Exposing the hidden cost of Payroll and HR Administration
A total cost of ownership study

A PwC/ADP study

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ADP

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Executive overview

Do you know how much your organization is really spending on HR processing? You may not be considering "hidden" costs related to administering these important processes, and as a result, may be spending more than you think.

In this white paper, we'll identify:

- The different cost drivers of payroll, time & attendance, HR data administration and health & benefits.

- Strategies that allow some organizations to more cost-effectively deliver these functions.

PwC Canada was commissioned by ADP Canada Co. to study and shed light on these costs. Our key finding is that outsourcing leads to cost efficiencies. We have found that organizations underestimate the true expense (the "total cost of ownership," or TCO) of processing and managing payroll, time & attendance, HR data administration and health & benefits.

Many organizations identify costs that are easily recognizable, such as processing staff and technology acquisition costs, but fail to recognize "hidden" costs necessary for operating and integrating these interdependent processes. Additionally, organizations often use separate technology and process solutions to administer each function without considering how those solutions work with each other. This fragmentation drives up administration costs through task overlap and after-the-fact technology integration.

Contributors to a higher TCO

Here is a summary of the top cost-reduction strategies uncovered through this study, as measured by overall TCO:

Outsourcing
Organizations that outsource the management of payroll, time & attendance, HR data administration, and health & benefits, spend on average 27% less than those that deliver these functions using a manual approach.

Using a single vendor strategy
Organizations outsourcing payroll and time & attendance to a single provider spend 43% less on average than those administering these functions in-house.

Seams cost
There is a cost associated with the activities organizations must undertake to integrate various HR business processes. Companies that outsource payroll, while employing other methods to deliver time and attendance and HR data administration, spend on average 21% more than companies that outsource all three processes to a single vendor.

Hidden costs
Costs such as indirect labour and system maintenance are often overlooked. These hidden costs can represent more than 50% of TCO.

This study demonstrates the importance of managing HR service delivery strategically. It starts with the decision making process. The true total cost of ownership will only be apparent when looking across HR processes, rather than focusing on a single process in isolation. A holistic approach that accounts for people, process and technology will enable organizations to make sound decisions on their HR service delivery strategy, ultimately resulting in lower overall TCO.

Methodology

This research study is based on data collected from 125 participating organizations, ranging in size from 50 employees to more than 5,000 employees. We believe this to be one of the largest and most comprehensive studies of its kind ever conducted in Canada.

The goal of this study is to measure the Total Cost of Ownership (TCO) of four core business functions—payroll (PR), time & attendance (TA), HR data administration (HA) and health & benefits administration (H&B)—and to analyze the key factors impacting the cost of these business functions. Since this study focused only on TCO, variability of service levels were not taken into account.

A confidential, web-based questionnaire was used to gather data for this assessment. Senior financial and HR executives (i.e. CFOs, VPs of HR, VPs of Finance, Directors of Payroll and Controllers) were invited to participate. If an organization had multiple respondents, we created a single consistent response. Over-the-phone support was provided on request for anyone who needed help to complete the questionnaire.

PwC also conducted multiple follow-up calls with respondents to verify, clean and complete data. This approach allowed PwC to gather and calculate total cost of ownership in a consistent fashion and laid the foundation for the comparative analysis captured in this report.

Profile of participants

A total of 125 organizations participated in this study.

Due to the economies of scale that usually exist in larger organizations (which are discussed within this study), it was important to differentiate between mid-size and large organizations.

The term "outsourcing" in this paper specifically refers to outsourcing to ADP. ADP clients were surveyed to measure the TCO of organizations outsourcing payroll, time & attendance, HR data administration and health & benefits. The study did not evaluate, and 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 service providers.

The organizations surveyed use a wide range of platforms and solutions. Many in-house clients operate these processes manually.

All participating organizations are Canadian companies or subsidiaries within 18 industry categories. The most prevalent industries were manufacturing (21%), healthcare and social assistance (10%), and wholesale trade (8%).

This white paper has been researched and prepared by PwC; PwC is the sole author of this white paper. ADP is the sponsor of the TCO study, which PwC conducted in order to prepare this white paper.

The data

The following four processes were the focus of this study:

Payroll (PR): The process of collecting and entering data related to employee hours worked, determining taxation, calculating gross and net pay, distributing compensation, and responding to employee questions regarding payroll.

Time & attendance (TA): The process of scheduling, collecting, reviewing, submitting and approving time reporting data, including employee hours worked, paid time off (vacation, illness, holidays) and leave balances.

HR data administration (HA): 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 for payroll, new hire reporting, health & benefits administration, back-end reporting, and other HR activities.

Health & benefits administration (H&B): The administration of employee H&B programs including: managing enrolment, terminations, payment generation and reconciliation, and status change maintenance.

Respondents were asked to answer questions that quantified all one-time and ongoing costs for the areas of PR/TA/HA/H&B administration. The costs were broken down into three broad categories: technology implementation and upgrade; processing; and technology maintenance. Each cost component was defined in the survey and referenced during phone interviews to capture data in a standard fashion. PwC contacted participants directly when data fell outside the normal range of responses and normalized data where necessary.

Key findings and recommended strategies to reduce administration costs

Five key findings surfaced related to the cost of administering payroll, time & attendance, HR data and health & benefits.

Reduced per paycheque expenditure

Outsourcing delivers a reduction in spend on a per paycheque basis. Organizations that outsource payroll spend on average 30% less per paycheque than those that use in-house solutions.

Integrating functions such as payroll and time & attendance can lead to financial benefits

Organizations that use a single outsourced service provider to integrate payroll and time & attendance spend on average 43% less versus a manual approach or one that is not integrated.

Outsourcing multiple functions delivers cost efficiencies

Organizations outsourcing, payroll, time & attendance, HR data administration, and health & benefits spend on average 27% less than those that use an in-house approach.

Employing a single vendor strategy delivers overall TCO advantages through the avoidance of seams costs

Companies that outsource payroll, while employing other methods to deliver time and attendance and HR data administration, spend on average 21% more than companies that outsource all three processes to a single vendor.

In-house technology implementation costs increase TCO

On average, companies that employ an in-house payroll system spend three times more on initial implementation than those that outsource.

We'll explore in the paper how different service delivery models and software options can have a material impact on technology upgrade and installation costs of in-house software.

We'll also explore each of these findings and their implications for organizations.

In-house administration of payroll, time & attendance, HR data and health & benefits requires a surprisingly large commitment of time and resources.

This study showed that many organizations may be unaware of the true expense of administering the PR, TA, HA and H&B functions, primarily because some costs are not visible.

Tracking total costs, especially across functions, is difficult because related functions are often "owned" by different departments in the organization (finance, HR, IT). Accordingly, many organizations make decisions about technology and sourcing that work best for an individual function but don't take into account the potential synergies and savings that would be achieved with an enterprise-wide solution.

A complete cost analysis should consider:

System installation costs
The one-time costs related to the initial acquisition and implementation of an organization's PR, TA, HA, and H&B systems.

System upgrade costs
The periodic acquisition and implementation costs related to upgrading to a more current version of the PR, TA, HA, and H&B systems.

Direct labour costs
The cost of labour (salary plus benefits) of the direct staff necessary to support the PR, TA, HA, and H&B functions.

Direct non-labour costs
The total costs of consultants, vendor fees and facilities, general and administrative expense (G&A), and corporate overhead related to the PR, TA, HA, and H&B functions.

Indirect labour costs
Cost of labour for employees who are not directly related to the payroll and HR departments, but support these functions in the field (i.e., collecting, approving and preparing employee hours for payroll; distributing paycheques; answering employee questions about benefits, etc.).

Outsourcing costs
The total annual costs of any outsourced services related to processing of PR, TA, HA, and H&B, such as tax filing, paycheque printing, etc.
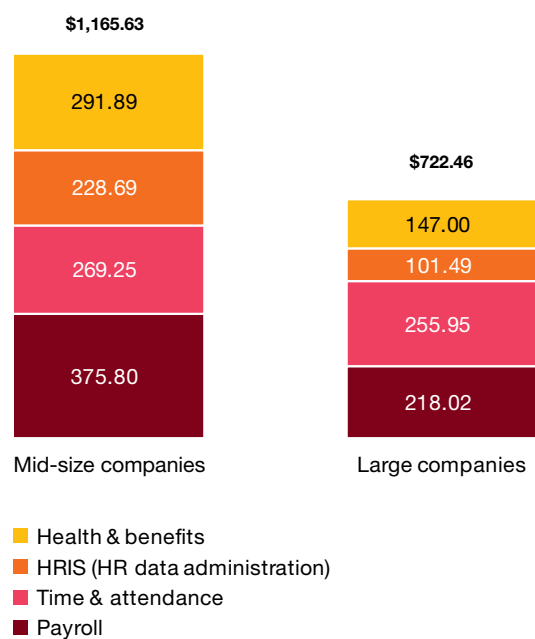
System maintenance costs
The IT costs (labour and non-labour) specifically related to maintaining the HR systems.

Economies of scale result in a lower TCO.

Figure 1 shows that when all costs associated with the four key functions are taken into consideration, large organizations (more than 700 employees) spend on average $722.46 per employee per year (PEPY), and mid-size organizations (50-700 employees) spend $1165.63 PEPY.

Figure 1: TCO PEPY by function

$1,165.63

291.89	
228.69	
269.25	
375.80	

Mid-size companies

$722.46

147.00
101.49
255.95
218.02

Large companies

■ Health & benefits
■ HRIS (HR data administration)
■ Time & attendance
■ Payroll

Do large organizations achieve greater economies of scale and experience lower TCO per employee?

Yes—it is no surprise that larger organizations have a lower average TCO per employee. Economies of scale are particularly evident when considering the relative labour cost required to deliver the processes reviewed in this study. Smaller organizations have fewer, typically more senior resources that are responsible for business processes covered in this study. Larger organizations will generally employ a larger number of entry level staff to run these processes. Mid-size organizations also tend to have less automated processes in place. As you will see later in the white paper, the adoption of outsourcing and software as a service technology by mid-size companies is anticipated to close the 'automation gap' noted here.

We observed that larger organizations tended to be more automated because they have the scale to justify the investment required to move away from manual processes. That said, larger organizations still realize TCO savings across the functions in the study for the reasons we outline later (process improvements, elimination of seams costs, etc.) despite the benefit of economies of scale.

Hidden costs

Organizations often fail to consider several key cost components when developing a business case to assess a process or function for outsourcing. The resulting effect is that the business case is understated and incomplete. This error was frequently observed during the course of this study.

At the outset, TCO survey participants would only provide those costs that were top of mind (i.e. visible costs), such as system installation and direct labour cost. However, after several follow-up discussions, hidden costs such as indirect labour and system maintenance cost were uncovered. As shown in the diagram, hidden costs can represent more than half of the TCO for a given process.

Intuitively this makes sense. For example, when HR managers estimate system maintenance cost, they need to first consider all of the relevant systems used by their staff. Next, the manager needs to identify a contact in IT, who, in turn, has to source the contract that contains the system maintenance cost. Finally, that manager has to allocate a percentage of the total maintenance cost to the process under review, a necessary step as most systems support many different processes. With so many stakeholders and business systems, it's not surprising that many organizations omit critical costs and hence are underestimating their TCO.

Inaccurately completing TCO can also be misleading. On average, visible costs represent a higher percentage of TCO for organizations that have outsourced. As a result, if an organization considering human resources outsourcing was to complete their TCO without consideration for hidden costs, their TCO would be overstated (Figure 2).

Figure 2: Breakdown of TCO by cost type

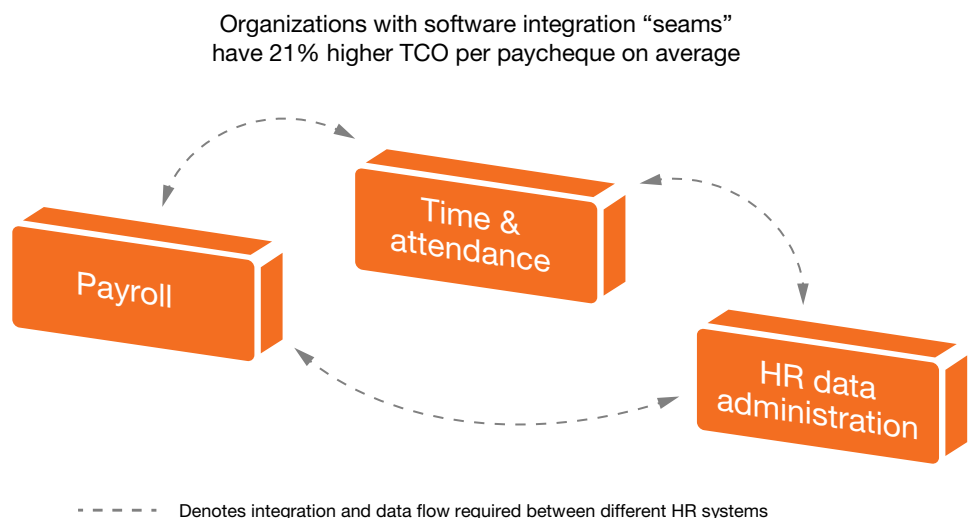37% — Visible costs

63% — Hidden costs
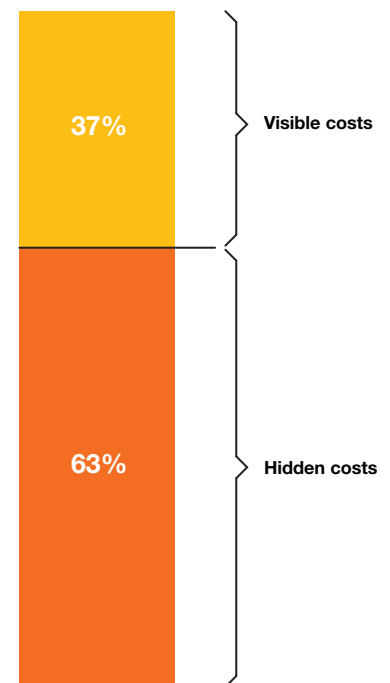
Seams costs

Business decisions around service delivery and technology strategy are often made for a single process or function without consideration of the bigger picture. The end product is a series of disconnected processes that require manual intervention or technology integration, resulting in additional costs that are defined within this report as "seams costs".

Organizations are usually unable to see the technology costs associated with integrating systems that would otherwise stand alone. What are also often missed are the changes in direct labour cost, especially if a manual workaround is employed to close a technology gap.

This study found that while seams costs exist in many HR departments, these costs are largely absent in companies that have outsourced payroll, time & attendance and HRIS to a single provider. This explains why they spend on average 21% less than companies that take a 'best of breed' approach (Figure 3).

Figure 3: Average cost of integrating core HR systems

Organizations with software integration "seams"
have 21% higher TCO per paycheque on average

Payroll

Time & attendance

HR data administration

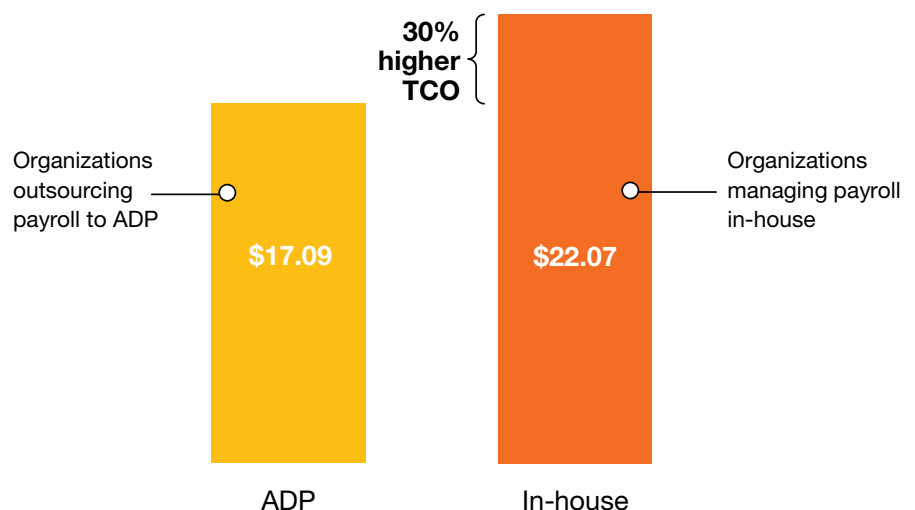- - - - - Denotes integration and data flow required between different HR systems

Outsourcing results in lower TCO.

Organizations that outsource payroll spend on average 30% less per paycheque compared to those that use in-house solutions (Figure 4).

Furthermore, organizations that outsource multiple functions also realize savings. This study shows that organizations delivering payroll, time & attendance, and HR data administration in-house, spend on average 20% more than those that outsource these functions. The spend variance demonstrated here aligns with our previous conclusion around "seams costs"—there are benefits to managing multiple HR processes with a single provider.

In Canada, it is common for the insurer to provide the technology required to offer health and benefits coverage. As a result, this study only identified a few clients that delivered payroll, time and attendance, HR data administration and health and benefits using a common system or service provider. In the Canadian market, traditional HR service providers, such as ADP, are developing their offerings in the health and benefits space. As a result, we anticipate that organizations will move toward integration of these four functions to achieve further savings. Presently, organizations that outsource payroll, time and attendance and HR data administration to ADP, along with health and benefits to an insurance provider, spend 27% less than those that do not outsource.

Figure 4: Average payroll function TCO per paycheque

30% higher TCO

Organizations outsourcing payroll to ADP ——○

$17.09

○—— Organizations managing payroll in-house
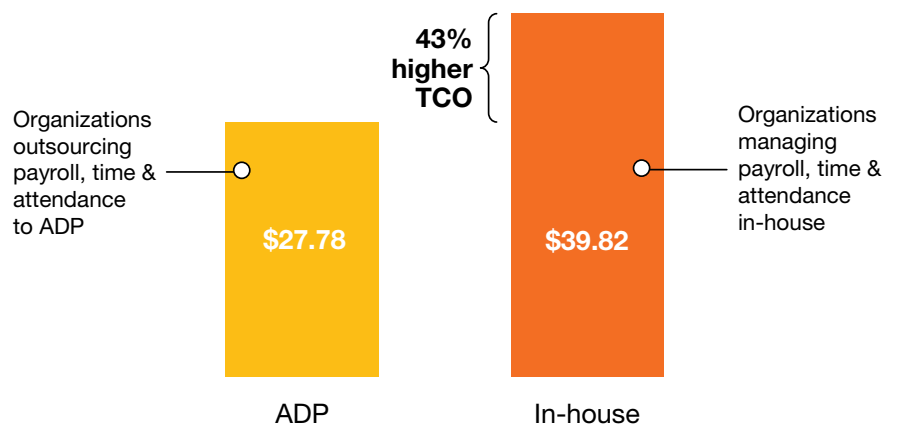
$22.07

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In-house

Integrating functions such as payroll and time & attendance leads to financial benefits.

There are benefits associated with integrating payroll and time & attendance. Why? If time is captured on paper or using some other system, human intervention is often required before the time data can be used to run payroll. This human intervention increases the risk of error. For example, if time is captured on paper, a simple data entry error can result in a pay discrepancy. If the error is uncovered an adjustment will be necessary, which will involve yet further human intervention.

Organizations also run the risk of alienating employees that are negatively affected by these pay discrepancies.

The savings driven by integration were particularly evident in this study. Organizations that use a single outsourced service provider to integrate payroll and time & attendance spend on average 43% less than a manual approach or one that is not integrated (Figure 5).

Figure 5: TCO (per paycheque) comparison by method across payroll and time & attendance

Organizations outsourcing payroll, time & attendance to ADP

43% higher TCO

$27.78

$39.82

Organizations managing payroll, time & attendance in-house

ADP

In-house

We anticipate the adoption of SaaS technology will grow in Canada, driven in part by lower TCO.

PwC's industry analysis suggests that HR-related technology adoption in Canada is lagging behind the U.S. market. The results of this study confirmed that. This is particularly evident in the HR data administration function where, overwhelmingly, respondents either use ADP's Software as a Service (SaaS) offering or operate this function manually. Our research indicates that Canadian companies are either staying with an inefficient manual approach to HR data administration or they are looking to adopt a next generation SaaS approach, effectively "leap-frogging" over a traditional in-house software implementation.

The key reason for this is that there are costs associated with customizing, implementing and maintaining an HRIS software solution. The investment is particularly difficult to justify in Canada as the average company lacks the economies of scale needed to justify the expenditure. However, the emergence of SaaS solutions from providers such as ADP is providing Canadian companies with a way to access the capabilities provided by an HR information system without incurring the costs traditionally associated with implementing and maintaining an HR information system.

The survey revealed that approximately 40% of ADP clients currently use the ADP HRIS as a service package. In comparison, 10% of ADP clients use a commercial off-the-shelf HRIS package. The results of this study confirmed the value of employing an ADP solution, as respondents that installed and maintained HRIS in-house spend 19% more on average than those that outsource to ADP.

In the coming years, we expect HRIS as a service adoption in Canada to increase, which will further result in better solutions and pricing for customers. We expect companies operating HR data administration manually to move towards SaaS solutions, in part, because they will not be able to justify the investment required to procure and maintain an in-house software solution. In addition, efficiencies are realized through the outsourcing of the domain, regulatory and process expertise to third-party vendors like ADP who possess an outsourcing service model that delivers this expertise and support back to their clients.

Companies that outsource spend three times less on implementation.

To automate payroll, for example, an investment is normally required. There are two broad approaches to automate: (1) outsource services to a third-party that provides technology to automate the process and a strong service model to support it; (2) implement a technology solution in-house. Notably, on average, respondents that outsource payroll (i.e. option #1) spent three times less on implementation than those that implement an in-house technology solution. The outsourced service provider is able to offer a lower implementation cost for two key reasons:

Less customization

The outsourced service provider has control over the technology and process. They build their technology to enable their process and optimize service delivery. When an organization implements a commercial off-the-shelf solution, costly customization is often required to meet 'unique' business requirements.

Lower costs

For companies like ADP that specialize in delivering payroll services, the cost associated with developing the payroll technology portion of their offer is spread across a broad base of customers. This drives the overall cost down on average.

In addition to cost savings, it is important to look at the longevity of a SaaS solution.

Organizations stay with an outsourcing provider's SaaS technology longer than the alternatives.

Long periods of customer retention suggest that the outsourcing model is here to stay. The average payroll customer employing an outsourced SaaS-based solution had been with the same provider for about 10 years. In comparison, the average customer employing an in-house payroll solution had only been using the same solution for six years. A primary reason for this difference can be linked to upgrade costs.

In the outsourcing model, the provider is responsible for maintaining and upgrading their products and staying on top of legislative changes, regulatory requirements and compliance elements that would otherwise fall to the individuals in an in-house scenario. This process is largely seamless to the customer and generally does not involve periodic upgrade surcharges because of the SaaS one-to-many deployment

model. For companies that have employed a commercial off-the-shelf solution, upgrades can be a headache. First, in order to receive the upgrade, the provider will request a one-time charge. In many cases, third-party consultants are also needed to manage the upgrade installation process, resulting in yet further cost. Finally, many years after the original installation, the provider may cease to support the product, which will necessitate investment in another solution altogether. ADP solutions allow companies to avoid all of these problems and leverage its domain expertise in the areas of payroll, HR data administration, time & attendance and benefits management services.

As companies review their system investments both past and future, we expect to see a further shift towards outsourced SaaS offerings in the market.

Conclusion

This study demonstrates the importance of managing HR service delivery strategically. It starts with the decision-making process. The true total cost of ownership will only be apparent when looking across HR processes, rather than focusing on a single process in isolation. Organizations that fail to do so will underestimate the 'seams cost' associated with integrating their various HR processes. These same organizations often omit 'hidden costs', such as system maintenance, which may ultimately lead an organization down to an inaccurate TCO conclusion. A holistic approach that accounts for people, process and technology will enable organizations to make sound decisions on their HR service delivery strategy, ultimately resulting in lower overall TCO.