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As Mid-market Buyers Eye HRO, a Hybrid Model Shows Its Appeal

ERP or proprietary solution? Why not both? With hybrids offering the best of both worlds and mid-market buyers willing to settle for less customization, look for more of these alternative solutions.
By Paul Knowles

Prior to 2004, ERP solutions dominated the European HRO market with more than 85 percent of all large-scale deals incorporating an ERP system as part of the core offering. In recent times, this picture has changed with proprietary systems playing an increasing role in HRO propositions. This is partially due to the fact that in Europe, payroll is increasingly the hub to which most multi-process HRO deals is built on. In contrast, U.S. deals are much more centered around benefits administration.

The payroll-centric approach is hardly surprising given that payroll data is the greatest single source of people data for European businesses seeking to manage ever more complex cross-border organizations. This point was highlighted by my Everest Group colleagues Darryl Conley, Vipul Taneja, and Phil Fersht in their article "Fertile Grounds for a Common European HRO Market in 2007" in the Winter 2006 edition of HRO Europe. They emphasized the growing trend for both global and regional outsourcers to develop or acquire their own pan-European payroll capabilities upon which they can build out a full-blown HRO delivery model.

Implicit in this developing trend is the desire by suppliers to deliver standardized technology solutions for their pan-European clients. While this is fast becoming a proven strategy in the large scale market segment (more than 15,000 employees), the complexity of the European HR landscape in terms of labor relations, technology, and organizational culture presents significant barriers to this ambition in all but the largest one-to-one pan-European HRO deals.

Despite this impasse, there is growing recognition within the HRO supplier community of the emerging European mid-market (companies with 3,000 to 15,000 employees). Less well-served today, this market nonetheless has the potential to be broadly comparable in revenue terms to the Tier-one clients pursued by most Global HRO players.

According to the Human Resources Outsourcing—Market Update published by Everest in June of last year, the market is characterized by decreasingly complex service needs, greater willingness to adopt standardization, and acceptance of one-to-many delivery models. It is, therefore, not surprising that an increasing number of mid-market companies look to explore the HRO option in search of cost reduction, technology access, and more effective uses of resources. There is also evidence that suppliers are becoming more flexible in their approach to the technology standardization issue, with multiple stakeholders influencing the evolution of the market (Fig.1).



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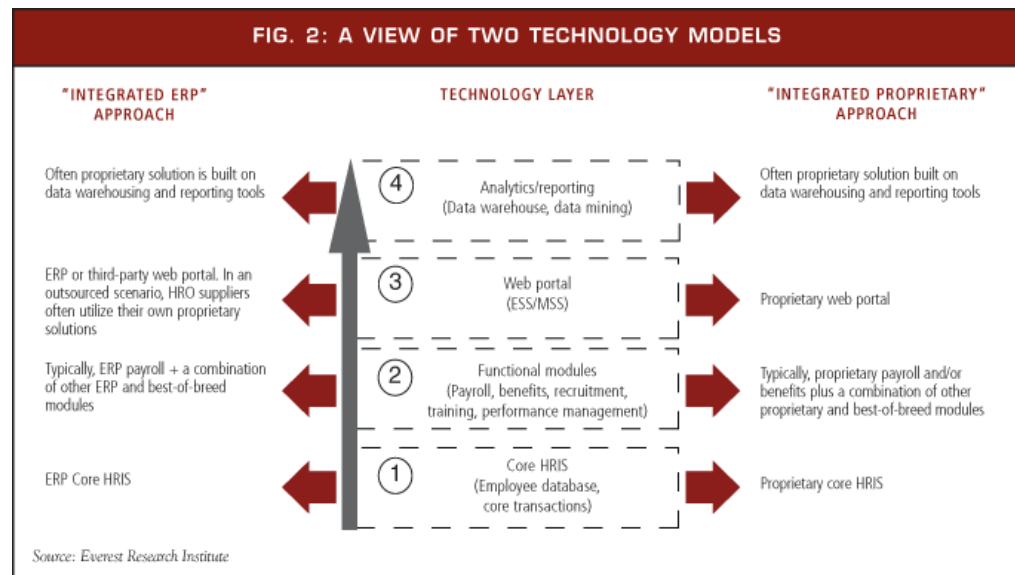
FIG. 1: VARIOUS TECHNOLOGY APPROACHES

SOLUTION	EXAMPLE	DESCRIPTION
ERP-led	<ul style="list-style-type: none"> ■ Arinso ■ Convergys ■ IBM¹ 	ERP provides creating incentives for BPO suppliers to ERP platform at the core of their solution
Propriety	<ul style="list-style-type: none"> ■ Hewitt ■ Fidelity 	Creating their own proprietary solutions that would largely replace ERP platforms
Mix and match	<ul style="list-style-type: none"> ■ Excellerate HRO ■ Xansa ■ Accenture 	Utilizing select modules of existing ERP platforms Mixing these with best-of-breed proprietary solutions
Build out	<ul style="list-style-type: none"> ■ ADP² ■ Ceridian 	Leveraging existing payroll solutions to build out feature functionality in incremental steps

¹ IBM tends to leverage buyers' existing platform
² ADP offers an SAP solution for large global clients
 Source: Everest Research Institute

While the main ERP players continue to lead the market, proprietary solutions hold a significant and growing market share. Recent figures show that some 26 percent of HRO deals awarded on a cumulative basis up until December 2005 are based on a core proprietary solution rather than an ERP solution. Within the emerging mid-market employer segment, this percentage rises to 4 percent.

However, what these figures disguise is the growing number of deals included within these numbers that are based on a hybrid technology solution comprising a core ERP or proprietary platform, combined with best-of-breed solutions. At the minimum level, the ERP/proprietary solution simply forms the core "vanilla" HRIS with data manipulation and specialist functional applications included in a technology layer (Fig. 2).



At face value, the hybrid model only appears to add complexity. However, after taking a step back, the reason for this evolution in base technology strategy is more easily understood.

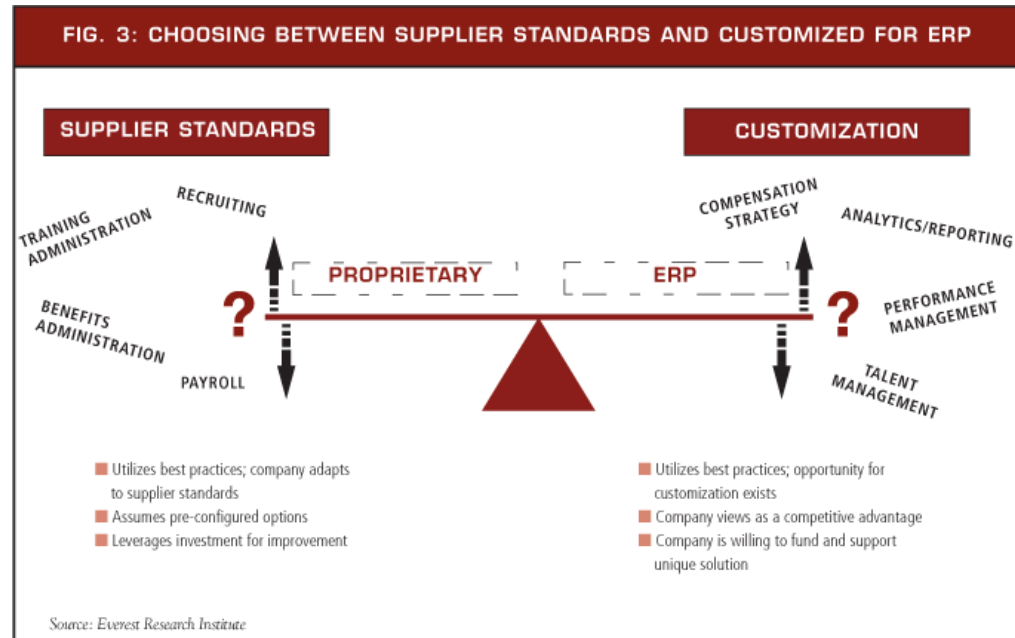
ERP systems are characterized by high direct implementation costs, maintenance, and customization—factors proving prohibitive for mid-market companies to accept as part of the HRO proposition. The offer of client-independent licensing by SAP to partner HRO suppliers has helped somewhat to mitigate implementation costs. And most, if not all, ERP providers are making considerable investments in enhancing functionality. However they still have some way to go.

Proprietary or standalone systems historically had low functional capability, especially around judgment-intensive processes, and were not licensed or hosted by their suppliers separate from their HRO solution. In the past, this led to high exit costs for buyers looking to move services back in-house and proved a barrier to many mid-market companies taking an initial decision to outsource. Arguably, with the advent of more mature data conversion processes and XML standards, this is proving a less limiting factor, albeit it remains an area of concern.

For these reasons, HRO hybrid technology solutions are increasingly augmenting the functionality of ERP and proprietary systems. This "tools-on-top" approach provides suppliers with the opportunity to offer a one-to-many model, including advantages of both economies of scale and flexibility in process adoption/implementation.

From an organizational perspective, the ability to phase the adoption of new technologies allows companies

to consider HRO without the potential of losing significant investment in legacy systems. Furthermore, it also allows them to balance trade-offs between supplier standard processes in basic back-office HR administration and the potential for some areas of customization in either technology or process that the buyer considers a competitive advantage or a key strategic HR activity (Fig. 3).



This is particularly attractive for mid-market employers, not least for the scale opportunities offered through the one-to-many model. However, it does require the company to have a clear and explicit set of goals and desired business results, both near and long term, in order to assess the trade-offs against appropriate measures. Additionally, companies need to ensure that they avoid getting locked into a model that lacks the flexibility required to change and grow as circumstances dictate. This obviously needs to be managed carefully during supplier negotiations and built into both the contract and governance model.

While the need to clearly articulate business goals and objectives is a prerequisite for effective long-term success, perhaps the key point for a mid-market organization is that the hybrid technology HRO solution provides a degree of flexibility, price competitiveness, process standardization, and technology enablement not available through in-house ERP or outsourced ERP/proprietary systems alone.

As the HRO market continues to develop and mature, suppliers and technology providers will need to face a number of choices that will impact the evolution of the HRO business landscape. One such choice revolves around the decision on the technology road map.

It is arguable that a one-to-many delivery model is key to a successful HRO business in the mid-market. However, large multi-country, one-to-one HRO deals continue to dominate the European landscape. It, therefore, remains to be seen whether there is an appetite within the supplier community to invest in a technology road map that can accommodate both the mid-market and large-scale employer requirements.

We are nevertheless starting to see divergent technology solutions being adopted by the major players. Only time will tell which strategy is right. What is certain is that such decisions will have a significant impact on the rate of growth in HRO at both the enterprise level and the mid-markets, relative supplier market share and, ultimately, on the long-term profitability of the suppliers themselves.

The Everest Research Institute will hold a webinar on March 27 to explore the theme of pan-European payroll delivery. Registration is available at <http://www.everestgrp.com/events.html>

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