HR Challenges and Solutions

Payroll and HR Administration: Use Total Cost of Ownership Methodology to Expose Process Improvement Opportunities
Executive Summary

Corporate leaders are under growing pressure to make the best possible use of resources, people, and processes. To meet this challenge, they need a clear understanding of all elements of their organisation – costs, efficiency, effectiveness, and processes. All too often this understanding is missing. In many companies, HR is still the only function that fails to measure and benchmark its performance. As a result, their HR leaders do not know the true costs – the “total cost of ownership” (TCO) – of HR processes.

ADP has developed a method of measuring TCO that helps HR functions find opportunities to improve processes and reduce costs. TCO scans analyse the total cost of ownership of managing payroll, time and attendance, HR data administration, and health and benefits processes by looking at all the costs relating to people, processes, and technology. These include both “visible” and “hidden” costs, which can represent well over half of the TCO of a process, according to a 2012 study by PwC. Uncovering both the visible and hidden costs of HR will reveal opportunities to make cost savings and establish a link between HR activities and business results – becoming more strategic and getting closer to a seat on the board.

Chart 1: Breakdown of TCO by Cost Type

Source: Exposing the hidden cost of payroll and HR administration: a total cost of ownership study, PwC, March 2012.
Executive Summary

ADP’s benchmarking database shows that HR processing costs vary from country to country – a reflection of different levels of payroll complexity. There are also large differences between companies and industries within the same country.

National and international benchmarking provides HR functions with clear direction. It can help them define their “as is” situation and begin their journey to where they want to be.

Why Conduct a TCO Scan?
Companies that have made this journey after carrying out a TCO scan have achieved a range of benefits. They have:

- Cut HR processing costs
- Improved efficiency
- Made better use of resources
- Improved service delivery
- Increased productivity
- Transformed HR, making it more flexible and responsive to changing business needs.

It can help them define their “as is” situation and begin their journey to where they want to be.”
Exploring the Reality

Understanding the “total cost of ownership” – or TCO – can help HR leaders make a compelling business case for investment in process improvements. This means showing that the improvements represent opportunities to reduce costs, says Andre Rampat, Director at CorporateLeaders, the business transformation network. He argues that in the current economic climate, no company can afford to ignore these opportunities.

“Companies have always looked for ways of managing their resources,” says Rampat. “But in today’s challenging business environment not only has the need to cut HR costs and make savings without damaging business performance gained urgency, there is also a strong business case for new ways of working that increase employee engagement and productivity by removing administrative tasks from their jobs.”

Is HR at a Disadvantage?

Many HR departments underestimate the cost of payroll, time and attendance, HR data administration, and health and benefits processes. They identify the most visible costs but overlook many others. As a result, they do not know the true cost of running payroll and other HR processes.

Olivier Parent du Chatelet, Head of HR Consulting at Bearing Point, the management and technology consultants, points out that to optimise their effectiveness, HR departments need to monitor HR policies against clear performance indicators. “It’s even more important to use strong performance indicators to measure the effectiveness of HR processes, as well as perceptions of the HR function held by employees and/or managers,” he says.

“The indicators generally used are both qualitative and quantitative – including, for example, processing times, volumes and employee numbers. But it’s very rare – indeed, all too rare – for HR departments to use financial indicators to measure their performance.”

This puts HR at a disadvantage, especially when company resources are limited, according to Michele Gray, Director of Business Consulting for ADPs Europe, Middle East and Africa region. “It’s important to understand what HR processes really cost because if you are going to compete for funding to introduce change, you need to show what savings or return on investment that change will bring,” she says. “So it’s critical to understand, certainly your baseline costs, but also the total cost of ownership.”

Exploring the Reality of Your HR Costs

If you are going to compete for funding to introduce change, you need to show what savings or return on investment that change will bring.
Exploring the Reality

The Tip of the Iceberg

The TCO of payroll and other HR processes includes both obviously visible costs (buying and installing systems) and less obvious hidden costs (maintaining and running them). There are also direct and indirect labour costs linked to upgrading systems to newer versions. Over the long-term, the cost of replacing systems can have a further impact on TCO.

One reason why some costs are hidden is that HR processes are often “owned” partly by HR and partly by finance, IT, or other functions. So when HR departments look at their own administrative costs, they may overlook the costs of employing IT staff to install, maintain, and upgrade HR systems.

For companies with multiple local payroll systems, data consolidation is another hidden cost. Pulling together reports generated by different systems takes time. People performing these tasks may not be part of HR, but their time needs to be taken into account when looking at the total cost of the organisation’s payroll solution. (See chart on the next page for the costs HR needs to consider when conducting a TCO analysis).

Choosing the wrong solution can be an even bigger hidden cost. For example, if a company needs to set up a new project team, its HR processes must be flexible, responsive, and fast. “In those situations, the hidden cost of the wrong solution can hit the bottom line,” warns Gray. “If you can’t get people online, registered, and paid quickly – if there is any part of a project build that’s slowed down by those processes, that can have a tangible cost or risk.”

One reason why some costs are hidden is that HR processes are often “owned” partly by HR and partly by finance, IT or other functions.

Understanding Your Total Cost of Ownership

A complete cost analysis or TCO scan of HR processes should consider all the following costs, including those that are visible and the less obvious, “hidden” costs listed below. Chart 2 provides an overview of the hidden costs for payroll that is often overlooked and is uncovered by a TCO scan.

Chart 2: Structure costs of Payroll

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Understanding Your Total Cost of Ownership

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Exploring the Reality

Clearly Visible Costs:

System Installation
The initial costs of acquiring and implementing payroll, time and attendance, HR administration, or health and benefits systems. Often representing major investments for an organisation, these one-off costs are easy to identify.

System Upgrading
The costs of periodically upgrading systems to the latest versions. System upgrading costs are generally highly visible.

Direct Labour
Direct labour costs include salaries and benefits paid to people employed to operate HR processes. These costs are usually easy to recognise. Larger companies often keep their direct labour costs relatively low by employing entry-level employees to handle administrative tasks and by investing in process automation. Small and medium-sized companies typically use fewer automated processes and employ more senior people in administrative roles, increasing their direct labor costs.

Hidden Costs:

System Maintenance
IT systems need infrastructure, support, software, and regular maintenance – which all carry costs. But with IT staff often involved in maintaining HR systems, it can be difficult for HR managers to track their system maintenance costs.

Training
The cost of training employees to use HR systems is sometimes overlooked. However, it can drive overall costs up, especially when employees need to be re-trained to use upgraded or replacement systems.

Indirect Labour
Indirect labour costs relate to people working outside HR who help deliver HR processes. They include employees who collect information for payroll processing or answer employees’ questions about pay and benefits. It is important to consider these often hidden, indirect labour costs.

Direct Non-Labour
The total costs of operating payroll and other HR processes may include fees paid to consultants and vendors, as well as corporate overheads, such as rent and building maintenance. Again, these costs are not always easy to recognise.

Seams Costs
The cost of integrating payroll, time and attendance, HR data administration, and health and benefits systems. HR departments often install these systems separately without considering the costs of transferring data from one to another. This can be done either electronically or manually – with all the associated labour costs. Human involvement in data transfer also increases the risk of error – itself a hidden cost. Seams costs are largely hidden but can be a significant component of the TCO of HR processes. The PwC study cited above found that companies with software “seams” spend, on average, 21 percent more per pay cheque than those that have outsourced payroll, time and attendance, and HRIS to a single provider.

Data Consolidation
Companies with multiple local HR systems, rather than a single database, may need to pull all their data together – for example, to calculate global employee numbers. Consolidating data is time-consuming and represents another, often overlooked, cost.

Outsourcing
Outsourcing can deliver significant savings, but it also carries costs. Even companies that have not outsourced entire processes often outsource selected services linked to those processes, such as tax filing. Fees paid to an external supplier for these services are not always visible, but can account for a significant proportion of the TCO.

Quality-Related Costs
Perhaps the hardest costs to detect are those linked to the quality – or lack of quality – of HR solutions. Choosing the wrong solution is sometimes the biggest hidden cost of all, as it can have a major impact on the company’s bottom line.
Exploring the Reality

TCO Scans: Identifying Future Potential

The existence of hidden components means that HR functions often fail to consider the total costs of processes when deciding on future delivery models. That leads to poor choices. It is critical to conduct a full audit of HR processes before investing in new systems, setting up a shared service centre, or outsourcing any processes. But calculating the TCO is highly complex and there are few accurate benchmarking tools on the market to help companies with this task.

For almost a decade, ADP has been carrying out TCO scans for clients around the world. In the process, it has built up a unique database, holding data for 880 companies or business units in 72 countries. ADP has also developed a number of free tools and services that help HR leaders benchmark and analyse their HR TCO. Outputs of TCO scans are presented to client companies and are also anonymously included in the database for detailed benchmarking.

TCO scans enable HR teams to understand their current or “as is” situation. They can then develop future or “to be” scenarios, showing how cost savings could be achieved by making better use of people, processes, and/or technology.

TCO scans look at a wide range of indicators:

- Employee population (number and types of employees)
- Company organisation (number of sites, legal entities, and business units)
- Type of HR/payroll organisation (shared service centre, on-site, mixed, etc.)
- Process complexity
- HRIS type
- Level of payroll outsourcing, quality of HR services, productivity (number of employees managed by each FTE on administrative teams)
- FTE average costs per profile (for example, manager, clerk, IT specialist)
- IT costs
- Outsourcing costs
- Payroll costs per employee, per year

Benchmarking, using data collected through TCO scans, shows HR departments how well they are doing compared to peers (identified by industry, size, or location). “That is of real value to HR teams, which sometimes feel isolated – even within their own company,” says Laurence Fourrier, Payroll and HR Administration Manager at Fresenius Medical Care France, which recently conducted a TCO scan of its HR organisation and processes.

It is critical to conduct a full audit of HR processes before investing in new systems, setting up a shared service centre, or outsourcing any processes.
Developing a Successful Business Case

ADP has developed the following four-step approach to building a convincing business case for HR transformation.

Step 1: Conducting a TCO study

TCO scans first look at the combined costs of payroll, time and attendance, HR data administration, and health & benefits processes. This reveals the big picture and makes benchmarking easier.

After analyzing the combined costs, TCO scans usually break processes down into their main elements to measure the costs associated with each task. For example, for health and benefits administration, tasks include enrolment in programmes, termination of membership, and generating payments.

Gathering the Data

Questionnaires and structured interviews with stakeholders are the most widely used methods of collecting data for TCO scans. This simple methodology, which can be adapted to specific company situations, makes it easy to collect data and can provide results for more than 300 processes. However, small and medium-sized enterprises may be able to collect all the data they need via a short questionnaire, followed by a workshop bringing together key stakeholders.

Highlighting Value Add of HR Processes

In addition to assessing costs, TCO scans look at the value add of HR processing. “When you get to the executive board level, people will look at both costs and strategic value add,” says Gray. “So we have value add assessment questionnaires or structured interviews and we usually ask the project team handling the business case to talk to their executives about what’s important for them. That,” she continues, “helps the project team structure its recommendations around the executive board’s strategic priorities.”

This simple methodology, which can be adapted to specific company situations, makes it easy to collect data and can provide results for more than 300 processes.
Developing a Successful Business Case

Step 2: Carrying out analysis and benchmarking

A TCO scan will reveal opportunities to improve processes and cut costs. Questions the project team might ask at this stage include the following:

- Do the results of the scan show that HR administration processes are efficient or not?
- What does the benchmarking data show when compared to the best performers in the peer group?
- Where are the opportunities for improvement?
- How much can be saved by introducing process improvements or installing new technology?

Step 3: Defining future scenarios

Possible future scenarios might include installing a new in-house payroll system, setting up a shared service centre or outsourcing HR processing. By factoring the costs of these solutions into the future total cost of ownership, the project team can make like-for-like comparisons between the "as is" and the "to be" scenarios and decide on the right direction to take.

The project team also needs to look at the functional and geographical scope of each scenario. In other words, will the proposed changes affect all HR processes or only some of them? And will all the company’s entities and regions be covered?

The "to be" scenarios need to show what the HR function will look like after any move to outsourcing or shared services. How large will the retained function be? What roles will it play? And does the organisation have the talent to fill these roles? If the right talent is not available, the cost of hiring new people or developing existing staff will have to be factored in.

Chart 3 illustrates the findings of a payroll TCO scan for a large international company, which has been benchmarked against peers. The chart maps the "as is" or current situation and potential cost reduction and increased productivity through outsourcing in the "to be" or future situation. The data is then used to develop the business case for outsourcing.

Step 4: Implementing the best option

After comparing different scenarios, the project team has to make recommendations to the company’s top decision makers. While the most cost-effective solutions are often favoured, the need to maintain high service levels should not be forgotten in the drive to cut costs.
The ADP TCO database provides insights into the total cost of ownership of HR processes – in particular, payroll. For this report, the term “payroll” includes some pre-payroll and post-payroll activities, as well as time and attendance processing.

International TCO comparisons

The benchmarking data shows wide variations in the total costs of payroll activities in different countries. This is partly due to differences in the cost of living in the countries covered by the database.

The variations also reflect differences in levels of payroll complexity. “Payroll is far from being a purely transactional process,” says Jerome Philipps, Senior Consultant in ADP’s Global Consulting division. “It requires understanding of process control and legal expertise, among other competencies. Both the legal framework and the number and scope of payroll and sub-payroll processes differ dramatically from one country to another.”

Processing employees’ personal data can account for more than 50% of the time spent on payroll in Italy or France, but considerably less in the UK, where the legal framework for payroll activities is less complex. “This translates into high variations in payroll complexity, which range from a factor of 1 for the UK, compared to 9 for Brazil and 10 for Italy,” Philipps adds.

The main factors determining payroll complexity are:

- Local legislation – including variations by industry, proportion of companies with union agreements, and number of wage types
- The frequency and predictability of legal changes
- The nature and scope of pre- and post-payroll activities, such as employee registration and deregistration

The resulting differences in complexity have an impact on payroll costs. The more complex payroll activities are, the greater the expertise needed to perform them. As a result, average salaries for people in payroll positions range from £35,885 per full-time equivalent per year in the UK to £50,240 in Germany, where payroll operations require more knowledge and expertise.

Differences between the laws of individual countries also make it difficult for multinational companies to implement global payroll solutions. The pharmaceutical company, Pfizer, for example, hopes to reduce the number of vendor relationships it has in Europe from 25 to four or five. “Just the burden of managing 25 different vendor relationships and 25 different contracts across 38 countries in Europe brings in such a level of administrative complexity that we are starting to consider other options,” says Brian Zachary, the company’s Global Director for Payroll and Time & Attendance. However, he believes it would be unrealistic to look for a single global payroll provider. “There are too many variations in terms of governance and compliance issues,” he says.
Payroll processes covering hourly-paid, blue-collar employees are far more complex than those for white-collar employees.

Productivity Gaps
The benchmarking data also reveal big gaps in productivity, defined as the average number of employees a payroll team manages per month. Payroll teams of approximately the same size in France and Brazil deal with 237 and 302 employees per month, respectively. In India, equivalent teams process payroll for an average of 900 employees per month.

Market Forces
The state of the HRIS and payroll market in different countries is a further influence on payroll TCO. In France, where this market is highly competitive, HRIS payroll costs account for 25 percent of TCO for companies that use systems hosted by an external supplier – an arrangement known as “processing services.” The comparable figure for the UK is 40 percent.

In-Country TCO Comparisons
Payroll complexity and costs vary not only from country to country, but also within the same country.

Industry and Employee Population
Payroll processes covering hourly-paid, blue-collar employees are far more complex than those for white-collar employees. So payroll TCO is higher in the manufacturing sector – which employs large numbers of hourly-paid workers – than in, for example, financial services.

Employee turnover also affects payroll complexity and workload. Turnover rates of between 30 percent and 50 percent in the retail industry generate many more transactions around starters and leavers than in industries with more stable employee populations.

Company Culture
The culture of a company and the way it handles relationships with employees is a further cost-driver. Some companies want to maintain a dialogue with employees and will therefore create dedicated payroll positions on each site. Others prefer to operate shared services to handle employee payroll and administrative queries. This is obviously a more cost-effective option, especially for companies with large numbers of sites.

A company’s approach to process improvement also makes a difference. As Philipps says, “The number of efficiency improvement initiatives rolled out over the years within HR will lead to very high inherent variances of payroll TCO.”

Company Size
Larger companies can take greater advantage of economies of scale when operating payroll and other HR systems. “But the tricky thing is that the mathematical equation between size and productivity is not linear,” says Philipps. For example, in Germany, one person can typically handle the payroll of up to 350 employees. If that number rises to 450, 1.5 FTEs may be needed, but two full-time positions will often be created. “Without a savvy job split that means lower productivity and higher payroll operating costs,” Philipps explains.

International Variations
While payroll TCO in Italy is £328 per employee per year, the figure for Spain is £200. For India, it is just £73, reflecting the country’s relatively low cost of living.

Countries with much higher living costs can also have a relatively low payroll TCO. In the UK the figure is £167, per employee, per year. That’s similar to Spain, although the cost of living in the UK is much higher. The reason is that the UK has simpler legislation, requiring people with less experience and legal knowledge. That translates into lower costs.
In-country Variations
Within the same country, payroll TCO varies from one sector to another, and from one company to another – even within the same sector. While the average payroll TCO in a sample of 35 Italian companies is £328 per employee per year, the minimum is just £157, and the maximum is £565.

“Overall, the ratio between the highest and lowest performers within the same country can be an impressive 1:5 and offer significant opportunities for improvement in payroll efficiency and TCO,” says Philipps.

The information within ADP’s benchmarking database is not only intended to help HR teams identify these opportunities. As Philipps points out, employees and top management still often see HR as largely “administrative,” not very efficient, and adding little value. But a full understanding of the costs of transactional HR activities enables the function to change outdated views of its own role. More importantly, it helps HR leaders contribute to their company’s efficiency programs. That is why it is so vital to uncover all HR processing costs through a TCO scan.

TCO: A Lever for Optimised HR Performance
Once a TCO scan has revealed the true costs of HR processes, programmes can be developed to optimise HR performance. According to Olivier Parent du Chatelet, Head of HR Consulting at Bearing Point, these programmes can deliver the following key benefits:

- Globally consistent HR policies
- A more flexible HR function that responds to business needs
- Clarification of roles within HR
- Harmonisation and/or standardisation of HR processes to help ensure fair treatment for all employees
- Real integration of HRIS with other systems
- Improvements in the quality of HR services through service level agreements and changes to HR roles
- Reallocation of HR resources to activities with higher added value

“As consultants, one of our challenges is to find the right balance between the ambition of HR leaders to add value and the need to reduce HR costs, especially in times of economic crisis,” says Parent du Chatelet.

“However, when we audit HR activities such as payroll, we try to measure other elements that we view as fundamental to sustainable performance. These include the level of professionalism within HR, the skills levels of key HR players, and their relationship with customers.”

“Creating an effective customer relationship model, especially for shared service centres, is another major challenge. It requires regular dialogue between the service centre and its clients, satisfaction surveys and a direction set by clear service level agreements.” He concludes.
It has never been more important for companies to understand the total cost of ownership of their HR processing. Only by developing a real understanding of these costs will HR be able to deliver the efficiency, savings, and service improvements so critical to business success in today’s challenging market conditions.

In order to calculate their TCO, companies need to look at all their processes – and not focus on any one process in isolation. They also need to identify the critical “hidden” costs, in addition to the more obvious costs.

The case studies featured in this report show that identifying all these costs can help HR build a business case for new ways of working that deliver savings, while improving productivity and employee engagement. A full TCO analysis can also transform the HR organisation itself, making it more flexible and responsive to strategic business needs. By achieving operational efficiency and looking at HR strategically will it get visibility and start the process of getting a seat at the board reporting directly to the CEO.

However, assessing TCO is a complex task that requires high levels of expertise. To discover how ADP’s TCO scanning methodology can help HR functions measure their processing costs, visit www.adp.com/hr-tco to get a high-level payroll TCO calculation online.

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