AN EXPLORATORY STUDY ON HUMAN RESOURCE OUTSOURCING

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DEDICATION

I would like to dedicate this research to my Savior, my Lord and my Inspiration, Jesus Christ who gave me all the blessings in terms of finance and resources for my research. I am glad because His grace is always sufficient for me. In addition, I would also like to express my gratitude to my family members; especially my parents and God’s family members who always encourage me throughout the progress of fulfilling this research. It would have been an arduous task for me to accomplish this research without all your support and encouragements.
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With a sincere and deep gratitude to my supervisor, Dr Ng Kim Soon, I would like to thank him for his patience and intellectual guidance in leading me throughout the journey of completing my master’s degree. He motivates me to give my best in this study. Moreover, I would also like to express my gratitude to several lecturers who provided me with some constructive comments in regards to improving my research.

I wish to convey my appreciation to the Faculty of Technology Management and Business for providing me with journals and theses from senior postgraduate students. I also want to thank the office staff there who always helped me to prepare the documents that I needed for the interview.

Besides this, I would like to express my thankfulness to my church members who gave me encouragement and financial support during times of hardship which allowed me to experience the goodness of this great family of God. My sister in Christ, Peniel Ang is the one who gave me guidance in my study and even brainstorm how to continue when my thesis reached the bottleneck. I would also like to especially thank my shepherd, Calebie Tan, who proofread my thesis and gave me full support in this journey.

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ABSTRACT

Malaysia is a developing country with a competitive environment. Hence, there is an in full potential to grow in the market. In the era of rapid economic growth, HR department plays an important role in company. HR function outsourcing is important as it helps companies to be more efficient and deemed to cut cost. Outsourcing is defined as a delegation of non-core tasks by company to the outsourcing company due to the substantial amount of time and resource required by employee management. This research is aimed to explore current issue and challenge of HR, factors affecting HRO and the benefits of HRO in manufacturing industries, Malaysia. In this qualitative study, data were collected from six manufacturing companies by using multiple case study method. Purposive sampling had been chosen and semi-structured interview was used to collect the relevant data. In this research, it was found that the HR decision for adopting HRO is to improve manpower effectiveness, and not only to reduce cost, which is one of the most cited reason in the previous studies. Manpower management is very important because it can generate many benefits in many areas of the company, such as production and administration are managed properly. The productivity of the operation and the quality of the products are determined by the effectiveness of manpower management through outsourcing. Outsourcing produces benefits in financial terms. Therefore, if a company channels the resources to the right places and maximises their function, it will help the company to achieve high returns with low cost in the upcoming years. As for outsourcing training, once the company experienced the transformation of the employees’ mindset, the positive mindset will then increase their motivation at work.
ABSTRAK

Malaysia ialah sebuah negara berdaya saing dan berpotensi tinggi untuk berkembang di pasaran. Pada zaman yang ekonominya bertumbuh pesat, bahagian sumber manusia memainkan peranan yang penting dalam sesebuah industri. Penyumberan luar sumber manusia merupakan langkah strategik yang penting untuk membantu industri menjadi lebih efisien dan mengurangkan kos. Penyumberan luar sumber manusia didefinisikan sebagai pembahagian aktiviti-aktiviti yang bukan teras daripada industri kepada syarikat yang penyumberan sumber manusia oleh kerana kebanyakan kuantiti masa and sumber digunakan dalam permintaan pengurusan pekerja. Tujuan kajian ini dijalankan adalah untuk meneroka isu-isu semasa dan cabaran dalam sumber manusia, faktor penyumberan luar sumber manusia dan kebaikan penyumberan luar sumber manusia dalam industri pengeluaran, Malaysia.

Dalam kajian kualitatif ini, data yang dikumpulkan daripada enam industri pengeluaran dengan menggunakan kaedah kajian kes. Purposive sampling telah dipilih dan temuduga struktur separa digunakan untuk mengumpulkan data yang berkaitan. Dalam kajian ini, didapati bahawa tujuan penyumberan luar sumber manusia dilakukan adalah untuk meningkatkan keberkesanan sumber manusia, dan bukan sekadar mengurangkan kos yang merupakan salah satu sebab yang paling banyak dipetik di dalam kajian-kajian yang lalu. Pengurusan tenaga kerja adalah sangat penting kerana ia dapat menjana banyak manfaat dalam banyak bidang seperti pengeluaran dan pentadbiran syarikat. Produktiviti operasi dan kualiti produk ditentukan oleh keberkesanan pengurusan tenaga kerja melalui penyumberan luar sumber manusia. Penyumberan luar sumber manusia menghasilkan manfaat dari segi kewangan. Oleh itu, jika sesebuah syarikat menyalurkan sumber pada tempat yang betul dan memaksimakan fungsi sumber syarikat, ia akan membantu syarikat tersebut untuk mencapai pulangan yang tinggi dengan kos yang rendah pada tahun-tahun akan datang. Bagi latihan penyumberan luar, apabila pekerja mengalami transformasi
dari segi mindanya, pemikiran yang positif akan meningkatkan motivasi mereka di tempat kerja.
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CHAPTER 1

INTRODUCTION

1.1 Introduction

Human resource outsourcing is a delegation of non-core tasks by the company to the outsourcing company or service provider due to the inadequacy of time and resource. According to Sriwongwanna (2009), outsourcing HR task is one of the ways to improve the company’s efficiency. Outsourcing is a strategic tool that is being used by companies in a competitive environment (Corbett, 2004). It can allow HR administrative work to gain more strategic value (Hern & Burke, 2006), re-focus on strategic activities, decentralize structure, mitigate bureaucratic load if HR administration is centralised, and approach new ideas from external service providers (Seth & Sethi, 2011). Cost reduction is not only the key driver to attract companies to adopt outsourcing, it also opens an entry for company to access specific knowledge, expertise and tools in Northern Europe, such as Sweden, Norway and the UK (European Outsourcing Survey, 2013). Outsourcing is not only limited to the IT sector (Singh, 2006), it encompasses business processes which are Information Technology (IT), HR, manufacturing, management service, distribution and sales of products or services, manufacturing of the final product or purchasing, product design, engineering, and Research & Development (R&D) (Halim et al., 2011). Outsourcing is a widespread activity which has become a common and accepted business practice (Bradac & Sirec, 2008). HRO has also increasingly become popular among the organisations (Azhar & Shehzadi, 2013). The global market for HR outsourcing is estimated to achieve US$53.9 billion by 2020, stimulated by the growing need among enterprises to increase operational efficiency, reduce cost, streamline operations and step up compliance management (Global company
analysts, 2016). Figure 1.1 shows the trend of global outsourcing. It can be seen that it has been a transformation process of the global outsourcing from the past until recent years.

![Figure 1.1: Global outsourcing trend (Mida, 2012)](image)

1.2 Background of Study

Malaysia is considered as a developing country with a competitive environment hence there is an enormous potential to grow in the market. In the era of rapid economic growth, HR department plays an important role in a company. The appearance of HR outsourcing in Malaysia is becoming a trend especially in the manufacturing sector. According to Halim et al., (2011), many organisations realised that outsourcing is important to expand the organisation operation by helping the organisation to focus the strategy and planning on the core competencies. Malaysia is also among the world’s top 20 trading nations, so the government’s emphasis on HRM is focussed on the manufacturing sector (Halim & Che-Ha, 2011). Based on the observation of SHRM (2008), HR is growing continuously and it is transforming from an operational function to a more strategic function where results need to be evaluated and cost controlled. The employees in the organisation play critical roles that make outsourcing a vital strategy to deliver high-performing workforce (Brown, 2010). However, the study by Choi and Wan Ismail (2008) revealed that HR
Professionals in the Malaysian manufacturing sector are still weak in certain roles and lack of knowledge.

Shortage of skills and several other factors have driven organisations to adopt new ways to effectively manage the human capital (Wiblen, Grant & Dery, 2010). The improvement of the organisation’s performance is very critical nowadays in order to increase the competitive level of the organisation. Competitiveness can be a key driver of the economy (Productivity Report Malaysia, 2014). The organisation’s HR and administrative activities are not obvious ways to boost manufacturing productivity (Halim et al., 2011). As Corbett (2004) mentioned, there is no organisation which can stay competitive longer if the organisation relies solely on internal resources.

Outsourcing is one of the business tools that can help the company to perform fully to their competencies in the business. Outsourcing is a technique to strengthen organisation core competencies; therefore, company should identify the core activity and main area of the respective company, so that can avoid spending resource in non-core competencies (Corbett, 2004). The company can also reduce the need to hire specialised staff and lower the operating expenses thereby cutting down the processing time. Generally, organisations would outsource services such as catering, cleaning, employee transportation and security to the third party because those activities are the non-core activities which are considered non-core competencies that would not affect the benefits of the organisation (Kamyabi, 2011). Through this study, it is the researchers’ intention to bring out the latest HR issues in Malaysia and the research questions are drawn out from the highlighted HR issues. This chapter includes the background of the study, aim, significance, scope of study and organisation of the thesis.

1.3 Problem statement

Based on the results of the APAC survey report, HRO is still in its embryonic stage (Mandy, 2012). HR outsourcing as a competitive strategy in Malaysia is still quite new and it contains tremendous potential benefits which are still not fully comprehended (Ee, Halim & Ramayah, 2013). According to Delmotte & Sels (2008), future research should be focused on the impact of HRO, because there are very few
studies which investigate the impact of HRO on the organisation of the HR function (Internal human resource customer satisfaction). Consistent with the research of Halim & Che-Ha (2010), despite increasing HRO practice, the empirical investigation in this area in Malaysia is still limited. Studies carried out in this area encouraged future researchers to collect information in this area regardless of the size of employees and the year of establishment in order to generate the scenario of the small organisations. Even small companies that might not get noticed much in big studies of outsourcing trends turn to outside services for help on such chores, such as payroll, benefits administration, training and recruitment (Seth & Sethi, 2011). As HR outsourcing development in Malaysia has not been intensively studied, managers may still encounter a lack of information on how to select the right service providers and how to manage the outsourcing relationship (Ee et al., 2013).

Manufacturing based firms face a variety of challenges as today’s business market) is greatly competitive and aggressive if compared to 20 years ago. In other words, technological expansion is happening from time to time, and around the world (Hilman & Warokka, 2011). The change of industrialization strategy in Malaysia toward building a nationally owned and controlled automotive industry in the early 1980s is indicated by the Heavy Industrial Policy has indicated (Govindaraju, 2011). The local automotive industries maintain relatively good achievement in the year 2014 and 2015 (Malaysian Automotive Association, 2016). Othman (2008) believed that Malaysian electrical and electronics companies make up a strategically influential sector which plays important roles to the country’s manufacturing productivity, exports and employment. Moreover, with increased globalization and global competition, mergers and acquisitions, organizations in their sector are facing increased challenges in their constant quest to extend new knowledge and employee commitment, pursue innovation and creative scheme; and manage change. Therefore, strategic deployment of their human resources is required

1.4 Research Questions

The research questions formulated for this research are as follow:

i) What is the existing outsourcing HR in the electronic and automotive companies?
ii) What are the issues and challenges of existing HR faced by electronic and automotive companies?

iii) What are the factors that drive existing HR practices to adopt HRO in the electronic and automotive companies?

iv) How has HRO benefited human resource management?

1.5 Aims of the study

This research aims at exploring current issues and challenges of HRO in manufacturing companies. In this research, it also explores the factors that drive existing HR practices to adopt HRO and to understand the benefits of HRO for existing HR practices to the manufacturing companies.

1.6 Objectives of Study

The objectives of this research are

i) To identify the existing outsourcing HR in the electronic and automotive companies.

ii) To explore the current issues and challenges of HRO for electronic and automotive companies.

iii) To explore the factors of HRO that drive existing HR practices for electronic and automotive companies.

iv) To explore how has HRO benefited human resource management.

1.7 Significance of Study

The outcome of research is expected to benefit future researchers by providing knowledge for academic purposes. It identifies the factors and impacts of HRO which can be a reference for manufacturing companies that are interested to adopt HRO in their management.
1.8 Scope of Study

The respondents of this research would cover the automotive and electronic companies located within the state of Selangor, Malaysia. This research was conducted in Selangor due to the fact that there are numerous manufacturing and outsourcing companies in this state. National Automotive Policy (2014) was implemented to initiate more investment prospects as the nation’s automotive industrial direction is geared towards the manufacturing of energy-efficient vehicles. Malaysia has been graded third largest automotive market after Indonesia and Thailand in terms of total vehicle production and sales in year 2013. According to MITI report (2014), the Electrical and electronic companies are Malaysia’s largest manufacturing sub-sector in terms of GDP contribution. It is also one of the key drivers of Malaysia’s exports and industrial growth. These companies have developed a significant volume in the manufacturing of a wide range of semiconductor devices, high-end consumer electronic goods and information and communication technology products.

1.9 Organisation of Thesis

This thesis is organized into five chapters.

Chapter 1 includes an introduction, background of the study, problem statement, research questions, objectives of study, significance of the study, scope of the study, the organisation of the thesis and summary.

Chapter 2 presents the introduction, HR functions, the current issues and challenges of HR, emerging trend of HRO, definition of HR management, definition of HRO, and benefits of HRO. This chapter will also discuss the factors affecting HR functions outsourcing; theories of the framework and the impact of the HR functions outsourcing.

Chapter 3 describes the methodology used to carry out the research, such as introduction of methodology; research design; process of research; purposive sampling; case study data collection; case study protocol; validity and reliability; and data analysis technique.
Chapter 4 comprises of results and data analysis. Four parts of the interview are analysed. Part A is regarding the description of the companies; Part B is about exploration of the issues and challenges of existing HR faced by manufacturing companies; Part C is about exploration of factors of HRO for manufacturing companies; Part D is the exploration of the benefits of HRO for existing HR practice to the manufacturing companies.

Chapter 5 consists of discussion from the data analysis. It examines the analysed result with regards to the objective. Further discussion relating to the current issues and challenges of HRO; factors of HRO; and the benefits of HRO for existing HR practice to the manufacturing companies will be covered in this chapter. Besides this, the limitations of this research and further recommendations are also proposed. Finally, a conclusion of this research shall be made based on the research questions and objectives.

1.10 Definition of Key Term

**Human resource outsourcing** : HRO is defined as delegation of non-core tasks by outsourcer to the third party due to the lacking of time, resources, skills and certain knowledge.

**Human resource functions** : Human resource functions are categorised into 2 groups, which are core and non-core task. The purpose of HR function is to support HR with business strategy.

**Company performance** : Company performance is the impact of HR functions outsourcing, such as financial, service or product quality and productivity.

**Member checking** : The process of member checking involves the researcher who will pass the data to the respondents in order to check the validity of the narrative account.
1.11 Summary of Chapter

This chapter provides the background of the study. It covers the introduction of the chapter, background of the study, the problem statement, the research questions, objectives of the study, significance of the study, scope of the study, organisation of the study and a summary of chapter. In this research, the current issues and challenges of HR, factors of HRO, and benefits of adopting HRO are investigated.
CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter presents an overview of HR functions outsourcing. It reviews factors affecting the company’s decision and determines the challenges in adopting HRO. The impacts of HR functions are examined from the performance of the automotive & electronics companies. A summary of the main issues discussed and the findings from the review of the literature are also presented here.

2.2 HR Functions

Based on Brown (2010), HR functions are being requested to support HR with business strategy as organization desires to attract, attain and develop employees. HR functions included core (for example HR planning and development) and non-core tasks (for example: payroll and benefits administration) (Azhar et al., 2013). Some tasks help HR functions to shape its investment or policies in order to sustain critical core knowledge (Sparrow, 2013).

Figure 2.1 shows the cost and value of the HR tasks (administrative, service development and strategy) in the traditional department. About 60% of time and resources are committed to the administration, such as record-keeping and paperwork; 30% of the time and resources are devoted to the service delivery, such as development, training, compensation and management; 10% of time and resources are spent on strategy-planning. However, the value of administration is relatively lower than strategy planning though the cost of administration is much higher than strategy-planning (Robert, 2005). Traditionally, HR functions are performed in-house (Braun, Pull, Stormer & Thommes, 2011). However, many administrative
works are presently outsourced to the outsourcing company with the intention of releasing the potential of the HR team to be involved in a more strategic role (Brown, 2010; Sarwar et al., 2013).

HR management is categorised into two groups which are functional and strategic. These two groups of activities are designed to coordinate the HR of the company. Functional HR is related to day-to-day tasks and the processes which have to be completed every day in order to enable the organization’s processes to run smoothly.

Strategic HRM is a practice that incorporates vertically with business strategy and horizontally with one another. The strategies define scheme associate to overall organizational consideration, such as resourcing, learning and development, reward and employee relations (Cania, 2014). The strategy of the HR must be aligned with the organization’s goal and future. Peoples are very important resources because this is related to human capital which is related to structure, quality, culture, values and commitment. The organization will gain benefits as long as the organization realizes and recognises their employees’ value because employees are valuable and capable.
Strategic HR has a few characteristics namely (Ramona & Anca, 2013):

a. it has a business impact,

b. it has a broad impact on the organization’s goal,

c. it focuses the organization future’s needs; it has the potential to provide the competitive advantage,

d. it has a direct impact for long-term impact on the organization’s goal,

e. it has the potential to generate revenue.

Table 2.1 tabulates the difference between core and non-core tasks. Core tasks are tasks that generate benefits for the company and non-core tasks are merely involving the day by day administrative work.

Table 2.1: Differences between core and non-core tasks (Reilly & Wolfe, 2004)

<table>
<thead>
<tr>
<th>Core</th>
<th>Non-core</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skills specific to the company</td>
<td>Generic skill requirements</td>
</tr>
<tr>
<td>Limited labour supply</td>
<td>Minimal supply restriction</td>
</tr>
<tr>
<td>Hard to define task</td>
<td>Well-defined but limited task</td>
</tr>
<tr>
<td>Activities which are well-integrated</td>
<td>Job easily separated from other work</td>
</tr>
<tr>
<td>Easy to fund work</td>
<td>Resource intensive (in financial terms)</td>
</tr>
<tr>
<td>Stable work demand</td>
<td>Fluctuating work demand</td>
</tr>
<tr>
<td>Mature technology</td>
<td>Subject to rapid technology change</td>
</tr>
</tbody>
</table>

2.3 The Current Issues and Challenges of HR

In the research of Salleh, Rosline & Ag. Budin (2015), Malaysian organizations perhaps face several difficulties and challenges in managing human resources. Organizations had a transformation in the 1970s from a producer of raw materials to a developing multi-sector economy.

a. Massive absence of highly skilled workforce (Salleh et al., 2015)

The challenges that Malaysia is facing now would be a massive absence of highly skilled workforce. Malaysians need to acquire relevant skills that can fulfil the immediate needs of the industry.
b. Lack of intellectual HR professionals (Abdullah, 2009)
The core and the focal challenge are the lack of intellectual HRD professionals in manufacturing firms, causing employers to view HR training and development as a secondary function to HRM and perhaps consider it as being less important. This implication could lead to the ineffective implementation of HR training & development activities and ambiguity and failure in effectively managing HR training & development as a whole.

c. The ageing workforce and position (Abdullah, 2009)
The ageing workforce and their position within the company also pose a major challenge in terms of developing older workers to become knowledge workers, particularly with regards to their levels of education.

d. Lack of commitment in training (Abdullah, 2009)
Lack of commitment in training can be seen in organizations, from the top management to shop floor employees. The top management and managerial level employees are found to be uncooperative towards HR training and development, whilst lower level employees lack the commitment to participate in training and development activities.

2.4 The Emerging Trend of HRO

Outsourcing has appeared in the world since the early 1990s as a response to the trend of globalisation (Chen, Pham and Yuan, 2013). The appearance of HRO in Malaysia has become a phenomenon for the manufacturing sector, it is because Malaysia has committed to international competitiveness in terms of trade and investment (Halim et al., 2011).

HRO can bring about effectiveness to the company by allowing it to focus on the core tasks of the business (Torrington, Hall and Taylor, 2008). Some researchers found that outsourcing is a key trend that is shaping the future of HR (Adler, 2003) as some other researchers realized that outsourcing is a more strategic decision and should be built on the basis of supporting the business for expansion; generate tangible benefits and leading cost reduction (Brown, 2010).

For the past decade, outsourcing was used for assisting the company to refocus scarce resources on the core value activity, to change the perception of
customer toward the company and reduce unnecessary cost (Halim et al., 2010). Although this is not a new strategy in the HR field, some countries are still trying until they find some value or benefit from the strategy. HRO is an effective approach to enhance efficiency by gaining access to obtain the expert in HR area (Halim et al., 2010).

There are two principles of HRO that take part in this tight economy. The first principle is that outsourcing save direct expenses on HR functions that do not bring financial benefit to the company such as payroll and recruitment. The second principle is outsourcing can help the company to focus resources on its core business; therefore, the resources can be used for generating benefits through developing the quality of the product (CPEHR, 2015).

2.5 Definition of HRO

HRO is the process of transferring the element of HR tasks to the external organizations. The activities that are outsourced include payroll, recruitment, training, etc. Table 2.2 tabulated the definition of HRO by different authors. According to Sriwongwanna (2009), outsourcing the HR tasks is one of the ways to improve organization's efficiency. The outsourcing strategy can help the organization to focus on core competencies without investing in the HR and technology in the department. If the organization is unable to gather the resources for its needs, it will cause the organization to be in an unstable condition (Roy & Dugal, 2005). Besides, the resources of organization will not necessary be drained because outsourcing helps to allocate the resources in HR wisely. The organization will be effective because it is able to meet the needs of the department or division in that organization. Moreover, outsourcing can meet the demand of the organization, achieve company goal, gain competitive advantage, increase access to advanced technology and improve focus on the core task.
Table 2.2: Definition of HRO

<table>
<thead>
<tr>
<th>Author</th>
<th>Year</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reilly and Tamkin</td>
<td>1996</td>
<td>Tasks that are carried out in-house by a third party who performs it on their behalf.</td>
</tr>
<tr>
<td>David Madison</td>
<td>2005</td>
<td>Researcher defined that the work done by the organization other than their own company’s full time employee but in the modern setting, the reason of outsourcing is because the organization may not do the job.</td>
</tr>
<tr>
<td>IDS</td>
<td>2000</td>
<td>Outsourcing is mean that the suppliers of services are involved in the administrative and transactional task that across the HR function with the purpose of cost-saving through cost control through investment in technology.</td>
</tr>
<tr>
<td>Cicek and Ozer</td>
<td>2011</td>
<td>It is contracting out the whole part of HR functions to external service provider. Their opinion is outsourcing the task rather than performing in-house by transferring the entire non-core task (HR functions) such as payroll and benefit administration.</td>
</tr>
<tr>
<td>Halim et al.,</td>
<td>2011</td>
<td>Transfer of functions previously performed internally to an external provider. It plays an important role as strategic tool to the firm.</td>
</tr>
</tbody>
</table>

2.6 Benefits of HRO

Denisi and Griffin (2008) has shown that the purpose and benefit of outsourcing are that the company is able to spend more money to attract better quality employees to work within the company and convince the employees to work harder for the company. An example of HR non-core task is employee’s benefits which are non-wage salary; its nature is not strategic and it does not bring apparent benefit to the organization (Saba, 2010). Therefore, an organization should outsource this task to the outsourcing organization since it is non-strategic. This can retain the employee’s commitment in the organization and at the same time, the organization will be able to focus on value-added activities. Outsourcing is the trend of HR management in the future (ADP, 2012). Some of the advantages are discussed below:
a. Cost-saving and reducing the operational cost of organization

Cost reduction is one of the primary reasons for outsourcing though many researchers disagree that cost reduction should be the only factor to be considered while making outsourcing decision (Azhar et al., 2013). From the study carried out, the results proved that outsourcing could save cost and avoid huge investment in non-core tasks. According to the work carried out by Sriwongwanna (2009), HRO can assist the organization to forecast HR budget so that they could estimate the amount of HRO fees and it is easier to set the budget for the HR department. Organization needs to utilise a lot of time, resources and energy for HR functions such as looking for talents, interview, recruitment, training and examination. The management cost will be reduced if the HR functions are outsourced to specialized company (Guo, Liu, & Liu, 2008). However, the cost is no longer the sole driver of outsourcing (Shelgren, 2004)

b. Release the organization to focus on core tasks

Outsourcing has a close relationship with core competency (Chen et al., 2013). It is one of the methods that delegate the non-core work to the service providers. The main advantage is not only cost-saving. On the other hand, productivity, flexibility and innovation in the core competency of the organization will be increased (Elmuti, 2003). The organization is able to focus on their core tasks which are related to upgrading the performance of organization such as planning, development and others. Outsourcing could also reduce the workload of employees and make them more effective, especially when the production operation is the key strength and core task for the production factory. Thus, HRO releases the HR department of the production factory from the non-core tasks and trifle jobs in order to achieve its main goals which are to pay attention to core tasks, generate more profit, and focus on market competency (Guo et al., 2008). It frees the internal HR staff to focus on strategic activities that add more value than administrative work (Seth et al., 2011)

c. Improve quality of HR activity

Outsourcing can lead the organization to its best performance in the entire HR process when the outsourcing company can deliver better value to the business and employee, such as recruitment, training, compensation, talent-planning, and HR administration (Brown, 2010). The increasing demand of HRO will bring a rapid
growth of HR activity. It can also provide specialised service for HR departments because professional service and consultation advice of HR activity are provided (Guo et al., 2008). It enables decentralised structures that support higher rates of innovation and flexibilities. It alleviates the bureaucratic burden of centralized HR administration (Seth et al., 2011)

2.7 Theories of Framework

The theories below are applied to support the theoretical framework and it builds an understanding of adopting HRO.

2.7.1 Labour Division Theory

HRO is the extension of the division of labour theory which is the specialisation of workers in a specific task or certain function (Li & Li, 2010). For Adam Smith’s theory, the potential of labour division is in increasing the quality of production and labour division is described as the dynamic tool to motivate the progress of the economy. This is because the workers are very experienced and professional in certain knowledge, therefore, they can very effectively do to the best in their field and it will lead to economic growth. However, Adam Smith criticised that labour division is a way that causes mental-mutilation. This is because the worker may become bored, ignorant and limited in exploring more new knowledge due to their long term repetitive work. In terms of the HR management function, the rise of the so-called knowledge economy has had a major effect with a considerable transformation from HR management as a bureaucratic ‘personnel management’ operation to the development of separate HR management functions over the past few decades (Chivu & Popescu, 2008). From this theory, it shows that HR management is gradually following the trend which is able to retain highly skilled staff. The service that HR can provide to the market is staffing agencies, training and others. Labour division will be more efficient and it provides quality to achieve the goal faster.
2.7.2 Transactional Cost Theory

Transactional cost theory was founded by John R. Commons. It is not the exchange of commodities but division and acquisition. However, as indicated by Ronald Coase (1937), there are a number of transaction costs being performed in the market. According to Coase, a good manager needs to take into account bureaucratic costs of the outsourcer. When the transaction costs of monitoring another company are lower than the bureaucratic costs of the company, outsourcer will consider outsourcing the activity to the third party. According to the transaction cost theory, company can cut down the internal transaction cost (overhead cost) rapidly through outsourcing or allocating the HR function to the third party. It can achieve the purpose of cost-saving and enable the in-house HR management to be more effective and reduce burden. When the internal transaction cost is higher than the transaction cost in the market, outsourcing is the choice to reduce the internal transaction cost and to maintain the quality of in-house HR management. It is a pressing issue because it does not only involve short term solution but also long-term strategy. Besides, it may influence the overall organization performance. Therefore, it is not merely a cost-saving decision but also a decision to maximise the value of the company and reduce unnecessary problems that arise to hinder the growth of the company.

2.7.3 Core Competencies Theory

The core competency is the factor which determines the survival and development of the competitive advantage of a company. Theoretically, the company understands that it should focus on the core business such as strategic planning, quality of product, research and development activity of company. In core competencies theory, the company will concentrate on core tasks such as planning, development and production. There are three standards are further discussed in the core competencies theory, which are (Xu, 2009)
i. Acknowledged by the market and it can offer opportunities to approach potential markets

ii. Offer customers with increasing special benefits. Core competency of the firm has to produce value to the firm and increase customer’s benefits through decreasing cost

iii. Core competency must be difficult to duplicate as to support the competitive advantage on the basis of core competency

Outsourcing is very closely related to core competencies theory because one of the actions to build up core competencies in a company is to divest non-core capabilities to release resources that can be used to develop core capabilities (Bain & Company guide, 2015). Outsourcing is itself a relocation of the non-core activities to the third party so that the company can focus more on the in-house core activities and long-term planning (Halim et al., 2010). It is about transferring their non-core activities to the external so that the internal (in-house) can more have more time, resource and energy to plan long term goals and implement them.

The value chain of the primary activity shows that development of core competency and every value chain can also generate value. Core competency assists a company to achieve target quality as they focus on their core tasks. There are three tests to determine a core competencies, which are (Hamel & Prahalad, 1990)

a. Provides potential enter to a wide and diverse market
b. Makes a contribution and it bring the benefit of products to the customers.

c. A core competency is hard to be imitated by competitors. (same as above)

2.7.4 Relational Exchange Theory

Relational exchange theory is viewing HRO from the perspective of relationship and partnership. Past research has shown that it may neglect the relationship aspect between vendors and client. It is not a separate issue from the transaction and economic theory. The partnership plays a significant role in HRO because it determines the success of outsourcing. However, many companies are facing
challenges to building partnership in HR outsourcing (Halim et al., 2014). A successful partnership can assist the client to express the details to vendors and help in the coordination of the outsourcing work. A successful outsourcing requires both party’s cooperation and a good relationship.

2.7.5 Resource-Based Theory

The resource-based view is an economic tool that is employed for investigating strategic practice and distribution of resources within the firm. In Penrose (1959), the author explains that internal resources have significance influence on firm strategy. Figure 2.2 is the practical framework of a resource-based approach to strategy analysis and it involves 5 stages of strategy formulation.
For Barney (1991), resources encompassed huge areas, such as assets, capabilities, organizational process, firm attributes, information and knowledge. Barney states that the competitive advantages of firms are drawn from its heterogeneity. The heterogeneity is presumed as resource or strategies of firm and the variety of resources affect the firm’s decision to adopt different strategies to allow some firms to gain competitive advantage. In the resource-based theory, the HR tasks are outsourced when the task does not meet the criteria of deliverability and durability of the HR task. Resource-based theory provides the perspective that the
HR task should be considered for outsourcing when it brings advantages to the firm (Woodall, Jackson, Newharm & Gurney, 2009).

2.7.6 Institutional Theory

The institutional theory concentrate on the relationship the organization with the environmental factor, internal and external environment that influence firm’s decision (Lundgreen, 2013).

2.7.7 Summary of Theories of HRO

The table below shows a summary of the theories that are used in HRO and the findings of the researches. Table 2.3 states the reason and outcome of using the theory on HRO from 2004 to 2014.

Table 2.3: Summary of theories of HRO

<table>
<thead>
<tr>
<th>Year</th>
<th>Authors</th>
<th>Theory</th>
<th>Remark</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>Gilley, Greer &amp; Rasheed</td>
<td>Transaction cost, resource-based view</td>
<td>Outsourcing enables the firm to focus on specific and high value task. High value task should not be outsourced.</td>
</tr>
<tr>
<td>2004</td>
<td>Reilly &amp; Wolfe</td>
<td>Core competencies, transaction cost economics</td>
<td>Atkinson and Meager (1986) proposed a model that differentiating the core and non-core tasks will affect the decision of outsourcing for a company. According to Williamson’s theory (1975, 1985), the company should seek the structure that allows most economic domination.</td>
</tr>
<tr>
<td>2007</td>
<td>Perunovic</td>
<td>Core competencies, transaction cost economics, relational view, resource-based</td>
<td>The relational view, neoclassical economic theory and core competencies theory will influence the decision factors of outsourcing relationship. The finding of research is that the company should be focused on cost-based;</td>
</tr>
<tr>
<td>Year</td>
<td>Author(s)</td>
<td>Theory and Concepts</td>
<td>Description</td>
</tr>
<tr>
<td>------</td>
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<td>---------------------</td>
<td>-------------</td>
</tr>
<tr>
<td>2009</td>
<td>Xu</td>
<td>Core competency, transaction cost</td>
<td>The focus of outsourcing is not only cost economic, but also a strategic decision. Core competency has potential to develop and reinforce</td>
</tr>
<tr>
<td>2009</td>
<td>Woodall, Jackson, Newharm and Gurney</td>
<td>Transaction cost, and resource-based view</td>
<td>The end results of HR outsourcing for the future of organization HR functions are therefore quite critical. This research revealed that it was often difficult to reallocate the HR staff that stay within the organization to higher value-added work. This problem can be solved by raising the HR budget.</td>
</tr>
<tr>
<td>2010</td>
<td>Halim et al.,</td>
<td>Transaction cost economics, core competency theory, Resource-based view</td>
<td>Transactional Cost Economics theory not merely provide lower cost by channelling non-core activities to third party, it also sharpen the core competency value and emphasize resource-based view.</td>
</tr>
<tr>
<td>2012</td>
<td>Tayauova</td>
<td>Transaction Cost Theory, Resource-based view, Core competencies</td>
<td>Organization should fill in the gap in resources and cost effectiveness to maintain an inimitable products and competitive advantage. (Original: Organizations will plug gaps in resources and capabilities in the most cost-effective manner to maintain a distinctive product and its competitive advantage)</td>
</tr>
<tr>
<td>2013</td>
<td>Samuel</td>
<td>Relational exchange theory, resource-based view</td>
<td>Relational exchange theory will assure cost effectiveness, quality and speed of production.</td>
</tr>
</tbody>
</table>
2.8 Factors of Affecting Decision to Adopt HRO

A significant amount of resources is still focused on the non-core tasks (Halim et al., 2010). The intention of the company to outsource HR administration is to release HR staff from day-to-day administrative works and to focus on more strategic tasks (Brown, 2010). Company should focus on goal-planning, customer satisfaction, core competencies and decision-making in order to maximize the competencies of the companies. The decision of outsourcing is made on the basis of service cost and performance. If the outsourcing company is able to provide service of lower cost or the cost is equal with the internal service, and the service provided from external service is in higher return, it is worthwhile and therefore makes sense to outsource this service to outsourcing company (Brown, 2010). From the finding of this research, it proved that the relationship between HRO and service quality is stronger when the outsourcing company provided complicated service. Therefore, the finding proved that the quality of HR service will be elevated when obtained from external instead of an in-house provider (Braun et al., 2011). From the literature review, it concludes that there are five factors affecting the decision to adopt HRO.

a. Transaction cost

HR professionals have many titles and positions, so it may make people confused. Besides this, the company needs to invest huge amount of money (Guo et al., 2008) to support the department. Outsourcing is able to keep the task simple and effective because company can outsource it to the professionals who are more expert in handling since they are focused in this area. Cost is the key driver for an outsourcing
initiative. According to the transaction cost theory, transaction cost will arise at the contracting (negotiating, and drafting) or implementation (operational and establishment). The decision maker must measure and compare the cost related when executing a transaction between their organisation (in-sourcing) and outsourcing. The theory also suggests that the managers need to take production cost and coordination cost (controlling cost, monitoring cost and managing transaction) into consideration when arriving at the outsourcing decision. The researcher also shared that information system (IS) service vendor lowers the transaction cost through allocating the fixed cost to some greater end clients (Claver, Gonzalez, Gasco & Llopis, 2002). This variable is a measurement of how outsourcing becomes a method to reduce the operating cost in the organisation. By outsourcing the non-core tasks, capital can be saved to further invest in the core business and gain revenue for the organisation (Islam & Sobhani, 2008).

b. HR Strategy

HR strategy guides the process by which the company enhance the competitiveness by maximising human capital (Snell, Shadur & Wright, 2000). Strategic business is able to reposition through outsourcing (Craumer, 2002). They can create new segments at a price below the current market and dominate the market when they grow. They can produce higher returns compared to their competitors at a lower cost through higher asset productivity. The research of Beaman (2004) shows that the outcome of the HR functions outsourcing is not only in cost reduction but also in quality improvement. Based on the research of Azhar et al., (2013), the drivers of HRO are gaining specialized HR expertise, achieving flexibility, reducing risk and improving access to advanced technology. HRO strategy can help the organisation to specialise services from different expertise and to achieve benefit over their competitors (Azhar et al., 2013).

c. Manpower

Weak employee organisational linkages often cause the phenomenon of turnover. The issue of staff retention and job motivation have continued to plague organisations in Malaysia (Chew, 2005). Organization will not able to sustain their workers without proper human resource practices. Training and development are also
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