

OUTSOURCING AND HUMAN RESOURCE MANAGEMENT

A DISCUSSION STARTER

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Outsourcing: some definitional issues

Outsourcing can be defined as the situation where 'an external vendor provides, on a recurring basis, a service that would normally be performed within the organisation'.¹ A definition favoured by lawyers sees outsourcing as a legal partnership between two or more organisations where one contracts out the ownership, *management and staff* of a particular function to a specialist company. In other words, outsourcing is a process in which companies concentrate on aspects of their business which give them a competitive advantage (core-business) and contract out the more peripheral or non-core aspects for other firms. It is in this sense that the term is often used interchangeably with subcontracting or contracting out.

In the traditional employment relationship, the employing company is also the producing company. Outsourcing has added another dimension to this relationship by introducing (in some cases) an intermediary that acts as some kind of labour supply company.

Box 1: Employment Relationship where producing company is not employing company

- Labour hire/employment agencies (workers are employees)
- Labour hire/employment agencies (workers are 'dependent contractors')
- Independent contractors (sole traders or own account workers)
- Outsourced suppliers

Box 1 outlines four different situations where the labour supply comes from outside the producing company. The conditions of employment depend on what kind of labour supply company is involved. Moving from top to bottom in box 1, we see that there are companies which act as intermediaries (labour hire), tradespeople who work for themselves as sole traders, and companies which exist as outsourced suppliers. In the movement from top to bottom is a *change in the directness of the relationship between the main producing company (the host company) and the labour-supplier*. For example, labour hire tradespeople often work under the same conditions as do tradespeople in the host company. On the other hand, sole traders work to a contract and set their own conditions, while outsourcing suppliers usually have no employment parallels with what is happening in the host company.

¹ P.J. Harkins, S.M. Brown & R. Sullivan, 'Shining new light on a growing trend', *HR Magazine*, 40(12), 1995, pp.75-79

In terms of traditional employment relationships there is often further confusion within the labour hire area. Sometimes the workers will be employed by the labour hire company in an employee relationship and then leased out to the host company. Amongst some labour hire agencies, however, the workers will be engaged as contractors, not employees. These workers can be termed 'dependent contractors' and be distinguished from 'independent contractors' who legitimately work as sole traders. The labour supply company in this case is acting as a broker rather than as a supplementary labour hire company.

A further complication is sometimes raised when companies *convert their existing workforces into someone else's employees*. This can take two forms:

1. a section of the organisation (eg. maintenance or canteen) is contracted out. The same workers retain their old jobs but now work for the contracting company;
2. a section of the organisation is set up as a separate business and is sold off to another company, with the workers transferred along with the premises and equipment.

To date the implications and impact of outsourcing on HRM and ER issues have not been extensively explored. In contrast there is an impressive literature on the financial and strategic reasons that firms should outsource. The aim of this discussion is to provide a brief background to outsourcing and highlight what some of the key HRM/ER issues of outsourcing may be, and suggest areas for further research.

Extent of outsourcing

There is no detailed survey of outsourcing activity in Australia; however, it is possible to piece together trends on agency workers and contracting out from various surveys.

According to the Australian Workplace Industrial Relations Survey (AWIRS), conducted by the Federal Department of Industrial Relations in 1990 and again in 1995, non-employees as a percentage of employees have increased from 4.7 per cent to 6.5 per cent. In manufacturing the increase has been greater, from 4.3 per cent to 7.4 per cent. The percentage of workplaces using agency workers jumped from 14 per cent to 21 per cent—an increase of 50 per cent. In manufacturing, the increase was somewhat greater—from 15 per cent to 23 per cent. It is quite likely that these figures are an under-estimate of the true extent of non-employees in the workforce because the AWIRS population only includes workplaces with 20 or more employees.

The AWIRS panel data, which examines a subset of workplaces that survived from 1990 to 1995, suggests that the majority of workplaces in 5 industry sectors had contracted out services during the previous 6 years. This is shown in table 1.

Table 1 Contracting out by industry

Industry	% workplaces with services contracted out during last 6 years
Electricity, gas & water supply	66.8
Construction	60.8
Education	60.4
Mining	55.3
Government administration	51.5
Manufacturing	45.7
Property & business services	33.3
Cultural & recreational services	33.2
Communication services	32.8
Transport & storage	32.3
Wholesale trade	29.8
Personal & other services	28.7
Health & community services	22.4
Accommodation/cafes/restaurants	21.7
Finance & insurance	14.8
Retail trade	10.6
Total	34.7

Source: AWIRS, panel data.

Population: All workplaces with 20 or more employees which survived from 1990 to 1995.

Some of these industries—such as construction—have always been heavy users of contracting, but others are very much a 1990s phenomena — with education and government administration particularly hard hit. The State government of Victoria, for instance, released a book containing details of the 8,305 outsourcing contracts it is now party to.² The Federal government is outsourcing most of its \$5-6 billion IT infrastructure.³

The AWIRS data also shows that the most common services for contracting out have been:

- cleaning and laundry;
- building and maintenance;
- provision of other parts for manufacturing or production.

A smaller survey of members of the Personnel and Industrial Relations Group of the MTIA conducted in 1994 suggested that 96% of respondents had outsourced

² Simon Domberger, 'Doing business with government', *Australian Financial Review*, 15 March 1999, p.42.

³ M. Lawson, 'handing over the right slice of the business', *AFR*, 15 march 1999, p. 43.

at least one activity, and more than half had outsourced cleaning, transport, catering and maintenance work.⁴

It is estimated that up to a quarter of the top 200 Australian corporations now have employees of external services suppliers looking after areas like the mail room, courier services, reception, records management, registry, accounts payable, payroll processing, supply of office furniture and purchase of office consumables.⁵

The increase in outsourcing activity has led to an identifiable 'outsourcing industry', comprised of firms whose sole activity is the provision of particular services to other companies. A special survey of outsourcing by the *Australian Financial Review*, identified at least four separate segments in the Australian outsourcing market:⁶

1. Property and facilities management;
2. Financial processes and HRM;
3. Office support services; and
4. Internal auditing.

We could also add other areas such as customer services, call centres, manufacturing, and maintenance functions.

The changing nature of outsourcing

Not only has the *extent* of outsourcing been increasing but the *type of functions* that are outsourced has also been changing. There has been a growing re-assessment in many industries and firms about what constitutes the core and non-core aspects of their business. One survey conducted in the US suggested that the average number of functions outsourced by organisations had risen by 225% (from 1.2 to 3.9) between 1992 and 1997.⁷

Some firms (eg. Compaq and Apple) now outsource their entire manufacturing process. Known as 'turnkey contract manufacturing', firms retain control only over the brand name and marketing of the product. Many airlines, for instance, initially began outsourcing functions such as baggage handling and refuelling. Some now suggest airlines should retain control of marketing but outsource everything else, including flying.

⁴ John Benson & Nick Ieronimo, 'Outsourcing decisions: Evidence from Australian-based enterprises', *International Labour Review*, 135 (1), pp. 59-73. In their study, 85 firms were contacted of whom 26 responded, a 31% response rate.

⁵ C. Jay, 'Outside specialists move into office support services', *AFR*, 15 March 1999, p.42.

⁶ C. Jay, 'Each segment has potential', *AFR*, 15 March 1999, p.44.

⁷ Cited in Brown, op.cit.

Outsourcing of customer service, for instance, has also become increasingly popular (eg. Call centres). A survey of over 1000 Chief Financial Officers by Drake suggests, however, that Australian firms are lagging behind their international counterparts in terms of what functions they are prepared to outsource. A recent study by the Australian Call Centre Association found that only 7% of organisations were prepared to outsource their call centre business.⁸

One implication of outsourcing for HRM/ER is the extent to which the HRM/ER function itself is being increasingly outsourced. An extensive literature on the pros and cons of outsourcing the HR function now exists, much of it a 'how to' guide rather than analysis of its implications for the firm and the management of labour. Box 2 highlights some findings of interest in this area.

⁸ Ibid.

Box 2 Outsourcing of the HRM function

- Of 121 senior-level HR professionals that responded to a survey in the US, 91% outsourced one or more of their HR functions.⁹ The reasons given for outsourcing HR (in order of importance) were: To use the expertise of specialists, To save time, To save money, To save administrative costs, To focus on more strategic initiatives, Function not part of core business, Responsibilities have increased, Staff reductions, Budget cuts, To reduce liability.
- The authors of the above study suggest that these findings show that quality and flexibility rather than cost are the most important reasons for making outsourcing decisions.
- Other surveys of outsourcing in HR departments suggest that the most common reasons for outsourcing are to: enhance expertise, improve service quality, reduce staff, and streamline process and lower costs.¹⁰
- A 1998 survey of 132 firms by the Hay group in the US showed that 57% outsourced aspects of their HR functions. Of those who did, almost 20% were not satisfied. Reasons for dissatisfaction included:
 - lack of proactiveness by the vendor (firm supplying services);
 - turnover of the vendor team;
 - vendor errors and mistakes;
 - incompatibility between client and vendor cultures.¹¹
- According to a Drake survey of over 1000 Chief Financial Officers across the corporate sector in Australia, human resources is the most likely corporate function to be outsourced by Australian companies - mainly in the traditional areas of HR such as recruitment, selections and training. Drake study predicted that the outsourcing of tactical functions by medium-sized firms would form the next stage in the evolution of HR outsourcing.¹²

Why outsource?

The literature suggests that there are four distinct management rationales for outsourcing:¹³

1. Capacity outsourcing: the flexibility to supplement existing capacity in response to changes in demand;
2. Specialisation subcontracting: where a product or process requires the use of specialised equipment or specialised skills that is/are otherwise not always

⁹ P.J Harkins, S.M. Brown & R. Sullivan, 'Shining new light on a growing trend', *HRMagazine*, 40(12), 1995, pp.75-79. The authors surveyed 1750 senior-level HR professionals in the US obtaining only 121 usable responses, or a 7% response rate.

¹⁰ H.R. Mitchell, 'A moving issue: to outsource or not to outsource', *HRMagazine* 43(6) 1998, pp.59-68.

¹¹ J. Laabs, 'The dark side of outsourcing', *Workforce*, 77(9), 1998, pp.42-48

¹² Helen Meredith, 'Study exposes Australian companies' narrow view', *AFR*, 15 March 1999, p. 44.

¹³ Harrison & Kelley, op.cit; and Simon Domberger, *The Contracting Organization: A Strategic Guide to Outsourcing*, Oxford: Oxford University Press, 1998, p.51.

needed. Specialisation also refers to concentrating on those activities in which the firm has established a distinctive capability;

3. Cost reduction: other firms can often complete a process or service more cheaply than in-house production. Linked to cost reduction, outsourcing is sometimes seen as a way of avoiding the higher costs of unionised labour or paying for statutory employee costs such as taxes, superannuation, leave loadings and entitlements and so on;
4. Market discipline: leads the purchaser of services to focus on outputs rather than inputs, competition between suppliers argued to lead to more innovative work practices.

Most studies suggest, however, that firms undertake outsourcing for a combination of reasons and rarely simply to avoid higher labour costs. One survey of outsourcing projects in the Australian public sector which covered 7,500 outsourcing contracts from 1995 to 1998, suggested that the main reasons for outsourcing were:

- to achieve better access to skills;
- improved quality;
- cost savings.¹⁴

The survey also found that cost savings varied by the service that was outsourced, varying from savings of 46% for cleaning services to minus 9% for IT services.

Is Employee Relations a factor?

The degree to which firms are guided in making outsourcing decisions on the basis of ER or labour relations reasons is difficult to determine. An alleged benefit of outsourcing is said to be the ability of improving employee relations due to shifting ER responsibility to a third party. This is especially the case where the union representing the current 'in-house' employees is perceived as militant or where workplace reform is being resisted.

Whilst most studies suggest that ER/labour costs ranks towards the bottom of the decision-making structure, one study of why firms in the Australian metal manufacturing industry outsourced their maintenance function arrived at a different conclusion.¹⁵ In this study, nearly half of the respondents stated that reducing the number of unions, reducing union influence and improving ER were important factors in the decision to outsource the maintenance function. The importance of ER was also confirmed by case studies of 4 firms conducted by

¹⁴ A. Mitchell, 'Outsourcing no cure for costs', *AFR*, 24 March 1999, p.21

¹⁵ Benson & Ieronimo, op.cit.

the same authors. The case studies suggested that the existence of demarcation issues were particularly important in accounting for managements' decision to outsource maintenance, as were union restrictions on use of supplementary contract labour, and the failure to restructure maintenance work after attempted negotiations with unions.

Similarly, a case study of the use of agency workers at the South Australian power utility, ETSA, found that 'employee relations' was a key reason in management's decision to contract out some of its operations to agency workers.¹⁶ ETSA management saw the enterprise bargaining process as too slow and constraining to achieve the flexibility they wanted, and that the use of agency workers assisted in changing the workplace culture in order to deal with a more competitive environment.

The costs and disadvantages of outsourcing

For every study of outsourcing showing its advantages, there is a study pointing to its failure or actually increasing costs. For instance:

- Only 5% of 300 companies surveyed by PA Consulting found outsourcing high on benefits and low on drawbacks. For the remainder, the outcome from outsourcing was either mediocre or a failure.¹⁷
- A study conducted of 116 large organisations in the US and Britain found that for a third of the companies that outsourced IT, it resulted in dramatic cost blowouts, disputes, high levels of failure and loss of control. Failures were particularly high among companies that outsourced more than 80% of their operations.¹⁸
- Experience of these problems has led in some instances to a change in the way outsourcing is conducted. Some outsourcing consultants now promote 'co-sourcing', where the client company keeps responsibility for the management of the outsourced activity, but the outside provider supplies consultancy services and experienced personnel on a 'needs' or 'projects' basis. While traditional outsourcing may be suitable for low risk peripheral activities like cleaning or car fleet management, companies want to retain more of a say with higher risk strategic functions.

¹⁶ Roma Gryst, 'Contracting Employment': *A case study of how the use of agency workers in the SA Power Industry is reshaping the employment relationship*, ACIRRT working paper, (forthcoming 1999).

¹⁷ Cited in Brown, op.cit.

¹⁸ The study was conducted by Dr Leslie Willcocks, Templeton College, Oxford, cited in Lawson, op.cit.

The problems and disadvantages associated with outsourcing include:

- Co-ordination costs: the increased costs and difficulties of coordinating production and exchange with several external service providers rather than in-house control;
- Quality and service issues: there is often an incentive for the contractor providing the service to renege on quality, especially where quality is difficult to verify (eg. Prison guards);
- Costs of transacting: search and selection costs to find an appropriate contractor; Contractors can often extract post-contractual revenue in the event of unforeseen circumstances due to bargaining advantage. The whole premise of transactions cost theory is that internal transactions are less costly than external ones, which is why firms arise in the first place, to internalise and coordinate market transactions;
- Costs of monitoring: As with all contractual relationships, the client firm may need to intensify the monitoring of the contracting firm's performance in order to minimise the latter's incentive to shirk or cut-back on quality and service;
- Control: Outsourcing may lead the client firm experiencing a loss of control over key areas, including the employment relationship and the management of employees.

The impact of outsourcing on HRM/ER

Despite the many claims and counter-claims surrounding outsourcing and the myriad studies of its impact on costs, there is still surprisingly little research into its effects on HRM/ER outcomes. Outsourcing advocates such as Domberger conclude with statements such as:

“Contracting improves organizational performance by creating change along three principal fronts: reducing staff numbers; introducing new skills and working practices; and modifying individual incentives, employment terms, and attitudes to the workplace. But resistance to change is ubiquitous, and nothing quite resists change like organizational inertia”¹⁹

This begs the question of what the longer-term impact of such changes may be. Critics of outsourcing have pointed out that cost savings need to be evaluated against additional costs and long term effects.

¹⁹ Domberger, *The Contracting*, op.cit, p.151

The impact of outsourcing on ER variables will also depend on the form and nature of the outsourcing operation (see Box 1). The ER/HR effects will be different, for instance, according to whether outsourcing involves the contracting out of an entire function (eg. maintenance) where some or all of the existing employees are either made redundant or transferred over to another entity, or situations where some activity may be contracted out to staff from labour hire agencies who may work alongside employees of the firm.

Employee Relations Climate

One case study of four manufacturing companies that had outsourced their maintenance activities to Skilled Engineering suggested that employee relations (from a management perspective) had improved.²⁰ The reasons for this improvement were attributed to the removal of demarcation issues and work restrictions, a reduction in number of unions on site and a cited improvement in shopfloor morale.

The improvement in productivity was due to the decrease in the number of direct maintenance labour needed (two companies achieved reductions in their maintenance workforce of 50%). In two cases, however, management felt that the maintenance service had declined due to the new staff's lack of experience. Machine downtime had also increased for these two companies.

Improvements in productivity may arise from simply reducing staff or because employees who are contracted may work harder because their employment is less secure. This raises the question, however, of whether fear is the best incentive for longer-term productivity improvements. Fear may lead to increased worker anxiety, stress and lack of commitment, all potentially damaging to productivity and quality in the longer term.

Employee commitment

Much of the HR literature of the 1990s has stressed that to be competitive, firms will need to adopt strategies that enhance employee commitment. It is possible that the use of outsourcing, especially that which involves the use of employees from labour hire firms working alongside 'regular' employees of the firm, will create problems of commitment for both groups of workers:

- Outsourcing creates the possibility of a form of dual commitment: the commitment of employees to the enterprise where they work as well as to the firm that employs them (i.e. the labour hire firm).
- Outsourced labour may be less committed to the host company than regular employees. If contract workers have little loyalty to their host company they are unlikely to cooperate with regular employees to improve work processes

²⁰ Benson & Ieronimo, op.cit.

and productivity. As one Silicon Valley manager disgruntled with the outsourced service provider's employees remarked:

*...a mercenary may shoot a gun the same as a soldier, but he will not create a revolution, build a new society, or die for the homeland.*²¹

Although there are only few studies on the subject, they show that:

- The presence of contractors is associated with lower trust among the *firm's regular employees*. This is often because the regular employees see the contractors as a threat to their own position and this leads to divisiveness in the workforce.²²
- In some situations, the disparity in pay and conditions between agency workers and permanent employees doing the same job causes tension and stress, with little team spirit and teamwork between both groups. This can have a negative impact on employee commitment to both host firm and labour hire firm.
- A study of contract employees (all from Skilled Engineering) in four manufacturing firms found that over half of all the contract employees had similar levels of commitment to their employer and to the host company (ie. most respondents displayed dual commitment), but that their commitment to the host company was higher than that to their employer (ie. SE). The author concluded that:

Organizations that outsource maintenance functions do not appear to end up with a poorly committed group of contractor employees...It appears that any negative feelings about contract employment tend to affect the relationship with the employer and not the relationship with the host enterprise.

It should be noted that the results of this study should not be generalised as all contract employees were employed by one organisation (SE) that offers permanent employment, award wages and conditions and is supportive of union membership.

Union avoidance and presence

US studies have found little or no evidence that subcontracting is associated with union avoidance strategies per se. One key study, however, did find a relationship between union presence and a plant's likelihood of engaging in

²¹ Cited in, D.J. Bryce & M. Useem, 'The impact of corporate outsourcing on company value', *European Management Journal*, 16(6), 1998, p.639.

²² J. Pearce, 'Towards an organizational behaviour of contract labourers: their psychological involvement and effects on employee co-workers', *Academy of Management Journal*, 36(5), 1993, pp. 1082-96; Gryst, op.cit.

outsourcing activity.²³ The study found that non-union plants with collaborative problem-solving committees were significantly more likely to contract out than similar plants without employee involvement schemes. The authors suggest that such problem solving committees are often a vehicle for management to achieve numerical and functional flexibility.

In contrast, when the plant had both a union and an employee involvement program, the plants likelihood of engaging in outsourcing was relatively lower. The authors suggest this finding may be indicative of a greater commitment by management to employment stability within the plant.

As indicated earlier, union avoidance or reducing the number of unions may be more of an issue in the Australian environment. Some firms have reached agreements with particular unions who in return for agreeing to contracting out have been given coverage of the employees involved. The introduction of subcontractors, however, may be a source of tension with unions and lead to industrial disputation.

Training and skills

A key issue in outsourcings' impact on ER/HR is its impact on skills and training. As some have argued:

*outsourcing can provide a short cut to a more competitive product, but it typically contributes little to building the people-embodied skills that are necessary to sustain product leadership.*²⁴

This may lead to what outsourcing speak is termed a 'hollowing out' of the organisation, referring to the loss of skills, loss of corporate memory, weakened innovative capacity and switching costs, that may accompany outsourcing.

Once again, the likely impact on the skill base or knowledge of a firm will depend on which function/s has been outsourced. The impact of outsourcing IT or HR is likely to have a much greater impact than say outsourcing cleaning or canteen facilities. There have been several reports of firms outsourcing their IT function, only to find that the lack of in-house expertise causes a reversal of the strategy.

In contrast, some argue that a major reason for the growth of outsourcing, especially in areas like IT, has been the difficulties certain companies have in attracting the right staff to run these operations in-house.²⁵ IT professionals, for instance, may see their career path in terms of the wider IT industry rather than as IT managers in manufacturing or service sector companies. For such employees, joining firms such as Andersens, or KPMG is increasingly seen as

²³ Harrison & Kelley, op.cit.

²⁴ C.K. Prahalad & G. Hamel, 'The core competence of the corporation', *Harvard Business Review*, 68(3), 1990, cited in Benson & Ieronimo, op.cit.

²⁵ Lawson, op.cit., p. 41.

the most attractive way of gaining exposure to the latest developments in the profession. Increasingly, much of what happens to the internal labour markets, training and career structures in professions such as IT, accounting, finance, and HR will depend on the practices adopted by these large outsourcing service providers.

There is evidence, especially in skilled blue-collar trades, that firms that outsource might be reluctant to invest funds in training the employees of contractors.²⁶ Agency workers often receive little or no training from either their agency or host firm and are required to undertake and pay for skills training themselves. Clearly there is little incentive for firms to pay for or provide training to agency employees as it in some ways defeats the purpose of outsourcing in the first place. While this may not necessarily pose a problem for individual firms in the short term, this situation may pose problems for all firms in the longer term if the overall skill base of the workforce is reduced. Certain types of training and skill acquisition are too expensive to be undertaken by individual employees and much is also acquired on-the-job. The relationship between outsourcing and skills/training deserves further investigation and research.

Occupational Health & Safety

Another possible impact of outsourcing on employee relations issues is whether and how it impacts on occupational health and safety (OHS). A study of contract workers in the US petrochemical industry, for instance, found that contract employment relationships created stress with potentially serious effects on safety.²⁷ Outsourcing may increase the risk of occupational accidents if it leads to work intensification, poorer OHS related training, or the firm having less control over contract employees compared to its own.

A study of OHS and outsourcing in the Australian Child Care, Hospitality, Transport and Building industries found that although subcontracting and outsourcing can and does have significant adverse effects on OHS, the differences in OHS risk and effects between subcontract workers and regular employees were not substantial.²⁸ The major differences in OHS outcomes were between the different industry groups with employment status (whether workers were subcontractors or employees) being an important *secondary effect*. The study also found that subcontracting was associated with increased economic competition, work disorganisation, regulatory failure and divisions in the workforce, which had adverse OHS effects on *all workers* in the industries.

²⁶ Gryst, op.cit.

²⁷ T. Kochan, M. Smith., J. Wells, & J. Rebitzer, 'Human Resource strategies and contingent workers: the case of safety and health in the petrochemical industry', *Human Resource Management*, 33(1), 1994, pp. 55-77.

²⁸ Claire Mayhew, M. Quinlan & Laura Bennett, *The Effects of Subcontracting/Outsourcing on Occupational Health and Safety*, IRRC, UNSW, 1996.

A more recent study of outsourcing and OHS in the Australian Textile, Clothing and Footwear industry by the same authors, found that:

The OHS of outworkers was unequivocally and significantly worse than that of factory-based TCF workers.²⁹

Unemployment

While there is no clear link between outsourcing and unemployment at the macro-economic level, there is clearly an impact at the level of the individual firm. In most outsourcing arrangements, employees are either transferred to the contractor, redeployed within the firm, or made redundant. The case studies of outsourcing in the Australian manufacturing industry noted earlier all experienced large employee reductions in their maintenance workforce after outsourcing. Indeed, much of the 'how to' outsourcing management literature is geared to examining how to best deal with the financial and legal implications of making the workforce redundant.

An analysis of manufacturing workplaces using AWIRS data conducted by ACIRRT suggested that outsourcing has a significant impact on employment. Manufacturing workplaces were divided into two categories: those that had engaged in contracting out and those that had not. When asked what the impact of workplace change had been on the number of full-time employees at the workplace, *nearly half of the contracting out workplaces reported that full-timers had decreased. For non-contracting out workplaces, the comparable figure was only 12 per cent.* Clearly, contracting out was being used to reduce the workforce, not just to supplement employee numbers during peak activity.

Legal issues

The legal implications of outsourcing for employee relations comprise of two main issues:

1. The broader conceptual issue regarding the status of employees in an environment where outsourcing is increasingly used.

One of the key conceptual issues that outsourcing raises is the question of whether agency workers are in fact employees, and whether they are employees of the employment agency or the host firm. As was noted in box 1, the nature of the employment relationship is changing, with labour now not always 'belonging' to the producing company. This trend also creates confusion at the workplace level. The ETSA case study referred to earlier asked the different parties to indicate who the employer was. The responses are shown in table 2.

²⁹ Claire Mayhew & Michael Quinlan, *Outsourcing and Occupational Health & Safety: A comparative study of factory-based and outworkers in the Australian TCF industry*, IRRC, UNSW, 1998.

Table 2 The nature of the employer (%)

Suggested employer	Agency workers' view	Agency view	ETSA Managers' view	Barrister view
Agency	58	44	90	
ETSA	32	-	5	
Self-employed	5	56	5	100
Don't know	5			

Source: Gryst (1999)

These findings suggest that there exists confusion over who is the employer of agency workers, or if in fact there is an employer. Most agency workers saw themselves as being employed either by the agency or their host firm. The employers in the host firm (ETSA) however, overwhelmingly saw the labour hire agency as being the employer. The agency views were split between seeing themselves as the employer or regarding their employees as self-employed. The host firm's legal advice (Barrister view) was that the workers were self-employed!

The issue is not just conceptual for who the employer is has implications for areas such as the benefits and entitlements of employees, responsibility for training and OHS and so on.

2. The more practical implications of outsourcing with respect to complying with various statutory Acts.

Practical legal implications of outsourcing mainly relate to the redundancy implications of such decisions. In particular, the impact of the transmission of business provisions in the federal Workplace Relations Act 1996 (section 149); and the obligation to consult those employees affected by a decision to outsource (section 170GA). Courts have in the past awarded compensation to employees who have been 'transferred' to labour hire agencies after an outsourcing decision, especially if they were not adequately consulted or provided with alternatives.³⁰

Other issues relate to whether the relevant award or agreement flows on to the new employer after an outsourcing arrangement. This is of importance to the third party/contractor since it could determine the economic viability of the outsourcing operation. A recent decision by the Federal Court means that private sector companies winning contracts to carry out services for government agencies will have to ensure their employees' wages and conditions are in line with federal public sector awards and agreements. The key legal issue in the case was whether an entity that takes over delivery of services outsourced by a State government department is legally bound by the industrial awards that

³⁰ See Work alert, 'Outsourcing former employees: beware of the legal traps', No.17, October 1998.

applied to the government when it delivered the services. Section 149 of the Federal WR Act provides that existing industrial awards continue to apply to a business after it is taken over by or 'transmitted' to a new employer.³¹

Apart from complying with the letter of the law with respect to outsourcing, the *process* or *implementation* of outsourcing is also important for creating or maintaining a cooperative industrial climate. What may be needed therefore are some 'best practice' case studies exploring the implementation phase of outsourcing.

Outsourcing and HRM/ER: what we need to know?

If the current literature is to be believed, outsourcing is not just another management fad but here to stay. To date, the bulk of that literature has concentrated on the benefits of outsourcing, why firms outsource, and how to implement outsourcing contracts. There have been few studies, both in Australia and overseas on the HRM/ER implications of outsourcing. This brief discussion would suggest that the following issues would prove useful areas for further inquiry:

- Conceptualising the changing nature of the employment relationship in the context of the different forms of outsourcing (including legal implications).
- The relationship between outsourcing and 'production networks' in particular sectors of Australian industry and the HR/ER implications of these.
- The implications of outsourcing the HRM function for firms operating in Australia.
- The degree to which ER is a factor in pursuing an outsourcing strategy.
- The effect of outsourcing on ER climate and productivity.
- The impact of outsourcing on employee commitment.
- The relationship between outsourcing and union presence at the workplace.
- The impact/relationship between outsourcing and skills and training.
- The nature of internal labour markets in large outsourcing consultancy firms in areas such as IT, Human Resources, finance, customer services.
- The relationship between outsourcing and OHS at the workplace.
- A longer term assessment of the cost effectiveness of outsourcing, especially post GST
- Developing an outsourcing best practice study focusing on the introduction and implementation of outsourced activities

³¹ M. Davis, 'Court rules workers can't lose from outsourcing', *AFR*, 19 July 1999, p.1.