Headnote

BP's trailblazing 1999 pact with Exult has had its successes, but it also serves as an object lesson in how not to carry out an HR outsourcing deal-and illustrates how much the landscape has changed.

View Image - STRIKING SAVINGS Despite early difficulties, the British oil giant has cut its HR costs by 20 percent.

LIKE MOST STORIES ABOUT REVOLUTIONS, the tale of human resources' switch to outsourcing starts small and swiftly builds momentum. It's punctuated with drama and disappointments, struggles and successes.

The beginning of this revolution comes in 1999. That's when BP, the British-based multinational oil and gas conglomerate, decides to outsource nonstrategic HR functions in its various businesses. BP is already big on outsourcing, but not in human resources.

In fact, nobody has ever done what the company wants to do. Only one business outsourcing consulting firm, PricewaterhouseCoopers, even makes a pitch for the contract. BP executives decide it's not good enough. Eventually they give the job to an outsourcing startup named Exult, along with a seven-year contract worth $600 million. Despite everyone's good intentions, the first 18 months are chaotic, with both sides figuring things out as they go. As BP transfers functions like payroll, Exult uncovers a mess of poorly documented processes and other glitches. Web-based tools, some the first of their kind, are oversold and underused. BP's human resources employees are reluctant to cooperate with the transition, knowing they're eliminating their own jobs. Initially, the corporation's HR costs go up instead of down. Contracts are revised over and over.

It's a textbook case of how not to conduct an HR outsourcing deal-literally. University of Southern California management professor Ed Lawler, former Exult CEO James Madden and two other co-authors devote an entire chapter to the travails of getting the BP-Exult deal off the ground in a book published last year titled Human Resources Business Process Outsourcing: Transforming How HR Gets Its Work Done.

The final chapter in this saga of an outsourcing pioneer isn't written yet. But five years into BP's precedent-setting contract, much has changed. Human resources functions for the world's third-largest oil company are now handled by Hewitt Associates, the $2.2 billion HR consulting firm and benefits outsourcer that bought Exult for $690 million last year. Many of the managers at BP and Exult who worked out the contract have moved on, parlaying their experience as outsourcing pioneers into leadership roles at other companies or as consultants.

Many of the kinks are gone too. Some goals that BP and Exult outlined early on, such as serving all 100,000 BP employees worldwide, never materialized. But today Hewitt oversees employee recruitment, training, relocation, severance, payroll and benefits administration for 72,000 BP employees in the U.S. and U.K. and 3,000 expats who work in 40 other countries.

BP executives declined to be interviewed for this story, but by Hewitt's estimation, HR service levels have increased.

The bottom line also looks good. According to Hewitt, BP's annual HR costs are 20 percent lower than they were before the switch. In his textbook, Lawler states that as of 2003, BP was saving $ 15 million a year in HR operating costs by outsourcing and had avoided more than $30 million in capital expenditures. Those once buggy Web tools today help BP's human resources executives do things like match employees' expertise and goals with company directives.

BP's contract with Hewitt is still one of the largest, most lucrative HR outsourcing deals ever, but it's set to end in December 2006. Industry watchers say that given the contract's troubled start and current outsourcing vendor options, they wouldn't be surprised if BP shopped around and ended up with another partner. Bryan Doyle, president of Hewitt's $1.4 billion outsourcing business, says he's in talks with BP's new executive vice president of human resources management, Sally Bott, who started her job in March. "She's taking an overall look at what the strategy is for HR, let alone for HR administration," Doyle says. Hewitt has re-signed 95 percent of its BPO relationships that have come up for renewal, and Doyle expects clients to look around. "Every organization needs to understand what their options are," he says. "Procurement (procedures) almost require that."

View Image - INCREASED COMPETITION Hewitt's Bryan Doyle says he expects clients to shop around.

Whether or not BP switches partners, it's a dramatic time for HR outsourcing. Since BP and other early customers such as Bank of America and International Paper signed deals five or six years ago, the landscape has blossomed. Use of HR outsourcing among U.S. and international corporations still isn't widespread, but it's swiftly growing.

POISED FOR GROWTH

Yankee Group, the Boston-based business researcher, reports that only 8 percent of fortune 1,000 companies currently farm out multiple HR functions but that the market could increase more than 30 percent this year. The organization estimates that HRO spending could reach $14 billion by 2009. "We're way beyond the early adopters," Lawler says. "If you're not looking at it and thinking about it, you're not awake."

Initially, HR outsourcing vendors targeted only megacorporations like BP because they needed very large employee pools-25,000 or more per deal by one estimate-for the economies of scale necessary to make outsourcing financially feasible. Then competition increased and per-employee prices started to drop.

Now outsourcing is trickling down to large and medium-sized businesses. Eight of 13 HRO contracts signed in the first quarter of 2005 covered 25,000 or fewer employees, according to Everest Group, a Dallas-based HR outsourcing researcher. Regardless of size, companies are looking to farm out benefits administration and other mundane, processintensive operations to focus on strategic issues.

View Image - SEMI-RETIRED Exult CEO James Madden left shortly after Hewitt's purchase.

On the outsourcing vendor side, major players such as Accenture, IBM, Fidelity and ACS have bought into the market or created offshoots of existing consulting or BPO work to handie HR outsourcing clients.

Six years ago, though, none of it existed. No established vendors. No industry research. No case studies. No map for how to put together an outsourcing deal.

It was into that vacuum that BP and Exult jumped.

In the late 1990s, the time was right for BP to look at HB outsourcing. Oil prices were low, and the company had to cut operating costs. BP had already successfully outsourced IT and finance functions, so top-level management was sold on the concept.

Most important, BP was in the midst of a major buying spree, giving it many redundant HR processes and programs to cull but also a critical mass of employees to make outsourcing feasible.

BP's initial contract called for Exult to take over general HR administration, payroll, benefits, retiree administration, relocation services and HR information services and to manage any other HR outsourcers for BP employees worldwide, starting in the U.S. and the U.K. By contract, the Irvine, California, outsourcer had just 14 months from the December 1999 signing date to "deliver direct labor-related services at BP's existing cost less 20 percent," according to Hitman Resources Business Process Outsourcing. As a show of good faith, BP bought a 9 percent interest in Exult, which at the time was a startup with only a handful of employees and no other clients but had $150 million from General Atlantic Partners, a Palo Alto, California, venture capital firm that funds outsourcers.

It was an ambitious undertaking, and things went wrong right away.

One of the biggest dilemmas: BP's various acquired companies and business units had their own methods of handling payroll, benefits enrollment and administration and other procedures. In the U.K. alone, various BP entities used 100 different employment contracts.

The outsourcing deal called for BP and Exult to pick the best of those processes, then simultaneously switch all work to them and transplant everything from BP to service centers that Exult was opening in the U.S. and Scotland. However, because of the contract's short time frame to show cost savings, it didn't always happen. In many cases, Exult simply "lifted and shifted" many duplicate processes, according to Nick Starritt, then BP's group vice president of human resources.

View Image - COVERAGE EXPANDSSince the inception of multiprocess HR outsourcing seven years ago, the number of employees covered has increased by more than 100-fold, to 3.7 million as of March 31.BUSINESS ON THE RISESince 2000, as the nascent multiprocess HR outsourcing industry took off, the total value of worldwide contracts has grown more than 250% to $12.5 billion in 2004.COSTS COME DOWNCompetition among vendors and economies of scale have helped push down the price per employee for multiprocess HR outsourcing contracts by more than a third both for large and very large companies.TRANSACTIONAL FOCUSNot surprisingly, the more transaction-oriented the HR process, the more likely it is to be included in a multiprocess HR outsourcing contract, according to a March survey of 99 companies with such deals.

Eventually, streamlining did occur. By 2003, BP had cut the number of employment contracts to 10, says Starritt, who left BP that year and is now an HR consultant with Sirota Consulting in Surrey, England.

But that streamlining wasn't without struggle.

"There were times when I've wanted to throw the people from Exult out the window. And I'm sure there have been times when they've felt the same about me," Chris Moorhouse says in Human Resources Business Process Outsourcing. Moorhouse succeeded Starritt as BP's group vice president of HR in 2003 and in turn has been succeeded by Bott and will retire this year, according to a BP spokesman.

Because the original contract came in the midst of the dot-corn mania of 1999, having an HR Web portal became part of the outsourcing contract and was of particular interest to BP chief executive John Browne, Lawler and Madden write in their book.

Plans called for one Web service that BP's board could use to track senior managers, another portal that BP employees could use to look at internal job postings, and a third Web-based database of employees' personal information and skills they could update themselves. But building Web services proved much harder than anticipated. Lawler writes that it wasn't until 2003 that internal Web sites started coming into their own. That year, 25,000 employees a month were accessing HR services through BP's myHR portal. As of October 2003, more than 5,500 jobs had been posted online, receiving 17,000 online applications from BP employees. As of 2004, 70 percent to 80 percent of employees updated information such as emergency contact and direct deposit information online instead of calling Exult, the authors note.

Originally, BP executives expected outsourcing to cover employees worldwide. That proved unworkable. It was cost-effective to perform payroll and other HR administrative tasks together for multiple English-speaking countries, Madden said in an April interview. But it didn't pay to set up service centers in non-Englishspeaking countries with fewer than 5,000 BP employees, notes Madden, who left Exult four months after Hewitt acquired the company and is now semi-retired, advising General Atlantic Partners and racing sailboats. Eventually, BP dropped the goal of worldwide coverage from the contract.

BP's outsourcing contract also stipulated that Exult manage third parties providing BP with relocation assistance, background checks, drug tests, language training and other services. That, too, caused problems, says Patrice Gilles, who managed BP's third-party contracts as Exults global operations vice president.

When she signed on in 2001, Exult was just taking over managing other outsourcers and there were lots of gaps, Gilles says. "We had an unimaginable number of change orders-10 a week just to supplement the contract," she recalls.

Exult and BP were to split 50/50 any cost savings from managing other outsourcers. But the cost-savings formula was nebulous, so BP employees had no incentive to use the approved outsourcers. BP and Exult initially worked out cost-savings formulas on a case-by-case basis and gradually developed a contract language that new third-party contracts could plug into, says Gilles, who left Exult in 2003 and now works at EquaTerra, a New York consulting firm.

When BP outsourced HR functions to Exult, the company displaced the equivalent of about 400 full-time HR positions. A handful of HR managers went to work for Exult. Others found work elsewhere within BP.

As of 2004, however, BP still had too many employees in human resources, Lawler writes. Still, from 2000 to 2003, the ratio of BP human resources personnel to employees dropped from 1-to-60 to 1-to-80 as BP continued to make acquisitions, he says.

CLIENTS JUMP SHIP

Overall, BP achieved most of its goals of streamlining and standardizing HR processes within the first three years of the contract, says Starritt, who stays in touch with the company's HR team. Today, BP's HR managers have "a more reliable measure of how much money they're spending on human resources, and where and when in the year they spend it," he says.

If BP doesn't renew its contract, however, it won't be the first client Hewitt has lost.

Since Hewitt acquired Exult, two former Exult clients have ended their contracts, including one that Hewitt announced in early May but hasn't named. The other is Bank of America, which merged with FleetBoston Financial last year. After the merger, the bank said that beginning in 2005 it would turn over payroll and benefits administration work that Exult had been doing to Fidelity, which had been handling those processes for FleetBoston.

Madden downplays the loss, saying it was a natural outgrowth of the merger. But several industry watchers say it was a major setback for Exult at a time when the company needed the cash flow to fund international expansion to keep up with client demands and win new business-and was ultimately one reason the company sold to Hewitt.

Hewitt's clients aren't the only ones to leave their original HRO partners. In January, chemical company BASF took its HR outsourcing business away from Mellon and gave it to Fidelity; Mellon subsequently sold its HRO business to ACS. In 2004, after Gateway closed its retail stores, the computer maker ended what was to have been a seven-year HRO contract with ACS.

As BPO contracts come up for renewal, analysts believe more companies will jump ship. Major HR outsourcers have opted to build service centers around standard software such as PeopleSoft and SAP, the same platforms corporations use to run their HR processes, says Lisa Rowan, HR management and staffing services program manager at IDC, a researcher in Framingham, Massachusetts. If BP managers feel they've accomplished transforming and standardizing their HR processes well enough for another vendor on the same software platform to step in and take over, they might consider it, Rowan says. "The grass is going to look greener; that's just the way of the world," she says.

Companies shopping for a BPO vendor have more options than ever, including expensive custom offerings from companies like Hewitt to more mass-market, standardized packages from companies such as payroll processing powerhouse ADP, says Michel Janssen, managing research director at Everest Group's Everest Research Institute in Dallas.

"High-end players like Hewitt are thinking about their ability to differentiate themselves in the next three to five years, or otherwise it becomes a commodity game, with the (vendors) with the lowest price winning," Janssen says.

As HR outsourcing deals go, BP's story is already ancient history. Contracts no longer take 18 months to implement. Standards are set. As industry observers see it, companies looking to outsource HR functions will see BP's experience not as a blueprint for what to do, but as a cautionary talc of what not to do.

As for BP, executives there "will tell you they're still at it," Starritt says. "This isn't simple work." As BP found, major corporations may claim their people are their greatest assets, but they generally do a poor job of tracking those assets, he says. "You have quite sophisticated systems like PeopleSoft down to quite literally pieces of paper in some back office in some far-flung part of the world. It's an issue large corporations are still wrestling with."

View Image -

Sidebar

AT A GLANCE

Sidebar

BP is one of Britain's largest companies and one of the world's main suppliers of petrochemical and oil products. The company has operations in more than 70 countries, and its key areas of interest are oil and gas exploration and production; the refining, marketing and supply of petroleum products; and the manufacturing and marketing of chemicals. BP's brands include Arco, AM/PM convenience stores and Castrol motor oil.

Ticker symbol: BP (NYSE)

Headquarters: London

CEO: John Browne

Employees: 102,900

Market cap: $211 billion

Sales (2004): $285 billion

Profit (2004): $15.7 billion

52-week range: $51.20-$66.65

Background: William Knox D'Arcy, who set out to explore Persia (now Iran) for oil resources, founded the Anglo-Persian Oil Co. in 1909. The British government took a 51% shareholding in the company in 1914, shortly before the outbreak of World War I, and contracted AngloPersian to supply the Royal Navy with fuel oil. In 1987, the government sold off the last of its holding in the company, which was renamed the British Petroleum Co. in 1954 and is now known simply as BP.

Sources: BP and Hoover's

Sidebar

HEWITT EXULTS IN HRO DOMINANCE

FROM ITS POSITION as an independent business process outsourcing pioneer, Exult has in the past year become the crown jewel of Hewitt Associates' human resources outsourcing business.

Since buying Exult for $690 million in stock in October, Hewitt has used the company to vault to the lead of the HRO industry, closing almost $1 billion in deals with 10 companies including Marriott, Pepsico and Sun Microsystems during the first seven months of fiscal 2005.

Hewitt now holds 21 percent of all HRO deals worldwide, with competitors Accenture and Fidelity running second and third, respectively, according to an April 2005 report by Everest Research Institute, an industry researcher in Dallas.

By jumping headfirst into the HRO market, the Lincolnshire, Illinois, company is banking on higher growth rates and operating margins in the still-young industry. This will bolster stagnant financial results in its more mature businesses: providing Fortune 500 clients with benefits administration and HR consulting.

Currently, HRO contracts account for 21 percent of Hewitt's total revenue. The company does not break out earnings for that segment of its business.

But swallowing Exult hasn't come without a price. As it refocuses, Hewitt has reported lower earnings on narrowed margins for the second quarter ended March 31, including a one-time $10 million charge stemming from two contracts originally signed by Exult.

After the May 4 announcement, Hewitt's stock fell to a 52-week low.

In a Q2 conference call with analysts the same day, Hewitt CEO Dale Gifford characterized 2005 as a building year for the company's HRO business, saying that as newly signed outsourcing deals mature, they should generate profit margins as high as 20 percent. According to Gifford, Hewitt has signed additional contracts, worth $150 million in annualized revenue, that the company hasn't started working on yet, and it has bids out for contracts worth an additional $290 million.

Analysts and industry observers agree that Hewitt looks smart for buying Exult when it did and at the price it paid.

"Given what they've done since, it made (Exult) a great buy," says Ed Lawler, a management professor at the University of Southern California's Center for Effective Organizations and co-author of the 2004 book Human Resources Business Process Outsourcing: Transforming How HR Gets Its Work Done, which chronicles Exult's early days.

Still, Hewitt can't afford to sit still. In addition to Accenture and Fidelity, several much larger companies have entered the business, including IBM, ADP, ACS and-through its ExcellerateHRO joint venture with Towers Perrin-EDS. That alphabet soup of a dozen or more competitors should dwindle to a core of three or four first-tier vendors over the next two years, predicts former Exult CEO James Madden, who left Hewitt in January.

"That's the way it is in most of the BPO markets," Madden says. "IT has three major vendors, and more at a second tier. I think you'll see the same thing here."

A bigger player could decide to buy its way into a heftier market share, and then Hewitt is the prime takeover candidate, analysts say.

"They're not so big they couldn't be bought," says Michel Janssen, Everest's managing research director.

Bryan Doyle, president of Hewitt's outsourcing business, doesn't see that happening. Since merging with Exult, Hewitt can fill all of its clients' HR needs and doesn't need-or want-to be part of another organization, he says. "Our assets are our employees and the relationships we have with their clients," Doyle says. "If we were interested, it would have to make sense for our clients and the industry overall." -M.V.R.

Adventures in outsourcing

Rafter, M. V. (2005). Adventures in outsourcing. Workforce Management, 84(6), 51-55. Retrieved from http://search.proquest.com/docview/219790067?accountid=27965 View this document in ProQuest