy is not adequate by itself, and therefore point to other features of importance (e.g. Quelin and Duhamel, 2003; Lepak et al. 2005). Lepak and Snell (1998), for instance extend the core and non core focus to include uniqueness. HR activities should be categorised in accordance with their contribution to the organisation’s core competencies and competitive advantages, and also in accordance with the extent to which they are rare in the external market. Nevertheless, other authors (Klaas et al., 2001; Gilley et al., 2004) related the organisational characteristics such as environment and idiosyncratic practices to HR outsourcing and also focus on the degree of HR outsourcing to which HR activities entail an interactive relationship with the employees and other business units.

The purpose of this paper is to address these issues by developing a framework on the factors that would influence the decision to outsource HR functions. Building on the current theory and research, this study provides a comprehensive review of the different variables that may affect HR outsourcing. Based on the Transaction Cost Economics (TCE) and Resource based view, this study aims to define a specific model on the decision to outsource. Based on previous research, there are several factors that influence the reliance on outsourcing namely environmental dynamism, organisational size, strategic competition, and managers’ characteristics.

**Theory and Proposition**

Questions about outsourcing relate to many of the broader make or buy issues addressed in the TCE. A purely production cost-based decision would suggest that the organisation pursue more outsourcing (Elango, 2008; Klaas et al. 2001). However, increased governance costs for activities such as the search for suppliers, the specification of agreements and the enforcement of contracts associated with open market transactions may make it more cost-effective for the organisation to perform these activities in-house (Kraut et al. 1999). This is applicable for the organisation since constraints in the resources are generally much more significant than they are for larger organisations (Lei and Hitt, 1995). Thus, the management level of the organisations must be more creative if they are to bundle the organisations' resources in ways that will produce competitive advantage (Delmotte and Sels, 2008).

In congruence with the TCE, the decision to outsource is to build core competencies (Quinn and Hilmer, 1994). In this respect, organisations seeking a greater focus on assembling and developing the internal skills, knowledge and capabilities would not consider outsourcing as the option to pursue (Prahalad and Hamel, 1990; Quinn and Hilmer, 1994). This is because outsourcing supports the strategies of selective building valuable skills through outsourcing non-core functions, which provides existing employees more time to focus on core and high skill functions. (e.g. Barney, 1991; Ulrich, 1996). Nevertheless, research suggests that most new emerging organisations may focus more on building internal capability since external relationships may take a much longer time to establish (Lee et al., 2001).

To address the above issues, the conceptual framework that will be used in this study is illustrated in Figure 1. The four factors namely, strategic orientation, organisational size, the managers’ characteristics and environmental dynamism are considered to have an influence on the outsourcing decision and the performance of the organisations.

![Figure 1. Factors Influencing HR Outsourcing](attachment:image)

**Strategic Orientation**

- Differentiation Strategy
- Cost Leadership

**Organisational Size**

- Environment
- Knowledge

**Manager's Characteristics**

- Environment
- Knowledge

**Environmental Dynamism**

The strategic orientation of the organisation can play an important role in the decision to outsource. This is because strategic orientation plays a positive role in the general business performance (Vilaseca-Requena et al. 2007). It is understood that to cope with the various demands of the different strategic orientation, organisations hope to apply outsourcing to achieve their strategic goals such as cost reduction, access to expertise in
specialised areas, and enhanced service quality (Shih et al. 2005). Therefore, it is expected that benefits coming from outsourcing will be influenced by the organisations’ chosen strategy (Gilley and Rasheed, 2000). Organisations with different strategies are frequently the innovators and creators of change in their industry. They possess flexibility and react rapidly to changes. For these organisations, maximising flexibility and creativity, in addition to focusing on strategic practices, are paramount rather than monitoring the day-to-day operations. The existing workforce in the organisation may not quickly possess the adequate skills and abilities to meet the demands of the new market. Besides, the internal employees may be insufficient to satisfy the changing demand of the organisations (Shih et al. 2005). As such, the HR department in differentiator organisation tend to acquire their employees from outside and are more likely to outsource part of the HR functions to the service providers. Based on this argument, it is proposed that:

P1a: Organisation with differentiation strategy will have a higher reliance on HR outsourcing.

On the contrary, organisations with cost leadership strategy choose to operate limited product lines and attempt to gain profit in a stable environment. This is because a low-cost organisation aims to reduce cost especially on repetitive work, non-core functions, non strategic functions and never ending burden works (Laabs, 1993; Gupta and Gupta, 1992; Kremic et al., 2006). Additionally, the management of these organisations will tend to reflect the central bureaucracy and their operations tend to pursue efficiency. In this case, the HR department within these organisations tend to nurture the employees from within and maintain long-term and stable employment relationship with their employees (Shih et al. 2005). Even, if HR outsourcing’s contribution still prevails, they might not fit well with the demand of a cost leadership strategy (Gilley and Rasheed, 2000). Based on the above explanation, it is proposed that:

P1b: Organisation with cost leadership will have a lower reliance on HR outsourcing.

Organizational Size

The size of the organisation is very crucial and is likely to affect the transaction costs associated with the alternative governance mechanisms because of its impact on the economies of scale (Klaas et al., 2001). Previous research has found that larger organisations have more resources and infrastructures and specialised expertise. Smaller organisations are more likely to have a more informal approach to HR outsourcing (Sheehan and Cooper, 2011). However, in small and medium-sized organizations many specialised activities will be performed infrequently. Since the high costs is associated with acquiring the expertise to perform these activities, the per unit cost associated with providing such activities in-house will also be relatively high.

Small and medium-sized organisations operate in a highly competitive environment; face severe financial constraint, lack of professional expertise and susceptibility to external forces. In contrast, larger organisations are more able to hire people with specialised skills and these specialised activities will be performed more frequently thus spreading the cost of acquiring expertise across a larger transactions. Due to difference in economies of scale, the transaction costs associated with organisational governance are likely to be greater for small and medium-sized organizations than for larger organisations (Abraham and Taylor, 1996). Therefore, small and medium-sized organisations that move away from organisational governance via increased outsourcing will most engage in HR outsourcing than larger organisations. It is proposed that:

P2: Small and medium-sized organisation will have a higher reliance on HR outsourcing.

Managers’ characteristics

The characteristics of the HR managers are important in determining their practice in human resource management (Vilaseca-Requena et al. 2007). This is because the HR managers’ qualities are the main determinants of the overall management style of the business (Martines-Ros and Orfila-Sintes, 2011). In fact, the abilities and inclination of the HR managers and the extent to which the managers are able to devolve management play a crucial role in deciding the decision to outsource. In this sense, certain characteristics of the HR manager may influence HR outsourcing and may be made on the basis of the managers’ innovativeness and managers’ knowledge.

According to Thong (1999) every person is located on a continuum ranging from an ability to do things better to an ability to do things differently. The HR managers who are innovative tend to explore on new opportunities and constantly designing the new ways and strategies to manage the employees. In this sense, HR managers can focus on strategic activities that lead the innovative of the organisation. As such, they tend to assign the non-strategic or non-core activities to the service providers. By doing this, they are able to devote their time and energy in performing strategic activities as well as creating the environment for new ideas and technologies. Therefore, it is proposed that:

P3a: The more innovative the HR manager the lower the reliance on HR outsourcing.

On the other hand, the knowledge and skills of the HR managers also play an important role in making decision on HR outsourcing. Many organisations embark on outsourcing because of the obstacles with developing the necessary skills and knowledge in certain areas of HRM. For instance, Kaplan et al (2007) posit that managers with more knowledge of new technology, innovation are more likely to have the ability to perform in house. This seems to imply that if the HR managers are not educated enough and lack of strategic thinking and analysis, they may not be able to identify significant problems and opportunities in performing strategic HR functions such as research in HRM, new system in the HR design. Similarly, in the situation of volatile environment, the HR managers may not speedily acquire the changing in new skills and abilities to meet the demands of the new market. Based on the above discussion, it is proposed that:

P3b: The higher the knowledge of HR manager the lower the reliance on HR outsourcing.

Environmental dynamism

Environmental dynamism refers to the variability and unpredictability of an organisation outside the environment (Shih et al., 2005). The competitive environment in which an organisation operates for instance, influence the organisations’ propensity to outsource. This is because the level of uncertainty facing an organisation has the potential to affect the transaction costs associated with alternative governance structures (Klass et al., 1999; Lepak et al., 2005) and this uncertainty is likely to vary depending upon the environment in which an organisation operates (Shih et al. 2005). When an organisation confronts a volatile environment, it cannot adopt a stable strategy to respond
properly to market demands. As environment conditions change, an organisation must make corresponding adjustments in its strategies to adapt to new circumstances. In fact, by relying on outsiders for non-core activities in more dynamic environments, organisations are able to take advantage of emerging technologies without investing large amounts of capital in them (Quinn, 1992; Gilley and Rasheed, 2000). In this sense, outsourcing may be attractive particularly for organisations competing in dynamic environments characterising as threatening, complex, and risky (Gilley et al. 2004).

Moreover, D’Aveni and Ravenscraft (1994) posit that when industry demand is uncertain, administration cost may increase due to increased coordination and information processing costs. Also changes in technology that typically accompany high levels of environmental dynamism can make what was once a very valuable technology suddenly obsolete. Thus, by relying on outsourcing during periods of high environmental dynamism, organisations may have flexibility to change service providers as technology advances warrant (Gilley et al. 2004). Specifically, organisations can use outsourcing to cope with environmental dynamism by contracting with service providers who possess advanced talent and resources, and by avoiding excessive dependence on rapidly changing technologies. In fact, outsourcing allows organisation to concentrate on its unique competencies while gathering efficiencies from other organisations that are focusing on their areas of expertise. Based on this explanation, it is anticipated that environmental dynamism may represent important determinant in decision to outsource HR functions. Therefore, it is proposed that:

P4: The higher the environmental dynamism, the higher the reliance on HR outsourcing.

Research Methodology

This empirical research is quantitative in nature and data will be collected by means of self-administered questionnaires which will be distributed to HR manager in the organisations from various industries operating in Peninsular Malaysia. This study is a cross-sectional type of enquiry in which data will be collected at one point of time in an uncontrolled setting. The measuring instrument is a structured questionnaire. Questionnaires will be designed in two languages-English and Malay. The participants will be invited to respond to the questionnaire in the language that they are most comfortable with and that they commonly use in their daily work life. Prior to conducting a pilot study and a quantitative data collection, preliminary interviews will be carried out among ten respondents to obtain a “fresh” view of their experiences in managing their business; in particular, the practice of outsourcing.

Discussion

The aim of this study has been to conceptually provide the factors influencing the engagement in HR outsourcing. The intention has been to provide a critical explanation of the specific model on the decision to outsource HR functions. Existing literature on HR outsourcing appears to be rather limited in general. This may be due to both research and practice in HR outsourcing being in its early stages of development. The present evidence also suggests that the key to developing an efficient strategic outsourcing lies in understanding how outsourcing adds value to the firms.

Although the growth in outsourcing, specifically HR outsourcing has prompted research, the overwhelming discussion for outsourcing appears to be cost reduction, the relationship with service providers, advantages and disadvantages of outsourcing. In fact the outcome of research on HR outsourcing is fragmented and inconclusive. Hence, it is difficult to draw any clear conclusions on the factors that influence HR outsourcing. It is possible; however, to identify the range of factors that influence the decision to outsource HR functions, insofar as it includes aspects from the organisation’s competitive environment as well as organisation-internal aspects. With respect to this, the current research aims to consider the impact of strategic orientation, managers’ characteristics, organisational size and environmental dynamism on the decision to outsource HR functions.

References


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