Balancing Cost and Service Quality in Payroll

How new practices, internet software and a taste for the unconventional can help organisations cut costs and sustain service quality

By Keith Rodgers
Webster Buchanan Research, March 2009

WEBSTER BUCHANAN RESEARCH

www.websterb.com

Published in association with Computers in Personnel

Computers In Personnel

www.ComputersinPersonnelHR.com

Contents

Disclaimer and Copyright Notice

Executive Summary

With payroll departments under relentless pressure to cut costs and improve efficiency, this Briefing Paper examines what options are open to organisations looking to make both short-term and long-term improvements. Focusing on the difficult balance between reducing costs and maintaining service quality, it argues that organisations should weigh up a combination of strategic and tactical steps. In particular, the Paper argues that:

- Tackling the cost versus service quality argument may require HR and payroll managers to challenge traditional assumptions, from their quality objectives to the metrics they use to measure performance. While goals relating to timeliness and compliance are effectively immoveable, some organisations striving for 'world-class' performance may benefit from accepting a marginally lower level of service quality (perhaps 'industry standard') in return for lower costs
- There are a number of ways to reduce costs while maintaining (or even improving) service quality, ranging from sharpening up the quality of payroll data input to reducing the volume of one-to-one interactions with employees. In some cases the change management process may require more emphasis on the 'stick' than the 'carrot'
- In order to drive down costs, organisations are advised to assess the business case for investing in IT tools and services that automate manual tasks, help streamline processes and reduce people-dependent interactions. At a time when both funds and IT resource are limited, the business case for investment needs to be compelling and is likely to incorporate additional factors beyond cost, such as risk reduction
- HR and payroll managers should look broadly at their software and service options, and not be afraid of weighing up HR and payroll self-service – which can cut payroll administrative overhead and reduce employee inquiries – as well as newer, low-cost internet-based collaboration and communication tools
- Every assessment of payroll efficiency should include a detailed cost/benefit analysis of running payroll on-premise, versus shifting to outsourced services. Keeping in mind the danger of making comparisons based on distorted data, organisations need to carry out a comprehensive assessment of all the relevant cost components, including indirect costs that they may not immediately think to bring into the equation
- The outsourcing market is broad, and there are a number of different types of outsourcing service. They range from tactical outsourcing of tasks such as pay slip printing to full-blown business process outsourcing, where the bulk of the payroll function is handed over to a third party

Introduction

Compared to its peers in HR and finance, payroll has found itself in the media spotlight less frequently over the last two decades as organisations have pushed for 'transformational' change. Through the 1990s, finance directors found themselves under pressure to move away from their traditional transactional duties, improve the quality of information they deliver to senior management and develop more of an advisory role. Likewise, HR has long been urged to take on a more 'strategic' role, by automating or outsourcing its administrative responsibilities and refocusing its efforts on Human Capital Management, helping organisations acquire, retain, manage and leverage top talent.

Payroll, by contrast, has typically been perceived as a tactical rather than strategic function – highly-valued for the critical role it plays in a complicated and pressured environment, but primarily acknowledged for its execution capabilities. Its focus continues to be on core requirements such as paying employees on time, meeting its compliance targets, achieving acceptable levels of accuracy, keeping to budget and getting reasonable satisfaction ratings from employees.

That's not to say, however, that payroll experiences less severe pressure than other business functions. Many payroll operations have been through dramatic change over recent years, shifting to shared services operations, automating manual processes, outsourcing core activities and dealing with reorganisations, mergers and acquisitions, and significant swings in headcount. Finance and HR functions may have grabbed more of the headlines as they make the journey from administrative support to strategic partner – but payroll is grappling with similarly significant challenges.

In a highly-pressured economic environment, where organisations are striving to cut costs across the board, the pressure on payroll will only grow. This Briefing Paper explores some of the options open to HR, Payroll and Finance managers as they confront that challenge. Some areas of focus are well-versed yet merit revisiting – including analysing the business case for running payroll on-premise versus adopting some form of outsourced service – while others may involve different ways of working and in some cases, adoption of unconventional technologies. The challenge payroll faces is to retain an acceptable quality of service while capping or reducing costs – and to do so, it needs to confront some of its challenges in new ways.

Part 1: Cost, Efficiency and Payroll Quality

1.1 Fine-tuning the cost versus quality equation

For a profession that already labours under the strain of being targeted to achieve near-perfection, performing difficult balancing acts is nothing new in payroll. On the one hand, it strives to deliver 100% accuracy, 100% timeliness, 100% compliance and high-quality employee service. On the other, it attempts to do so within tough budget constraints. Most payroll functions could achieve their goals with unlimited spending: but in the real world, with expenditure capped, compromises inevitably have to be made. Since compliance with statutory requirements and 100% timeliness remain hard and fast objectives, the give and take typically comes in terms of accuracy and quality of employee service.

Payroll tends to be targeted on what's agreed to be a reasonable level of quality, often measured against previous years' performance and external benchmarks. But with costs under rigorous scrutiny, some of the assumptions payroll has worked with in recent years are starting to be tested again. Without significant change in the way it operates, as costs are cut, service delivery will inevitably be impacted. To redress the balance, payroll needs to weigh up three important issues:

- Are existing service objectives still relevant and desirable?
- Are objectives and performance being measured in a meaningful way?
- Are there different ways that payroll could deliver the same (or better) quality of service for a lower price?

The first two issues revolve around performance measurement, where it's important to differentiate between world-class performance and industry standard – and just as important, to ask whether world-class is always the most appropriate goal. Is it acceptable, for example, for payroll to accommodate the possibility of a marginally higher level of errors – particularly errors with lower monetary value – in return for lower costs? Total accuracy may be desirable in theory, but in practice, mid-sized and large organisations will inevitably experience some level of errors, whether they're created by payroll or the business. The issue is, how much resource should be committed to eradicating them pre-payment?

This is not about breaking business models that work: in organisations where payroll is processed with world-class levels of accuracy and at a cost that's acceptable to the business, it would be illogical to compromise on quality. But if the costs are too high – for example, if there's a lot of manual work involved within the payroll department – then there may be a trade-off in switching from world-class performance to industry standard in return for cost reductions, if only as an interim measure while the automation options are weighed up. Likewise, in an organisation where accuracy levels are still unacceptably low, the cost of striving for world-class performance may be prohibitive, and industry standard may be a more realistic target.

The same principles apply to employee service. While in theory it's desirable to provide the highest quality service to employees, with instant telephone response and large qualified teams dedicated to rapidly resolving complex queries – in practice, is top-quality service necessary? It may be irritating for employees to have to wait slightly longer for their queries to be tackled. But unlike a consumer service environment, where speed of response can be critical for customer acquisition and retention, keeping employees on hold is hardly likely to prompt them to hand in their notice or trigger workforce protests. This is particularly true if they have other ways of answering their queries, such as by email or over the web (*See Part Two*).

Secondly, in any analysis of payroll performance it's important to ensure that payroll is comparing like with like. HR and payroll have long relied on benchmarks, both internal and external, to assess their performance. But on their own, bald comparisons of numbers can be misleading without some reference to the contextual factors that influence performance.

A good example is the FTE ratio, a standard payroll metric that compares the number of payroll team members against the number of employees they serve. When Webster Buchanan Research carried out a qualitative research study among multinationals last summer, we found huge variances in these ratios – ranging from 1:200 to 1:1000 in Europe, and going even higher in some US operations. But these variances have to be interpreted with care. While an organisation with a 1:1000 ratio is clearly more efficient than one with a 1:200 ratio, it isn't necessarily five times better.

Working with leading payroll practitioners, Webster Buchanan Research has identified nine different contextual factors that impact performance, from the size of the employee base to the nature of each payroll function's specific work. The findings form part of *Webster Buchanan's Payroll Performance Scorecard*, a set of tools designed to help Payroll, HR and finance managers and other senior executives measure payroll efficiency and effectiveness.[1]

[1] See 'Webster Buchanan's Payroll Performance Scorecard, A toolset for measuring single country and multi-country payroll performance', available for free download at www.websterb.com/payrollstrategist

1.2 Improving payroll efficiency

Even if service quality goals are marginally reduced, the biggest focus within payroll will remain on improving efficiencies and cutting costs. Key areas to consider include:

Improving data collection and data management Much time is spent in payroll tackling errors pre- and post-payment, and in many cases the problems stem from poor quality information supplied by the business. Inaccuracy also impacts cost (because of the resource required to rectify errors) and quality of service. Late delivery of pay data also increases costs, particularly in the form of late processing fees charged by outsourcers.

Potential investments to improve the quality of data input include:

- ***Automating time data collection*** - for example, by implementing Time and Attendance Systems for hourly-paid employees, or time tracking systems for hourly-charging employees
- Repositioning the HR management system as the single ***central source of truth*** for payroll information. Organisations that consolidate all of their different HR activities in one database, from recruitment to absence management, avoid data duplication and data replication errors, and can generate a single employee record. The cleaner the data is in an HR system, generally the lower the cost of managing it for payroll
- Improving the ***quality of data transfer*** from HR and T&A systems to payroll, and from payroll to the GL, both of which reduce the level of manual intervention and cut data errors. The HR-payroll data flow can be improved by running HR and payroll on the same software platform, or by building an automated interface between systems or services provided by different 'best-of-breed' suppliers. Many vendors offer pre-built interfaces to third party systems to speed up integration.

Reducing the volume of one-to-one interactions between employees and payroll. This can be done through investment in established technologies such as internet-based HR/Payroll self-service, as well as newer tools such as blogs and wikis (*see Part Two*).

Automation of time-consuming manual processes, which reduces payroll administrative overhead. This can be done on a targeted basis or through a comprehensive review of payroll operations – the latter usually preceding implementation of a new payroll system.

Consolidation of payroll operations This applies to organisations that run multiple payroll set-ups in one or more countries and choose to consolidate in a shared services centre, either purely for payroll processing or in a multifunction operation. In the public sector, some organisations have also teamed up to provide support services across multiple authorities.

Reducing IT system support costs The cost of system support should be assessed during the software selection process, given that some systems are more expensive than others to support. Alternatively, it may be a factor in decisions about IT outsourcing.

Outsourcing some or all activities (*see Part Three*)

Some of these changes are relatively cheap to implement, although they may require significant changes in payroll working practices. Others will require investment in software and services. While securing investment may well be challenging, a case can often be made around cost savings, supplemented by other high-priority issues such as risk reduction or improving management information (*see Part 1.3*).

It’s also worth noting that there are ways to defray the upfront cost that has traditionally been associated with implementing business software. Some suppliers now offer on-premise systems through subscription-based arrangements, spreading the cost of the initial licence and implementation fees over an extended period. Alternatively, as we explain in Part Three, outsourcing through hosted services or managed services arrangements presents an opportunity to shift from a traditional software ownership model to regular ongoing fees, which again reduces the upfront capital investment.

1.3 Beyond cost: other drivers for change

While cost is a key business factor in any analysis of payroll efficiency, it’s only one driver for change. Other factors that may support a business case for investment in change include:

Risk reduction As an operational necessity rather than a revenue-generating activity, payroll tends to get pushed down the pecking order when investment programmes are prioritised. The risk factors, however, are significant. Fraud is a particular concern, particularly in tougher economic times when individual employees may be under greater personal financial pressure. In environments where management has limited visibility into payroll activity, there may be a strong case for action.

Similarly, the risk of major or catastrophic payroll problems – non-payment, mass errors or regulatory compliance failures – is higher when organisations rely on older systems, home-grown spreadsheets and manual processes. There are also business continuity risks – how easy is it to get your home-grown systems back up and running after a disaster? – and data privacy risks if information is stored insecurely or transmitted unencrypted on disk. In addition, many payroll set-ups depend on the knowledge of one or a handful of individuals, which can endanger the organisation if employees fall sick or quit.

Improved quality of service On their own, small incremental improvements in the quality of service delivered to employees are unlikely to sway an investment decision, unless the existing payroll service is particularly weak and is causing disruption. However, it may be possible to demonstrate that improved accuracy helps increase productivity (by minimising the amount of time spent by employees and payroll in resolving errors) or through the introduction of self-service, which reduces employees' interactions with the payroll function during work hours (*see Part Two*).

Better management information Good quality standard reports, the ability to generate reports on-demand and visibility into data are all key criteria for effective payroll management.

Part 2: Internet-based Data Management and Communications

2.1 Internet-based services

Regardless of its size, every payroll operation can learn lessons from customer-facing service industries, where organisations have strived for years to balance the conflicting demands of high-quality customer service with the need to cap costs. Long recognising that one of the biggest overheads in the service environment is people, the aim has been to reduce the volume of one-to-one interactions that take place between call centre agents (or other service staff) and customers. In particular, the focus has been on automating high-volume, low-value interactions – which in a consumer environment may mean reducing the number of telephone calls about store opening hours, for example, or basic product support calls.

Over the years, customer-facing service centres have experimented with numerous initiatives to better balance the cost-quality equation, most of them internet-based. They include:

- Putting **frequently-asked questions** (FAQs) onto their corporate website, so that customers can find out basic information for themselves
- Running **tutorials** on the internet so that customers can walk through support queries unaided
- Using **Interactive Voice Response** (IVR) to filter enquiries and encourage customers to use the web. Although widely disliked by consumers, the negative impact of an IVR system can be mitigated if there is an easy route to reach a live agent
- Encouraging customers to **email enquiries** rather than telephone. Email is more efficient because agents can choose when to respond and do so during quieter periods
- Using live **web chat**, where customers 'talk' live to an agent using instant messaging. One advantage of this approach is that agents can typically handle more than one enquiry at a time, and some of their responses can be templated

Many of these customer-centric tactics can be adapted for inward-facing employee service environments, whether it's a large shared service centre or a small administration department. Encouraging employees to make contact by email rather than telephone is one easy option. It allows payroll teams to manage their workloads more productively and avoid the constant switching from task to task that characterises communications overload, although some payroll employees may need training to cater for the fact that 'tone of voice' in emails can be easily misinterpreted.

Likewise, putting HR and Payroll FAQs on a company intranet is a relatively easy way of reducing the volume of calls about basic issues, and also a useful way to inform employees about changes to rules or procedures. This is more than simply about saving costs: providing a central pool of information means that employees can find the information they want, when they choose. It's important to keep in mind that many employees will instinctively reach for the phone to deal with emotive topics such as pay, so encouraging them to make the transition to the web may require more 'stick' than 'carrot' – for example, payroll might declare itself closed to telephone queries during certain hours of the day.

2.2 HR and payroll self-service

Many organisations are now starting to expand on this principle of 'self-service' by providing pay information online. Distributing electronic pay slips rather than paper is a cost-effective way of reducing printing and distribution costs, but it serves a further purpose. By making pay information available online, organisations can build up a confidential electronic pay history for each employee which can be accessed securely over the internet, at a time of their choosing. Again, this also has the effect of reducing the volume of basic information requests.

While self-service may be relatively new to the payroll function, it's becoming increasingly well-established in the HR sector[2]. At a basic level, HR self-service allows employees to input their own personal data (such as home address and bank account details) directly into the HR system, cutting HR administrative overhead and reducing the potential for errors through rekeying. It also offers a range of informational services, allowing employees to check their outstanding vacation days, for example, or view their benefit entitlements. In addition, many services are now interactive. Employees can view and sign up for training courses online, for example, directing a request to their manager for approval through pre-defined workflows: similarly, managers can record information relating to performance reviews and set-up reminders for follow-up actions. HR self-service now even extends outside the organisation, with some organisations enabling external candidates to track the progress of their job applications online.

While early pilots of HR self-service initially ran into some resistance – in part because of a belief that HR was attempting to push its administrative workload onto employees – experience has shown that it typically enhances the employee experience by improving access to information. Concerns that employees who don't have internet access at work or home will be 'disenfranchised' have also largely been resolved, with many organisations

[2] See 'Beyond efficiency: building a broader business case for HR self-service', a briefing paper from Webster Buchanan Research, published November 2007, www.websterb.com

providing shared 'kiosks' at work where employees can log on. Today, in fact, many employees now simply expect to be able to interact with their employer's support functions online, in much the same way that they use the internet for banking and other services.

Ideally, the payroll-based components of self-service will be combined with the HR elements, providing a single service where employees can access information from both functions. In some cases, organisations pull their different information feeds together in an employee portal that gives employees one window onto corporate and other relevant information.

2.3 New web-based technologies

As well as drawing lessons from the customer service environment, over time payroll may also start to 'borrow' from the internet-based consumer technology world, where new forms of low-cost software and services offer different ways of collaborating and communicating. While most organisations still see social networks, blogs, mobile devices and similar tools as the domain of Generation Y consumers, some companies have started to adopt them in a business environment, albeit at a largely experimental level today.

What distinguishes these Web 2.0 tools is the fact that they're easy-to-use and they provide a platform for user-generated content that can easily be shared, such as posting videos on YouTube. In addition, they're often accessible online as 'hosted services', a set-up where the service provider runs the software on its own IT infrastructure and users access it over the Internet (*see Part 3.2*). Each of those attributes has potential benefits in the work environment.

Blogs are a good example. While their consumer counterparts are often derided, blogs actually provide a cheap way for organisations to communicate with customers, partners and employees – some organisations use them as a platform to communicate internally, while others use them to update customers on product plans or support issues. What makes them particularly useful as communications tools is that you can link easily to other documents or websites, and recipients leave comments that can be viewed by the whole community.

Wikis – which are websites where multiple people can read and edit content, like the online encyclopedia Wikipedia – are also getting a lot of attention as a tool to help companies collaborate. Rather than sending out a document to multiple people, getting five sets of corrections back and trying to compile them into one document, wikis provide a central site where participants can jot down notes and work on one version of a document that's updated in real-time by all participants.

Both tools have potential uses in payroll. Running a blog might be more effective for communicating some types of payroll-related changes, for example, particularly where employees are likely to ask the same kinds of questions or give similar feedback. Similarly, a wiki might enable employees to air their thoughts about potential improvements to the payroll service, download sample documents and float their own ideas about planned changes.

Social networks are also starting to be used by business professionals to keep in touch with contacts, put feelers out for jobs - and even hire people.

As with any technology, there are challenges in embracing these new kinds of services. For one thing, it's still early days for using many of these technologies in a business environment, so early adopters are still feeling their way – and for another, security is a perennial issue, particularly if the services are hosted externally and linked to internal systems. As low-cost communications tools, however, they're likely to play an increasing role in reducing payroll's cost while potentially improving information flows.

Part 3: The Outsourcing Options

3.1 The outsourcing market

No analysis of payroll costs and service quality is complete without looking at the outsourced service options available, which range from tactical services to full-blown business process outsourcing. In the HR market, Webster Buchanan Research identifies seven different types of outsourcing[3]. In the payroll sector, the market is better broken down into five categories:

- **Tactical services**, ranging from pay slip printing and P11D preparation to broader business-based services such as business continuity or training. Most organisations engage tactical outsourcers in some form, even though they may not perceive it as an outsourcing arrangement
- **Hosted services**, or 'software as a service'. In a hosted set-up, the service provider runs and maintains the payroll software on its own IT infrastructure, while the customer uses it over the internet to process payroll and generate reports[4]. This is an IT-centric solution. The main benefits are that it removes the hassle of running, maintaining and upgrading software from the customer's IT team, and brings a greater degree of system flexibility when customers look to grow or reduce their headcount. In addition, hosted services tend to be paid for on a subscription basis, through anything from a monthly to annual fee, and this reduces some of the upfront capital costs associated with purchasing a traditional software licence
- **Managed services and bureau services**, the longest-established forms of outsourcing in the payroll sector. In a traditional managed services set-up, the outsourcer takes over responsibility both for running the payroll IT system and processing payroll, while the customer's in-house team retains responsibility for core activities such as data gathering or responding to employee service enquiries. Arrangements vary and the allocation of responsibilities is usually determined by customer need
- **Business process outsourcing (BPO)**, a full-blown service where the provider takes over control of the bulk of the payroll function, from administration staff to systems, usually in conjunction with other functions such as HR and finance. In many cases the customer will retain a team of core specialists, although their roles may cross into other business functions – for example, where organisations have highly complex compensation schemes

[3] See 'Weighing up the Business Case for HR System Outsourcing', a briefing paper from Webster Buchanan Research, published March 2009 www.websterb.com

[4] See 'From automation to business intelligence: the next generation of hosted services', a briefing paper from Webster Buchanan Research, published November 2008 www.websterb.com

- **Payroll brokers and aggregators** operating in the multi-country payroll field, which rely primarily on a network of partners to process payroll in individual countries rather than processing it on their own systems. In some cases, aggregators take a hybrid approach, processing some country payrolls in-house, the rest through partners

The business case for signing up to these different types of service will of course vary. Tactical services are typically purchased on a pragmatic operational basis: decisions over tasks such as pay slip printing come down to a fairly straightforward assessment of cost versus in-house capability and resource, with the hassle factor alone often weighting the argument in favour of the outsourced service. At the other end of the scale, the business case analysis for a BPO arrangement is highly-involved, built around the potential for significant transformation across multiple business functions and often incorporating extensive automation. For single country payroll set-ups, however, the criteria for switching to a hosted or managed service typically centre on the factors outlined in Part One, chief among them costs.

Any business case should also address the potential downsides of outsourcing. For example, with the exception of some custom-designed BPO deals, most outsourcers' business models are based on providing standardised processes across multiple customers. But standardisation requires some degree of compromise: it may mean, for example, that the customer has to submit payroll data earlier than it's accustomed to doing through an in-house processing set-up, and submit it in a specific format.

3.2 Outsourcing versus in-house: the cost equation

While cost is usually at the centre of any decision to outsource or run payroll in-house, it's unwise to assume that an outsourced service will inevitably be cheaper than the in-house option.

Firstly, while the outsourcer will enjoy economies of scale, they only kick in when it's able to offer a standard service to all of its customers – and as a result, customers are typically charged for services that fall outside the core contract. Since most organisations require some degree of personalisation in their service provision – for example, in areas such as reporting – this needs to be factored into the equation. It's important to understand exactly what is included and excluded in the outsourcing agreement, as 'hidden' costs can accumulate rapidly.

Secondly, outsourcers are in business to make a profit, so some of the benefits of economies of scale will of course fall to the service provider's bottom line.

Just as important, it's not always easy to carry out an accurate comparison of in-house versus outsourced costs – in fact, one of the perennial complaints of outsourcers is that organisations typically underestimate the true costs of carrying out work on-premise when they assess the outsourcing option. Because on-premise costs tend to be spread across multiple teams – and are often not separately itemised for budgeting purposes – it can be difficult to get an accurate picture of exactly how much expenditure is being incurred.

The full range of costs outlined in Webster Buchanan's Payroll Performance Scorecard[5] include:

- Direct costs for payroll employees such as salaries, benefits, training and National Insurance
- Associated employment costs: for example, an allocation for a manager whose time is split between payroll and other functions
- IT operational costs: hardware, software (licences, maintenance fees and upgrades) and telecoms costs for all payroll-related systems
- IT implementation costs
- Time data collection costs

[5] See 'Webster Buchanan's Payroll Performance Scorecard, A toolset for measuring single country and multi-country payroll performance', available for free download at www.websterb.com/payrollstrategist/

End Notes

About the Authors

Webster Buchanan Research is a market research and consultancy company specialising in business management and the supporting role of technology. Webster Buchanan's primary focus is on People Management, Multi-country Payroll, Strategic Payroll, Customer Relationship Management, and Financial Management. The company is based in London, San Francisco, Singapore and Hong Kong. For more information and copies of recent research reports, visit www.websterb.com.

About the Sponsor

Computers in Personnel is a leading provider of software and services for people and data management. Recognising that effective people and data management are critical drivers to organisational success, it provides a broad range of software, outsourcing services, data management capability and knowledge-based services. Ciphr is a richly-functional web-enabled HR and payroll management system that helps organisations manage all aspects of people management, from recruiting and payroll to people data analysis. For further information visit www.ComputersinPersonnelHR.com