HUMAN RESOURCE OUTSOURCING (HRO): A STUDY ON SERVICE QUALITY AND ITS RELATIONSHIP WITH PARTNERSHIP QUALITY

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DEDICATION

To

My dearest wife Norshidah,

and my lovely children

Norshafirah,

Aizad,

Aizam Nazreen

and

Norlily Izzati

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With the completion of this thesis, I am very grateful to my family for their patience, understanding and support throughout these challenging years completing the program.

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Last but not least, to all my MBA course mates, it has been great knowing all of these outstanding individuals. I am grateful for the support and friendship.

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ABSTRAK

Persumberan luar perkhidmatan sumber manusia telah menjadi satu tajuk yang sering diperkatakan sejak kebelakangan ini di Malaysia. Banyak syarikat telah melaksanakan persumberan luar perkhidmatan ini untuk syarikat mereka kerana persumberan luar selalu dikaitkan dengan penjimatan kos. Ini membuatkan initiatif untuk melaksanakan persumberan luar menjadi sesuatu yang cadangan yang sangat menarik minat dan perhatian pihak pengurusan syarikat. Kajian ini dibuat berdasarkan perkembangan ini. Ia bertujuan untuk mengenalpasti tahap kualiti perkhidmatan yang diberikan oleh syarikat-syarikat yang memberi perkhidmatan tersebut. Kajian dibuat berdasarkan maklumbalas daripada pekerja-pekerja industri di negeri Pulau Pinang melalui penyelidikan bertulis. Penyelididkan ini dibuat menggunakan model ServQual dengan mengambilkira maklumbalas terhadap kualiti perkhidmatan yang diharapkan dan dibandingkan dengan kualiti perkhidmatan yang diterima. Kajian ini juga bertujuan menyelidik kesan perhubungan antara syarikat dengan penyedia perkhidmatan sumber manusia terhadap kualiti perkhidmatan. Secara keseluruhan, kajian ini mendapati pekerja mengangap kualiti perkhidmatan sumber manusia yang diberi oleh penyedia perkhidmatan adalah memenuhi kehendak kualiti perkhidmatan yang diharapkan. Bagaimanapun, hasil kajian tidak menunjukkan hubungan antara syarikat dengan pernyedia perkhidmatan memberi kesan yang tinggi keatas kualiti perkhidmatan.

Human Resource Outsourcing (HRO): A Study on Service Quality and its Relationship with Partnership Quality

ABSTRACT

Human Resource outsourcing has lately become a much talk about HR strategy in Malaysia. Many companies decided to adopt this strategy as outsourcing in general is always relate to cost saving. This makes HR outsourcing a very tempting proposition. Basing on the development in the HR outsourcing business, this study attempted to assess service quality of the outsourced HR services from employees' perspectives. The study used the ServQual model to assess the service quality of the services provided by the HRO service providers in the manufacturing industry in the state of Penang. The study also examined the relationship between service quality and partnership quality, referring to collaboration between the companies and the HRO service providers. Deploying self administered questionnaires, the survey were conducted by obtaining responses from employees working in the manufacturing companies in Penang. Using the gap score, the difference between perceived service quality against expected service quality, it was found that the employees perceived the outsourced HR service met their expectation. However, the study seemed to indicate weak relationship between partnership quality and service quality.

<h1 style="text-align:center">Chapter 1</h1>

<h1 style="text-align:center">INTRODUCTION</h1>

1.1   Background to the Research

Lately, human resource outsourcing (HRO) has been one of the much talk about agenda in many HR forums and among HR circles in Malaysia. Outsourcing of HR functions started many years ago in Malaysia but only recently that this strategy has taking shape in a manner that other functions in an organization has adopted outsourcing - as a way forward to improve business results.

The trend towards outsourcing or a shift from make to buy in general is quite well known in the manufacturing industries (Wahrenburg *et al.*, 2006). Outsourcing initially involved subcontracting of specific production work in an organization. It later encompasses more and more functional areas as well as business processes. International research indicated the volume of the outsourcing business stand around USD1,200 billion by 2006 (Rafter, 2005). The outsourcing of HR service or functions emerged in a later part of the business outsourcing development. Companies around the world started outsourcing of HR functions for many reasons. For many businesses that do not have the time or the resources to manage HR functions, outsourcing is a cost-effective alternative to hiring an in-house human-resources staff.

Nowadays, HR firms offer a wide variety of services to companies that need to focus on their core business activities and yet still establish and maintain good HR policies. Industry insights show many outsourcings decisions from big organizations took place in recent years. "Human resources outsourcing is booming this year. In April 2005, Pepsico signed a 10-year agreement with Hewitt Associates. In May 2005, Duke Energy announced a 7 1/2-year contract for Hewitt to handle payroll, performance management and other HR back-office administrative services" (Weatherly, 2005). Experts from sourcing advisory firm

Technology Partners International highlighted in their report in by Henneman (2005) in (Workforce Management, July 2005) "…it isn't surprising that human resources outsourcing is the fastest-growing segment of the business process outsourcing sector". In another recent market research study in 2004 by a well-known business process outsourcing (BPO) analyst firm forecasts that the worldwide market for multi-process HR BPO will grow at the rate of 21% annually, reaching $7 billion by 2008. This same study forecasts that the total HR outsourcing market will grow by 11% to $33 billion worldwide by 2008 (Weatherly, 2005).

For many organizations, outsourcing of HR functions is seen as a business strategy to address some of the business problems, such as cost saving reasons. Organizations made strategic move to adopt HRO to reduce costs through superior service provider performance and the provider's lower cost structure. In many cases, the outsourcing decision is often taken by business executives independently of the HR (Khanna and New, 2004). The decision is mostly driven by business objectives such as cost reduction, increasing flexibility, gaining access to particular technologies, or simply to concentrate management bandwidth on core activities. Companies adopted HRO to change the costs structure from fixed to flexible expenses and variable costs. One of the organizations that have embarked on the HRO is Delta Airlines. As interviewed in (Workforce Management, July 2005), Delta HR VP has mentioned that when "Delta Air Lines signed an agreement this year for end-to-end human resources outsourcing, it had a key goal: to cut costs. The No. 3 airline in terms of U.S. traffic anticipates that the deal, valued at $120 million, will save it 25 percent, or $42 million, over its seven-year term. Outsourcing also averts the need for Delta to spend $50 million on updating human resources technology. Saving money is vital to the struggling carrier, which posted a first-quarter loss of $1.07 billion. So a governance team will monitor 50 metrics in hope of ensuring that the deal with Affiliated Computer Services delivers on its promises."

Another reason for companies to adopt the HRO strategy is the "improvement-driven reasons" (Jeffay *et al.,* 1997). These companies viewed the HRO as initiative to improve HR functions' performance by getting access to HR expertise, skills, and technologies from external HRO service providers that would not otherwise be available internally or very expensive to obtain them internally. Companies can get innovative ideas outside of organizations. This will also helps companies to improve reputation and image by associating with superior providers.

The argument for outsourcing is that by outsourcing all or a portion of their HR functions, executives can devote more attention to their core business, while providing employees with access to benefits that an organization would be not able to offer on their own. This helps to put companies in the same level in Human Resource management and practices.

In local scenario, the presence of multinational companies (MNC) in Malaysia helps to develop HR outsourcing strategy as well the HR outsourcing industry itself. MNC Companies like Motorola for example, has outsourced some of its HR functions like payroll administration to HRO service provider for quite sometime. The outsourcing of their payroll administration was part of their global HR Management initiative. Hence, Motorola Malaysia also took part in the exercise to outsource its payroll services. Subsequently, when the outsourced services proved successful, the company is continuing to assess other areas of HR services that are suitable for outsourcing.

In many cases, when MNC companies like Motorola and Intel undertake to outsource some of their HR services, they strategize the initiatives at their corporate level. In this regard, they are able to negotiate a global deal with HRO service providers. When this happened, the HRO service providers may also be required to provide the services to countries that the MNC companies are operating, not just at the origin country. In doing so

the HRO service providers have to set up offices in countries like Malaysia where many big MNCs are operating. This helps to build and develop the HR outsourcing industry in Malaysia as the HRO service companies from developed countries like the United States of America have been involved in the industry very much earlier. When they come to Malaysia, these companies will bring with them new technology and new solutions in HR services. While at the same time they are also promoting and developing their HR outsourcing businesses to Malaysian companies.

As MNC companies have been one of the major forces of Malaysia industries, especially in the manufacturing sector, it is explainable that manufacturing companies are among the frontiers in the HR outsourcing strategy in Malaysia. In this sense, many manufacturing companies in Malaysia or in Penang in particular have started to adopt outsourcing strategy of their HR functions, either as their local initiative or as part the global programs where the directives are coming from their corporate head quarters.

For whatever reasons and determinants that motivate organizations to outsource their one or more Human Resource functions, the services or performances provided by the HRO service providers must be effective and meet the service quality as expected by the organizations as well as their employees. Service quality plays an integral part to ensure that employees continue to receive expected HR services when the providers of the services change hand, from internal HR persons to outside service providers. Companies certainly do not want problems arisen from poor services. As cited by Marquez (2007) in article discussing about service quality of HR outsourcing, the early adopters of HRO in the United States like Lockheed, whose HRO contracts approaching renewal time, were expanding how they measure the performance of their providers. Many of these companies have attained the cost savings they were promised from the initial agreements, but not the quality of service.

In many cases the ultimate receivers of the HR services are the employees, thus it is expected that companies putting extra effort to make sure the service quality of HR services that they are outsourcing to HRO service providers meet expectation of the employees. In doing so, organizations must closely monitor and engage with the HRO service providers. HR outsourcing is more than just relieving some of internal functions to the outsiders. To certain extent, there could be some form of relationship between the company and the HRO service providers to ensure deliverables of services being outsourced are met.

Hence, the scope of this study will focus on employees' perception of the service quality provided by the HRO service providers and to examine whether the partnership quality between the company and its HRO service providers have any effect on service quality of the outsourced HR services.

1.2   Problem Statement

Among strategic purposes of HR outsourcing is improving effectiveness of HR functions by engaging outsiders that can provide superior services (Noe *et al.,* 2006). From employees' stand point, one of the measures of HR effectiveness is the quality of HR services or programs that are undertaken by the HR functions. In other word when HR Department for example, promise to deliver certain program to address any specific problems or issues, the employees expect the HR department to deliver the program on timely manner and at the right cost and meet the desired goal. Similarly goes when the same function is performed by an outside service provider, employees would expect similar if not better program to be delivered.

Since HRO is relatively new, some shortcomings are expected as cited by Teng, (2008) in (HRO Today, April 2008), among the most notable problems encountered by companies are service delivery failure and buyer dissatisfaction. Local industry insiders also

mention about employees' dissatisfaction with the services provided by the service providers especially during initial roll out of the outsourced services. For what ever reasons a company decides to outsource its HR service, the company must ensure the changes would result in the betterment of the service quality itself. This is the concern among the companies and forms the underlying problem of this study: whether the service quality of the outsourced HR services provided by the HRO service providers meet the expectation of the employees in the organization.

Another concern on the HRO is the relationship between the organization and the service providers. When the function is being outsourced, the scope of relationship is more than just buying of services or products. Certain form of collaboration takes place between the service providers and the organization. Thus, the second issue that the study attempt to examine is whether the partnership between the organization and the HRO service providers lead to service quality from perspective of the employees.

1.3   Research Questions

Many organizations approach outsourcing for purpose of obtaining better service at lesser cost thus improve the HR functions of the organizations. The objective of improving HR functions is always related to quality of services provided by the HR functions. In the case of HRO, the quality of services provided by HRO service providers are expected to be better from what is experienced by the companies and employees before the outsourcing. This produced questions for this research:

1.   What is the employees' perception of the service quality of the outsourced HR services?

2.   Does partnership quality between the organization and the HRO service providers lead to service quality?

1.4   Research Objectives

1.   To study the service quality that is provided by HRO service providers from employees' perspective.

2.   To examine the effect of partnership quality on service quality of the outsourced HR services.

1.5   Significance of the Study

The HR Outsourcing (HRO) is relatively new to Malaysian businesses. Many big multinationals have started the HRO initiative, partly due to corporate program that drive it to their worldwide organizations. With setting up of many HR service providers in Malaysia be it internationals or local, more and more HR services and solutions are made available in the market to industries and companies. Hence, this in itself also promotes the HRO industry as well as an eye opener to companies to start looking into HRO as a way forward in HR management. One the most important aspect in service industry is the service quality. This study will try to examine the service quality issues in local HRO, whether this initiative helps companies to improve their HR services. This study also attempts to look at the effect of partnership quality between company and service providers on service quality of the outsourced HR services. The study can provide an insight to the employers on the level of service quality of outsourced HR services. The HRO service providers on the other hand can gain understanding of how employees perceived their service quality. Both the client companies and the HRO service providers can gain understanding on the effect of their partnership quality on service quality.

1.6   Definition of Key Terms

For better understanding, below are the definitions of key terms and variables that will be used in the context of this study:

Human Resource Outsourcing (HRO) is defined as having one or more third party service provider or contractor to provide one or more services of any HR functions (Noe *et al.*, 2006). Another definition offered by Pelham (2002), HR outsourcing involves engaging a service provider to manage the people, processes and technologies related to a company's HR functions. The size of the HRO can range from payroll and benefits administration to entire HR service lines. The Company pays the third party for the services they deliver either directly or indirectly to the employees. Examples of HR services or functions that may be outsourced are Training and Development, Benefit Administration Services, Payroll Administration, Health services, Recruitment/Staffing, and Employee Relations (Wahrenburg *et. al,* 2006). The abbreviation HRO for Human Resource Outsourcing will be used through out this study.

Service Quality is adapted from Parasuraman *et al.* (1988) to refer to perceptions about the performance of the HRO service providers in providing HR services that they are contracted to carry out for the company, which is their client. In the context of this study, service quality is assessed from employees' perceptions about the services they received from the HRO service providers. The study will be looking at the perceived service quality in comparison to what they expect from the service providers. In this sense, the service providers which offered HR services such as Payroll Administration services, Benefit Administration, and the rest of relevant HR services are generalized and termed as **HRO service providers**.

Service Quality Dimensions are the five dimensions that formed the ServQual model developed by Parasuraman *et al.* (1998). It consists of tangible, reliability, responsiveness, assurance, and empathy.

Partnership Quality is defined as collaboration between the organization and its suppliers, in this study refers as the HRO service providers, to work together to achieve mutual benefits.

1.7 Organization of Remaining Chapters

The remainder of this paper is structured as follows: Next chapter (2) will cover literature review of HR outsourcing and service quality, and from there the paper will define the research hypotheses and the research framework. Chapter 3 will outline the research method and the survey conducted for this study. Survey analysis and results will be reported in Chapter 4, and final chapter (5) presents the discussion and conclusion of the study.

CHAPTER 2

LITERATURE REVIEW

2.1   Human Resource Outsourcing

Human Resource Outsourcing in principal is similar to any other types of outsourcing such as manufacturing outsourcing and business process outsourcing. The concept of outsourcing can be traced from the transaction cost theory in which it holds that the properties of a transaction determine what constitute the efficient governance structure – market, hierarchy or alliance. The transactions are always guided by; "bounded rationality" where human behavior is limited by the ability to process information; Opportunism, people are opportunists and guided by self-interest; Small numbers bargaining, where the cost of obtaining full information is prohibitive; and Unequal distribution of information among interested parties (McIvor, 2000). Transaction Cost increase when these factors combined with transactions characteristics of high asset specificity, uncertainty and infrequency.

The essential of the transaction cost theory is that the characteristics of the transaction determine the governance structure. Asset specificity refers to the non-trivial investment in transaction-specific assets (Williamson, 1985). When asset specificity and uncertainty are low, and transactions are relatively frequent, transactions will be governed by markets. Vertical Integration takes place when high asset specificity and uncertainty that lead to transactional difficulties with transactions held internally within the company. In between these two extremes is the level in which asset specificity calls for cooperative alliances between organizations to realize the economic profits from the alliances. At this juncture, organizations can look for horizontal integration in which outsourcing is one of the best suitors. In many cases, the company should outsource activities that require excessive investment if the company were to carry out the activities internally.

The need of organization to outsource also lies in notion of building "core competencies". Core competencies are not physical assets (Prahalad and Hamel, 1990). Physical assets, no matter how innovative they may seem in the present circumstances, can be easily replicated or sometime become obsolete. Instead, Prahalad and Hamel (1990) argue that the real sources of competitive advantage are the ability of the organization to consolidate corporate-wide technologies and production skills into competencies that empower individual businesses to adapt rapidly to changing business opportunities. Competencies are the skills, knowledge and technologies that an organization possesses on which its success depends. Although an organization would need wide variety of skills and knowledge in order to perform and compete, only a few of the skills and knowledge are their core competencies (Johnson and Scholes, 1998). Hence, for organization to focus on these few identified core competencies, the organization may choose other alternatives to access other skills and knowledge. Outside providers is one of the viable alternatives.

Whereas based on the resource based theory, unique organizational resources of both tangible and intangible nature are the real source of competitive advantage. Resource based theory viewed organizations as a collection of resources that are heterogeneously distributed within and across industries. Outsourcing gives a client organization access to resources in the vendor organization as the vendor handles the outsourced functions for the client (Gottschalk and Solli-Saether, 2006). In HRO's perspective, the Human Resource Information Service (HRIS) provider for instance, could have developed expertise in the HRIS solutions that become their sources of competitive advantages. Client companies can readily adopted this HRIS solution to their advantages.

Compare to other organizational functions such as production, or information system which has been outsourced for quite sometimes, HRO is getting momentum quite recently about more than a decade ago. HRO involves the use of external companies to perform some

or all of the firm's HR functions or activities. A key rationale for such outsourcing is that with intensified global competition, firms are concentrating their energies on core activities that are critical to the organization competitive advantage, and leaving the rest to specialist firms. The HRO service providers are in the position to integrate their HR services and HR solutions through their investments in dedicated experts, technologies and methods of organization. The scope of such relationships between the firms and HRO services providers encompass a variety of options ranging from specific activities like staffing function to broader activities covering substantive activities in the whole spectrum of Human Resource management like Training and Development, Compensation and Benefits, Payroll Administration, HRIS, etc.

HR outsourcing is still relatively immature when compared to IT outsourcing or other BPOs (Miller, 2007). Survey conducted by EquaTerra, during the latter half of 2006 and recounted in a 2007 on HR executives and decision-makers on more than 50 North American and global organizations actively involved with HR outsourcing, estimates that there are approximately 2.5 million employees being supported by HRO, with the total contract value of these collective transactions exceeding USD15 billion. While the HRO market numbers are large, the total number of employees served and the total number of HRO deals relative to the size of the market indicate that there is much room for growth (Miller, 2007).

The prospect of cutting costs is often what motivates companies to consider outsourcing. Estimates from the industry players ranges from 15 percent to 25 percent (Henneman, 2005). However, long-term data on net savings is scarce because of the infancy of the industry. In 44 percent of the cases, net cost savings remain "undetermined," according to research by the Bureau of National Affairs, U.S.A (2006). But several analysts say that after the initial excitement about potential savings, savvy companies put more focus on business metrics like productivity, profitability and employee satisfaction.

A recent survey by Hewitt Associates conducted on 129 companies in the U.S has found that 45 percent didn't deem cost savings as a top goal for their human resources outsourcing. The top three reasons cited were gaining outside expertise, improving service quality and focusing on the core business (Henneman, 2005).

Further investigation on literatures related to HR outsourcing showed many of them were centered on the determinants of HR Outsourcing (Klaas et al, 1999; Laabs, 1993; Lever, 1997). Klaas et al., (1999) examined the relationship between the degree of outsourcing and the perceived benefits generated, using reliance on idiosyncratic HR practices, uncertainty, firm size, and cost pressures as the moderators. Goldfarb and Naasz (1995) argued on economies of scale and market competition as determinant of HR outsourcing. Csoko (1995) discussed the effect of HR outsourcing; Jamrog *et al.* (1996) discussed the increasing trend of HR activities being outsourced. It was noted that many of the researchers cited the limitations by exclusive reliance on HR professionals as key informants (Klaas *et al.*, 1999).

Adler (2003) explored six factors that can help companies determine which HR processes to outsource and which to retain. Kathri and Budhwar (2002) examined the what?, how?, and why? of HR outsourcing with reference to Asian context. They concluded that culture, HR strategy and HR competency influenced organizational tendency to outsource HR activities.

2.2   HRO and Service Quality

In order to make HR Outsourcing as a strategic move, companies need to look beyond initial cost savings, and start looking at how outsourcing affects employee satisfaction and organizational performance. One of the key indicators for HR Management performance is the service quality provided to the organization and to the employees. In this regard, to HR organizations that have adopted the HRO, service quality of HRO service providers are very

critical. As mentioned by Ulrich *et al.* (1995) and Cunningham and Debrah (1995), the critical competencies for HRM are technical HR knowledge, people management skills, business knowledge, and analytical and visionary knowledge. The competency in HR technical knowledge calls for HR organization to ensure best quality service to the employees. Thus in any HRO initiative, it is very important for the company to ensure that their HRO service providers can deliver the expected service quality.

Many studies have been carried out to understand the measures of HR competencies, however the focus are primarily on the HRM practices and outcomes, and also the relationship between HRM practices, outcomes and performance of the organizations. Quite substantial numbers of studies have also been conducted to examine the effects of HRM practices on performance. Most of these researches, like Arthur (1994), Huselid (1995), Huselid *et al.,* (1997), MacDuffie (1995) and Youndt *et al.* (1996), look into the outcomes of HR practices on HR performance of the organization (Zheng *et al.,* 2006).

Many studies on HRO that focus on determinants of HR outsourcing decision indicated besides cost saving, another equally substantial determinants for outsourcing decisions is the need to improve HR service delivery and effective performance of HR department. This entails the need to ensure HRO service providers to provide quality service thus improvise HR service delivery to the employees and to the organization.

Investigation for literatures on HRO vis-à-vis Service Quality indicated that this area has not been well researched or explored. However, literatures on service quality are abundance in marketing literatures. In lieu of the studies or researches on the HRO vis-à-vis Service Quality, this study examined the literatures on service quality in its general applications.

Quality, to a great degree, is what the customer says it is (Peters, 1999). How could we know whether we give service which is judged 100 percent satisfactory by 100 percent of

our customers? Instead of making the judgment ourselves, we would have to ask, observe, find out from the customers themselves, whether they recommended us to others and so on. Quality of service arises from the service encounter itself (Peters, 1999). Influenced by the total quality management (TQM) philosophy, HR functions have recognized the need to provide more responsive, value added, and efficient services to their customers (Yeung and Brockbank, 2003). In HRO perspective, service quality is to provide effective HR service delivery and support to employees as well as organization. To assess, we should look how employees as the customers perceive the service they encounter and receive from the HRO service providers.

Customers' perceived service quality has been given increased attention in many studies about customers' satisfaction and other marketing related studies. This may due to its contribution to business competitiveness of the organizations. Brown *et al.* (1994) provided precise summary on the evolution of the services marketing literature. They examined and reviewed over 1,000 publications related to service marketing and marketing. Lewis (1993) examined service quality and addressed the determinants of service quality. Rushton and Carson (1989) focused on the theory, practice, and future of services marketing, especially the intangibility of services and the need in marketing to improve management of intangibles. Carson (1991) examined quality in term of managing customer needs. Botschen *et al.* (1999) researched on the importance of the relationship between customers' perceived needs and the product or service attributes.

Groth and Dye (1999) discussed about the different between services and the service quality itself. They argued a service (contemplated, expected, or received) is different from perceptions of quality of service (contemplated, expected, or perceived as received).

Delivering superior quality is considered a prerequisite for a success a business in this decade (Parasuraman *et al.,* 1998). However, service quality is quite subjective compares to

goods or products quality. The latter can be measured quite easily such as through product defects or functionality. Whereas, for service, with its unique characteristics or features; intangibility, heterogeneity, and inseparability of production and consumption, it is rather difficult to measures its quality. In the absence of objective measure, researchers in this subject are looking at the service quality as perceived by the customers or consumers to measure service quality. Groth and Dye (1999) stressed that quality of service, as perceived by the customers, has an effect on the perceived value of the rendered service. The relationships between the service event, "the customer's *ex ante* and *ex post* perceptions" (Groth and Dye, 1999), and perceived and actual quality of delivered service were altogether determined the success or failure of generating value.

SERVQUAL, a model developed by Parasuraman *et al.* (1988), is the most prominent and widely used model for measuring service quality. In the SERVQUAL scale, Parasuraman *et al.* (1988) identified five determinants of "tangibles", "reliability", "responsiveness", "assurance" and "empathy" as part of the 22-item SERVQUAL scale for measuring service quality. SERVQUAL is a concise multiple-item scale with good reliability and validity that service providers can use to understand the service expectation and perception of their customers. It is applicable to broad spectrum of services (Parasuraman *et al.,* 1998).

This study will be looking into service quality measures of the HRO service providers in the five dimensions based on the SERVQUAL model. The five dimensions include tangibles, reliability, responsiveness, assurance (staff knowledge, courtesy), empathy (caring, individualized attention). The model has been used in studies on different issues concerning service quality and in a variety of different industries and culture settings (Lai *et al.*, 2007). Lai *et al.* (2001) cited (Babakus and Boller, 1992; Bolton and Drew, 1991; Brown and Swartz, 1989; Carman, 1990; Cronin and Taylor, 1992, 1994) that the validity and reliability of the model were also tested. Parasuraman *et al.* (1998) cited previous exploratory research

conducted by Parasuraman, Zeithaml, and Berry (1985) in which they gathered consumers'

perception of service quality in four different services. They came to conclusion that

regardless of the types of service, consumers used basically the same general criteria to judge

service quality.

The five ServQual dimensions were operationalized in the context of this study as below:

1.   Tangibles

This referred to physical facilities, equipment, and appearance of employees of the

HRO service providers. Availability of up to date facilities or equipment like good

HR software, user friendly website or portal from HRO service providers were

important to determine service quality to client company employees

2.   Responsiveness

Service Quality was very much related to willingness of the service providers to help

customers, in the case of HRO, the company management as well as the employees of

the client company. Employees would expect speedier and prompt service from

HRO service providers.

3.   Reliability

Quality is about customers. Organizations need to figure out what it is their

customers like, and deliver it the same every time. Successful organizations expect

their customers to come back to them and also tell others about them. We can think

about quality in this way as reliability (Peters, 1999). It is the ability of the service

provider to deliver the service as promise accurately all the time. In HRO, the

company as the customers of the HRO service providers would expect reliable service

from the providers. It is quite natural that the company or employees to expect better

and more reliable service than what has been received before the outsourcing.

4.   Assurance

Another factor behind the quality management is about efficiency or assurance. Successful HRO service provider must know the most efficient way to produce a product or service, and stop wasting time, materials, replacing broken-down goods or delivering unsatisfactory services. In doing so, HRO service providers must have knowledgeable staff to attend to their clients' employees. Hence, this dimension is very much relevant to determine service quality of HRO service provider.

5.   Empathy

As HR is all about people management, HRO service providers must pay closer attention on the empathy dimension which is about provide service with caring and to certain extend individualized attention.

2.3   Partnership Quality between Company and Service Providers

Partnership in outsourcing context refers to the degree of collaboration or relationship between outsourcing service providers and the client organization. Managing outsourcing partner relationships requires more transparency, better communication, greater trust and genuine reciprocity. Essentially, success in outsourcing environment will heavily hinge on shifting the client-service provider relationship from adversarial to collaborative, from one which is based on procurement to one grounded in partnership (Miller, 2007). The concept of partnership quality is not only critical to assure high-quality partnership, but also a key predictor for managing and nurturing good outsourcing practices (Sigala, 2004).

Survey conducted by Price Waterhouse Coopers showed that "collaborative partnering and an openness to business model innovation become more important as clients start to look at "second wave" outsourcing of functions being streamlined within shared service centers, such as HR and finance or accounting. Companies identified as "expert

outsourcers" (those that met their business plan goals completely) measured their service providers as better collaborators than "learners" (companies for whom outsourcing only partly met business goals), with 81 percent of experts stating that they have honest and transparent dealings with providers (vs. 62 percent of learners)" (Miller, 2007).

Adebanjo and Kehoe (1998), stressed the importance of partnership with suppliers in his study on problems among UK companies in developing quality culture. It was reported that many UK businesses persist in dealing with suppliers on the basis of price tag while the need was to move to few or single suppliers, based on a long-term relationship of mutual understanding of needs, loyalty and trust (Hand,1992). In a study on service quality of Application Service Providers (ASP), Sigala (2004) advocated the importance of trust and the other partnership quality issues as they had a significant effect on ASP service quality.

Many researches have been done on outsourcing vis-à-vis partnership especially on IT outsourcing, but not so for HRO. Perhaps the concept can also applicable to HR outsourcing. Partnership appears to be a less rigorously defined analytical framework than other theories such as transaction costs, agency and core competencies. The word partnership itself had a more everyday routine context and readily understood characteristics to describe a relationship between two or more parties in a particular context. Partnership in the IT outsourcing literature seemed largely non-theoretical, perhaps reflecting a wide diversity of practical arrangements and the absence of a single commonly recognized theory (Gottschalk and Solli-Saether, 2006). The emphasis of the studies were often on the intangibles, such as trust, comfort, understanding, flexibility, cooperation, shared values, goals, and problem solving, good interpersonal relation, and regular communication (Hancox and Hackney, 2000).

According to relational exchange theory, a partnership is dependent on relational norms. Norms are expectations about behavior that are at least partially shared by a group of

decision makers. Norms are important in relational exchange because they provide the governance rules of the game (Gottschalk and Solli-Saether, 2006). Many classifications of norms have been proposed, one of them was by Kern and Blois (2002), who proposed that relational norms are a higher order construct consisting of three dimensions. First is flexibility, which defines as willingness to make adaptations when circumstances changed. Second is the information exchange in which each partner is expected to proactively provide information useful to the other partner. And finally is solidarity, which defines a bilateral expectation that a high value is placed on the relationship. It prescribes behaviors directed specifically towards relationship maintenance (Gottschalk and Solli-Saether, 2006).

Social exchange theory on the other hand suggests that each party in an exchange relationship compares the social and economic outcomes from these interactions to those that are available from exchange alternatives, which determines their dependence on the exchange relationship. The theory views people's social behavior in terms of exchanges of resources. The need for social exchange is created by the scarcity of resources, prompting actors to engage one another to obtain valuable inputs. Social exchange can be defined as voluntary actions of individuals that are motivated by return they are expected to bring and typically in fact bring from others. Social exchange can be viewed as an ongoing reciprocal process in which actions are contingent on rewarding reactions from others (Das and Teng, 2002). Positive economic and social outcomes over time increase the partners' trust of each other and commitment to maintaining the exchange relationship (Lambe *et al.*, 2002).

Another theory to illustrate the partnership is stakeholder theory. Stakeholder theory concerns with balancing the interests of the stakeholders in an outsourcing relationship. In IT outsourcing perspective, Lacity and Willcocks (2000) suggested there were four distinct client IT stakeholder groups and three distinct supplier IT stakeholder groups. Upholding four principles of; honoring agreements; avoiding lying; respecting the autonomy of others; and

avoiding harm to other, were necessary precondition for efficient working. In this sense, stakeholder theories of the firm established economic relationships within a general context of moral management (Gottschalk and Solli-Saether, 2006).

It is quite understandable in business to business relationship, forming partnership between business customers and service providers is something desirable. This can be explained from transaction cost theory whereby in business to business marketing, the transaction cost which include cost of reaching agreement between both parties, selection process, and enforcing the agreement itself. In the end, this will entail toward forming lasting relationship so that the transaction cost would not recur.

In other studies, Hunt (2002) and Hunt and Derozier (2004) explained relationship as a mechanism to make firms more competitive. They draw on resource-advantage (R-A) theory, which is a theory of competition that can provide a grounding framework for relationship marketing strategy. At its core, R-A theory combines heterogeneous demand theory with a resource-based theory of the firm. R-A theory viewed competition as a process that consists of the constant struggle among firms for comparative advantages in resources that will yield marketplace positions of competitive advantage. Thus, firms enter into relationships with other firms and consumers when such relationships contribute to their competitiveness (Hunt, et al., 2006).

Overall, many literatures on partnership quality in outsourcing context were studied in relation to IT outsourcing but not much reference were made to HR outsourcing. This was explainable as IT outsourcings were among the earlier functional outsourcing that taken placed. However, in HRO outsourcing or in any other outsourcing relationship context, service providers enter into partnership or relationship with their client organization so that they are better able to develop their services or solutions that are customized to the tastes and preferences of the individual client organizations.

Of the various theories used to explain partnership quality, this study on partnership quality vis-à-vis service quality is based on relational exchange theory and social exchange theory. Relational exchange theory suggested that the two parties in exchange relationship are interdependence on each other and they will make necessary adjustment and shared information to maintain their relationship (Gottschalk and Solli-Saether, 2006). Social exchange theory explains the need to realize social and economic benefits in the relationship. Based on Lee and Kim (1999), this study will look at partnership between the company and HRO service providers in three dimensions; trust, communication, and top management support.

2.3.1   Trust

Client's decision to maintain its relationship with the service provider and to further invest in this relationship is influenced by the extent to which the client trusts the service provider. The extent to which trust is developed in their relationship depends on among other things, the success with which the provider develops bonds with its client (Gounaris & Venetis, 2002). Many studies on the subject, measured trust in term of sincerity, goal congruence, (Sullivan & Peterson, 1982), honesty, and belief about information sharing (Crosby et al, 1990). Companies that are putting trust to the service providers, in their business relationship, are anticipating high level of service provision from the providers.

In their "commitment-trust" theory of relationship marketing, Morgan and Hunt (1994) identify "relationship benefits" as a key antecedent for the kind of relationship commitment that characterizes consumers who engage in relational exchange. Furthermore, consumers desire relationship partners that they can trust. Trust is associated with a partner's reliability, integrity, and competence (Hunt, et al. 2006).

Trust, in the industrial buyer-seller context, has been defined as "the firm's belief that another company will perform actions that result in positive outcomes for the firm, as well as not take unexpected actions that would result in negative outcomes for the firm" (Anderson and Narus, 1990). Trust is widely recognized as a critical component of successful partnering. Mutual trust was the most important factor, according to both buyer and sellers that characterized a good relationship.

2.3.2 Communication

Communication is an essence in any business relationship. Good communication helps to ensure the expectations between both service providers and customers are matched. Communication in outsourcing context is sharing of information between client organization and the HRO service provider. Information sharing refers to the extent to which critical information is communicated to the firm's partner (Mohr and Spekman, 1994). Sharing of information can be conducted formally or informally (Anderson and Narus, 1984).

Information exchange, according to the interactionists' approach, is a crucial component of the interaction process because it lowers buyers' perceived risk and improves the supplier's credibility (Hakansson, 1982). The absence of communications has been seen as a cause of conflict (Firat *et al.*, 1974). Successful relationships are theorized to be high on information exchange connected to long-term planning and product, production-logistic related issues (Frazier *et al.*, 1988).

A firm which has established close and extensive working relationships with its partner is theorized to be more willing to share key strategic and operating information. These contacts enable information which is exchanged to reduce perceived risks by one or both parties. Moreover, closer ties may result in more frequent and more relevant information exchange between partners (Huber and Daft, 1987). To achieve a high level of information

exchange, supplier firms may even locate personnel at the customer location and engage in other practices that enhance personal relationships (Nielson, 998). This is very much relevant in HR outsourcing setting whereby HRO service providers need to make direct contact with the organizations as well as the employees.

Elements of communication measures might include the effectiveness of communication, information exchange, information quality and timeliness, and the level of feedbacks (Cousins *et al.*, 2008).

2.3.3   Top Management Support

The commitment of senior managers has been described as the most important determinant of successful Total Quality (TQ) implementation and its absence is a prime reason why TQ fails (Morgan and Murgatroyd, 1994). Nakamura (1992) also stated that it is clear that unless senior management is fully committed to the idea of a real improvement in quality, exercises leadership and devotes time, energy and resources to this objective, it would be impossible to motivate the rest of the organization (Adebanjo and Kehoe, 1998).

With regards to HRO, top management support on the HRO strategy is very important in creating the high level of collaboration or partnership between the company and the service providers. This is also implied from the study conducted by Gottschalk & Solli-Saether (2006) where they found that competence management was found to be the most critical success factor in IT outsourcing relationships. Support from top management would send strong message to the HRO service providers that the company is serious to ensure successful of the HRO strategy.