

Payroll Outsourcing: Why Can't the Big Players get it Right?

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Payroll outsourcing is nothing new, but many big companies played a 'wait and see' game before outsourcing or offshoring their payrolls. Those who waited may feel vindicated in their actions, as the Outsourcing Industry in Europe has recently seen several large payroll deals in difficulties, with large penalties invoked and contract reversals. But why is payroll so different? Surely it is like any other function in F&A and HR, where the number of outsourcing success stories grows on a daily basis?

There are 2 key reasons why Payroll Outsourcing is more prone to failure than other business processes:

1. The complexity of payroll is often underestimated.

Payroll transactions are based on complex rules and multiple data sources. Outsourcing advisors typically recommend that any process which can be 80% or more rules-based can be outsourced. Payroll is particularly difficult to rules-base, with a high level of exceptions requiring in-depth understanding to ensure the correct application. Every day payroll administrators take decisions based on multiple factors and information from a variety of sources. For example, the type and level of social security to apply and indeed whether to apply it at all can depend on employment status, age, length of contract, earnings, number of hours worked, course of study and expatriate status etc.

Payroll is influenced not only by law and company policy, but also by industry standards, trade union agreements and many other factors. Rules vary between different divisions of the same company, between geographic regions and certainly between countries.

There is no standard common platform for payroll – each country needs its own configuration, legal updates and maintenance. This reduces the flexibility to share resources between countries or clients and increases the cost of system training and user testing.

2. Payroll is highly sensitive

Internally, every single employee is a customer of the payroll department – any mistake is highly visible and goes straight to the heart of the affected individual(s). When pay is wrong, employees tell their colleagues and their colleagues are appropriately disgusted. An error of €200 in a P&L posting or supplier invoice will have limited impact on the affected employees, but €200 short in the pay packet might impact an individual's standard of living.

Externally, payroll is subject to attention from a vast range of bodies – tax auditors, social security auditors, internal and external auditors. Governments receive a considerable proportion of their income from tax and social security payments, so they are particularly vigilant and highly intolerant of errors.

The Payroll Department is historically not a dynamic one – employees and auditors often have long-standing working relationships with their personal payroll contact. Needing to deal with an outsourcer is a much bigger wrench in payroll than for other functions. Experience shows that the further the outsourcing provider is from the original incumbent (culture, headquarter location, size, relationship history etc.), the greater the scrutiny of the outsourcer’s results.

So payroll is difficult, but surely not impossible to outsource and get right first time?

Indeed, but first companies and suppliers must overcome the fundamental error of assuming that Payroll is the same as other F&A or HR transactional processes. The big players naturally seek to commoditise payroll by driving out costs to the same extent as other simpler, processes. This has, in the past, led to several misjudgements in setting up payroll outsourcing contracts. These include:

1. Not enough time given to knowledge transfer

Knowledge transfer requires the documentation and training of all work processes and actions which a payroll administrator must take. For some functions with standard scope, processes and rules this can be completed in a short time span. The variety, complexity and multiple information sources in payroll mean that knowledge transfer takes considerably longer.

Ideally knowledge transfer should span a year end - year end and year start are the most critical and work-intensive times (the workload of the payroll department can double in these months), where errors are highly visible to the authorities and can cause considerable rework.

This extended knowledge transfer process is in conflict with the commercial drive to commoditize payroll, driving out costs and cutting over responsibilities in the shortest possible timings.

2. Sub-optimal hiring profile

Payroll requires experience and in-depth knowledge, so the typical operating model of a team of new graduates does not apply. New hires bring a fresh outlook to the payroll department and are critical to the success of an outsourcing deal, but enthusiasm must be balanced with experience.

Secondly, while highly rules-based processes can support and benefit from high employee turnover, payroll needs more stability. Experience and judgement are key, and these accumulate over time. Companies often overlook the important stability factor which mature, vocationally-qualified hires can bring. Given the complex and varied processes, it takes a minimum of 3 months to train someone in payroll and 6 months before they can work independently – career-hungry graduates will have sought their next opportunity before this investment pays back.

3. **Overoptimistic expectations of efficiencies put pressure on the delivery organisation**

Outsourcing typically delivers considerable long-term savings, as contracts bind suppliers to continuous efficiency improvements, with the benefits being shared between supplier and buyer. There has been a tendency for suppliers to overestimate the efficiencies they can get from a payroll process, compared to results achieved in other processes.

The complexity of payroll compared to other functions means a smaller volume of work can be pushed down the value chain to lower skilled (cheaper) employees or self service. Synergies are hard to achieve as the different statutory influences make standardisation between organisations or functions impractical.

In addition Internal and External Controls form a major part of each administrators' role, and cannot be eliminated. The amount of time to be dedicated to controls is increasing and often underestimated when building a business case.

This all puts pressure on the outsourced organisation to deliver good results with too few heads.

What can be done to ensure a successful payroll outsourcing deal

When suppliers and their clients work closely together with a mutual aim of success, a quality, cost effective deal can result.

1. Build a **realistic business case** with sufficient time for exhaustive knowledge transfer, budget for experienced payroll administrators, and understanding that there is limited 'bottom of the value chain' work.
2. Be **realistic about the headcount synergies and efficiencies** which can be achieved – even with best-in-class technology, payroll is very people-intensive and needs good quality administrators who pay attention to detail. Most customers are prepared to pay for a set-up which ensures quality and control.
3. Ensure there is provision in the contract for **investment in technologies** such as self service and workflow to ensure the payroll teams can operate at maximum effectiveness.
4. Ensure **proper measurement of results**, before and after the transition. This will allow a realistic separation of facts from emotion and increase the likelihood of early identification and correction of any issues.

Outsourcing payroll can be successful but we must accept that it is a different animal from other outsourced functions, and recognise this in the planning, implementation and evolution of a payroll outsourcing contract.

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