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AND CUT COSTS**

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**No More Excuses for HR:  
It's Time to Add Value and Cut Costs  
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When a company is striving to ferret out costs and promote innovative management, all parts of the enterprise should be fair game. Yet the human resources department in many companies has avoided downsizing, and is still run much the same way it was 10, or even 25, years ago when it was known by the impersonal name of personnel. In a typical large U.S. company about one out of every ninety employees works in HR, a ratio that hasn't changed in decades. Spending on HR administration, which usually runs over \$1,200 per employee annually, has increased steadily, albeit slowly, over the past ten years.

Since 1995, the Center for Effective Organizations at the University of Southern California's Marshall School of Business has conducted three (1995, 1998, and 2001) studies examining trends in the HR organizations of large corporations. In 1995, our survey of HR executives reported that the HR department spent 80 percent of its time on managing administrative services such as payroll, benefits, relocation, record keeping, and the auditing and development of HR processes. When we resurveyed these executives in 2001, their responses were the same.

Some HR executives do feel they are active business advisors to line executives on managing their human capital — helping them to obtain, develop, and deploy people in order to successfully execute business strategies. For example, seventy-nine percent of the HR managers participating in a 1998 survey described themselves as “business

partners”. Yet only 53 percent of the line managers responding to the same survey saw HR managers as business partners.

There are many reasons the HR department has been slow to change, not the least of which is the widespread perception that it is simply a fact of organizational life that has little or no effect on business performance. The time has come, however, to see beyond this limited view of HR. Technology is driving a revolution in the way HR administration can be managed, giving HR executives new data-collection and analysis tools with which they can more easily demonstrate the importance of effective human capital management — to strategy and the bottom line. Furthermore, large administrative cost savings can also be realized by outsourcing activities that don't contribute to shareholder value. Companies that hone HR's contributions in both the human capital strategy and administrative realms can build a significant competitive advantage.

### **Drivers of Change**

Sophisticated new IT applications and systems, and the emergence of technology-savvy business process outsourcers specializing in human resources administration (HROs), are the most significant drivers of change in HR.

Outsourcing of HR administration is not new, of course. For years, companies have outsourced specific services (typically payroll, benefits, relocation, and the management of HR information systems) to cut costs and improve service. But increasingly large companies want full-service HROs who can deliver and manage multiple HR processes — to cut HR administrative costs even more.

With paperwork for health insurance, compensation planning, flexible benefits, and legal compliance—to name just a few of the tasks HR handles — becoming even more burdensome and costly, demand for HRO services has grown rapidly. In 2003, HR services topped Gartner Inc.’s list of the business processes most commonly outsourced by large corporations.

The “soup-to-nuts” HROs that have been created in the last few years handle HR process design and provide a full range of HR administrative services — payroll and benefits management, compensation, planning, recruiting, training administrators, and management relocation. By offering an integrated service, these HROs eliminate the difficulties involved in coordinating and managing multiple vendors. Like IT outsourcers, the HROs have a level of expertise and a scale of operations that allows them to achieve process efficiencies and service levels in HR administration their customers cannot match.

The global energy company BP’s decision in 1999 to outsource HR administration to the start-up Exult, Inc., was a bold move that has triggered growth in the number of full-service HROs. Today Exult is the market leader serving large U.S. and European companies. Companies with well-known names in IT outsourcing (i.e. Accenture, EDS, and ACS) have entered the HRO market with full service offerings; established HR consultants such as Hewitt Associates and Fidelity have also moved into the market.

Full-service HROs rely heavily on Web-based “eHR” software applications and systems, they use self-service HR tools that allow employees to get routine HR-related

information and submit forms through a company intranet. Manager self service tools allow managers to do compensation management, employee transfers, and a growing list HR activities that formerly required paper work and discussion with the HR department.

Self-service is convenient for employees and relieves HR staff from time-consuming paper processing and interactions with their “customers.” A few companies are beginning to use self-service tools for career development and job searches. Using these tools, employees have remarkable opportunities to research and apply for new jobs within their company, sign up for training, and get current information about their company’s business performance. At BP, fifty thousand employees have online access to job information, career guidance, and resources for skills development.

In theory, outsourcing nonstrategic HR operations and giving employees self-service tools frees HR professionals to focus on being business advisors in organizational design, building management capabilities, assessing the costs and benefits of HR initiatives, and in business strategy formulation and implementation.

New human resources information systems — so-called HRIS systems — enable senior and mid-level HR professionals to perform potentially powerful strategic analysis. For example, the latest systems can track and analyze data to link competency development, staffing requirements, and the costs to support a new product launch. Using specific competency data, for instance, HR can identify skill strengths and gaps, recruiting needs, potential organizational changes, and control compensation and benefits costs.

Another new HR IT resource, employee relationship management tools (ERM), makes it easier to capture and analyze data from multiple sources. The result: insights into the costs and causes of employee turnover, better measures of the ROI of specific programs such as incentive plans and training offerings, and the ability to track individual employee's skills development and preferences. Like the better-known Customer Relationship Management (CRM) systems, ERM tools use advanced data mining techniques.

### **Outsourcing Strategies**

Outsourcing all of HR administration is highly attractive for most large companies. My research at BP, Prudential, International Paper, and Bank of America confirms that outsourcing HR administration and the use of self-service eHR systems have reduced their HR administrative costs by over 15 percent, and have improved the quality of HR services. Furthermore, my research shows engaging with a full-service outsourcer facilitates the integration of HR systems, and increases the probability that the internal HR group will be liberated from administration so that it has the chance to be a strategic partner to business units.

But handing HR administration to an HRO and implementing self-service are radical actions that warrant close scrutiny. Ultimately, the outsourcing strategy needs to fit the role top management wants HR to play, and the readiness of the organization to adapt to significant changes.

Before entering into any discussions with an HRO, a company needs to know its HR administrative costs and quality. If a company is unsure whether outsourcing HR

administration can save money, it probably hasn't carefully tracked its HR costs or service levels, because there usually is significant room for process improvements and labor cost reductions. Activity-based costing models are one tool that can help determine what is being spent on HR programs and services.

Wholesale outsourcing all of HR administration is far more disruptive than doing this one task at a time. The HR department that emerges will look and feel very different that it did before. The size of the internal HR staff will be rapidly and dramatically reduced. Managers will have to get along without someone in-house to answer their HR administration question and do their paperwork.

Organizations can count on resistance to and fear of change from their HR departments and the people they serve. For many long-time HR administrators working in an HR department that isn't immersed in administration is not only undesirable, it's frightening. Many HR administrators truly enjoy helping managers and employees solve their issues day-to-day and take pride in their expertise. They worry about losing personal contact with their "customers." One way companies can respond to these employees is to transfer their jobs to the outsourcer. The HRO gets the internal knowledge and talent of its client's best administrators, which makes it easier for the HRO to quickly build their service capabilities. This is the approach IBM used when it contracted with Fidelity for HRO.

There is also the issue of whether HR staffs have the business skills to meet new expectations. My research, supported by recent research at the University of Michigan on HR competencies, indicates many HR professionals don't have the right skills and

experience to take on more strategic responsibilities. Because they often have spent their entire careers in HR— or even HR one specialty such as training, compensation, or recruiting — they don't have sufficient knowledge of the business or experience in assessing organizational effectiveness or leading change.

Adjusting to an eHR self-service system can be difficult for many employees. Everyone needs time to get used to the electronic tools. Remember how people initially reacted to e-mail? Some took to it immediately; some were reluctant converts; and some, to this day, still prefer not to use it. At one company I studied, managers could do a number of administrative tasks (e.g., give raises, post jobs) on the company eHR system, but they still preferred to deal directly with their HR contact. The company finally broke this habit by eliminating the HR administrators so line managers had to use the new self-service system.

Finally, it's impossible to over-emphasize the importance of selecting the right vendor, and managing the relationship from the outset as a close partnership. When the outsourcer steps in to run the process, there are many operational details that can easily fall through the cracks and cause friction at a crucial time when the two parties are trying to build trust. An HRO, for example, can't instantly liberate HR managers from their administrative work, especially if imperfect data has to be corrected by hand to keep systems running smoothly, which is common in large companies.

Hiring outside experts in such areas as change management, organizational design and business strategy is often necessary, but these decisions need to be evaluated separately from outsourcing administration. These decisions require a deeper

understanding of an organization's market, its operating environment, and business strategy. We use the HR Pyramid to differentiate the low strategic value transactional HR processes that every company must perform from those that have the potential to create a strong competitive advantage. (See Exhibit 1.)

### **Organizational Effectiveness**

One way to reframe the role of HR is to try new terminology, perhaps replacing "human resources" with "organizational effectiveness," and appointing a "Chief Organizational Effectiveness Officer," with responsibilities for ensuring the organization has the right human capabilities and core competencies to meet its business goals.

With or without the change in language, appointing a respected senior executive, who reports to the CEO, to provide leadership in the areas of Human capital management, organization design, and effectiveness, is critical to setting a new tone and validating a new role for HR. When BP CEO John Browne made the decision to outsource its HR administration , there were senior HR executives ready to take charge of transforming the HR function, including internal marketing to change the perception of HR firm wide and to define new positions for HR professionals as advisors to businesses.

A business partner approach to HR has emerged at two U.S. retail companies, Home Depot, Inc., in the home-improvement business and Washington Mutual (WaMu) financial services. Both companies have HR executives who are highly visible and influential members of their company's top leadership team. The CEOs handpicked

them for the top HR job, giving them responsibilities far outside the traditional boundaries of HR.

What distinguishes HR at these companies is that senior HR executives are expected to be involved in all areas of business decision making — whether it is a long-term strategic initiative, such as buying and integrating companies, or changing the market and brand positioning, or ongoing operational concerns such as managing supplier relationships, communications, and customer service.

“We in HR exist for only one reason: to increase the organization’s capability,” Daryl David, senior vice president of HR at Washington Mutual, told *Chief Executive* magazine last December. Mr. David, reporting to the chairman and CEO Kerry Killinger, has played a pivotal role in Washington Mutual’s growth by acquisition. Since 2000, the firm has completed seven acquisitions, expanding from a midsize regional financial services company of 25,000 employees to a national player with more than [CK] 50,000 employees as of 2003. Mr. David and his team get involved in due diligence for each acquisition, in post-acquisition integration, and in planning for future organizational changes. In 2000, Linda Clark Santos, a PhD. in educational administration and former senior HR executive at Starbucks filled WaMu’s newly created position of senior vice president for talent acquisition and organizational capability, reporting to Mr. David.

Dennis N. Donovan, executive vice president of human resources at Home Depot, was one of the first senior executives hired by Robert Nardelli when he became CEO at Home Depot in December 2000. Mr. Nardelli, recruited his former colleague at General Electric, because he knew Mr. Donovan could immediately dive into leading

major strategy and change initiatives, and tackle the challenges associated with rapid growth.

In TK YEAR, Mr. Nardelli set a corporate goal of opening a new store every 43 hours, and hiring over TK a year. In 2002 alone the company hired more than 180,000 people, and expanded in Canada and Mexico. Within a few months of his arrival Mr. Donovan and his HR team came up with 300 different projects to initiate over a three-year period, many of them aimed at strengthening management and leadership skills in order to increase operating efficiency and customer service at the store level. For example, using information collected from an online survey of 276,000 Home Depot employees, Mr. Donovan was able to link the turnover of store managers directly to store financial performance, and identify the store manager job as a pivotal position in achieving corporate goals. He also showed how rapid growth had drained Home Depot's store management pipeline, and created service problems in some stores.

In response, the HR department introduced a learning forum for store and district managers, and within five months put 1,800 managers, many of whom were learning to develop strategy and create operating plans for the first time, through a week of intensive leadership training. Now there is an HR manager in every Home Depot store to help create a locally based Leadership Institute, a leadership development program for high-potential managers, and a new executive leadership program.

## **Pace of Change**

The reinvention of the HR department is inevitable; the only question is how fast it will happen?

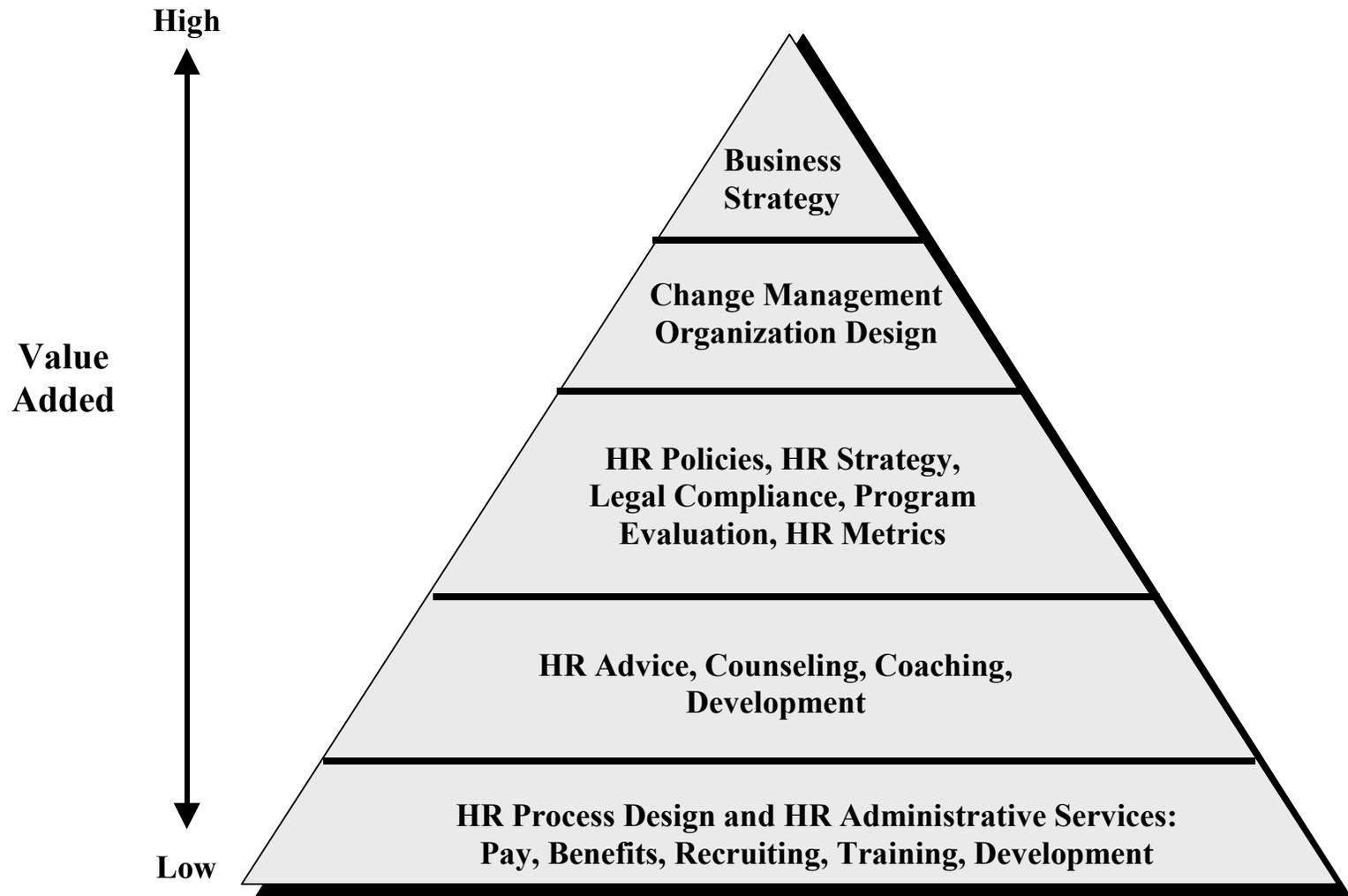
Fortune 100 companies are currently leading in outsourcing HR administration because they often have an IT infrastructure to support it. Small- and medium-sized companies potentially have plenty to gain from HR outsourcing as well, too, so there is every reason to believe that more and more vendors will target them.

It is less clear how quickly HR professionals can become, or for that matter if they ever will become, strategic business partners. In some instances, the HR department that emerges following a major outsourcing could be a very small group whose only job is to manage the relationship with the BPO. This is likely to happen if the company's senior management takes the view that value creation at the top of the HR pyramid is too important to be left to an internal HR function. In this case, senior executives from other parts of the company may take on the strategic HR role themselves.

Some involvement in HR strategy on the part of executives is not just OK it is needed, but it shouldn't be a substitute for having an HR staff that understands the business and can be strategic partners. Managers who are not experts in HR and organizational effectiveness just don't have the knowledge needed to link strategy and HR. Consultant's can help but they typically lack company knowledge and the ability to manage change. I strongly believe there is a need in modern organizations for a high-powered HR staff group that focuses on how human capital should be managed,

developed, and organized in order to implement an organization's business strategy. Whether it's work is called HR or organization effectiveness isn't important. What is important is that the group exists, and is staffed with talented business executives.

**Figure 1**  
**HR Pyramid**



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