



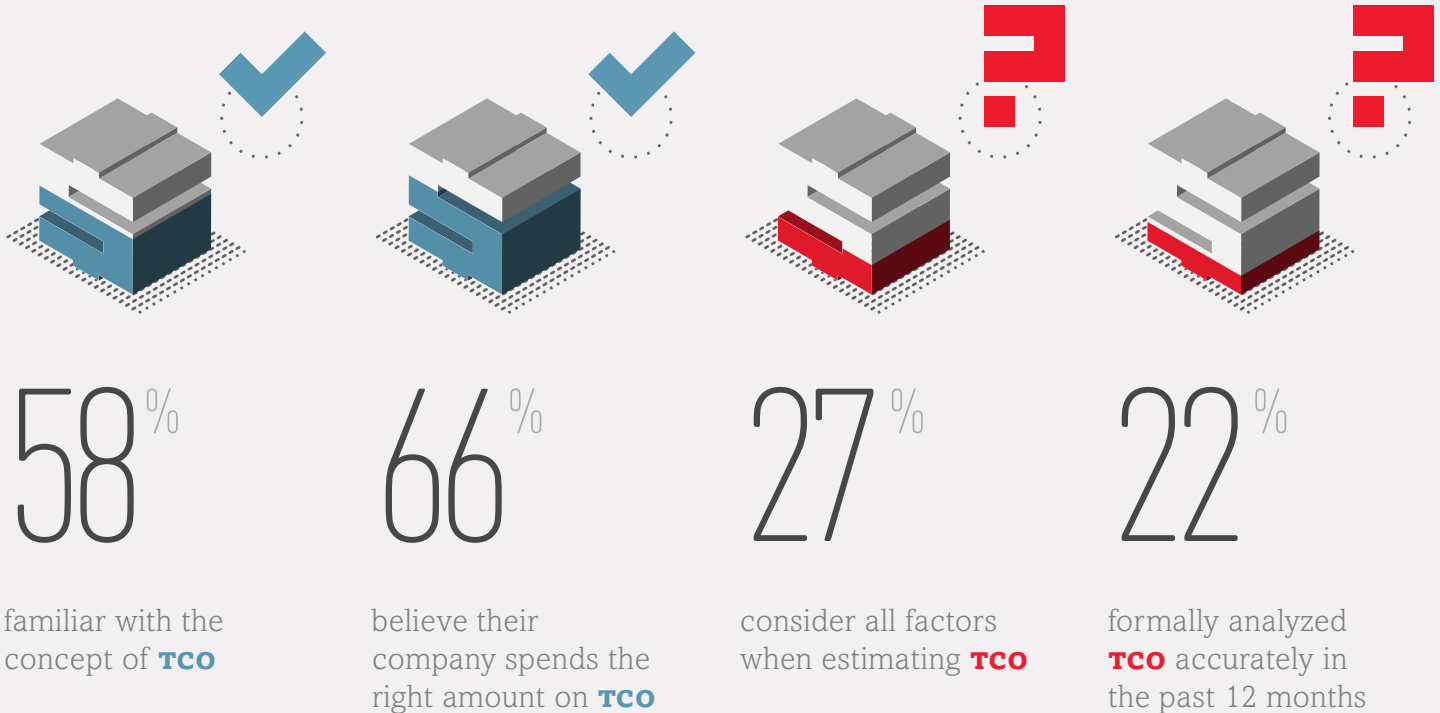
The Importance  
of Total Cost of  
Ownership:

How Midsized  
Companies Can  
Find Competitive  
Advantage

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## Do You Know Your Big Number?



Many organizations have done a considerable amount of restructuring and downsizing in recent years. Sometimes this has been done in the absence of having accurate information and metrics to make good decisions. Even in good economic times, organizations can operate with poor workforce-related data and/or the inability to know what information and metrics are really impactful to their business. One of the most important metrics that organizations need to think about is the total cost of their workforce. Referred to as Total Cost of Ownership (TCO), this measure enables an organization to obtain a realistic picture of what they are actually spending on their employees and the management of them. Focusing only on salaries and benefits can be misleading and can lead to making poor strategic and tactical business decisions. Companies that do only this also risk opportunities for competitive advantage. They also should be thinking about the costs associated with managing these areas and other functions like their talent management and time and attendance, as well as the costs associated with the systems and processes to support all of this activity.

# HUMAN CAPITAL MANAGEMENT

Organizations are increasingly thinking of their employees in terms of “human capital.” The fact that the word “capital” has been attached to the word “human” implies that these organizations recognize the financial impact that their employees have on the bottom line. Much has been said about the importance of human capital with respect to how businesses can differentiate themselves and increase their competitive advantage in their business.

**Cornell University**  
**IRL School**

*Making  
Human Capital the  
Creation Core of  
Strategy Execution*

*Financial capital has lost some of its primacy as the catalyst of growth.*

*Human capital is primed to become a more dominant variable and a key driver of productivity and profits. It is by far the most abundant, flexible, and readily leveraged resource organizations have.*

Given the importance of human capital to any organization's operation, it should be carefully managed like any business asset. This starts with how well the asset performs. Surprisingly, most companies do a poor job of managing their human capital from this perspective, despite many thinking that they are doing just fine. For example, a 2010 survey by Bersin & Associates among 725 firms with 100 or more employees revealed that 93% of them had no formal talent management strategy.<sup>1</sup>

Poor human capital planning and managing can be extremely costly in the form of high employee attrition, the increased need to recruit replacements, and inefficient HR systems and processes. Accordingly, human capital as an asset also must include the associated costs of the management process.

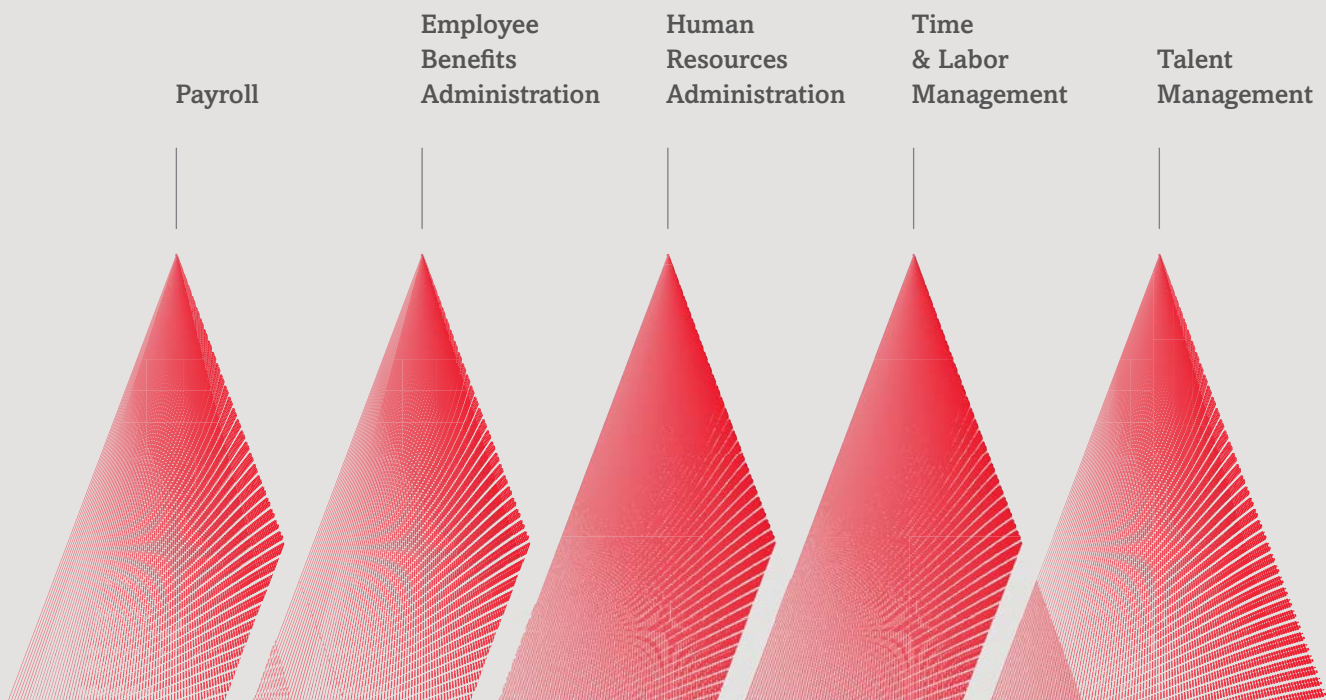
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<sup>1</sup> Bersin & Associates, *Talent Management: Benchmarks, Trends, & Best Practices*, June 2010.

# FIVE FUNCTIONAL PILLARS

## Human Capital Management Defined as Five Functional Pillars

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Each of these pillars involves both direct and indirect costs in the form of salaries, systems, and overhead expenses. Taken together they form the basis of the TCO of HCM. Although TCO is most often used in connection with Information Technology, it has found its way into every aspect of business to help estimate the total cost of services, systems, and processes.

This includes HCM. The relationship between TCO and HCM is underscored by a recent 2014 study by NelsonHall which revealed that North American firms that implement a human capital management strategy are able to reduce their TCO by 26%.<sup>2</sup>

Given the importance of HCM and its concomitant costs, in addition to questioning how well companies are managing their employees, one might also question whether these companies understand the TCO of their human capital. Here too the evidence is not very positive. For example, in a 2012 study, PwC reported that only 5% of their client companies who they surveyed had a full-scale human capital analytics capability in place and some 20% were conducting such analyses on an ad hoc basis.<sup>3</sup> Additionally, Deloitte reported that the great majority of very large companies (i.e., 10,000+ employees) consider HR and Talent analytics to be very important. However, some 45% of those surveyed said that they were “not ready” yet to implement such analyses.<sup>4</sup>

*Companies have a false sense of confidence with respect to what they know about HCM, its costs, and their own HCM performance.*

The ADP Research Institute (ADPRI) recently commissioned the Total Cost of Ownership (TCO) Awareness study with Harris Poll to address the Human Capital Management and Total Cost of Ownership questions head-on. The study, conducted in the summer of 2014 among a representative sample of 1,004 senior personnel, both executives and managers, responsible for one or

more of the five HCM pillars in midsized companies (50-999 employees) found that these companies have a false sense of confidence with respect to what they know about HCM, its costs, and their own HCM performance. The study also provides deep insight into the degree to which midsized companies understand and manage their Human Capital Management TCO.

<sup>2</sup> NelsonHall, *Targeting Payroll Outsourcing*, May 29, 2014.

<sup>4</sup> Deloitte, *Global Human Capital Trends 2014*, 2014.

<sup>3</sup> PWC, *Trends in Human Capital 2012: A Global Perspective*, 2012.

**HOW WELL  
ARE MIDSIZED  
COMPANIES  
MANAGING  
THEIR HUMAN  
CAPITAL?**

According to our study, senior staff in mid-sized companies believe their companies are doing a very good job of managing all of their human capital functions, especially around compliance—payroll tax laws and regulations, benefits rules and regulations, and the ACA. Some two thirds of the survey respondents feel they are also controlling and managing their HCM costs well. As shown by the TCO Awareness study, what lies beneath this sense of HCM well-being reveals the apparent weakness of this mindset.

**WHAT  
SENIOR STAFF  
WORRY ABOUT  
REGARDING  
HUMAN CAPITAL  
MANAGEMENT**

Despite feeling their company is doing a very good job of managing all of their HCM functions, including cost containment, some of these mid-sized company executives and managers express a sense of unease about their companies' employee costs. When asked what they worry about each day, they indicated ways to lower their overhead costs and the total cost of managing all of their employees as their top two daily concerns.

**Daily Worries**

Thinking about better ways to lower my company's overhead costs

64%

Total cost of managing my company's employees

54%

I'm spending/my department spends too many hours manually entering in employee data

42%

Don't understand all the nuances of the ACA that affect our company

40%

Too many open positions for which we cannot find qualified candidates

39%

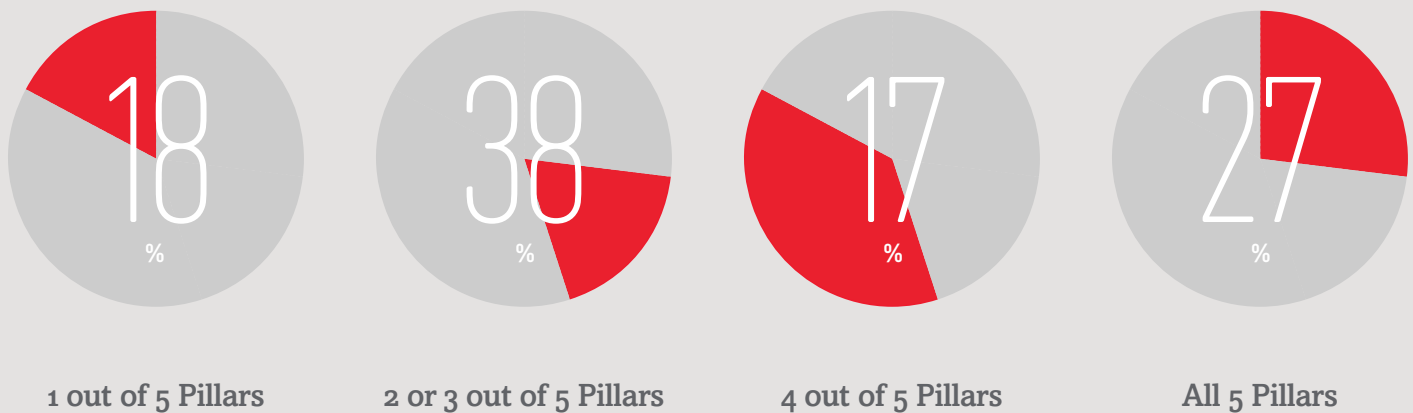
Cannot retain talent for more than a year or two

37%



# THEIR BEHAVIOR BELIES THEIR CONFIDENCE

## Number of Pillars Considered In Estimating TCO



One of the key findings of the study was the degree to which mid-sized companies have a poor grasp of their HCM TCO. While slightly less than six in 10 respondents indicated that they have a good familiarity with the TCO concept and most of these individuals attach a great deal of importance to their HCM TCO, only one in four of those who could provide an estimate of their HCM TCO included all five HCM pillars in their answer. The result is that they tend to grossly underestimate these costs.

What do senior executives think about when considering their HCM TCO? Typically, it is payroll and benefits administration. Time and Attendance is the least considered element, among those surveyed.

**ADP  
Research Institute**

Survey Results

*Some survey respondents' comments reveal how poorly they understand their HCM TCO*

*The cost analysis is too complicated with our current system ...*

*The top people keep some of that confidential ...*

*That is a cost that is very hard to track ...*

*I'd have to look into QuickBooks to figure it out ...*

*We do not keep track of TCO ...*

# HOW MIDSIZED COMPANIES ARE MANAGING THEIR HCM COSTS

If HCM TCO is as important to them as they say, we would expect that the way midsize companies handle the different HCM functions would reflect this concern. The vast majority of midsize companies feel that they have adequate systems in place to manage all of their direct and indirect labor costs, including salaries, benefits, and administration costs.

Interestingly, our study found, cost is not a major motivator for how companies process their payroll. It is, however, a key underlying reason for how they process their benefit administration tasks.

## **PAYROLL PROCESSING**

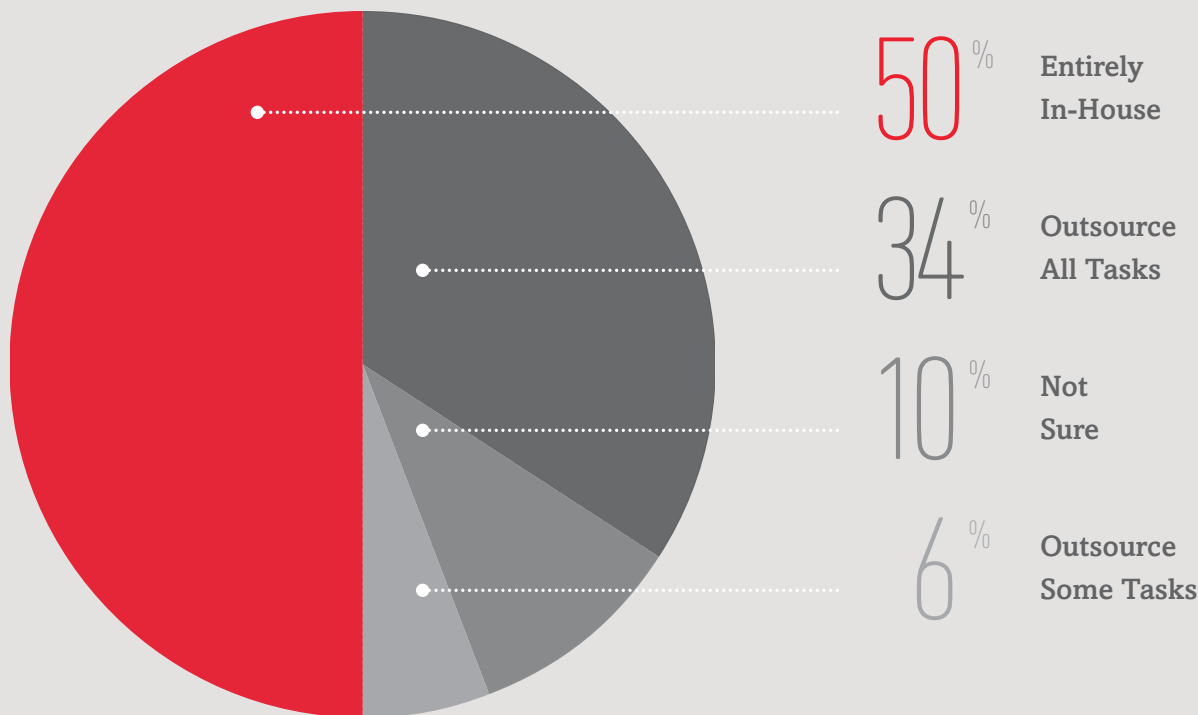
According to our survey, cost specifically is not a dominant motivator for how companies handle their payroll processing.

However, many of the reasons cited can have a direct impact on cost to the company (i.e., compliance, accuracy, burden on the internal staff). On average, executives think about three reasons when determining the best processing approach. This implies that while companies do not feel that cost is a major factor in the decision process, it would appear that in fact it is.

When it comes to the ways respondents mentioned they can lower their direct and indirect payroll costs, systems and processes are not top-of-mind. Among the three quarters of companies in our study who have been making efforts to reduce their labor costs, the most frequently mentioned efforts focus on their employees and reducing associated costs. These midsize

companies make very few, if any, mention about introducing more cost-efficient systems and processes.

How Benefit Administration Tasks Are Handled



BENEFITS  
ADMINISTRATION

The study also found that mid-sized companies are equally likely to handle benefits administration in-house as they are to outsource some or all of these tasks, irrespective of the size of their company. Asked what their benefits administration challenges are, costs top the list. One in three who handle benefit administration tasks internally cite cost as a reason. Just as many senior staff say the same thing about why their company outsources some or all of its benefits administration tasks.

# WHAT MIDSIZED COMPANIES ARE DOING ABOUT HCM TCO

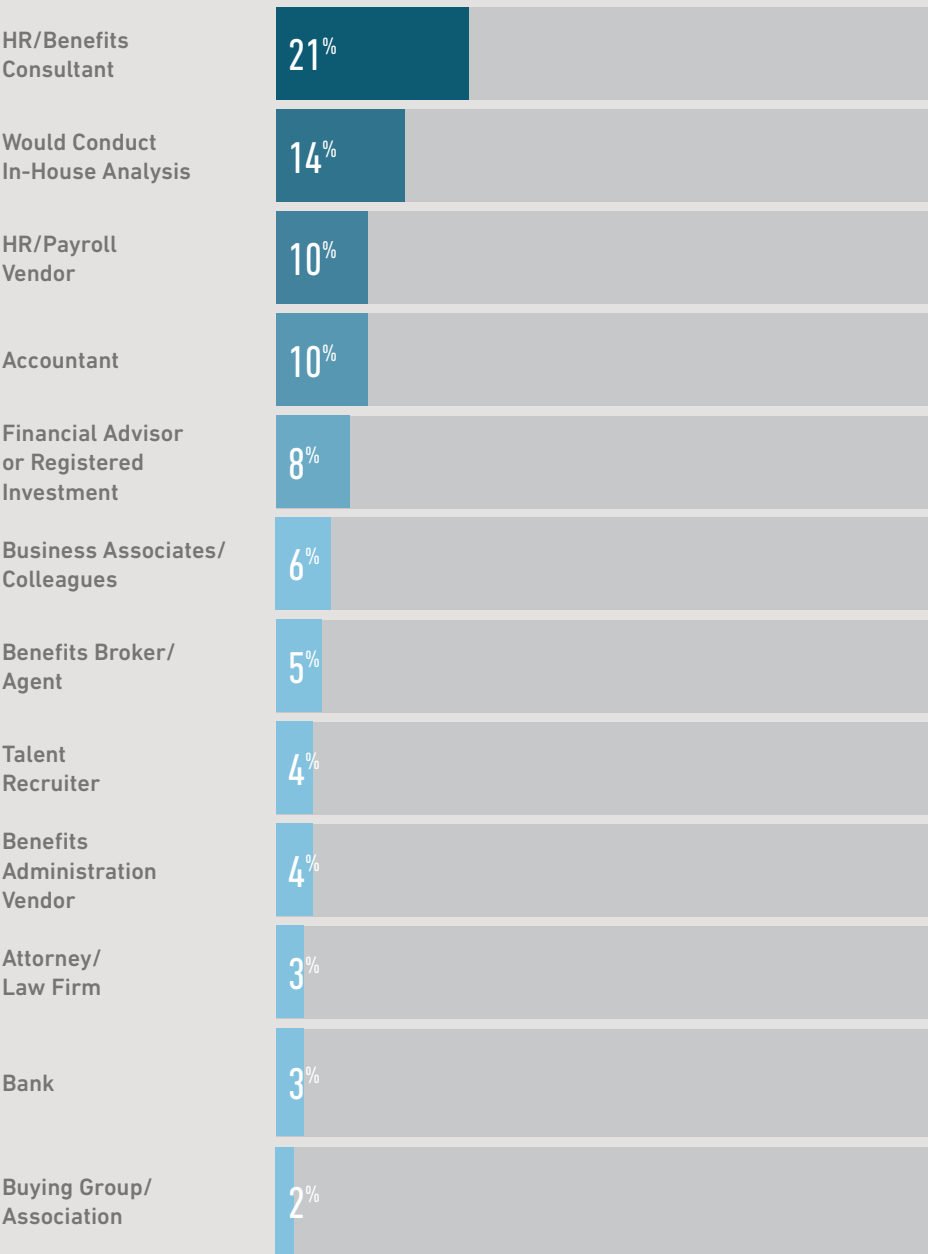
So what are midsize companies doing regarding their HCM TCO? On average, just over one in three have done a formal cost analysis on any one or more of the five HCM functions in the past year and only one fifth have done it across all five pillars. Some one in six had not done any analysis in more than three years or longer. And, very few of these companies have examined all five HCM functional areas in the recent past. Moreover, some tend to do these analyses in-house rather than turn to an outside expert. When they do turn outside for help, our study reveals that there is no one trusted advisor that dominates. There are at least a dozen or more credible sources among which these companies have turned to for assistance in analyzing their HCM TCO costs within any one of the HCM functions. Typically these include accountants, HR/payroll vendors, banks, HR/benefits consultants, lawyers, and financial advisors.

If they were to formally analyze all five HCM pillars, our study indicated that they again would consider a multitude of sources. HR/benefits consultants top the list.

Whether or not they have conducted a formal analysis of their employee-related costs, only about half of those surveyed report having a plan to manage or reduce their labor costs in the next year. Among this group some one in three are not totally confident in the plans they have in place.

**Source That Companies  
Would Rely on for Formal  
Cost Analyses of All HCM Areas**

**Plan  
to Manage  
Labor Costs**



56%

Have  
a Plan

37%

Lack  
Confidence  
in a Plan

# INTEGRATION OF HCM FUNCTIONS

One of the underlying cost drivers of HCM is the fact that most companies operate their HR tasks on different platforms. This leads to cost inefficiencies among other things. With the increased importance of HCM and the complexity of linking payroll with multiple administrative tasks, it will become increasingly imperative that in order to optimally manage each

*Just less than half of our respondents indicated that it is essential that their company integrates some or all of its HCM functions onto one system.*

of the HCM tasks they be integrated onto a common operating platform. Just less than half of our respondents indicated that it is essential that their company integrates some or all of its HCM functions into one system. This is an example of the kind of TCO component that many companies overlook, as integrating systems will help eliminate the types of

mistakes and inefficiencies that can have a real impact on a company's bottom line. If they did integrate their systems, a majority would prefer a fully integrated HCM system over a composite of best-in-breed solutions. And, in fact, according to a 2011 PwC study, organizations outsourcing multiple functions to a single vendor see even stronger cost efficiency—on average 32%—versus organizations using a multiple vendor or “best of breed” in-house approach.<sup>5</sup>

Two thirds of the companies in our survey reported having two or more of the five HCM functions already integrated. Payroll tops the list of functions that are most likely to be currently integrated with other HCM functions.

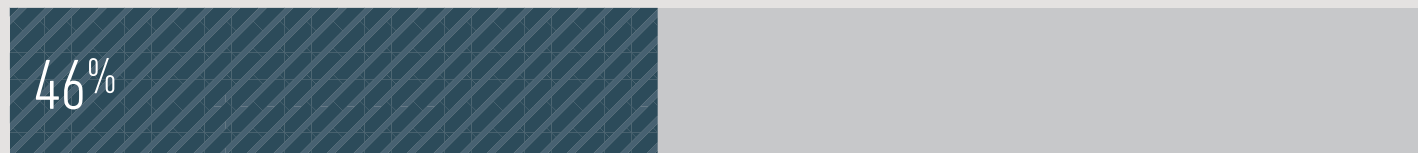
**HCM Functions Currently Integrated**

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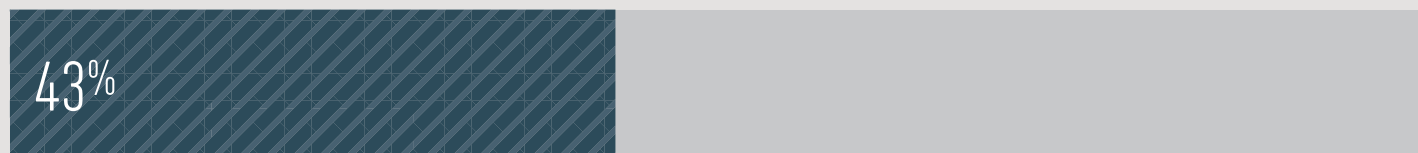
**Payroll**



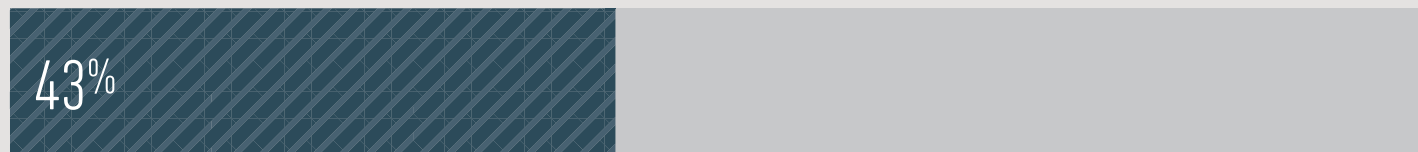
**Time & Attendance**



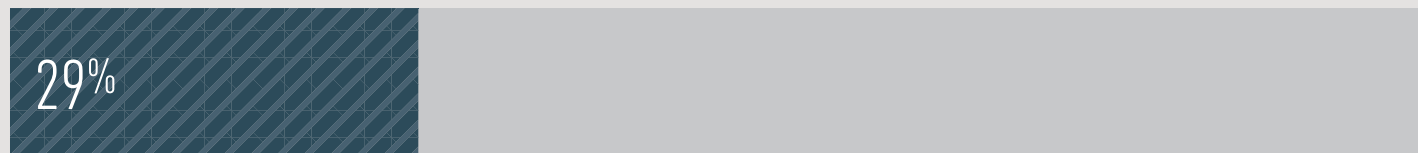
**Employee Benefits Administration**



**HR Management**



**Talent Management**





# CONCLUSION

In today's highly competitive world, businesses must continue to find ways to differentiate themselves not only externally but also internally. These two dimensions are integrally linked because a business is only as good as the people that run it. Attracting, managing, and keeping top talent comes with a cost. Some of these costs are very apparent. Others are hidden. Some of these costs are directly monetary. Others are indirectly monetary and take the form of operational inefficiencies, poor management, loss of personnel, and the like.

There is an old saying that what gets measured gets attended to. HCM should be a corporate strategy. For this strategy to be effective, it requires that key stakeholders have good information. In order to have good information, companies need a high degree of knowledge, measurement tools, and complete and accurate analyses. The study findings would seem to imply that mid-sized companies get failing grades on all three of these factors.

Our study reveals that mid-sized companies have a long way to go with respect to HCM and understanding its associated costs. It would appear that these companies are not as educated as they need to be about the topic and despite feeling TCO is important, their behavior does not reflect their attitude. This leaves the door open for significant education of this market segment about what constitutes HCM TCO, the best practices for managing it, and the financial risks associated with not completely understanding it.

# ABOUT

## **The Total Cost of Ownership Awareness of Human Capital Management Study**

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The 2014 Total Cost of Ownership Awareness of Human Capital Management Study was commissioned by the ADP Research Institute with Harris Poll and included 1,004 U.S. employees working full-time, part-time or self-employed in a company with 50-999 employees and have responsibility for one or more of the following areas: Payroll, Time and Attendance, HR Management, Employee Benefits Administration, and Talent Management who participated in an online survey between July 29 and August 13, 2014.

## **The Harris Poll**

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Over the last five decades, Harris Polls have become media staples. With comprehensive experience and precise technique in public opinion polling, along with a proven track record of uncovering consumers' motivations and behaviors, The Harris Poll has gained strong brand recognition around the world. The Harris Poll offers a diverse portfolio of proprietary client solutions to transform relevant insights into actionable foresight for a wide range of industries including health care, technology, public affairs, energy, telecommunications, financial services, insurance, media, retail, restaurant, and consumer packaged goods.

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