

# HUMAN RESOURCE OUTSOURCING AND OFFSHORING

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## ABSTRACT

During the past decade Human resource Outsourcing (HRO) has become increasingly common and companies based in highly developed regions of the world, like North America and Western Europe, are increasingly outsourcing HR tasks to cheaper regions of the world. Two regions are seeing a considerable rise in popularity as a location for HR outsourcing: Southern Asia and Central and Eastern Europe (CEE). India has been the most attractive place for outsourcing and offshoring. The potential of CEE is just being realized. The advantages of the CEE countries over India include language (English, German, French) availability, cultural similarity with Western Europe and the US, time-zone affinity, connection to Europe, regulatory restrictions on employee data movement, and highly-developed educational system. This study identifies the factors that make a particular country a good location for HRO. It compares CEE countries to India and analyzes their advantages and disadvantages in terms of suitability for HRO work.

**Keywords:** outsourcing, human resources, HRO, offshoring

## INTRODUCTION

Due to the globalization and increased competition between firms all over the world, business in developed countries, such as USA, are facing great challenge. So, retaining their competitive advantage over their rivals has become a strategic issue for all companies. There are two ways they can increase their profits and keep and increase their market share: outsourcing or offshoring their business processes.

In order to consider the outsourcing and offshoring industry, it is best to define the terms up front, since the words are often used in conjunction and are sometimes used incorrectly.

Outsourcing refers to the situation when companies-buyers hire other companies, called providers, to perform some functions for them or even outsource the whole business process. The roots of outsourcing come from production outsourcing. This type of outsourcing was the first one that companies used for many years. But then, because of the development of technologies, new markets began to appear, the companies grew and the number of the function they performed also increased. Outsourcing corporate functions was driven by global and local competition and the desire to minimize costs. For example, companies can outsource their financial, production, human resource, and marketing functions. Outsourcing was an approximately \$500 billion global industry in 2009, with three major divisions: 1) logistics, sourcing and distribution services; 2) information technology services, including the creation of software and the management of computer centers; and 3) business process outsourcing (BPO) areas such as call centers, financial transaction processing and human resources management. [19].

Offshoring refers to the situation, when the company sets its office in a different country or geographic region. Offshoring is increasingly used by U.S., Japanese and Western European firms to send both knowledge-based and manufacturing work to third-party firms in other nations. The intent is to take advantage of lower wages and operating costs in such nations as China, India, Hungary, Poland, Romania. The choice of a nation for offshore work may be influenced by factors such as the language

and education of the local workforce, transportation systems, natural resources, availability of governmental support in this region and political and economical situation. For example, China and India are graduating high numbers of skilled professionals from their universities—thus enabling these nations to attract massive amount of contracts. Countries of CEE offer well-educated employees, high percentage of graduates in the workforce, high-grade office space, high levels of security, extensive use of quality management techniques such as Six Sigma, and geographical and cultural proximity [18]. In many cases, offshoring utilizes less-skilled labor working for low wages. In other cases, offshore contracts go to firms in nations that have developed technology and highly-skilled and educated workers. [19].

## **HUMAN RESOURCE OUTSOURCING AND OFFSHORING**

Human resource management is of management that deals with special practices that help company to build highly educated, efficient and motivated workforce in order to reach firm's strategic goals. Human Resource Outsourcing and Offshoring simply refers to outsourcing and offshoring human resource management functions, such as recruiting, selection, development, appraising performance, compensation, benefits, and others.

The basic services offered by Human Resource Outsourcing firms may include: overseeing organizational structure and staffing requirements, recruiting, training and development, tracking department objectives, goals and strategies, employee and manager training, benefits administration, employee orientation programs. Businesses who outsource HR are typically small to midsize firms with between 25 and 1,500 employees, providing a company with skilled professionals who are focused specifically on HR, helping a firm reduce and manage operating costs, improving employee relations [9]

## **REASONS FOR HR OUTSOURCING**

Human Resource Outsourcing helps companies achieve four objectives. The first is organizational. Many companies seek greater efficiency by outsourcing “back office” operations such as human resources [14]. This also allows companies to concentrate on their core competencies saving time. HRO can improve the level organizational management and control as well as create a good image of the company through working with a credible provider. [2] The second type of objective is financial. Through working with a good provider company can increase shareholder's value. [2] Also a firm can cut its costs by outsourcing and offshoring to cheaper locations, like CEE and India. The third objective is employees. Outsourcing and offshoring HR functions to different countries can help the company to hire well-educated and talented employees there [22]. Concentration on core business processes and most importantly helps in ensuring employee satisfaction. For example, outsourcing HR processes to professional leasing companies can ensure the firm that employees will be effectively managed. Moreover, PEO can also help companies to cut costs: the Society for Human Resource Management of the US reports that companies with fewer than fifty employees can save anywhere from \$5,000 to \$50,000 in time and labor costs annually by hiring a PEO [8, p.21]. Fourth objective is strategy. Outsourcing HR activities to highly-technological nations, like India or China, might give the company an access to these technologies. In these countries a firm might acquire new knowledge and ideas from the provider or subsidiary that can be implemented to increase company's competitiveness. Also business might receive a long-term tax exemption and other benefits in different countries by having good relations with officials of these courtiers.

## **REVIEW OF THE GLOBAL HRO MARKET**

In the HRO market major suppliers are the following companies [12]: Northgate ARINSO, ExcellerateHRO, ADP, ACS, Accenture, IBM, Convergys, and Hewitt. It would not be expected, that each of these suppliers would be equally represented on each continent. For example, according to the Everest Research Institute Hewitt with the share of more than 30% is the main HRO supplier in North America followed by Convergys and IBM. In Europe Accenture is the largest HRO supplier with the market share equal to the Hewitt's in North America. Convergys is the main HRO supplier in Latin America and in Asia and Pacific regions with the share little bit more than 25% in each market. Also the most equally represented companies on the all continental market are Hewitt and Convergys.

In CEE Accenture's market share is almost three times more than that of its closest rival on the HRO supplier market – IBM. Accenture has two service centers in Prague that handle outsourcing services. In 2001 the Hungarian Oil and Gas Company (Mol Rt) signed a six-year deal with the consulting firm Accenture. IBM, in its turn, won incentives for an expert solutions centre in Brno, Czech Republic, to handle outsourced customer information systems. [12]

Because of the economic crisis that began in the second half of 2008 global HRO market slowed down and reached 2.9 billion dollars, according to the Everest Research Institute. The reason was that companies didn't have enough financial resources to sign big multifunctional HRO deals. Still the organizations were interested in outsourcing small HR activities, like payroll. In 2009, the HRO market is projected to grow by 5% and reach 3.2 billion dollars [11, p.7]. This growth will be primarily achieved by the entrants of new suppliers, and not by the increase in the sum of HRO deals. Buyers are focused on financial benefits from outsourcing; which has always been a concern but is even more so these days. Clients are looking for shorter ROI in their deals. This means that short-term gains as well as long-term gains are important, but firms are trying to be cost-neutral or cost-beneficial in as short of a time frame as possible. Thus, as fewer companies outsource huge multifunctional HRO operations and more HRO suppliers are appearing in the global market, the competition is becoming more intense, the prices are going down. It becomes more visible that the tendency of outsourcing to cheap locations as Asia and CEE, in particular, will grow in the nearest future. Industry experts such as Everest predict the growth of HRO market in CEE in the next few years. [11, p.7] Suppliers' profitability in the lower cost locations is expected to grow as buyers are less interested in expensive customized deals. By providing companies with cheap globally standardized deals, suppliers will increase their revenues and profits.

Driven by the demand to reduce cost HRO suppliers are likely to adopt new software systems that will create global service offerings. The implementation of new technologies will lower prices and increase the quality of HR services. [11, p.9]

## **HRO OUTSOURCING TO INDIA**

During past years India has become one of the major centers for HR Outsourcing in the world. According to a 2005 survey three important reasons in selecting a location were: expertise, cost savings and time savings [17]. The main advantage of Indian labor is its cost. It is very cheap compared to European and Asian Markets. For example, it is easy to compare an average income in these countries. In 2008-2009 in India it was \$66 per month or \$794 per year. [3]. The Californian mean annual wage at the same time was \$48,090 according to the Bureau of Labor Statistics. In Poland it was \$13,265 [20], in Russia - \$7,353 [16]. The difference is huge. But labor costs are only one reason why companies outsource to India. Another important reason is the availability of a huge pool of English speaking people. There are 280,000 of English speaking people in the US and 100 thousand in India [1]. Amazingly, the difference is not so big. There are no such a statistics for many Central European and all Eastern European countries. There are two possible explanations for this difference. First, there are few universities in these countries that prepare students to speak English fluently. Secondly, not many multinational companies have major operations in these countries to encourage people to learn English.

A third reason for companies to choose India is its convenient geographic positioning. India is located in the most quickly developed region in the world – Asia. It is located near such Asian economic “tigers” like Malaysia and Singapore and borders China. A fourth reason is the large opportunities for the Indian HRO market. The Indian HRO market is growing at a rate of about 50 percent annually [21].

The top three reasons for not outsourcing work to a given country were lack of data privacy, lack of market maturity and lack of reliability. The Indian HRO market has all these drawbacks. Many specialists cite the lack of data privacy as a major issue. The fear of losing jobs, losing control over confidential data, ethics and quality of outsourcing vendors, security breaches and overall confidence in the vendor deters many organizations [17]. The Indian government is reluctant to address the suggestions of the companies. As a result many companies will not outsource or offshore to India until this problem is solved.

### **CENTRAL AND EASTERN EUROPE**

In this part of my research I examine why many companies outsource and offshore their HR functions to CEE. As recent trends show, since 2005, European HR outsourcing suppliers have gained 10 percent of the global market, currently hold 30 percent of it, and these numbers will likely continue to increase to meet rising demand in a market that hasn't been significantly penetrated.

Many US and Western European companies underestimate the value of the HR market in the region of CEE. In this section I provide the list of the reasons, explaining, why it is important to consider CEE as a good place for HRO. For example, a 2004 report from AT Kearney listed the Czech Republic, Poland and Hungary as among the 12 most attractive offshore investment locations.

CEE has an advantage over rivals such as India because it is closer in timezone, distance and culture to company headquarters and customers in Western Europe and the US. [7] For example, many companies find it difficult to deal with a caste system in India, as there a person earns its status when it is born. Also, if to consider the cultural dimensions of Hofstede, CEE doesn't differ so much from the US and Western Europe, as India, for example. Below I listed the table that compare Hofstede's cultural dimensions (of the US and Poland and India) [15].

**Table 1**

<b>Country</b>	<b>PDI</b>	<b>IDV</b>	<b>MAS</b>	<b>UAI</b>	<b>LTO</b>
U.S.s	40	91	62	46	29
India	77	48	56	40	61
Poland	68	60	64	93	32

PDI – Power Distance, IDV – Individualism, MAS – Masculinity, UAI – uncertainty avoidance, LTO – long-term orientation

As I've mentioned time zone and geographical proximity make the region of CEE extremely attractive for Western European companies, as they save time and money, when they offshore and outsource their HR processes to CEE. Besides, geographical proximity makes it easier for firms to manage their foreign subsidiaries. If we calculate the distance to 2 major US cities from capitals of Poland, India and Russia we will see that it takes more time and money to get to India that to CEE Countries. (table 2)

**Table 2**

<b>Country</b>	<b>Distance to LA (miles)</b>	<b>Distance to NY (miles)</b>
Poland	6001	4269
Russia	6085	4680
India	8000	7315

CEE locations have become an integral part of supplier strategies to deliver HRO services in Europe, serving as HRO hubs to support European operations. [13]

Western companies are increasingly seeking workers from CEE markets because of talent shortages in their own backyards. Also companies are looking for the employees who have good knowledge of the most widely spread language in the world – English. The table below compares literacy rates and knowledge of English of Asian countries: India and China and CEE countries: Poland, Czech Republic and Belarus. From the table you may understand that literacy rates in the countries of CEE is higher than in the developing countries of Asia. In addition, the level of knowledge of the English language is almost equal among 4 countries, except China. [16, pp. 31-32] [4]

**Table 3**

<b>Country</b>	<b>Literacy rate</b>	<b>Knowledge of English (according to the official results Of the TOEFL tests- 2008)</b>
India	79,9	93
China	90,9	76
Poland	99,8	87
Czech Republic	99,0	90
Belarus	99,7	89

New European centers in CEE are benefiting from the experience that providers have had in growing their Indian and Far Eastern service centers. It is not uncommon to find the Indian leadership of those centers at the forefront of the establishment of the Eastern European centers.[18]

As many of the CEE countries have become a part of the European Union in 2005, their political and economical stability is guaranteed these days. And, still many companies, are afraid of investing in Asian countries as they are considered less politically and economically stable. Poland, for example, is “considered politically stable with strong institutions” by the EDC (Export development of Canada) Association. The same resource of information says follows about political stability in India: “Several terrorist attacks in 2007-2008, including bombings in Delhi, Ahmedabad, Bangalore, Jaipur and Hyderabad have highlighted the threat posed by Islamist terror groups within India.

A growing number of foreign investors have been relocating jobs from their western operations to the European Union's new member states to benefit from investment incentives offered by governments. For example, in Poland there are 14 Special Economic Zones (SEZ) which are administratively separate parts of Polish territory and which have been allocated for the running of businesses on preferential terms. A foreign company, through settling in an SEZ, is assured of tax benefits and is granted permission to begin trading directly by the managing board of each zone. Also the Polish government promotes selected sectors, in particular services sector. These sectors are offered the highest growth potential and the best prospects for sustainable development in Poland. The sectors promoted by the government are also international trade in services (call centers, shared service centers, and others. [10]) Considering Belarus this region has a free economic zone. Businesses operating in these zones enjoy a range of benefits including: zero-rate tax on exports for the first 5 years; exemptions on turnover tax, road tax and property tax, entitlement to open foreign and Belarusian currency bank accounts, priority at border crossings, full exemption from import duty on raw materials [5]

The CEE (mostly members of European Union) countries are becoming an integral part of the offshore and outsource equation, because of the regulatory restrictions on employee data movement, which doesn't exist in India.

## CONCLUSION

The study shows that despite the fact that today India is the major provider of HRO in the world the CEE region has lots of advantages over India to become a huge market for HRO in future.

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