

BENEFITS AND CHALLENGES OF OUTSOURCING HUMAN RESOURCE
ACTIVITIES: A SURVEY OF COMMERCIAL BANKS IN NAIROBI, KENYA

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DECLARATION

This research project is my original work and has not been presented for a degree in any other institution, college or university other than the University of Nairobi for academic credit.

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This project has been submitted for examination with my approval as university supervisor

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DEDICATION

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To my Beloved Husband Dr. Kizito and my dear sons Ezra and Joel for their love sacrifice and support.

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ABSTRACT

INTRODUCTION

As many organization turns to Outsourcing some of their Human resource activities it is important to establish the benefits and challenges of the practice. This study was done to establish the benefits and challenges of Human Resource outsourcing in commercial Banks in Nairobi Kenya.

Data was collected in Nairobi in August 2006. A sample of 30 banks out of the 43 commercial banks was selected. However only 17 responded. The researcher used descriptive statistics to analyse the data and presented the findings by use of tables.

In this research it was establishes that over 50% of banks surveyed have benefited from Human resource outsourcing and each of the ones that have benefited from HR outsourcing has also faced challenges in the process, however the benefits outweigh the challenges and outsourcing of Human Resource activities is recommended.

1.1.1 Outsourcing

Outsourcing has been identified as one way of adapting to the environmental changes. By mid 1990's, many organizations had turned their attention to reducing in-house performance on activities that could be outsourced. McLean & Schmitt (1998) argue that Organizations around the world are increasingly using outsourcing as a strategic human resource management and which should be leveraged to allow them focus on their core competencies (Price Water House Coopers 1997).

In Kenya many organization have adopted the trend of outsourcing non-core services, and this has been evidenced by the service layoffs and redeployment of many persons in the recent years. For example as part of

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND

For many years strategic management literature and practice have demonstrated the need for organisations to operate outside their boundaries and to establish strategic relationships with external stakeholders, such as suppliers and distributors. Attention has been given to the growth of strategic alliances and joint ventures. The trend has been the downsizing of organisations and outsourcing of a range of functions, which were previously considered to be an integral part of in-house operations (Walton 1998).

There has been a move towards subcontracting and franchising arrangement of some in-house operations. Not only are organisations operating outside their boundaries, but also individuals who are not in a conventional employer-employee relationship are increasingly conducting more and more organisations' functions. (Jarrillo 1998) Emerging Economic trends such as globalisation, rapid proliferation of economic technology, declining growth rates, competition from external enterprises, and need to lower costs of operation have forced many enterprises to adapt their activities to the changing environment in order to survive. To cope with these pressures, enterprises are repositioning themselves in the market place so as to gain competitive advantage (Sweezy 1997).

1.1.1 Outsourcing

Outsourcing has been identified as one way of adapting to the environmental changes. By mid 1990's, many organizations had turned their attention to reviewing 'in house' performance on activities that could be outsourced Johnson & Scholes (1999) argues that Organizations around the world are increasingly using outsourcing as a strategic human resource management tool which can be leveraged to allow them focus on their core competencies (Price Water House Coopers 1991).

In Kenya many organisation have adopted the trend of outsourcing non-core services, and this has been evidenced by the massive layoffs and retrenchment of many personnel in the recent years. For example as part of

government reforms, many government institutions have resorted to concentrating on their core business and subcontracting smaller firms to handle their non-core activities.

Though many organizations are now resorting to outsourcing some of their support functions such as human resources activities, it should be noted that not all human resources activities could be outsourced. In Human resource management outsourcing of activities can only be done on specific activities for the purposes of freeing the human resource professional to concentrate on strategic partnerships with the CEO to align HR objectives with the organisational general objectives (Mondy, Wayne 2000).

Outsourcing of HR activities in many organisations has been necessitated by the changing role of Human Resource management as a function. The role of HR has changed with globalisation of business. In today's competitive environment, the HR function can no longer afford to be the personnel department of old of hiring and firing. The increasing recognition of HR as a legitimate business unit has made it highly strategic in nature and more critical to achieving corporate objectives Mondy, R. Wayne (2000). Thus there is need to free the HR professional to concentrate on strategic issues and to leave out routine /Administrative work which does not touch on the core, so as to make personnel better able to focus attention on issues of strategic importance. Heinemann, Todd (2005) agree that Outsourcing is supposed to free a company's HR executives to focus on more important matters, says Arthur Mazor, vice president of business development for ACS.

1.1.2 Areas of HR Outsourcing

Examples given by Armstrong (2000) of HR activities that have been commonly outsourced include: Recruitment testing; pay roll processing; Training; Benefits administration and Temporary staffing.

Institute of personnel management and development (1998) identified the primary areas for outsourcing as below: -

Payroll management: the analysis and preparation of payroll is very critical, tedious, specialized and labour intensive for most organizations. There are

firms that run payroll management that are automated, efficient and cost effective. Firms that outsource this service save money.

Staffing: This is also one of the most outsourced functions. This is because many companies find it more cost effective and certainly faster to outsource staffing to an agency or HR consultant who specializes in staffing.

Training: Outsourcing-training function is very common in smaller organizations. Smaller firms do not have training departments to handle training activities. It only costs them when it's needed.

Pensions Administration: These also are major activities that many firms often outsource. The Administration of pension has become very complex and regulated thus firm's find it cheaper to outsource the function.

Armstrong (2003) highlighted that other main areas for outsourcing considerations include: Employee welfare and counselling activities; Childcare facilities; Occupation health and fitness services; Health and safety monitoring and advice; Security services; Cleaning and laundry services.

In Kenya though organisations have adopted outsourcing, many of them practice the traditional HR outsourcing where outsourcing is done on a single process area; such as pay roll or Benefits Administration, as opposed to grouping of lots of HR transactional and administrative processes into a business process outsourcing arrangement. Around the world there has been a paradigm shift in HR outsourcing especially in the Western countries where HR activities are grouped together into a business process and outsourced to a professional organization. (CPA Journal, 2005) Kenyan organizations outsource HR activities from professional organisations and management consultants. Examples of such organisations include Deloitte and Touché; Price Waterhouse Coopers; KPMG; Manpower planning; Preferred Personnel Peak performance for training of staff among others.

1.1.3 THE KENYAN BANKING SECTOR

In Kenya the Banking industry is one of the very dynamic sectors, it has had tremendous transformation in the recent past, this has been attributed to the tremendous changes that have been brought up by a rapidly changing information and Communication technology sector which has had a direct impact on banks and necessitated the transformation of banking structures and work processes (Daily Nation 14 march 2006). There are approximately 43 banks in the banking industry in Kenya. Following improved economic performance, the banking sector continues to record a relatively stable growth, both in profitability and asset quality. However, the level of non-performing loans continues to be the sectors main challenge. The other challenge is the stiff competition being experienced in the banking sector of the Kenyan economy.

The customer of today has become sophisticated. He is widely travelled and has wide access to information from a wide range of sources. The information superhighway has contributed immensely to the world becoming a global village. Globalisation has therefore expanded customers' choice of products and services. This has lead to customers demanding products of high quality coupled with efficient and effective service. The present customer is only interested in those products that will give him value for money. Recent research has shown that customers are likely to maintain a lasting relationship with those firms that are able to give value for money in terms of the products they enjoy as well as the kind of customer service they receive. Since products are more or less similar in most firms in the same industry, the kind of service offered will play a great role in differentiating the firms. This has become even critical in the financial sector were cut throat competition is being experienced.

A great opportunity has therefore been created for banks to gain competitive advantage. Only those banks that will recognize the changing tastes and preferences of the customer and formulate appropriate strategies to address the change will be better placed to gain competitive advantage. (Banking survey October 2006)

Most major banks in Kenya are aware of this great opportunity for growing their business. They have all reacted to gain competitive advantage in respect to the customer care they give their customers. Routine administrative work has been reduced by new strategies such as automation and outsourcing so as to free the staff to concentrate on more strategic roles of meeting specialized customer needs.

The environmental changes in the banking sector have impacted on the Human resources of the banking institutions who now have to play a more strategic role as opposed to operational. As mentioned HR outsourcing is one of the strategies that have been adopted by banks to reposition themselves. Outsourcing has been commonly done for human resources activities such as recruitment and selection, payroll administration for the purposes of freeing the personnel from routine and administrative procedures, so as to enable them to concentrate on their core business, which is customer satisfaction.

1.2 STATEMENT OF THE PROBLEM

An increasing number of organisations are adopting HR outsourcing practice as a way for minimization of costs, facilitation of efficiency and for competitive advantage. However no research has been done, particularly in the Kenyan context to determine the benefits and challenges that are associated with the use of the strategy. This constitutes a gap in knowledge that the proposed study intends to address; objectives obtained by banks through outsourcing of HR activities reflect the benefits of outsourcing to the firm.

While outsourcing has been found to have tremendous benefits to an organisation, if not done appropriately it could lead to detrimental consequences according to Jarrillo Carlos (1998) This is why it is important to find out if organizations that outsource human resource services experienced the expected benefits such as efficiency, reduced operational costs among others.

Mondy, and Wayne (2000) say that 'The key to outsourcing success is to determine which functions to outsource, to what extent they should be outsourced, and which ones to keep in house.' Making this important decision is a challenge to many organisations because of inadequate information on

various issues on outsourcing. This study seeks to analyse the benefits and challenges that result from the decision by an organisation to adopt the HR outsourcing strategy with a focus on commercial banks in Nairobi.

Although Serem (2003) did a similar study that focused on the extent on which outsourcing has been adopted, it did not focus on the challenges and benefits of outsourcing, which is the focus of the proposed study.

1.3 RESEARCH QUESTIONS

- What are the benefits that accrue from outsourcing HR activities?
- What challenges do banks face in outsourcing HR activities?

1.4 RESEARCH OBJECTIVES

1. To establish the benefits of outsourcing Human resources activities in commercial banks.
2. To establish the challenges of outsourcing Human resources activities in commercial banks.

1.5 IMPORTANCE OF THE STUDY

1. The findings of this study will aid the human resource managers of the commercial banks when deciding to outsource.
2. To Human resource practitioners will give insight in decision making on structuring human resources function in organisations.
3. To Human resource students this study will add to the body of knowledge in the subject of human resources management.
4. To the government the findings of this study will be useful in establishing government policies on human resources practices
5. Academic institution it will add to the body of knowledge.

1.6 THE SCOPE OF THE STUDY

There are 49 commercial banks in Kenya categorised either local or foreign owned. This research will focus on commercial banks based in Nairobi. The researcher chose to carry out this study among Banks because they are the ones that have faced tremendous environmental changes in the recent past.

And because they are the ones that are more flexible and agile enough to responding to environmental changes and adapt to new trends easily thus most banks have adapted outsourcing of some of their HR activities.

Due to limitation of time and resources this study will only be limited to Banks in Nairobi.

There have been a considerable number of studies done on various aspects of outsourcing. Some of the aspects studied by the various writers are reviewed as below. The style adopted is by citing some of the emerging themes and subtopics that have been handled. This review will help in identifying some of the major gaps in knowledge on outsourcing of human resource activities. The issues covered in the review comprise the concept of outsourcing, growth in outsourcing of HR activities, Reasons for outsourcing, benefits and challenges of HR outsourcing.

2.2 – The Concept of Outsourcing

Generally defines outsourcing as a management strategy by which an organization delegates its major non-core functions to efficient and specialised service providers (Kashyap & Eimull 2009). In recent years, there has been a clear move among many enterprises to outsource non-core activities (Hill and Jones 2001). According to Johnson and Scholes (2002), Outsourcing occurs when organizations decide to buy in services or products that were previously produced in-house. For example, Pfizer, a pharmaceutical manufacturer, has an increasingly occurring examples of outsourcing activities. At the level of its value chain, it is about withdrawing from activities such as distribution, customer service or maintenance.

The Institute of Personnel Management (1998) has stated that the biggest cause in the literature of outsourcing has been the concept of the core activity of the organization, which focuses on in-house expertise as its primary function and purchases any necessary support from a range of sources from elsewhere.

Balmer and Greyser (1999) refer to outsourcing as finding new suppliers who now have to deliver quality of the materials, goods, components and services. This means that the organization acquires and uses the knowledge, skills, services and expertise of the new suppliers. Pearce and Robinson (2007),

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

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2.2 The Concept of Outsourcing

Kaathawala defines outsourcing as a management strategy by which an organization delegate's major non-core functions to efficient and specialised service providers (Kaathawals & Elmuti 2000). In recent years, there has been a clear move among many enterprises to outsource non-core activities (Hill and Jones 2001). According to Johnson and Scholes (2002), Outsourcing occurs where organizations decide to buy in services or products that were previously produced in house. For example, Payroll, component manufacture, IT Services are all commonly occurring examples of outsourced activities. At the end of the value chain, it is about withdrawing from activities such as distribution, customer service or maintenance.

The institute of personnel management (1998) has stated that the biggest cause in the increase in outsourcing has been the concept of the core activity of the organization, which focuses on in-house expertise as its primary function and purchase any necessary support from a range of sources from the periphery.

Rothery and Robertson (1995) refer to outsourcing as finding new suppliers and new ways to secure delivery of raw materials, goods components and services. This means that the organization acquires and uses the knowledge, experience and creativity it did not have before. Pearce and Robinson (2001),

consider outsourcing as the use of a source other than internal capacity to accomplish some tasks or processes. It is the strategic use of outside resources to perform activities that are traditionally handled by internal staff and resources.

2.2.1 Growth in Outsourcing of HR Activities

Human resource outsourcing is changing face as it has been observed in Western countries. Ann Bednarz (2005) argues that there's more to human resources application outsourcing than finding a service provider to manage a discrete core such as payroll. She further says that these days' companies are handing over broad sets of HR functions — from payroll and benefits processing to recruitment and employee management — to service providers that promise to trim costs. Streamline processes and deliver integrated performance metrics in return.

"Outsourcing of HR functions on a point basis — meaning a single process area, such as payroll or parts of benefits — has been around for a long time," says Steve Unterberger (2005), HR outsourcing technology leader at services firm Hewitt Associates. "What is relatively recent in the last six years is the grouping of lots of HR transaction and administrative processes into a business process outsourcing arrangement" (Ann Bednarz; 2005).

In its most recent quarterly index of outsourcing deals, sourcing advisory firm TPI reported human resources outsourcing as the fastest growing and largest segment of the broader business process outsourcing market. Total contract value more than doubled from \$545 million in the first quarter of 2004 to \$1.7 billion in the first quarter of 2005, TPI says. (Ann Bednarz 2005)

2.3. Reasons For Outsourcing

Armstrong (2003) gave reasons for out sourcing as being cost saving; concentration of Human resources effort to more strategic activities and obtaining expertise. Mondy R. Wayne etal (2002) argue that outsourcing is a good way of eliminating functions that bog down the department. She further argues that once administrative responsibilities are removed, the staffs are left with more interesting jobs to do and better career development opportunities.

The key to outsourcing focuses on determining which functions to outsource and the extent to which they should be outsourced; and which ones to keep in house. Pearce and Robinson (2001), argue that Outsourcing is based on the notion that strategies should be built around core competencies or activities that add value and activities that cannot be done cost effectively should be done outside the firm. According to Daniel (1998) in order for organizations to remain competitive, a number of strategic options such as downsizing, re-engineering, restructuring and rightsizing are being pursued. Many organizations are working towards the concept of core organizations dealing with core or strategic activities, surrounded by a network of smaller companies and individuals providing a range of supporting ancillary services on a contracted basis. Carlos Jarrilo (1998) argues that vertical integration had been the dominant philosophy of large organisations, historically they believed that one should establish control over all activities contributing to the value chain of a given product, however this trend is beginning to break down in favour of variants of subcontracting and strategic networks which essentially constitute an alternative market based organisation form.

Proponents of the subcontracting approach will increasingly seek to outsource activities.

Ann Bednaz (2005) argues that Cost savings and a desire to focus on strategic HR tasks are among the most popular reasons companies are turning over more of their HR functions to business process outsourcing firms, according to findings of an advisory firm EquaTerra which included the following:

1. Gain measurable HR cost savings: 54%
2. Shift focus to more strategic activities: 44%
3. Leverage third-party expertise for
4. Transformation: 38%
5. Make HR cost structure more viable: 34%
6. Speed the transformation: 28%
7. Better address regulatory compliance: 21%

2.4 THE DECISION TO OUTSOURCE

If the reasons for outsourcing are all compelling, the way to minimize problems is initially to give a careful consideration to the case for outsourcing (Armstrong 2003) The questions to be answered include: Is the activity a core one or peripheral; how efficiency is it run at present; and what contribution does it make to the financial well being of the organization.

Outsourcing may well be worthwhile if it is certain that it can deliver better service at a lower cost.

Secondly, potential service providers should be required to present tender in response to a brief. Three or four providers should be approached so that a good choice is made. The tender should set out how the brief will be met and how much it will cost (Armstrong 2001).

2.4.1 Criteria For Selecting Potential Service Providers

According to Armstrong (2003) the following factors should be considered as the criteria for selecting potential service providers:

The degree to which the tender meets the specification; The quality and reputation of the firm; The cost; The level of service that will be provided; A reference to be obtained before contract is drawn; Services, costs and the basis upon which the contract can be terminated should be stated precisely; Agree on a detailed programme of work for the outsourced activity; Monitor the progress of work without undue interference in the day-to-day work of that activity and evaluate the outcome.

Lastly, managers must be much more competent at maintaining performance through their management of supplier (Distributors) relationship rather than through management control systems within their own organization.

2.5 Benefits Of Outsourcing Human Resource Activities

Lyle DeWitt (2005) argues that Integrated human resources service providers, known as human resources outsourcers (HRO) or professional employer organizations (PEO), can provide more and less in the right circumstances: less as in less liability, lower fees, and smaller benefit hikes, and more as in more choices, more available time, greater competitiveness, and greater overall value.

HRO and PEO services have been growing in popularity, especially with smaller businesses, which can leverage such services to compete with larger businesses in terms of employee benefit options and costs.

Several studies undertaken by Quinn, Julien and Negrin; (2000) have revealed a significant relationship between outsourcing and profitability margins.

Outsourcing indeed offers several benefits, which include:

Efficiency in Service Provision.

Plunkett (1998) defines efficiency as measuring the Cost of attaining a given goal. Efficiency is concerned with how resources (money, time, equipment, personnel) are used to get the desired result; one is said to be efficient if the minimum cost is spent to obtain the desired goal.

Firms within a given industry have to compete to retain and expand their market share. Organizations do appreciate the fact that they cannot do all the things required to add value for the customers. Companies should therefore concentrate on their core competences and outsource the service that other companies are more experienced and can perform better, faster and at a lower cost. This increases their efficiency (Quinn, Julien and Negrin, 2000).

Cost Reduction

Staffing budget, which includes the cost of recruitment and selection and also human resource development, can be quite expensive. Research indicates that staff costs constitute 30% of total cost for organizations with HRM departments in house. This implies that business organizations with low capital may not afford to maintain the HRM departments. Therefore one-off activities like hiring of staff may be outsourced from organizations, which specialize in such activities (Quinn, Julien and Negrin 2000).

Cost reduction may be achieved when performing the activity in house implies operating at less than efficient scale (Carrillo Carlos; 1998).

Risks and Liability

The risks and liability of the human resources are transferred to the contracted company. (Quinn, Julien and Negrin; 2000).

According to the Small Business Administration, business owners spend up to 25% of their time on employee related paperwork. Additionally, smaller companies are less likely to have a dedicated human resources specialist. The compliance requirements in The US of 401 (k) programs, the ADA, FLMA, and COBRA also represent significant liability issues. Many payroll service companies will claim they offer built-in compliance, but if an employee's benefits are interrupted because a deadline is missed, a lawsuit might ensue. One major advantage of a PEO-style benefits provider is the limitation on liability; only a PEO (Professional Employer Organisation) contractually assume most, if not all, liabilities related to the services it provides. The advantages of contracting a third party, integrated HRO can go beyond the time and money saved by automating payroll, leveraging group benefits, and handing off liabilities. Returns can include increased satisfaction and retention, for both employees and employers (Lyle Dewitt; 2005).

Ease in changing suppliers

Jarillo Carlos (1998) argues that a company that chooses among several possibilities the wrong technology will perhaps be stuck with the decision for a longer time whereas a company that subcontracts simply switches to suppliers that have made the right technology choice.

Access to world class capabilities

Partnering with an organization with world-class capabilities can offer access to new technology; tools; techniques that the organization may not currently possess, better career opportunities for personnel through transition to the outsourcing provider and competitive advantage through expanded skills (Quinn, Julien and Negrin; 2000).

Better use of resources

Every organization has limits on the resources available to it. Outsourcing permits an organization redirect its extra resources from non-core activities towards activities that have greater return in serving the customer (Quinn, Julien and Negrin 2000). By Outsourcing a non-core value creation activity to a supplier that has a distinctive competency in that particular activity, the company may also be able to better differentiate its final product.

Economies of scale

A network of suppliers can provide an organization with the ability to adjust the scale and scope of their production capability upward or downward, at a lower rate. As such outsourcing can provide greater flexibility than the vertically integrated organizations (Carlson; 1989, Harrison; 1994) Outsourcing enables the company to concentrate scarce human, financial and physical resources on further strengthening its core or distinctive competencies. It enables companies to be flexible and responsive to changing market conditions. The belief is that, unencumbered by commitments to internal suppliers, a company can switch more easily between providers of non core value creation activities in response to changing market conditions than can a comparable company that undertakes those activities itself (Quinn, Julien and Negrin; 2000).

2.6 CHALLENGES OF OUTSOURCING HR ACTIVITIES

Challenges in this research refer to new or difficult tasks that test the (outsourcing) ability and skill by an Organisation. (Oxford Advanced Learners Dictionary). In strategic terms outsourcing creates a major dilemma for senior management; it is increasingly being argued that what adds value to organisations is the knowledge and skills that individual workers possess.

Products, it is argued, become obsolete the moment they enter today's competitive environment what cannot be replaced are the distinctive competences that highly qualified staff bring.

One of the biggest challenges of outsourcing HR activities is the introduction of Non-Employees. Walton (1998) defined Non employees as those individuals or groups who have some relationship with an organisation but are not in an employer_ employee relationship; they include: Employees of another organisation dealing within the boundaries of the home organization by providing services on a subcontracting basis; Employees working for suppliers of raw materials on which the organisation depends; Distributors of organisational products to customers; They could be self employed consultants or volunteers; Members of the general public e.g. part timers.

Out sourcing practices increase the use of non – employees by organisations thus increasing use of non – Employee relationships which entails considerable risks unless such distinctive competences can be learned and sustained outside an employment relationship.

Holbeche L. (1998)) says Business strategies i.e. the technical and systems related issues, are in the vast majority of cases much better thought through than the people strategies. She says that once key decisions have been taken the damage is done, but the expectations are generally that people will accept and come to terms with the new realities. Very little consideration is given to the impact on people. She says a series of negative outcomes have been observed in such cases. She observes that while the idea of outsourcing non-core activities is initially attractive, the experience is that these are actually harder to manage. Reduction in number of employees mean that shorter absences cause major crisis in service delivery and from customer perspective the reassurance of dealing with the same people on regular basis and people who have time to talk with an interest in them, is replaced with a bewildering succession of different contacts as a range of direct and indirect services are used to meet customer needs (by outsourcing)

Other problems associated with outsourcing of HR activities include the following: Carrillo (1998) observes that if the company does not make the right decisions on what to do outside and what to do inside it may find it self working ' on the wrong ' i.e. least profitable activities of the business system, even if at the beginning it does not look like that. Also by outsourcing the company may end up emptying its contents, " hollowing it out". By subcontracting, the company lets outsiders capture key positions in their business system, eventually the company finds itself squeezed out of the most interesting activities.

He further observes that by subcontracting the company may transfer its competitive advantage to a subcontractor who might become a successful competitor.

Hill and Jones (2001) pg 320 say" in outsourcing an activity a company may lose both the ability to learn from the activity and may in the long run put the company in a distinctive disadvantage in as far as carrying out the activity is

concerned. A hostile union may seize the opportunity to derail management decision to outsource (Hine1996).

Serem (2003) cited challenges of HR outsourcing from (our problems our solutions 2001) report that indicate the following: - In Kenya a tendency to award contracts to relatives and friends regardless of their ability to deliver; a tendency by senior managers particularly state corporations to give contracts to their own companies even when it is not financially justifiable and wide spread kickback culture.

Linda Merritt, **human resources** strategic planning director for AT&T, agrees that companies risk disappointment if they don't structure their deals to match their expectations or fail to consider how their expectations might evolve. "I advise people to think about not what you want on Day One but what do you want in Year Four, Year Five, Year Six--and think about how you're structuring the deal that will allow that to evolve or develop over time," Merritt says. "If you focus solely on cost, you're going to find vendors out there who can run your basic services quite well and quite comfortably. But if you want some of these other things of value-added planning and improvements, you have to structure the deal a little differently to not have expectation gaps in Year Two or Year Three." (Heinemann, 2005)

Other Challenges of outsourcing observed by other authors include.

Failure to take the future into account

When deciding to account, thus what may seem to be core now may be non core in future and what may be non core now may turn to be core in future and may find the organisation unprepared to handle it in-house. (Jarrillo carlos; 1994)

Dependency on the supplier

An organisation may become too much dependent on a particular supplier. In the long run, this may hurt the company if the performance of that supplier starts to deteriorate or if the supplier starts use its power to demand higher prices from the company.

Loss of learning opportunities

By outsourcing an activity, a company loses both the ability to learn from that activity and the opportunity to transform it into a distinctive competency. Lack of a distinctive competency may place an organisation at competitive disadvantage. (Kipsang, 2003). In its enthusiasm for strategic outsourcing, a company might go too far and outsource value creation activities that are central to the maintenance of its competitive advantage. By doing so the company might well lose control over the future development of a competency, and as a result its performance might ultimately decline. (Jarrillo, 1994)

The loss of control over employee loyalty

A poorly conceptualised, developed or maintained outsourcing arrangement could mean loss of control and flexibility; quality control problems and information security problems with the provider (Harrison 1996, Quinn, 1994) None of this is meant to imply that outsourcing HR services should not be pursued, but it does indicate that managers should carefully weigh the pros and cons of the strategy before pursuing it.

2.7 SUMMARY OF LITERATURE REVIEW

While the trend is towards outsourcing and freeing the HR practitioners for more strategic purposes, with some organisations contemplating to outsource the whole HR function, careful consideration needs to be made as regards outsourcing Human Resource activities. Most of the studies done have dwelt on the general outsourcing practice and very much less on the benefits and challenges of the practice.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research design

The design that was used in this research was survey design. This is because of the cross sectional data that was collected and the type of research objectives addressed.

3.2 Population

The population consisted of 43 commercial Banks in Kenya (Central Bank Report 2005). However, since most banks have a policy not to provide any information to outsiders it reverted to a sample study 30 questionnaires were distributed among the 43 commercial banks in Nairobi.

3.3 Data collection procedures and instrument

Questionnaires were used to collect data for this research. The questionnaire consisted of both open ended and closed questions, which provided both qualitative and quantitative data, however it was mainly a structured questionnaire.

The respondents were Human resource managers in the banks. The questionnaires was divided into 3 sections A, B and C. Section A provided general information, Section B focused on benefits of HR outsourcing to banks while section C targeted the challenges in outsourcing HR services by banks. The questionnaires were dropped and picked after completion.

3.4 Data analysis and presentation

Data was analysed using descriptive statistics such as mean scores, percentages and frequencies. The findings were presented using tables.

CHAPTER FOUR

DATA ANALYSIS AND RESULTS

4.1 Introduction

The data were obtained by use of questionnaires. The purpose of the data analysis was to help the researcher clearly relate the variables. A total of 30 questionnaires were distributed but only 17 were returned. Data was analysed and presented through use of tables.

4.2 DEMOGRAPHIC DATA

Table 4.1 Analysis by Response rate

Questionnaires Distributed	No. Of Respondents	Percentage
Completed questionnaires	17	57
Non Response	13	43
Total	30	100

The response rate was fair. From table 4.1 above, 57% of the banks accepted to provide the information. Bank information is perceived to be very sensitive thus some banks are not willing to give feedback thus the low response rate.

Table 4.2 Analysis by Bank ownership

Ownership	No. Of Banks	Percentage
Local	10	59
Foreign	1	6
Joint	6	35
Total	17	100

As shown in table 4.2 above majority of the respondents were locally owned banks represented by 59%, followed by the jointly owned banks at 39% and lastly foreign owned banks at 6%.

4.3 BENEFITS OF OUTSOURCING HR ACTIVITIES

Table 4.3 Length of period of operation

Variable	No. Of Respondents	Percentage
1-3yrs	0	0
4-5	0	0
6-10	5	29
Over 10	12	71
Total	30	100

As evident in table 4.3, majority of banks have been in operation for more than 10 years. 71 % have been in business for over 10 years, indicating that most of the banks are well established.

Table 4.4 Distribution by size

Number of Employees	No. Of Banks	Percentage
Below 50	2	12
51-100	7	41
101-200	3	18
201-500	0	0
Over 500	5	29
Total	30	100

Majority of the banks who surveyed were small banks. From table 4.4 above 41% have between 51-100 employees followed by the large banks represented with 29 % this is an indication that the industry has many small banks however the big banks though few have a big asset value of the entire industry.

4.3 BENEFITS OF OUTSOURCING HR ACTIVITIES.

Table 4.5 Outsourcing of Human Resource activities.

	Level	No. Of Respondents	Percentage
Yes	1	9	53
No.	2	8	47
Total		17	100

As shown in table 4.5, 53% of the banks said that they have benefited from outsourcing HR. However, since the majority of the banks who responded were small, they do not outsource because every HR activity for a small bank can be done in-house cost effectively.

Table 4.6 Extent in which banks have benefited from HRO

Extent of benefits	No. Of Respondents	Percentage
A very great extent	10	59
A great extent	5	29
A moderate extent	1	6
A low extent	0	0
A very low extent	0	0
Not at all	1	6
Total		100

As depicted in table 4.6, banks that outsource Human Resource activities have benefited from the practice to a very great extent. This is represented by 59% of the respondents. 29% of the banks have benefited to a great extent while 6% of the banks have not benefited from the practice. On the overall over 90% have benefited from outsourcing human resource activities.

Table 4.7 Analysis by Types of Benefits derived by banks from HRO

Type of Benefit	No. Of Banks	Percentage
Less risks	10	59
Cost reduction	6	35
More choices	8	47
More time	8	47
Competitiveness	9	53
Efficiency	9	53
Ease in changing suppliers	7	41
Access to world class capabilities	8	47
Better use of resources	8	47
Economies of scale	3	18

From the findings represented in table 4.7 "Less risks" was the most popular benefit of Human resource outsourcing representing 59 % of the respondents, followed by competitive reasons and efficiency at 53%, respectively. The third most popular benefit among banks was More choices (47%), more time (47%), access to world class capability (47%) and better use of resources (47%) Cost reduction was not a major benefit of outsourcing as such, only 35% consider it a benefit of HR outsourcing. Economies of scale were the least popular reason of outsourcing with only 18% of the respondents considering it a benefit.

Table 4.8 Analysis by activities outsourced

Type of activity	No. Of Respondents	Percentage
Recruitment testing and selection	12	71
Training	9	53
Payroll processing	4	24
Temporary staffing	8	47
Pensions	11	65
Performance management	2	12
Restructuring/Retrenchment	1	6
Employee welfare	2	12
Counselling services	7	41
Health and safety monitoring	2	12
Childcare facilities	0	
Any other (please specify)	12	71
Medical		

From the findings presented in table 4.8 above the most popular activities for outsourcing were recruitment (71%) Medical (71%) followed by pensions (65%) training (53%) Temporary staffing (47%), Counselling services (41%) Pay roll processing (24%) Employee welfare (12%) Health and safety monitoring (12%) Performance management (12%), The least popular activity for outsourcing was Restructuring and retrenchment at 6% and child care facilities is not outsourced at all in Kenyan commercial banks. Most banks still have some activities done in-house.

4.4 CHALLENGES OF OUTSOURCING HR ACTIVITIES

Table 4.9 whether banks have faced challenges in HR outsourcing

	No. Of Respondents	Percentage
Yes	9	52
No.	8	48
Total	17	100

As indicated in table 4.9 above, 52% of the banks have experience one or more challenges in HR outsourcing 48% have not faced any challenges as evidenced by the fact that 47% of the respondents do not outsource any activity. Thus the majority of those who do not face any challenges are those that do not outsource.

Table 4.10 Analysis by types of challenges faced as result of HR outsourcing.

Type of Bank	Level	No. Of Banks	Percentage
Increased use of Non-employees	1	7	41
Confidentiality	2	5	29
Exposure to competitors	3	7	41
Poor quality services	4	6	35
Loss of control over employees	5	6	35
Loss of control over service outsourced	6	4	24
Loss of learning opportunities	7	7	41
Dilution of organisational culture.	8	6	35
Total		30	100

From the findings presented in table 10 above, the most popular challenges of HR outsourcing among banks were: increased use of non- employees (41%), exposure to competitors (41%), and loss of learning opportunities (41%), these were followed by poor quality services from service providers (35%) loss of control over the employees of the outsourced activity (35%) and dilution of organisational culture (35%) of the respondents. Confidentiality issues were cited by 29% of the respondents cited as a major challenge in HR outsourcing. Considerable but least challenge was the loss of control of the service outsourced with only 24% citing it as a challenge. These findings indicate that every bank that practices HR outsourcing faces at least one or more challenges.

24% agree that it is a competitive tool

24% agree that it reduces costs

47% agree that HR outsourcing gives more choices

47% agree that HR outsourcing helps to save time

47% agree that it improves efficiency

35% agree that it enable an easy change of suppliers

41% say it enables access to world class capabilities

47% agree that it enables better use of resources

18% say it benefits economies of scale

2. What challenges do banks face in outsourcing HR activities?

All banks that out source some of their HR activities have faced at least one or more challenges. 84% of the banks have faced at least one or more challenges.

From the survey the most popular challenges of HR outsourcing among banks were increased use of non- employees, exposure to competitors, and loss of learning opportunities each represented by 41% of respondents followed by poor quality services from service providers, loss of control over the employees of the outsourced activity and dilution of organisational culture each represented by 35% of the respondents.

SUMMARY OF FINDINGS AND CONCLUSIONS

5.1 Answering research questions

1. *What are the benefits of that bank get from outsourcing HR activities.*

According to this research, Banks consider outsourcing of some of their human resources activities beneficial to them especially the big banks. 53% of the respondents have benefited from HR Outsourcing. The benefits accrued from HR Outsourcing are as follows:

59 % think it reduces risks

53% agree that it's a competitive tool

24% agree that it reduces costs

47% agree that HR outsourcing gives more choices

47% agree that HR outsourcing helps to save time

47% agree that it improves efficiency

35% agree that it enable an easy change of suppliers

41% say it enables access to world-class capabilities

47% agree that it enables better use of resources

18% say it benefits economies of scale.

2. *What challenges do banks face in outsourcing HR activities?*

All banks that out source some of their HR activities have faced at least one or more challenges. 52% Of the banks have faced at least one or more challenges.

From this survey, the most popular challenges of HR outsourcing among banks were increased use of non- employees, exposure to competitors, and loss of learning opportunities each represented by 41% of respondents, followed by poor quality services from service providers, loss of control over the employees of the outsourced activity and dilution of organisational culture each represented by 35% of the respondents.

5.1.2 Summary of Benefits

Most respondents agree that HR outsourcing is beneficial to the organisations however most of them say that their organisations have not established policies to govern the outsourcing practice in the organisation thus it limits their full exploitation of the would be benefits.

The respondents also would like their organisation to expand the scope of the activities currently outsourced, there is no bank that fully out sources all its HR activities, in fact the majority still perform most of their HR activities in-house. Some of the organizations that do not currently practice HR outsourcing expressed interest in the area and would like to incorporate it in their policies. Some respondents expressed the need to have clear communication channels so as to enhance HR Outsourcing so that the existing employees are not threatened by HR outsourcing practice.

5.1.3 Challenges of HR outsourcing

The banks that do not practice HR outsourcing which were mainly small banks do not face any challenges related to this practice. 52% have experienced at least one or more challenges in HR outsourcing with the most popular challenges being increased use of non- employees, exposure to competitors, and loss of learning opportunities each represented by 41% of respondents, followed by poor quality services from service providers, loss of control over the employees of the outsourced activity and dilution of organisational culture each represented by 35% of the respondents. Some respondents said due to the nature of banks to be confidential about the information they handle, confidentiality issues and use of non-employees who may jeopardize these may hinder the expansion of activities that HR department in banks could outsource.

In handling the challenges of outsourcing most respondents said it was important to deal with reputable service providers who uphold high levels of integrity and who offer competitive services of high quality. The respondents agree that contracts must be drawn clearly to spell out clear terms and conditions of services, which should protect both parties from defaulting.

5.2 Conclusions and Recommendations

Majority of Commercial banks in Nairobi Kenya outsource at least one or more human resources activities. The banks that outsource some of their Human resources activities have benefited from the practice. The benefits are mainly: reduction of risks, competitive advantage, efficiency, time saving, efficiency, cost reduction and access to world-class capabilities. The benefits have however not been fully exploited because the banks do not have clear policies to govern the practice, also the range of activities outsourced by banks is still very narrow. The bank managers agree that HR outsourcing has potential to take HRM to the next level of effectiveness.

There also challenges experienced in HR Outsourcing in banks those established in this research include: Increased use of non-employees who jeopardize the confidentiality policy of banks, dilution of organization culture and increased exposure to competitors, loss of learning opportunities and poor service delivery by service providers. However the Bank HR managers agree that this challenges can be handled by taking appropriate measures such as setting clear policies, clear contractual agreements with service providers, and establishing credible service providers to partner with. If the appropriate measures are put in place to control the challenges, then the benefits of HR outsourcing in banks outweigh the challenges of HRO practice. Most bank managers recommended HRO to other banks.

5.3 RECOMMENDATIONS

5.3.1 Further Research

Outsourcing of Human Resources activities is still a new concept in Kenya there are many aspects of HRO that have not been explored a lot of information is required to expand the practice in many organizations, there is therefore need for other researches to be done which could include: Determination of what policies are required to enable the development of HRO practices in organizations. A similar study should also be done in other sectors of the economy such as the industrial sector and the information and technology sector.

5.3.2 Recommendations to Bank Managers.

Bank Managers should restructure their policies regarding outsourcing of Human resource activities to create an enabling environment for human resource outsourcing practice to develop in order to benefit from the benefits of the practice. The bank managers should expand the scope of activities that the HR department can outsource so that the HR department can be elevated to a strategic function in the organization structure.

5.4 LIMITATIONS OF THE STUDY

It would suffice this study to do a more comprehensive analysis by including organisations outside Nairobi, to increase the reliability of the findings, however due to the limitation of time and finances this study was limited to Nairobi region only.

In this research there was resistance by respondents to provide information. Many banks have a lot of bureaucracy and for questionnaires to be filled they must be approved by senior management who are busy and take long to approve.

Many banks have restrictive policies when it come to filling questionnaire a considerable number were not willing to give any information thus not all banks were surveyed. This may have altered the findings of the research in one-way or another.

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APPENDIX I- INTRODUCTORY LETTER

School of Business,
C/O MBA Co-ordination Office,
University Of Nairobi,
P.O. Box 30197 Nairobi

August 2006

Dear Sir/Madam,

RE: COLLECTION OF SURVEY DATA FROM YOUR ORGANIZATION

I am a postgraduate student at the University Of Nairobi, School of Business. As part the fulfillment of the requirements of the MBA degree, I am undertaking a management research project survey on the benefits and challenges of outsourcing Human Resources activities.

Your organization falls within the population of interest and this therefore is to kindly request you to assist me collect data by filling the accompanying questionnaire.

The information provided will be used solely for academic purposes. My supervisor and I assure you that the information you give will be treated with strict confidence and a copy of the final report will be availed to you on request. Your honest participation will be highly appreciated. Thanking you in advance.

Yours faithfully,

.....
Irene Makhino
MBA student

.....
Prof. Peter K'Obonyo
Supervisor and senior lecturer
University of Nairobi

APPENDIX II
QUESTIONNAIRE TO THE HUMAN RESOURCES MANAGERS OF
COMMERCIAL BANKS

SECTION A

General Information

1. Name of bank _____

2. Ownership

Local

Foreign

Joint (Tick appropriately)

3. How long has your bank been in business

1-3 years

4 -5 years

6-10 years over 10 years

4. (a) Does your bank have a Human Resource Department?

Yes

No

(b). If No, who is in charge of Banks Human Resources activities?

5. What is the size of your organization workforce?

Below 50
employees

50-100

100-200

200-500

over 500

SECTION B

HR outsourcing and services outsourced

7. To what extent does your bank outsource the following activities? (Select all the appropriate)

Service	A very great extent	A Great Extent	Moderate Extent	A Low extent	Very low extent	N/A
Recruitment testing and selection	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Training	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Payroll processing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Temporary staffing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Pensions/Benefits Administration	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Performance management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Restructuring/Retrenchment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Employee welfare	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Counselling services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Health and safety monitoring	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Childcare facilities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Any other (please specify)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

II Benefits of Outsourcing HR Services

8. Do you think HR outsourcing has benefited your Bank?

Yes No

9. If yes to what extent do you think your bank benefited from outsourcing HR benefits below?

Benefits	A very great extent	A Great Extent	Moderate Extent	A Low extent	Very low extent	N/A
Less liability/Risks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cost reduction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
More choices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
More time to focus on core business	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Greater competitiveness	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Improvement in Efficiency in service provision	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ease in changing suppliers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Access to world class capabilities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Better of use of resources	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Economies of scale	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Any other (please specify)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

10. What do you think your bank could do to improve on the current benefits of HR outsourcing?

III. Challenges of HR Outsourcing

11. Has your bank faced any difficulties in HR outsourcing?

Yes No

12. If yes to what extent has your Bank faced the following challenges in Outsourcing Human Resource activities?

Challenges	A very great extent	A Great Extent	Moderate Extent	A Low extent	Very low extent	N/A
Increased use of non – regular Employees	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Confidentiality issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Exposure to Competitors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Poor quality services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Inability to control non- Regular employees	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Loss of control over outsourced services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Loss of learning opportunities for the from the outsourced activity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Dilution of organisations culture	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Any other (specify)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

13. What suggestions would you give on how to manage the above challenges?

14. Would you recommend HR outsourcing to other banks?

Yes No

15. Why or why not?

16. If yes what precautions do you think should be taken?

APPENDIX III

In December 2005 these were the 43 Commercial Banks in Kenya;

1. Barclays Bank of Kenya
2. Kenya Commercial Bank
3. Standard Chartered Bank
4. Co-operative Bank of Kenya
5. National Bank of Kenya
6. CFC Bank
7. NIC Bank
8. Commercial Bank of Africa
9. Citibank N.A.
10. I & M
11. Diamond Trust Bank
12. Imperial Bank
13. Stanbic Bank
14. HFCK
15. Equity Bank
16. Bank of Baroda
17. Fina Bank
18. Prime Bank
19. Bank of India
20. K-Rep Bank
21. Southern Credit Bank
22. ABC Bank
23. Guardian Bank
24. Giro Commercial Bank
25. Charterhouse Bank Ltd
26. EABS Bank
27. Habib A.G.Zurich
28. Middle East Bank
29. Bank of Africa
30. Victoria Commercial Bank
31. Credit Bank
32. Equatorial Commercial Bank
33. Prime Capital & Credit
34. Chase Bank
35. Consolidated Bank
36. Development Bank of Kenya
37. Trans-National Bank
38. Habib Bank Ltd
39. Fidelity Commercial Bank
40. Paramount Universal Bank
41. Dubai Bank
42. Oriental Commercial Bank
43. City Finance Bank