

## **THE EFFECT OF OUTSOURCING HUMAN RESOURCE ON ORGANIZATIONAL PERFORMANCE: THE ROLE OF ORGANIZATIONAL CULTURE**

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### **-Abstract-**

*The improvement that high organizational performance provides is becoming more critical in today's increasing conditions of competition. The effects of human resource functions and organizational culture to perform a significant organizational efficiency attracts both theoreticians' and practitioners' interest much more. When outsourcing is considered as one of the methods that organizations utilize for strengthening their core competencies to allocate their resources efficiently, the question of the degree to which human resource functions could be outsourced brings in mind the effect of organizational culture enabling outsourcing on organizational performance.*

*Besides performing the administrative services such as catering, cleaning, employee transportation, and security as outsourcing, operations of some human resource practices like training and payroll via outsourcing contribute the desired performance positively by means of only true strategy and organizational culture shaping the strategy. The performance of human resource management and the viewpoints of employees about outsourcing have critical importance to improve a convenient strategy. In this literature research, what kind of human resource practices can be outsourced and can add value to organizational performance are discussed. The influence of workers' changing attitudes about outsourcing towards organization in detail and the effect of organizational culture in the mentioned relationships are missing in the literature.*

**Key Words:** *Human Resource Management, Organizational Culture, Outsourcing, Organizational Performance*

**JEL Classification:** M10, M11, M14, M19

### **1. INTRODUCTION**

The strategic value of an activity determines its capability as a source of competitive advantage. Barney (1991) states that sustainable competitive

advantage is a result of possessing immobile resources that permit clear product or service differentiation. However, not all resources have the potential to be a source of sustainable competitive advantage for the firm. Barney (1991) also affirms that for a resource to have that potential, it must satisfy four conditions: be valuable, rare, imperfectly imitable and non-substitutable. The strategic resources that satisfy the conditions for being sources of competitive advantage are superior assets and capabilities and distinctive core competences (Day & Wensley, 1988; Prahalad & Hamel, 1990). Distinctive core capabilities are those processes that involve a combination of physical and human resources and which are later responsible for the organization's tacit and explicit knowledge. (Espino-Rodriguez, Pardon-Robaina, 2005)

The debate on human resource (HR) outsourcing is polarised. HR outsourcing is seen as an opportunity for the HR function by some and as a threat by others. The first view suggests that HR outsourcing is an instrument creating time for HR to become a strategic partner. The second view considers HR outsourcing as a cost-cutting instrument gradually reducing HR staff. (Delmotte, Sels, 2008)

The purpose of this study is to examine the effect of outsourcing HR practices on the organizational performance in the light of detailed literature and question the role of organizational culture on this relationship.

## **2. OUTSOURCING**

With the increasing globalization, outsourcing has become an important business approach, and a competitive advantage may be gained as products or services are produced more effectively and efficiently by outside suppliers (Yang, et. al. 2007; McIvor, 2008). The need to respond to market changes on a daily basis and the difficulty of predicting the direction of such changes mean that organizations must focus on their core competences and capabilities (McIvor, 2008). Traditionally, outsourcing is an abbreviation for "outside resource using". Outside means to create value from without, not within, the company (Yang, et. al. 2007). Outsourcing allows firms to focus on their own core competences by relocating limited resources to strengthen their core product or service (Lee and Kim, 2010) and to strategically use outside vendors to perform service activities that traditionally have been internal functions (Raiborn, et. al. 2009; Elmuti, 2004; Bustinza, et. al. 2010). Outsourcing can also involve the transfer of both people and physical assets to the supplier (McIvor, 2005).

The traditional outsourcing emphasis on tactical benefits like cost reduction (for example, cheaper labor cost in low-cost countries), have more recently been replaced by productivity, flexibility, speed and innovation in developing business applications, and access to new technologies and skills (Elmuti, 2004; Gilley, et. al. 2004).

Two influential theories in the study of outsourcing have been transaction cost economics (TCE) and the resource based view (RBV) of the firm. According to transaction cost economics, a company will make the outsourcing decision on the basis of reducing production and transaction costs. Resource-based view which views the firm as a bundle of assets and resources that if employed in distinctive ways can create competitive advantage (McIvor, 2008).

### **3. OUTSOURCING AND ORGANIZATIONAL PERFORMANCE**

Because of resource limitations, few firms have the ability to apply world-class resources to all areas of competition. Thus, in order to gain competitive advantage they must select areas in which they will concentrate their resources (Hamel and Prahalad, 1994). By outsourcing to specialist organizations services not generated by core competences, companies can see an improvement in their organizational performance (Kotabe, 1989) Gilley and Rasheed (2000) state that there are three reasons for this. Firstly, the acquisition of non-strategic services allows the organization to centre on what it really can do well, that is, on the services whose resources have a high strategic value (Gilley, et. al. 2004). Such a focusing on services not included in the core competences can increase performance and allow the company to be more flexible. Secondly, increasing the outsourcing of non-strategic services can improve both the quality and the service (Dess et al., 1995). Lastly, the outsourcing of services of low strategic value enables the company to reduce costs and improve its competitive position (Gilley and Rasheed, 2000; Espino-Rodriguez and Robaina 2004).

Some research shows that companies that make alliances by trusting external sources have better results, reduce risks and improve the quality ratio while also increasing their capacity of innovation and flexibility (Espino-Rodriguez and Robaina 2004). Kotabe et al. (2008) propose a dynamic perspective, which suggests an inverted U relationship between outsourcing and performance (Kotabe et al. 2008; Lee and Kim 2010).

### **4. HUMAN RESOURCE OUTSOURCING**

HR outsourcing is the contracting out of parts or the whole of the functions of HR to external providers, rather than performing all the HR functions in-house (Adler, 2003; Patry et al., 1999). HR outsourcing ranges from simply transferring non-core activities such as payroll and benefits administration to external providers, to the outsourcing of recruitment, training and even HR strategic planning (Patry et al., 1999; Klaas et al., 1999). HR managers are expected to be more flexible, responsive, and efficient than personnel managers of old, and to contribute to the strategic decisions of their organizations. In response to this paradigm shift, many HR managers are turning to outsourcing as a way of meeting these demands (Cook, 1999; Lepak and Snell, 1998).

Gilley et al. have analysed relationships between HR outsourcing and organizational performance in manufacturing companies. They conclude that outsourcing of certain HR activities has a positive impact on overall innovation within the company.

Klaass, McClendon, and Gainey (2001) investigated the relationship between some organizational characteristics and the decision to outsource HR. The relationship between the degree of outsourcing and the perceived benefits generated was moderated by reliance on idiosyncratic HR practices, uncertainty, firm size and cost pressures. The impact of organizational characteristics varied among the different types of HR activities outsourced.

In making outsourcing decision, organizations need to consider the likely impact of outsourcing these activities on the organization's performance. To do so, they may need to distinguish between "core" and "noncore" activities. Finn (1999) suggests that a basic distinction can be made between HR "core" and "noncore" activities. The former include top-level strategy, HR policies, and line management responsibilities (e.g., appraisal and discipline), while the latter include specialist activities (e.g., recruitment and outplacement), routine personnel administration (e.g., payroll and pension), and professional HR advice (e.g., legal advice related to employment regulations). Ulrich (1998) goes one step further by suggesting that core activities are transformational work that creates unique value for employees, customers, and investors. Noncore activities would be transactional work that is routine and standard and can be easily duplicated and replicated. The development of technology is also significant. The Internet and new generations of software have revolutionized HR information systems, significantly improving HR productivity, increasing control of employee benefits, streamlining compliance efforts, facilitating the management of payroll functions and lowering the cost of recruiting (Jarvis, et. all, 2006)

While there may be consensus that organizations should perform core functions in-house and outsource those functions that are non-core to their organizations, what is considered core and non-core varies between organizations. Hence, the decision as to which HR functions should be outsourced is often driven by the organization's business strategy (Abdul-Halim, Che-Ha, 2009).

Through the end of 2008, *Human Resource Management Journal* had only two articles with outsourcing in their titles or abstracts but neither of them dealt with HRO. Through December 2008, *Human Resource Development Quarterly* had published only two articles on outsourcing and training. (Gainey & Klass, 2005; Leimbach, 2005, Norman, 2009).

Hall and Torrington (1998) found that training and management development, recruitment and selection, outplacement, health and safety, quality initiatives, job evaluation, and reward strategies and systems were the likely HR activities to be outsourced, either because they were considered noncore or because the

organization lacked the expertise to handle them internally. Hall and Torrington's findings are supported by Shaw and Fairhurst (1997), who found that training and development along with facilities management were the most likely areas to be outsourced, while industrial relations expertise was the least likely area (Cooke, Shen, McBride, 2005).

Gilley, Greer and Rasheed (2004) analyzed the relationship between the outsourcing of human resource (HR) activities, namely training and payroll, and firm performance. Researchers hypothesized that the outsourcing-performance relationship is not the same for all firms. Results indicated that training and payroll outsourcing have implications for firm performance (Norman, 2009).

In the book *Out of Sight* Sullivan (2007) articulates the case against HRO making four points. First, outsourcing does not provide an organization with a competitive advantage. Secondly, HRO limits the growth, the image and the capabilities of the HR function and stunts the development of HR Professionals. Thirdly, in most cases no "actual" cost-savings are realized. Vendors are proving value by listing customers. Sullivan (2007) suggests that HRO vendors offer reductions in costs or penalties, if they don't meet quality time and cost promises. Fourthly, Sullivan (2007) deals with the problem of maintaining company secrets and data security. Another concern is that in spite of the transfer of the work, outsourcing does not shift all legal liability to the vendor (Norman, 2009).

## **5. HR FUNCTIONS OUTSOURCED**

### **5.1. Recruiting Process Outsourcing (RPO)**

Recruitment process outsourcing (RPO) has a long history and is growing rapidly. A natural outgrowth of mass purchasing of recruiting services, RPO has matured in terms of size, scope, and duration of contracts. RPO taps into two core reasons for outsourcing gaining needed expertise and lowering costs (Norman, 2009)

### **5.2. Training and Development**

Although delivery of training has long been outsourced by companies, the level of outsourcing is increasing rapidly. Driving the increase in outsourcing of training and development activities has been the rise in the number of training projects and the nature of those projects (Friedman, 2005). Gainey and Klass (2003) highlighted strategic importance of outsourced trainings in their study. The researchers apply to view of transaction cost economies, social exchange theory, the resource-based view to identify factors thought to impact client satisfaction with external training vendors. Findings show that socially-oriented trust and contractual specificity mediate the relationship (Norman, 2009)

### **5.3. Compensation and Salary Surveys**

Executive compensation is often done by consultants like the Hay Group, Hewitt.

One advantage of outsourcing the salary survey process that is unique to this HRM activity is the issue of being charged with conspiring to set prices with other organizations. The employing organizations often avoid getting too deeply involved in collecting market data on pay rates by subcontracting this activity.

#### **5.4. Organizational Design and Development**

This is an area that the strategy consultancies and HR consultancies cultivate due to the access to senior organizational leaders that is required for this activity.

#### **5.5. HRIS/HRIT**

Accenture built on its strength in IT outsourcing to link IT rollouts to HR via Enterprise Resource Programs such as SAP, PeopleSoft and Oracle. This is often the backbone of the multi-process HRO arrangements. There are significant economies of scale due to the licensing costs of ERP software imposed by Oracle and SAP. (Norman, 2009)

#### **5.6. Payroll**

Payroll processing involves perhaps the most transactional, routine activity involving HR and is the most frequently outsourced HRM activity (Norma, 2007)

### **6. RELATIONSHIP BETWEEN ORGANIZATIONAL CULTURE AND ORGANIZATIONAL PERFORMANCE**

The term “culture” refers broadly to a relatively stable set of beliefs, values and behaviours commonly held by a society. (Lim, 1995). According to Hofstede (1980), organizational culture refers to the collective programming of the mind that distinguishes the members of one organization from another. (Abu-Jarad, et. al. 2010). And organizational performance is defined as the organization’s ability to attain its goals by using resources in an efficient and effective manner. (Daft 2000; Abu-Jarad, et. al. 2010)

It has been contended that organizational culture can enhance organizational performance by energizing and motivating employees, unifying people around shared goals, and shaping and guiding employee behaviours. Some researchers asserted that organizational culture can provide a source of sustained competitive advantage for firms, particularly when it is seen as a firm-level resource that is valuable, rare, and difficult to imitate (Ngo and Loi, 2008). An organization's cultural norms strongly affect all who are involved in the organization.

Lau and Ngo (2004) found that organizational culture with a development and innovation orientation had a direct effect on a firm’s innovation performance (Ngo and Loi, 2008; Ogbonna and Harris, 2000).

## 7. MODERATING ROLE OF CULTURE ON OUTSOURCING

An outsourcing strategy will lead to changes in policies, cultural values. In fact, outsourcing can lead to the disintegration of an organization's culture. (Corby, 1998). The redrawing of the boundaries of the organization will impact upon the prevailing values and norms of employees. The culture of the organization must be considered in the formulation and implementation of the outsourcing strategies. (McIvor, 2005).

The existing organizational culture is disturbed when an external outsourcing agent enters the organization (Hemmington and King, 2000). Thus it will affect collaboration between the organization and the agent when the respective cultures are not compatible to achieving their objectives. An outsourcing relationship can be conceptualized as an extension of the client company's (the dominant group) culture (Kshetri, 2007).

Culture of transparency is one of the foundations for outsourcing partnership. Establishing the culture of transparency and trust are significant elements in the communication framework (Schoker, 2008). Hendry (1995) highlighted the corporate culture enabling communication in all unit for the hidden cost of outsourcing in his study.

Ogbonna and Whipp (1999) highlighted the important role played by culture in the link between organizational strategy and HRM. Since organizational culture is a valuable resource for companies, it has a key role to play in the HR and firm performance link. Bowen and Ostroff (2004) suggested that the strength of organizational climate is an important mediator between HRM system and firm performance. Lau, Kilbourne, and Woodman (2003) suggested that cultural change involves changes in the shared perceptions and interpretations of certain domains of an organization by organizational members (Lau, Ngo, 2004). Therefore, it can be said that organizational culture has critical importance for the HR activities which can be outsourced considering the organizational performance.

An important rationale for outsourcing is to develop less bureaucratic HR departments, which are often criticized for the constraints they impose on operational flexibility (Greer, Youngblood, Gray, 1999).

Language similarity is also a critical component of cultural compatibility. Ethnic linkage between the managers of origin and destination countries increases cultural compatibility (Kshetri, 2007).

In the literature, offshore outsourcing is usually examined. The effect of national culture on the outsourcing of information and communication technology is studied.

Kshetri (2007) researched institutional factors affecting offshore business process and information technology outsourcing. The researcher examined the mechanisms by which regulative rules, social rules, culturally supported habits and subconsciously accepted rules and customs influence assessment, selection as well as continuation of outsourcing projects

The researchers examining the effect of culture on business process outsourcing are considered in the framework of organizational culture highlighting communication and transparency or national culture, especially offshore outsourcing of ICT, in the literature

## **8. EMPLOYEES' ATTITUDES TOWARDS OUTSOURCING**

As in any new area of research, there has been very little empirical research on the psychological aspects of the practice (Giardini, Kabst, 2008). How employees feel about BPO is important because it may have mediating effects on employees' behavior and attitudes as well as on variety of organizational outcomes

Employees cognitions and affects regarding outsourcing are likely to vary with the degree of their familiarity of various aspects of outsourcing such as its content, and process. Some aspects of outsourcing may be evaluated favorably, while other aspects may be viewed as detrimental (Drezner, 2004)

Organizations provide employees with a sense of identification and feelings of security and belonging. When these are disrupted, employees, as stakeholders, may feel resentful and retaliatory. About one-third of HR professionals resist outsourcing because they risk losing their jobs, may be forced to work for a vendor, and fear that management believes that outsiders are more competent. Once rumours of outsourcing arrangements are started, HR managers can expect talented employees to start job searches and all employees to suffer anxiety resulting in lost production (Belcourt, 2006).

Regardless of underlying reasons for outsourcing activities, employees perceive a qualitative change in their employment and psychological contract with the firm as a result of the firm's outsourcing decisions. Outsourcing may affect some employees positively by upgrading their role, requiring them to focus on high value-added activities, replacing mundane and repetitive work. However, for some employees, outsourcing can result in a loss of employment (Adler, 2003). Given such significant impact on employees, it can be posited that outsourcing may lead to a perceived alteration of the psychological contract, potentially leading to negative organizational outcomes such as perceived betrayal (Kessler, Coyle-Shapiro & Purcell, 1999), job insecurity, (Cooper, 1999), depression and low self-esteem (Applebaum, Simson, Shapiro, 1987)

Elmuti, Grunewald, Abebe (2010) researched consequences of outsourcing strategies on employee quality of work life, attitudes and performance. The attitudinal results of this research indicated that outsourcing strategies had a negative impact on the perceived quality of work-life dimensions.

Ndubisi, (2011) identified conflict handling typologies which affect trust and commitment in B2B outsourcing relationship. It is also considered the moderating effect of culture in the relationship. Data was collected from Chinese and Indian firms providing HR outsourcing services. The impact of compromising conflict handling on trust and commitment is moderated by culture -significantly higher for the Chinese (business culture is a blend of the moral values of Confucianism and comprising elements which relate to long-term business relationship including strong personal connection and interpersonal harmony) service providers compared to the Indians (spiritualism and the Notion of 'Karma'). Culture has also a direct impact on commitment but not on trust (National culture effect).

Giardini and Kabst (2008) hypothesized that Recruitment Process Outsourcing (RPO) has a negative effect on the perceptions and evaluations of job applicants. Results indicated that the satisfaction of participants with the process, the attractiveness of the organization, and the intention to accept a job offer decreased with increasing levels of RPO

## **9. DISCUSSIONS**

It is seen in the detailed literature research that the organizations apply to outsourcing for empowering core competencies and outsourcing of human resource functions is also for the same reason in the light of such theories as transaction cost theory and resource-based view.

The determination of business strategies on the decision of HR outsourcing is considered cautiously. The degree to which transactional or relational human resource activities can be outsourced is evaluated in accordance with this respect. Abdul- Halim and Che-Ha (2009) carried out a research related to outsourcing decision with 232 HR managers. According to findings, there is a significant relationship between organizations with proactive strategies and the decision to outsource both transformational and transactional HR functions. Outsourcing of both functions has a significant relationship with HR performance – traditional with a positive impact and transactional with a negative impact.

The status of multional or national company affect the decision of HR outsourcing and considering HR outsourcing as innovation can have impact on selection of HR practices that will be outsourced. Galanaki and Papalexandris (2007) examine the effect of company internationalization on the practice of outsourcing HRM functions in their study. They hypothesized that HRM outsourcing is perceived as an innovative practice and that foreign multinationals

(MNCs) would use this practice more than native ones do. A significant difference is found in the extent of HRM outsourcing between Greek companies and foreign multinational subsidiaries.

HR outsourcing has the potential to empower HR managers, allowing them to focus on strategic activities that add more value to their organization. Also, the results show that HR reduces actual HR labour costs.

Three main HR-outsourcing industry segments have emerged: consultants, administrative-service providers and technology enablers. (Adler, 2003). These outsourcing players also gain the significant role in HR processes in Turkey. HR information technology system, recruitment, training and development- especially outdoor trainings-, and administrative jobs (catering, cleaning, employee transportation, security) are the most common outsourced HR practices according to statement of HR managers.

Another point is external organizational commitment in human resource outsourcing. Lievens and Corte (2008) tested HR managers' commitment in outsourcing relationships. Affective commitment or desire for the outsourcing relationship to continue was related to the depth and frequency of HR outsourcing. Continuance commitment, which refers to the constraints that keep the outsourcing relationships intact, was not related to the continuity of HR outsourcing. Affective commitment was fostered by HR managers' perception that HR vendors shared the same values for managing people.

The employees' viewpoints about outsourcing and attitudes towards organization are discussed in the literature, empowering core competency that increases organizational performance is highlighted. The effect of national culture is examined for decision of particularly offshore outsourcing and shaping attitudes after outsourcing in the empirical studies. Conceptually, the impact of the culture enabling trust, knowledge sharing-integration and communication on attitudes is investigated. Cascio (1993) reports that only 44 percent of companies that downsized in the previous five years shared details of their downsizing plans with employees, and even fewer companies told the survivors where they fit into the new strategy. Two-thirds of the employee respondents in the same study reported a loss of trust and declining morale, following restructuring.

The effect of the organizational culture and its operationalized dimensions and types (Clan, Aggressive culture) on outsourcing HR process needs detailed research, there is a substantially missing that addresses organizational performance in this HR outsourcing-culture relationship.

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