

Payroll: the truth will outsource

The convenience of farming out routine payroll work may mask the value of the employee information contained within that system. Angus Kidman weighs up the pros and cons in the second part of our payroll special

Although the concept of outsourcing payroll systems effectively predates the widespread use of personal computers, the concept has become increasingly popular in recent years as companies have sought to extract greater value from their investment in employees and ensure more accurate payments.

"There seems to be a general trend to look at outsourcing," says Peter Harte, managing director for HR software vendor Kronos. "That doesn't mean people make the decision to go that way, but people definitely look at it."

"From our observations, decisions are now being made from a strategic HR perspective rather than finance, with a significant demand for outsourcing," concurs Alexia Lyons from provider JADE Star.

One incentive is a simple indifference to payroll as a process. "HR is seen as an in-house application, because it deals with people. But payroll is an engine," says Harte. "It doesn't really matter where the technology sits as long as you've got a data link."

Another argument for outsourcing is a fear of making mistakes when calculating pay, especially in union-intensive industries. "A lot of enterprises have agreements built into their enterprise awards that there are penalties for late payment," says Harte.

Fear, however, can also drive businesses in the opposite direction, maintaining all information internally to ensure confidentiality is protected. "The reason most people keep it in-house is that they have a fear of people's pay information being kept somewhere else," says Harte.

While that fear may well be misplaced, one good argument for keeping payroll within the organisation is to exploit the employee information stored within payroll records and use it for broader HR planning functions. "The actual data stored in payroll systems is becoming more important," says Bill Farrell, a partner with IBM Business Consulting Services. "Because of the value of that information, HR should own it."

Without a single source for such information, companies will often come up with multiple (and frequently inaccurate) answers to such basic question as 'How many employees do we have?' and 'What is the total amount we're spending on employee remuneration?' Farrell notes. Rationalising data into a single system may initially be painful, but the long-term gains may be worth those initial problems.

Of course, if a company does elect to keep payroll in-house, the question of which department will control it often comes into play. Payroll's roots in information processing can place it in the domain of the IT department; its critical role for employees makes it a natural fit for HR; and its high cost and ongoing use of core business data makes it a subject of great concern to finance departments.

According to Farrell, while there may well be a grapple between the HR and finance departments over controlling payroll, the involvement of the IT department will generally be limited to ensuring integration with other business data sources. "My experience is that IT has always taken a backseat in terms of functionality," he says.

Theory and practice

Historically, another reason for outsourcing within large corporations has been the difficulty of managing cross-border payment systems for companies operating in multiple locations. Even a decade ago, few payroll systems could cope with (for instance) paying staff in America, Australia and Japan, and as a result separate systems were often used in each location, with some being outsourced while others were handled in-house.

However, the increasing consolidation of the general HR and payroll software market means that this pattern is slowly becoming less common. "HRMS systems are becoming a lot more reliable," notes Farrell. "In Asia-Pacific, the systems are now able to do cross-border pay." As such, it has become easier for companies to roll out the same system – including payroll – on a worldwide basis.

Despite that, Farrell's work with major companies such as retailers and airlines has led him to conclude that the trend towards outsourcing will continue. "You'll see a lot more of the bigger employers outsourcing," he predicts.

For smaller businesses, one appealing element of outsourcing is that it eliminates the need to keep track of complex legislative requirements in areas such as superannuation. This can be a problem even in companies with relatively small numbers of employees.

For instance, Melbourne business Decor Kitchens has just 20 employees, but their superannuation is spread across six different funds. To simplify managing that problem, Decor made use of a superannuation service offered by payroll software company MYOB.

"This is not only good for my cashflow management, but what used to take me half an hour is now all done in two minutes and I now have the confidence that the contributions I am paying are correct," says John Wagenvoort, general manager of Decor Kitchens.

Online connectivity has made it easier for businesses to outsource some of their payroll management requirements, while still gaining access to required information. Outsourcing can also be useful when a company makes acquisitions and has to integrate disparate payroll processes.

That scenario came into play for transport operator Westbus, which last year acquired two of its rivals. "Westbus itself was operating five depots, while Blue Ribbon had two and Glenorie a further one," said Westbus finance director Kevin Harris. "What might possibly happen with the eight different operational areas, and the three distinct payroll applications being used, was that we could get differing interpretations of the same award conditions. Obviously that is neither in the interests of the staff or management.

"In addition to overcoming the issue of three different payroll systems, we also had to meet the challenge of unifying three different types of management reports emerging from them. In a margin-sensitive business such as ours, we needed to be able to benchmark different depots with each other, over similar pay periods, in order to ensure individual best practice and a healthy business overall."

Westbus' solution was to use Mantrack's online PayOffice system to integrate the different requirements of its sites and ensure award requirements were met at multiple sites. That task might have proved more challenging had the integration been attempted in-house.

ROI and the future

There have been relatively few technological advances in payroll systems in recent years, with one notable exception: the introduction of intranet-based systems for tracking employee hours and reporting payroll.

"Providing employees and management with access to selected pay data via the Internet is now a critical requirement for a replacement system," says Lyons. "This also includes workflow functionality for timesheet submission and annual leave requests which through increased process automation reduce traditional payroll data entry bottlenecks."

Such systems have been widely adopted, and the pace of that uptake continues to increase. "Employers have made significant investments in HR technologies, and they are rolling out new initiatives at a much more deliberate pace than in the past several years," notes Tedd Long, director of HR technology consulting at Findley Davies.

Whatever approach you choose, experts agree that coming up with a business case for payroll that incorporates real return on investment rather than legislative necessity is always going to be an uphill battle.

"With payroll, it's got 100 per cent market share," says Harte. "It's a have-to-have item."

"In terms of payroll production, the business case is always going to be difficult," agrees Farrell.

Large-scale HRMS providers are increasingly working in the payroll field, and the business case for payroll may be rolled into an overall plan to increase HR productivity. However, such solutions are not suitable for businesses below a certain size. "You need a certain scale to make the business case for top-tier systems," says Farrell.

11 March 2004