



(REVIEW ARTICLE)



## Review paper on outsourcing human resource functions in MSME sector

Meenu Rathore, Tejal Patel and Divyesh Patel \*

*School of Liberal Arts and Management, PP Savani University Surat, India.*

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### Abstract

This review paper aims to comprehensively analyze and synthesize existing literature on the outsourcing of human resource functions within the Micro, Small, and Medium Enterprises (MSME) sector. The MSME sector plays a crucial role in economic development, and as these enterprises grow, the need for effective human resource management becomes increasingly vital. Outsourcing HR functions has emerged as a strategic approach for MSMEs to optimize resources, enhance efficiency, and stay competitive in the dynamic business environment.

**Keywords:** Human Resource Functions; Human Resource Management; HR Outsourcing; MSME.

## 1. Introduction

### 1.1. Introduction To MSME Sector

The Micro, Small, and Medium Enterprises (MSME) sector is a vital component of the global economy, playing a crucial role in fostering economic development, generating employment, and promoting innovation. MSMEs are characterized by their size, and they encompass a diverse range of businesses across various industries, contributing significantly to both emerging and established economies.

#### 1.1.1. Key Characteristics of MSMEs

- **Size and Scale:** MSMEs are defined by their relatively smaller size compared to large enterprises, and this classification often varies from one country to another. They are typically characterized by limited manpower, lower turnover, and more localized operations.
- **Entrepreneurial Spirit:** The MSME sector is marked by a strong entrepreneurial spirit, with many businesses often initiated and managed by individuals or small groups of entrepreneurs. This sector serves as a breeding ground for innovation and creativity.
- **Diversity of Industries:** MSMEs operate in a wide array of industries, ranging from manufacturing and agriculture to services and technology. This diversity contributes to the resilience of the sector, as it is not overly dependent on any single industry.
- **Local and Regional Impact:** MSMEs are significant contributors to local and regional economies, often serving as key drivers of economic growth and development in specific geographic areas.

#### 1.1.2. Importance of the MSME Sector

- **Employment Generation:** The MSME sector is a major source of employment, providing opportunities to a substantial portion of the workforce, especially in developing economies. It plays a pivotal role in reducing unemployment rates and fostering inclusive growth.

\* Corresponding author: Divyesh Patel

- **Innovation and Adaptability:** Due to their smaller size, MSMEs are often more agile and adaptable to changing market conditions. They contribute to innovation and technological advancement, driving competitiveness in the broader business landscape.
- **Contribution to GDP:** Despite their size, the cumulative economic contribution of MSMEs to the Gross Domestic Product (GDP) of a country is significant. MSMEs contribute to economic stability and sustainability.
- **Local Development:** MSMEs are integral to the development of local communities, supporting social and economic infrastructure. They contribute to poverty reduction by providing income-generating opportunities.

### 1.1.3. Challenges Faced by MSMEs

- **Access to Finance:** Many MSMEs face challenges in accessing adequate financial resources, limiting their capacity for expansion and innovation.
- **Technology Adoption:** Limited access to and adoption of modern technologies can hinder the competitiveness of MSMEs in the global market.
- **Regulatory Compliance:** MSMEs often grapple with compliance issues due to complex regulatory frameworks, affecting their ability to navigate legal requirements.
- **Market Access:** Accessing broader markets can be a hurdle for some MSMEs, and they may face stiff competition from larger enterprises.
- **Government Initiatives and Support:** Governments around the world recognize the significance of the MSME sector and often implement policies and initiatives to support its growth. These may include financial incentives, capacity-building programs, and measures to ease regulatory burdens.

In conclusion, the MSME sector serves as a cornerstone of economic development, fostering innovation, providing employment, and contributing to the overall prosperity of nations. As the global business landscape evolves, recognizing and addressing the unique needs and challenges of MSMEs are essential for sustainable and inclusive economic growth.

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## 2. Significance of the study

No specific guidelines are available on how to select which human resource functions to be outsourced;

There is lack of literature on how performance management of Outsourcing agency are carried under business process outsourcing environment; and

There are no readymade course of action on how to negotiate HR outsourcing contract and maintain sound relationship with service vendors.

Small and medium enterprises the relevance of HR outsourcing seem to be quite significant. Since small and medium enterprises have very small HR department employing general HR talent rather than specific expertise. Therefore, small and medium enterprises are very prone to HR outsourcing. Very little work has been done in this area; hence I want to focus on this

HR outsourcing is considered to be a strategic option not only for cost saving and value-added services but also a substitute to talent deficit. Very little work has been done in this area, hence I want to work in detail to this

As per past researchers' study was done on assessing the impact of human resource outsourcing on employees of HR department. Study needs to be done on impact of HR outsourcing on employees other than those of HR department can be studied. This is an input area of study since the attitude and behavior of employees will largely influence the effectiveness of HR outsourcing, where much studies had not been found

Past researches have presented impact of HR outsourcing on organizational performance however there is need to study the impact of HR outsourcing on financial performance of the organization.

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## 3. Background of the study

A background study of human resource outsourcing involves examining the historical context, evolution, and current state of outsourcing HR functions. This analysis provides insights into the factors driving organizations to outsource HR, the growth of the outsourcing industry, and the impact of outsourcing on businesses. Here's an overview of the key components typically covered in a background study of human resource outsourcing:

### **3.1. Historical Evolution**

Trace the historical evolution of HR outsourcing, identifying key milestones and trends that have shaped the outsourcing landscape. Explore the initial motivations behind organizations opting to outsource HR functions.

### **3.2. Drivers of HR Outsourcing**

Examine the factors that drive organizations, including MSMEs, to consider HR outsourcing. Common drivers include cost reduction, focus on core competencies, and access to specialized expertise.

#### *3.2.1. Types of HR Outsourcing*

Classify HR outsourcing into various types, such as business process outsourcing (BPO), recruitment process outsourcing (RPO), and learning process outsourcing (LPO). Explore the scope of services typically outsourced, including recruitment, payroll, benefits administration, and employee training.

#### *3.2.2. Industry Trends and Statistics*

Present current industry trends and statistics related to HR outsourcing, providing a snapshot of the global and regional outsourcing landscape. Include data on market growth, key players, and emerging trends.

#### *3.2.3. Global and Regional Perspectives*

Discuss how HR outsourcing has evolved globally and highlight regional variations in outsourcing practices. Examine how cultural, legal, and economic factors influence HR outsourcing decisions in different regions.

#### *3.2.4. Technology's Impact on HR Outsourcing*

Analyze the role of technology, including HR software, artificial intelligence, and automation, in shaping the landscape of HR outsourcing. Explore how technological advancements have affected the efficiency and effectiveness of outsourced HR processes.

#### *3.2.5. Success Stories and Case Studies*

Showcase success stories of organizations that have effectively leveraged HR outsourcing to achieve strategic objectives. Highlight case studies that illustrate the positive impact of outsourcing on specific HR functions.

#### *3.2.6. Challenges and Risks*

Identify common challenges and risks associated with HR outsourcing, such as communication barriers, loss of control, and data security concerns. Discuss how organizations can mitigate these challenges through careful planning and vendor selection.

#### *3.2.7. Regulatory Environment*

Examine the regulatory framework governing HR outsourcing, including labor laws, data protection regulations, and industry standards. Discuss the importance of compliance and the role of outsourcing providers in ensuring adherence to legal requirements.

#### *3.2.8. Future Outlook*

Provide insights into the future of HR outsourcing, considering emerging trends, potential disruptions, and the evolving needs of organizations. Discuss how the industry may adapt to technological advancements and changing business landscapes.

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## **4. Introduction and Review of Literature**

Firms outsource human resource (HR) services for cost savings, efficiency, service improvements, access to HR expertise and increased flexibility (Bendorf, Barge, & Graziano, 2005; Marquez, 2007; Oshima, Kao, & Tower, 2005). Transaction cost economics (TCE) along with capital market and resource based theories suggests an association between outsourcing HR services and overall firm performance (e.g., Lai & Chang, 2010). Yet the existing outsourcing literature has not established an empirical link between human resource outsourcing (HRO) and firm performance, nor has a link been established to the equity capital markets. Prior HRO research primarily addresses the client's decision to outsource (e.g., Adler, 2003; Delmotte

& Sels, 2008; Klaas, McClendon, & Gainey, 2001; Kosnik, Wong-Mingji, & Hoover, 2006), characteristics of outsourcing clients (Klaas et al., 2001), the outsourcing relationship (Lievens & Corte, 2008), and the effect of outsourcing on employees (Fisher, Wasserman, Wolf, & Wears, 2008; Kessler, Coyle-Shapiro, & Pur-cell, 1999). Given the far-reaching effect of the HR function within the firm, understanding the outsourcing decision impact is critical for managers desiring to improve profitability and equity market impact.

Understanding the market and operating performance effects of outsourcing is important to stakeholders and investors, and closes a gap in the HRO literature (Shen, 2005). This study extends the HR literature in several ways. First, prior studies have lacked proprietary HRO data, and have constructed proxies for outsourcing costs or relied on surveyed managers' perceptions of performance following outsourcing (e.g., De Vita, Tekaya, & Wang, 2010; Dickmann & Tyson, 2005; Gainey, Klaas, & Moore, 2002; Gilley, Greer, & Rasheed, 2004; Klaas, McClendon, & Gainey, 1999; Lilly, Gray, & Virick, 2005). Heretofore, with few exceptions, researchers have not conducted empirical archival studies seeking to link HR management to corporate performance or market value (Abowd, Milkovich, & Hannon, 1990; Jiang & Qureshi, 2006). Second, in addition to operating performance, this study investigates the capital market reaction to firms announcing administrative HRO contracts. Third, the reported results statistically control for the boundary condition, optimality of the outsourcing decision. Finally, the study addresses outsourcing HR services which can directly and indirectly affect firm performance through the services provided to and treatment of employees. (Butler, M. G., & Callahan, C. M. (2014).

#### 4.1. Key HR Functions Outsourced by MSMEs

- **Recruitment and Staffing:** External agencies can assist in sourcing, screening, and onboarding candidates, helping MSMEs find the right talent efficiently.
- **Payroll Processing:** Outsourcing payroll functions ensure accurate and timely salary processing, tax compliance, and adherence to regulatory requirements.
- **Employee Benefits Administration:** Third-party providers can manage employee benefits such as health insurance, retirement plans, and other perks, reducing the administrative burden on MSMEs.
- **Training and Development:** External trainers or training firms can be engaged to conduct employee training programs, fostering skill development within the organization.
- **Compliance and Legal Support:** HR outsourcing can include services related to compliance with labor laws, regulations, and legal requirements, reducing the risk of non-compliance.
- **Employee Relations and Engagement:** Service providers can assist in managing employee relations, conducting surveys, and implementing engagement initiatives to enhance the workplace environment.

#### 4.2. Benefits of Outsourcing HR Functions in MSMEs

- **Cost Efficiency:** MSMEs can achieve cost savings by outsourcing HR functions, as they can avoid the expenses associated with hiring and maintaining an in-house HR team.
- **Focus on Core Competencies:** Outsourcing allows MSMEs to concentrate on their core business activities, leaving HR processes to specialized professionals.
- **Access to Expertise:** External HR service providers often bring specialized knowledge and expertise, ensuring that HR processes are handled efficiently and in compliance with industry standards.
- **Flexibility and Scalability:** MSMEs can scale HR services based on business needs, adapting to growth or contraction without the challenges of managing an in-house team.
- **Risk Mitigation:** Compliance and legal risks are minimized as HR outsourcing providers stay updated on labor laws and regulations, helping MSMEs avoid potential legal issues.
- **Time Savings:** By outsourcing time-consuming HR tasks, MSMEs can save time and redirect resources to strategic business priorities.

#### 4.3. Challenges and Considerations

- **Loss of Control:** MSMEs may face challenges in relinquishing control over certain HR functions, requiring careful selection of outsourcing partners.
- **Confidentiality Concerns:** Protecting sensitive employee data becomes crucial, necessitating robust confidentiality agreements and data security measures.
- **Vendor Selection:** Choosing the right HR outsourcing partner is critical; MSMEs should assess the vendor's track record, reputation, and ability to meet specific organizational needs.
- **Communication and Coordination:** Effective communication between the MSME and the outsourcing partner is essential for successful collaboration and achievement of HR objectives.

## 5. Conclusion

Outsourcing HR functions in the MSME sector can be a strategic move to optimize resources, reduce costs, and enhance overall business efficiency. However, careful planning, thorough vendor selection, and ongoing communication are vital to ensuring a successful outsourcing partnership. As the MSME landscape continues to evolve, HR outsourcing remains a dynamic and adaptable solution for organizations seeking to navigate the complexities of human resource management.

Study Summarizes the key findings from the literature review and draws conclusions about the overall impact and effectiveness of outsourcing HR functions in the MSME sector. It may also suggest recommendations for MSMEs considering HR outsourcing as a strategic option.

### *Recommendations for Future Research*

Proposes areas for further research to address gaps in the existing literature, explore emerging trends, and enhance the understanding of HR outsourcing in the MSME sector.

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## Compliance with ethical standards

### *Disclosure of conflict of interest*

No conflict of interest to be disclosed.

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