The hidden reality of payroll & HR administration costs

Exploring hidden cost drivers and characteristics of cost-effective organizations

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Contents

Executive overview

Do you know how much your organization is really spending on payroll and HR administration? Chances are you may not be considering major cost components related to administering these important functions and may be spending more than you think as a result.

In this white paper, we'll break down the different cost drivers of payroll and HR administration and lay out the strategies that are making some organizations more cost-effective at these functions.

As a general rule, we have found that organizations tend to underestimate the true expense (the "total cost of ownership," or TCO) of processing payroll, administering employee health and welfare benefits, and managing other key HR systems and functions.

While most organizations consider costs such as a payroll department's staff or the acquisition costs of a new ERP solution, many fail to recognize certain "hidden" costs necessary for operating and integrating these interdependent processes. Additionally, organizations often apply separate technology and process solutions to these individual administration functions without considering how those solutions work with each other. This fragmentation drives up administration costs through task overlap and other inefficiencies.

For nearly a decade, PwC, with the sponsorship of Automatic Data Processing (ADP), has studied these TCO costs and how to mitigate them.

Past studies have focused exclusively on large organizations (more than 1,000 employees). For the first time, the inclusion of mid-size organizations in our most recent study provides additional insight into this issue, and has allowed us to also measure baseline TCO costs for organizations between 100 and 1,000 employees.

As with previous studies, our current TCO study analyzed the TCO of key payroll and HR administration functions. The new data from this year's study, collected from 279 participating organizations, shows that administration of payroll (PR), workforce administration (WA), time & attendance (TA), and health & welfare benefits (H&W) remains expensive for employers—and it has gotten costlier over the years, despite a number of technological advances designed to diminish costs.

Although these functions are expensive, analysis of data collected in these PwC studies has uncovered several opportunities for increased cost effectiveness. The top cost reduction strategies, measured by overall TCO, are:

- Outsourcing—organizations managing payroll, workforce administration, time & attendance, and health & welfare benefits in-house using premise-based or hosted software solutions spend on average 18% more administering these functions than organizations that outsource[1] these functions
- Utilizing a common vendor or solution—organizations administering these functions in-house using software solutions from multiple vendors spend on average 18% more than those organizations administering them in-house using a common vendor. 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

In addition to the above findings, which are discussed in detail in this white paper, analysis of the data collected for this study also confirmed that two of the key findings of the earlier TCO white papers continue to present opportunities for increased cost effectiveness:

- Providing payroll and HR self-service functionality to employees—this strategy results in a 50% lower TCO of workforce administration for large organizations compared with peers managing the function without these features
- Integrating time & attendance with payroll—this leads to a cost efficiency of 14% over a manual approach or an approach that is not integrated

Furthermore, the current study clearly suggests that cost effectiveness stems from comprehensive process transformation, not just technology innovations. The required change isn't always easy, but significant financial benefits may await for organizations ready to really embrace and implement these changes.

1. The term "outsourcing" in this paper specifically refers to outsourcing to ADP as this study used only ADP clients to measure the TCO of organizations outsourcing payroll and HR functions.

Methodology

This primary research study includes data collected from 279 participating organizations, ranging in size from 100 employees to more than 100,000 employees. This study marks the fourth installment in a series during which PwC has surveyed more than 600 organizations. Previous studies occurred in 2003, 2004, and 2006.

The current study set out to measure the Total Cost of Ownership (TCO) of four core business functions—payroll (PR), workforce administration (WA), time & attendance (TA) and health & welfare administration (H&W)—and to analyze factors impacting these costs. Because this study focused only on TCO, areas such as quality of administration were not addressed.

PwC conducted this TCO assessment primarily through use of a confidential web-based questionnaire administered from May to August of 2010. Senior financial and HR executives (i.e., CFOs, VPs of HR, VPs of Finance, Directors of Payroll and Controllers) were invited to participate, and in cases where an organization had multiple respondents provide input, we created a single consistent response. Many organizations also participated in phone interviews conducted by a PwC representative.

PwC also conducted multiple follow-up calls with respondents to verify, clean and complete data. In total, PwC performed more than 500 phone and email follow-ups to clarify completed participant data. This approach enabled respondents to provide total costs, rather than just labor or system costs.

The data

PwC defined TCO in a manner that broke down total cost into its component parts. For the purposes of this study, the four core functions are defined briefly, as follows:

- ***Payroll (PR):*** The process of collecting and entering data related to employee hours worked, determining taxation, calculating gross and net pay, and distributing compensation.
- ***Workforce administration (WA):*** The maintenance and administration of the core HR database (often referred to as the Human Resource Information Systems or HRIS) and the activities associated with maintaining employee information and various processing activities such as payroll, health & welfare administration, and other HR activities.
- ***Time & attendance (TA):*** The process of collecting, reviewing, submitting and approving time reporting data, including employee hours worked, paid time off (vacation, sick, holiday) and leave balances.
- ***Health & welfare administration (H&W):*** The administration of employee H&W benefits and programs including open enrollment and life event status change maintenance.

Collectively, these four components provide a comprehensive measure of TCO of payroll and HR administration costs.

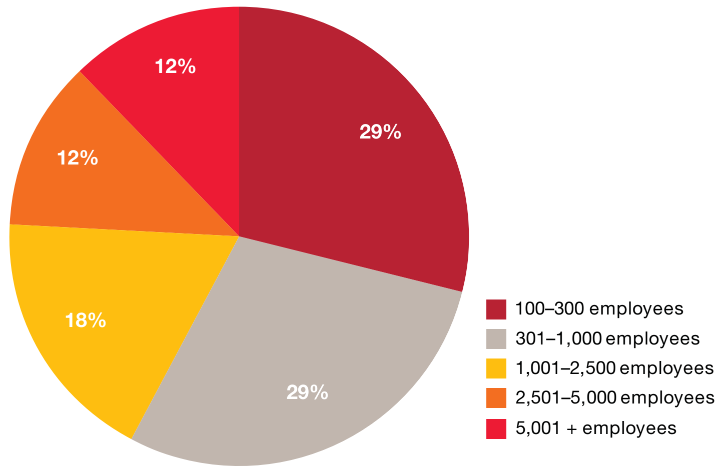
In addition to measuring the TCO of the four processes, and providing an overall TCO, the current study sought to update the original studies conducted in 2003, 2004, and 2006, especially in light of significant market changes in the delivery, technology, and scope of HR systems since 2003.

Respondents were asked to answer questions that quantified all one-time and ongoing costs for the areas of PR/WA/TA/H&W administration. Detailed component descriptions were provided in the survey itself as well as via personal follow up from PwC where necessary. PwC contacted participants directly when data fell outside the normal range of responses and normalized data where necessary.

Profile of participants

279 organizations (consisting of 205 organizations that do not outsource these functions and 74 organizations that outsource to ADP) participated in this study. 120 (43%) are classified as large organizations, with more than 1,000 employees; 159 (57%) are classified as mid-size organizations, with 100–1,000 employees.

Figure 1. Survey participants by organization size



Note: Percents may differ slightly from other figures in the paper due to rounding.

The larger sample in the 100–1,000 space is due to the larger number of organizations operating in these segments, and the need to augment the work completed in previous studies, which focused exclusively on large organizations.

The term "outsourcing" in this paper specifically refers to outsourcing to ADP as this study used only ADP clients to measure the TCO of organizations outsourcing payroll and HR functions. The study did not evaluate, and thus findings cannot be directly applied to, ADP's HR business process outsourcing offerings. PwC makes no representation that the comparative key findings of this survey can be generalized to other payroll and HR outsourcing providers.

Organizations surveyed used a wide range of platforms and solutions, including approximately 65 platforms in payroll alone. Payroll vendors represented in the in-house analysis include the market-leading software vendors.

Because of the economies of scale we see in larger organizations (which are discussed within this paper), when we compare the TCO of organizations that outsource to organizations that use in-house solutions, it was important to normalize the results for the effects of size—in other words, we compared the results as if both groups had organizations of similar size.

All participating organizations are U.S.-based companies or subsidiaries or business units of non-U.S. companies, and come from more than 17 industries, with the most prevalent industries being manufacturing (15%), healthcare (13%), and finance, insurance and real estate (10%). Federal and state governments were not specifically addressed in this study. This study, like previous studies, is focused only on costs.

This white paper has been researched and prepared by PwC. ADP is the sponsor of this TCO study.

Key findings & recommended strategies to reduce administration costs

Four key findings in connection with the cost of administering payroll and HR in-house surfaced during our analysis of the data collected in the study:

1. In-house administration of payroll, workforce administration, time & attendance, and health & welfare requires a surprisingly large commitment of time and resources—typically over $1,400 per employee per year (PEPY) for large organizations and nearly $2,000 PEPY for mid-size organizations.
   - "Hidden costs," as defined below, continue to account for more than 50% of the TCO of administering these functions in-house.
2. TCO for payroll is actually increasing—contrary to our expectation, and despite technological advances, administration costs have actually increased rather than decreased since 2003 as organizations focus on technology transformation rather than process transformation.
3. Outsourcing continues to deliver overall TCO advantages—using in-house payroll, workforce administration, time & attendance, and health & welfare solutions increases TCO by 18% on average.
4. Utilizing a common vendor or solution to manage multiple functions, rather than leveraging a "best of breed" approach or maintaining disparate legacy systems, can deliver tangible cost efficiencies—organizations administering these functions using software solutions from multiple vendors spend on average 18% more than those organizations administering them in-house using a common vendor. 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.

In the remainder of this section, we will explore each of these findings, and their implications for organizations.

In-house administration of payroll, workforce administration, time & attendance, and health & welfare requires a surprisingly large commitment of time and resources

This study, like PwC's previous benchmark analyses, showed that many organizations may be unaware of the true expense of administering the PR, WA, TA and H&W functions because not all costs are readily visible. Organizations may find that, upon detailed examination, their actual costs far exceed their expectations, by up to several hundred percent.

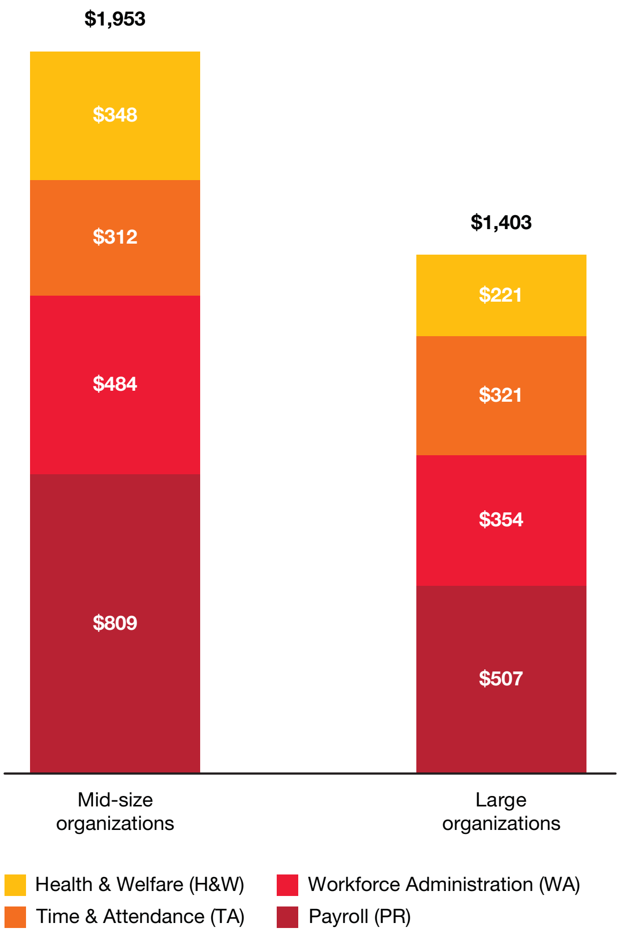
Visibility into the total costs, especially across functions, is low in part because these related functions are often "owned" by different functional leaders (Finance, HR, IT). Accordingly, many organizations make decisions about the technology and sourcing that work best for the individual function without consideration of the potential synergies across the enterprise.

A complete cost analysis should consider the following types of costs across all four functions:

- ***System installation costs***—The one-time costs related to the initial acquisition and implementation of an organization's PR, WA, TA, and H&W systems
- ***System upgrade costs***—The periodic acquisition and implementation costs related to upgrading to a more current version of the PR, WA, TA, and H&W systems
- ***Direct labor costs***—The cost of labor (salary plus benefits) of the direct staff necessary to support the PR, WA, TA, and H&W functions
- ***Direct non-labor costs***—The total costs of consultants, vendor fees and facilities, G&A, and corporate overhead related to the PR, WA, TA, and H&W functions
- ***System maintenance costs***—The IT costs specifically related to maintaining the current systems
- ***Indirect labor costs***—Cost of labor for employees not directly related to the payroll and HR departments supporting these functions in the field (i.e., collecting, approving and preparing employee hours for payroll; distributing paychecks; answering employee questions about benefits, etc.)—where employees are typically spending only a fraction of their time on these activities
- ***Outsourcing costs***—The total annual costs of any outsourced services related to processing of PR, WA, TA and H&W such as tax filing, paycheck printing, etc.

When all of these costs are included, large organizations (more than 1,000 employees) spend $1,403 combined PEPY on the four key functions surveyed and mid-size organizations (100–1,000 employees) spend $1,953 PEPY as shown in Figure 2.

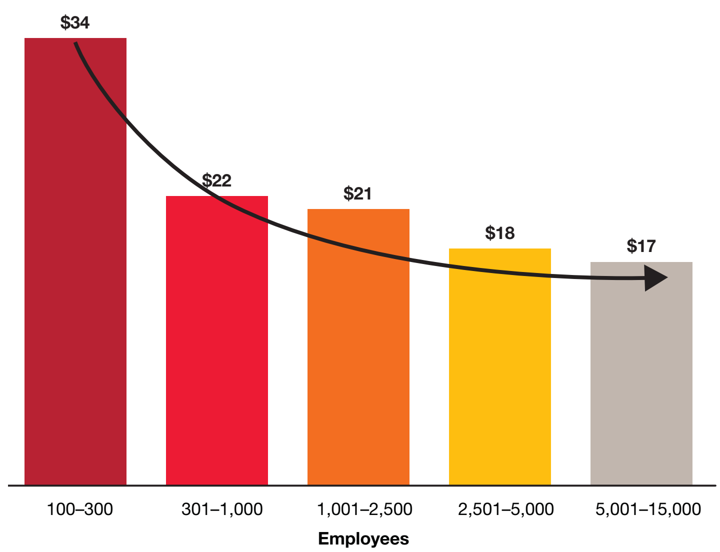
Figure 2. Average TCO per employee per year by function for organizations managing the process in-house



Economies of scale lead to a gradual shift in TCO

While we show two segments for organization size throughout this study, and the difference in results by segment can appear quite dramatic, we find that economies of scale within segments are generally more gradual. In centralized processes like PR and WA, we find that these economies occur quite smoothly. In more distributed processes like TA, however, they are not always as apparent.

Figure 3. In-house payroll TCO per paycheck by organization size



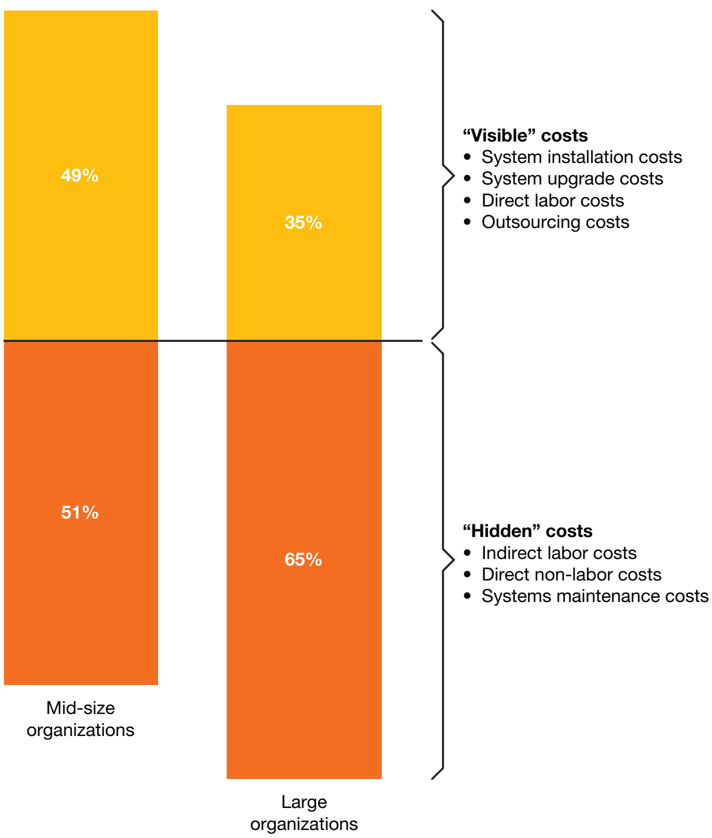
Note: The trend line depicts the gradual decline of TCO per paycheck as organization size increases.

It is no surprise that large organizations achieve greater economies of scale, and have lower TCOs per employee. With the amount of centralized labor required for these functions, larger organizations are better able to a) have an individual staff role support more employees; and b) develop specialization among staff roles to further drive efficiency. Systems spending results also demonstrate the impact of size, as systems costs can be spread over a greater number of employees.

Hidden costs account for more than 50% of the payroll TCO

When evaluating their current or potential future systems, most organizations fail to consider the significant costs beyond the direct labor needed to use the systems and the cost of the systems themselves. Overlooking these "hidden" costs could result in an underestimate of 50% or more as shown in Figure 4.

Figure 4. Breakdown of TCO by cost type



Hidden costs drive up the total TCO of these functions beyond what conventional wisdom generally suggests. The largest driver of TCO for PR, for instance, is labor costs, specifically indirect labor costs. The indirect time of employees to perform such tasks as approve and assemble submitted time for processing, distribute paychecks, and maintain the core PR system represents a substantial cost—nearly $10 per paycheck for both large and mid-size organizations.

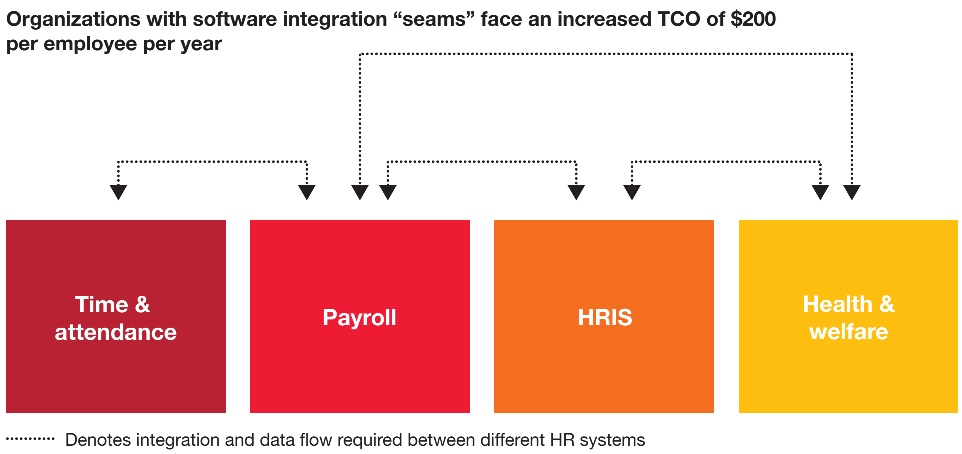
Analogous sets of hidden costs apply to the other processes we examined, including H&W, where business managers, HR professionals, plant managers, supervisors, and others are involved with activities such as enrollments, life event changes and plan support.

"Seams" costs

When viewed individually, each of the four processes contains unrecognized expense. But there is a bigger picture here, too, as the inefficient interaction between processes creates additional costs at the "seams." The administration functions covered in this study are interdependent and rely on one another to work. Seams costs refer to the activities organizations must undertake to provide integration between and among various processes, and occur when there is a need to implement a new interface or manually support or otherwise maintain the interaction between processes. We have differentiated these "seams" costs from "hidden" costs because seams costs refer to costs incurred from operating separate processes and systems within a single, interdependent business environment—and both have been captured in TCO.

The 2006 PwC study identified these "seams" and quantified their costs and found that, among the four processes we have studied, the average organization was spending approximately $100 per employee per year. The current study, which evaluated PR, WA, TA, and H&W functions simultaneously, suggested that organizations with seams experience higher costs—$200 per employee per year or more—to, among other things, get disparate systems working together.

Figure 5. Average cost of integrating core HR systems

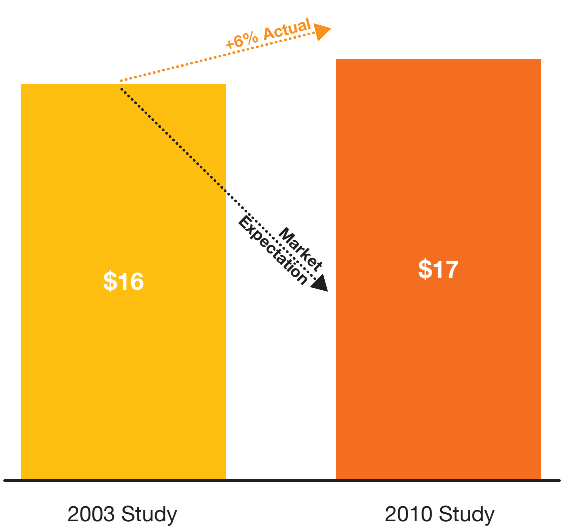


The TCO for payroll is actually increasing

Most would expect PR TCO to have dropped since 2003, the year of PwC's initial benchmark study. A focus on improved technology, new delivery models, department cutbacks, and other factors should have reduced PR TCO over the years.

But that has not happened. In fact, the TCO for PR has actually risen a full $1 per paycheck since 2003 for large organizations that use in-house solutions. The increases are primarily driven by the hidden costs described in the section above. TCO for mid-size organizations and functions beyond payroll was not measured in the initial 2003 study, so TCO trending for those segments cannot be included in this study.

Figure 6. Average TCO per paycheck in 2003 compared to 2010 for large organizations managing payroll in-house



Additional costs lurk in the mismatch of technology and business process

Because organizations have tight budgets and timeframes, they often implement technology improvements without taking into account the impact of technology on business process. Technology alone is viewed by many as the sole solution to cutting costs. However, by implementing or upgrading technology, whether in traditional or new technology models (such as Software-as-a-Service or SaaS), organizations will likely incur additional, unintended costs—such as manual activities to conform technology to existing processes, to accept customization within the organization, or to link the SaaS technology to existing technology within the enterprise.

It seems self-evident that organizations would seek to employ technology solutions that best support their business processes. But in reality it often does not work this way.

Many organizations have not matched their business processes with technology and thus cannot take full advantage of the applications available to them. The results of the study suggest that many organizations need to focus on process redesign when they decide to change software. Failure to do so drives both the hidden and seams costs described above.

Findings on Software-as-a-Service delivery models

Software-as-a-Service (SaaS) is a prominent delivery model that has gained momentum since we published our initial TCO study in 2003. This deployment model enables organizations to host applications as well as store and manage their data on remote, virtual servers, rather than on their in-house computers (premised-based model). Some software vendors now offer their solutions exclusively through a SaaS or on-demand model accessed via any Internet connection, while other vendors provide customers a choice of a SaaS or premise-based delivery model.

This study found that SaaS helps reduce costs for many organizations—but only to a point. It is clear that while SaaS can reduce a mid-size organization's total administration costs over a premise-based or traditional software model, organizations outsourcing process functions such as PR and H&W administration still demonstrate additional cost savings over organizations leveraging a SaaS model. Our analysis also showed that the benefits of SaaS models, when deployed without the added benefit of process outsourcing, taper off as organizations get larger and actually provided no TCO savings, on average, over on-premise software solutions for large organizations with more than 1,000 employees. These findings reinforce the discussion above regarding the importance of process transformation in conjunction with technology investment to reduce administration costs.

Outsourcing continues to deliver overall TCO advantages—using in-house payroll, workforce administration, time & attendance, and health & welfare solutions increases combined TCO by 18% on average

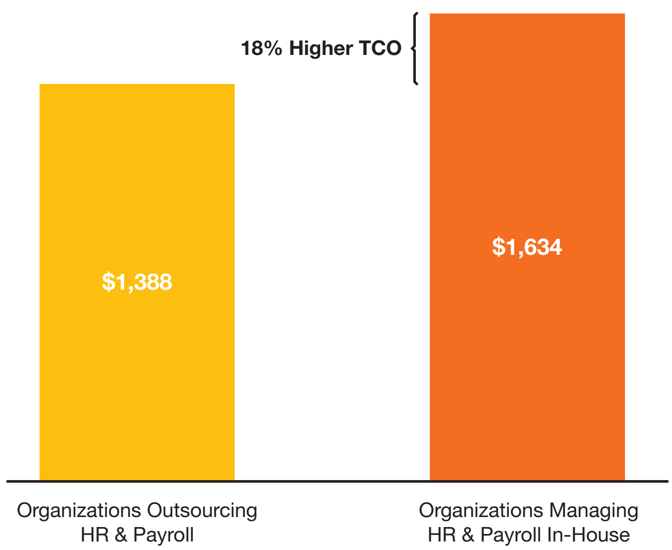
Consistent with the findings of our prior studies, the current study shows that outsourcing is a cost-effective way to administer these four functions. It is more cost effective than the various in-house solutions we reviewed. This study shows that organizations using in-house solutions for PR, WA, TA and H&W spend on average 9% more (for mid-size organizations 100–1,000 employees) and 27% more (for large organizations over 1,000 employees) than those that use outsourced solutions. Of course, costs for any individual organization depend on the specific circumstances of the functions outsourced and the organization's needs.

In our analysis, organizations that outsource experience lower direct non-labor costs, indirect labor costs, and system maintenance costs ("hidden" costs). These efficiencies are likely due to the strong process governance framework and increased process standardization that is typical in the outsourcing model.

Even allowing for economies of scale, where TCO drops as organizations are better able to spread labor and systems investments, large organizations that outsource core HR processes see an additional cost benefit when compared to in-house organizations.

Mid-size organizations that use outsourced solutions demonstrate a lower TCO across the comprehensive bundle of the four processes—PR/WA/TA/H&W—than organizations that use in-house solutions. Given the extensive bundling of solutions in this segment of the market, this comprehensive approach is the most accurate approach for cost analysis.

Figure 7. TCO (PEPY) comparison by method across all four functions

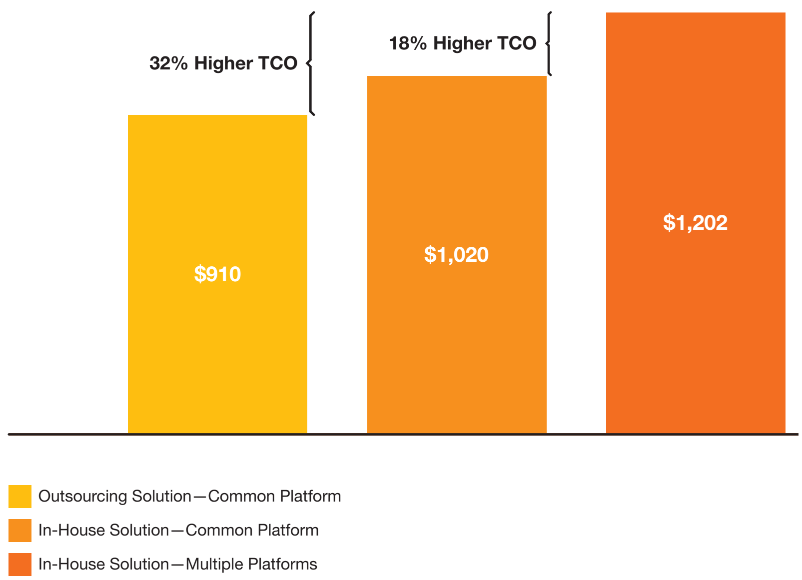


Utilizing a common vendor or solution to manage multiple functions delivers tangible cost efficiencies

For many years, the HR community has suspected that integrated PR, WA, TA and H&W functions cost less to administer than separate point solutions. The survey empirically confirmed that conventional wisdom. This applies both to in-house solutions, and, to an even stronger degree, to organizations that outsource multiple functions.

Unfortunately, for most organizations, common platforms remain a missed cost-savings opportunity. In fact, our analysis of the common platform approach could not look across all processes because there were simply not enough organizations with a common platform for all four processes. However, sufficient data is available to evaluate the impact of a common platform for three of the processes (PR, WA, and TA) as shown in Figure 8.

Figure 8. TCO (PEPY) comparison by platform type for payroll, workforce administration, and time & attendance



Additional cost efficiency from using a common platform provided by an outsourcer

As shown above, organizations using multiple in-house platforms experience a TCO that is 18% higher than organizations using a common in-house solution and 32% higher than organizations outsourcing these three functions to a single vendor.

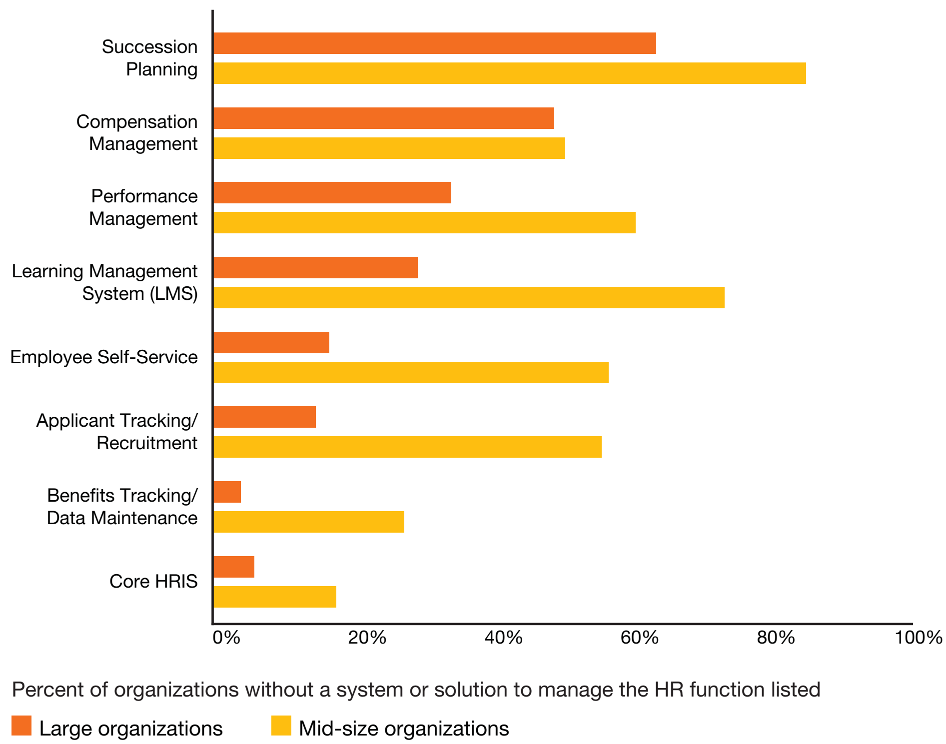
In large organizations, the impact was even more dramatic. In-house users on a common platform experience a 29% higher TCO compared to peers outsourcing the same functions to a single vendor.

Looking down the road

The need for seamless integration of payroll and HR administration functions will become even more acute in the coming years. As organizations add additional solutions to their mix for managing automated payroll and HR administration—such as recruiting, talent management, etc.—the lack of a common platform, and the resulting cost inefficiencies, is likely to increase.

Of the organizations participating in this study, more than half had no automated solution for performance management, compensation management, or learning management. In addition, more than eight in 10 had no automated solution for succession planning.

Figure 9. The lack of systems to manage key HR functions



If organizations continue down the path of pursuing best of breed strategies, they will continue to invest in a philosophy that produces hidden and seams costs.

Conclusion

Whatever solution an organization chooses, organizational design and process improvements—in conjunction with straight technology investments—will better address the hidden costs of HR management. Additionally, a comprehensive evaluation of the integration needs across payroll, workforce administration, time & attendance, and health & welfare benefits administration rather than individual process assessments, will allow organizations to identify interdependencies that can result in reduced costs for the overall solution. Better understanding of the sources and size of the hidden and seams costs in an organization, and addressing those process and technology options, will allow organizations to realize their objective of reducing TCO.