

White Paper

Is your HR business case flawed?



Contents

Introduction	3
Chapter 1 – Staff costs	4
Chapter 2 – Defining the workforce population	6
Chapter 3 – Determining the HR FTE's	8
Chapter 4 – Hidden costs	9
Conclusion	11

About the Author

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Michel has worked with numerous Fortune 500 companies on the rationalization of HR-costs and the right shoring of HR service delivery.

Introduction

I am often involved in evaluating business cases that support a company's HR transformation. As a vendor and supplier of HR outsourcing services to global companies, one should always treat the information provided by a customer carefully.

I cannot help but conclude that most business cases are flawed. We see examples where business cases are set up in such a way that they only support the outcome preferred by HR. Business cases regularly overstate the potential benefits of HR transformation and/or outsourcing. Conversely they usually understate the current costs of transactional HR.

An overstatement of the business case for HR transformation could be considered advantageous to an HR outsourcing services provider. However that is not what we want.

When engaging with clients, we typically enter into a long-term partnership. This means that both parties agree on the potential benefits of outsourcing upfront and work hard to achieve them.

A partnership would be based on a shaky foundation, should a customer discover that their outsourcing does not bring the benefits they had anticipated. The relationship would be strained and the vendor stands to lose the customer; usually forever. Not a good outcome for the parties involved.

That is why both parties, client and supplier, should have a vested interest in making the business case work before engaging in the actual outsourcing project. It is important that the decisions are made based on facts, and that everyone agrees on the outcomes.

However, getting the right data and making sure the business case is factual, is not always easy. This is understandable because a client does this infrequently compared to vendors like Alight | NGA HR who do this for each client. We have an established a model that allows us to see the basics very quickly. So let us look at the most common issues we tend to see in HR business cases.

Chapter 1 - Staff costs

Typically a customer has an excellent view on the organizational structure and its processes. We see slight deviations in definitions and breadth of scope but overall we experience a great deal of standardization across the globe when defining HR processes.

The problem starts when it comes to the HR workforce and the true cost of any process. How much does a process cost? How much does an HR process cost?

Processes are not normally defined as a cost unit in accounting. Accounting registers how much an employee costs or what the value of the office building is, but how much does it cost to, for example, hire a new employee.

To establish the cost of a process, staff cost and the cost associated with that process should be included. HR processes typically consist of labor and resources consumed directly by the process.

Therefore, if you determine their costs, you can calculate the overall process cost. The picture below shows the various kinds of costs associated with an HR process.

Direct staff costs	Indirect staff costs	Direct process costs
<ul style="list-style-type: none"> • Annual base salary • Performance related pay • Statutory and social cost • Benefit cost 	<ul style="list-style-type: none"> • Facility cost • Personal IT cost • Function cost 	<ul style="list-style-type: none"> • IT cost • Vendor cost
Staff costs		Process costs

Staff costs are all the costs related to individual employees involved in a process. They can be divided into direct and indirect staff costs. The total of direct and indirect staff costs will determine the “price” of an HR full time employee (FTE), which is a difficult topic in its own right.

1. **Direct staff costs** are directly related and allocated to an individual employee, such as their salary, bonus and benefits. Consequently, these costs vary by employee.

We do not see too many issues in the correctly attributing of direct staff costs. We do see a lot of pain in collecting the data; especially in European countries where the true staff costs is a myriad of legal, extra-legal and other fringe benefits. If we can dispense one piece of advice in this area, it would be to make sure the data covers more than 12 months (see later when we discuss the measurement period) to have an accurate summary.

2. **Indirect staff costs** are also related to the number of employees, but cannot be directly associated to an individual. Examples are facilities costs (desk, lighting, printing, office space), personal IT cost (e.g. the PC that sits on an employee's desk) and function cost (such as travel, training and seminars). These indirect staff costs should be allocated on an HR FTE basis.

We have noticed that most companies do not have a good sense of what indirect staff costs represent to them. Sometimes no information is available, sometimes regional averages are used.

Some would argue that these costs do not go away when the process is outsourced. While this is true to some extent (you cannot give back the real estate-cost portion of the process you have just outsourced). In most cases you will incur less indirect staff costs, or you can re-allocate the portion that became available to other business units.

3. **Direct process costs** are costs that are directly related to a certain process. An example would be the fees paid to an external agency to manage (part of) the recruitment process or the cost of an outsourced payroll.

Process costs are measured on a total per process basis. They are added to the costs of the labor part of the process to establish the total process costs. We have noticed on several occasions that the IT and external vendor costs tend to be underestimated.

Attributing IT costs to the HR process(es) in scope is usually a hit and miss. Most IT departments do not seem to hold specific cost data for HR applications and maintenance. Often the HR-IT costs sit in the overall IT budget and at best a percentage is allocated to HR.

We see another issue with third party vendor costs. Sometimes they are overlooked because they sit in the finance department. Other times they are grossly understated because of the large void that exists between "regular" invoices and the "additional" services that come on top.

We typically advise our clients to collect their actual third party invoices over a period of 16 month period. Then add them up divide by 16, and then multiply by 12 to arrive at the yearly fee. This accounts for 3rd party vendor activities that are only invoiced once a year (think year-end). You will be surprised at the vast amount you actually pay versus the amount you contractually agreed to so long ago.

Chapter 2 – Defining the workforce population

Once you have found the various cost types, you need to apply them to the overall HR Workforce. But what is the HR Workforce?

In the strictest sense, the HR workforce consists of employees working in the HR department (i.e. on the HR budget). However, there are always more staff involved.

There might be staff outside the HR department involved in HR processes. At the same time there might be staff on the HR budget that, according to the definition of HR processes, are not working on HR activities.

So looking at an organization’s headcount in the HR organizational unit does not give an accurate picture of the HR workforce.

To establish a clear picture of an organization’s population and the scope of HR, all employees should be assessed as to whether they are fully, partially or not at all dedicated to HR processes. This is in addition to whether they are on the HR budget or not. This is done using the table below. The shaded quadrants are the staff normally taken into account in a business case cost study.

Not dedicated to HR processes	5	6	
Partially dedicated to HR processes	3	4	
Fully dedicated to HR processes	1	2	
	No of FTE	On HR budget	Not on HR budget


 = in study scope

Figure 2 Defining the HR workforce

The six quadrants are explained as follows:

1. Fully dedicated and on the HR budget. This is the normal situation for HR staff.
2. Fully dedicated but not on the HR budget. In certain organizations some HR processes take place outside the HR function (e.g. in some organizations the payroll function is part of the finance department, whereas in the Alight | NGA HR definition it is part of HR).
3. Partially dedicated and on the HR budget. This occurs when certain HR staff also work on processes that are not part of the defined HR processes. For example a payroll assistant that also spends time on accounting activities or an HR assistant who spends the afternoon on the reception desk.
4. Partially dedicated, but not on the HR budget. Here you typically find line managers involved in HR processes such as recruitment or performance appraisals. It must be decided whether to include line managers' HR efforts or not.

We normally exclude them because it's part of their job to engage in people activities, which is not strictly speaking HR. If they are included, corrections should be made for peer analysis, as this data is not part of common benchmarks. However, a receptionist also performing HR administration should be included.

5. Not dedicated, but on the HR budget. In some organizations, other support staff such as security guards, catering and cleaners, are on the HR budget. These FTEs should be excluded from the analysis in all instances.
6. Not dedicated and not on the HR budget. This is the rest of the organization's employees.

The sum of all six quadrants gives the total population of the organization and the sum of the shaded quadrants leads us to the total HR workforce. (Note that the total HR workforce almost never matches the total HR department.)

Chapter 3 – Determining the HR FTEs

For each employee that is found to be part of the HR workforce (based on decision rules discussed earlier) a number of further variables must be determined. These variables are defined in the figure below.

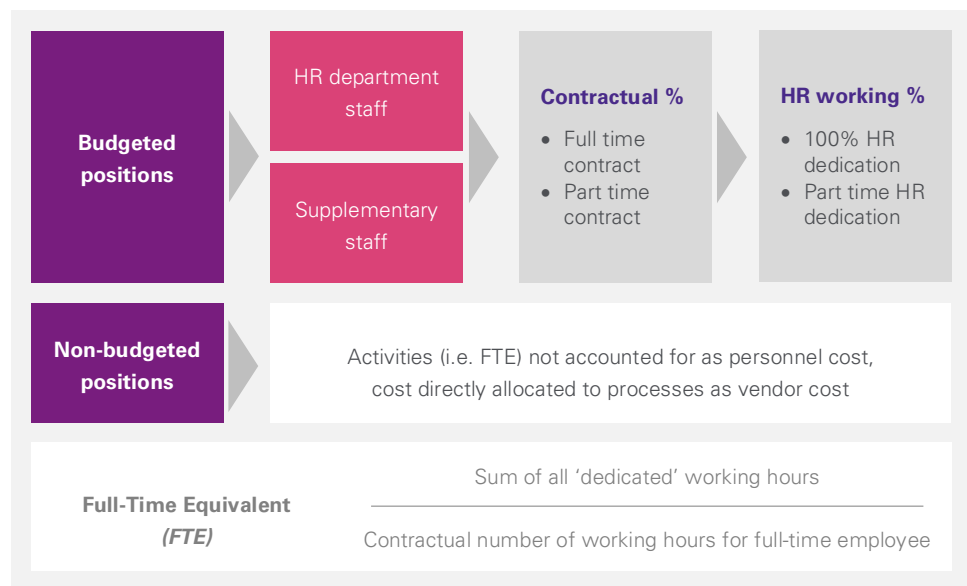


Figure 3 Deriving FTE

Although we like to express the number of people in an organization by headcount, that does not give a clear picture of the time spent on processes. Some employees might only work part-time and others full-time.

The time study determines the time spent per process, for which HR working time and HR workforce are expressed in Full Time Equivalents (FTE). In order to create a complete picture, the template gathers data on the contractual working percentage (part-time vs. full-time) and the HR process percentage (How much time of the contractual working time is spent on HR Processes).

So, if the contractual working hours for a full-time employee are 40 hours a week and an individual works only 20, he or she represents 0.5 FTE. (Contractual working percentage 50%) If this person dedicates a 100% of his or her time on HR processes, the HR working percentage is 100%.

The total time spent on these processes is also 20 hours. Should this employee only spend 80% of their time on HR activities their HR working percentage would be 80%. Both contractual and HR working percentage should be captured and the annual salary and other direct staff costs must be recalculated in case the HR working % is lower than 100%.

Chapter 4 – Hidden costs

Hopefully the above can guide you in the collection of costs for the HR Process you are contemplating outsourcing (or transfer to an internal shared service center). Now that we've discussed the basics of cost collection, we would like to show some extra elements to take into account in order to come to a business case that is as complete and accurate as possible.

- **The cost of doing nothing.** Everything in life comes at a cost and that includes doing nothing. When you confirm your current position through the business case, you might be tempted to harvest short term gains on investments not made.

Frequently, however these benefits are eroded by increasing future costs. Take for example your system landscape and imagine that it is coming towards its end-of- life. You might believe that by doing nothing now, you can harvest what you have. But you'll have to move off the system sometime.

Deciding to outsource your HR process means you also outsource the end-of - life issue of your HR application as the vendor will implement a new system for you. So when you do nothing, be sure to put a placeholder in your business case for increasing internal IT costs related to HR over the next five years.

The age-pyramid is another factor to take into account. Today this age pyramid might look good but what about in five year's time? What is your turn-over in HR? What is your recruitment cost to fill these positions again?

- **Data collection period.** It is essential for consistent and unambiguous data collection to define a fixed data collection period for all organizational units (e.g. the data collection period might be calendar year 2019 or fiscal year 2018-2019, etc.).

Although the data collection period can be any timeframe. The regular period is 12 months and data is normally expressed on an annual basis as well. We usually advise clients to extend this period to 14 or 18 months. The annual average derived from that longer period flattens out any exceptional cost and ensures you capture annual charges as well.

- **Currency.** The currency for data collection and reporting must be defined as well as currency conversion rates (and fixed). Do not get caught out on the conversion rates (positive as well as negative).

Quite some time can elapse between the building of the business case and the actual use of the numbers in the decision to outsource or not. If time passes between business case and decision, it is advisable to update the currency rates. Look at the Dollar-Euro conversion of the first quarter of 2018 to see what we mean.

- **Joiners, leavers, temps and vacancies.** Prior to starting the data collection you must clearly define how joiners, temps, leavers and vacancies will be treated. The standard method for including excluding HR staff is whether they occupy a budgeted position or not, (see figure 3). Effectively this means that budgeted positions are counted and not physical heads. A few examples:
 - A person who left the company but whose replacement has not yet started (their position is still budgeted): treat the position as if the person has not yet left.
 - People who are absent for a long term (maternity leave, sickness) and that are assumed to come back are taken into account. If there is a temp filling the position, this temp should not be considered (not in the personnel sheet, nor in the vendor costs). As in the previous example, the position is budgeted so treat it as normal.
 - Vacancies are counted as an employee with the assumed working percentages, role distribution and costs. Since this is budgeted, there are assumptions on the salary level.

Conclusion

In summary, invest time and money into your business case for HR Transformation before coming to the outsourcing table; it will be money well spent.

- Define staff costs; especially the hidden HR process costs that demand scrutiny during the data collection process
- Define your HR workforce: assess all employees as fully, partially or not dedicated at all to HR processes, and whether they are on the HR budget or not. This will help allocate the cost type of the HR workforce
- Determine the HR FTE's to calculate the cost for the HR process you are thinking of outsourcing
- Don't neglect the hidden costs and be realistic about the cost of doing nothing. Money saved today can come back to haunt you two years down the line. Try to picture it as deferring the maintenance of your car.

Nothing will happen when you ignore the service light for a day, a week or perhaps a month, but keep ignoring it and you will soon be finding yourself at the dealer with a bill twice the size of a regular service.

At Alight | NGA HR we believe in due diligence on all sides. We hope the above guidelines can give you food for thought and help to build a better business case. Both you and your future outsourcing partner will benefit from this approach.

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