

# HR AND BENEFITS: THE NEXT OUTSOURCING WAVE

A Study of Finance, Human Resource, and Benefits Decision Makers Among Large Companies



HR/BENEFITS OUTSOURCING REPORT

## TABLE OF CONTENTS

Executive Summary .....1  
 The Current State  
 of Outsourcing .....2  
 Methodology .....2  
 What Motivates Companies  
 to Outsource? .....4  
 Outsourcing Is Seen as  
 a Good Investment .....8  
 Outsourcing Delivers  
 Enhanced Control .....11  
 Outsourcing Leads to a  
 Shift in Responsibilities .....14  
 Conclusion .....18

### FIGURES:

Figure 1: Companies outsourcing  
 HR/benefits functions .....3  
 Figure 2: Motivators to outsource  
 and benefits currently realized .....4  
 Figure 3: Percentage of respondents  
 agreeing with various aspects of  
 outsourcing's value .....5  
 Figure 4: How decision makers  
 perceive the benefits resulting from  
 outsourcing .....6  
 Figure 5: How decision makers  
 rate the return on their outsourcing  
 relationship .....8  
 Figure 6: Companies measuring  
 return on investment (ROI) .....9  
 Figure 7: Change in control  
 resulting from outsourcing .....12  
 Figure 8: Satisfaction with  
 outsourcing implementation .....15  
 Figure 9: Satisfaction with  
 company-wide employee  
 communication .....15

## EXECUTIVE SUMMARY

In a business and economic climate that challenges corporate America to analyze the return on each and every investment, the outsourcing of certain non-mission-critical activities to external vendors is no longer just a novel idea. Indeed, outsourcing major components of corporate information technology programs has been under way for many years as organizations have turned to outside vendors to provide the systems and expertise needed to operate the IT function. Similarly, given the escalating costs of building the systems and infrastructure to fully administer corporate human resources and benefits programs, HR/benefits is quickly becoming the next major wave of outsourcing.

A recent study of finance executives and HR/benefits decision makers at 190 large companies, sponsored by Fidelity Investments, reveals that HR/benefits outsourcing is an evolving phenomenon that is already paying dividends for many organizations. Companies outsourcing their HR/benefits functions report a consistently strong level of satisfaction that increases as the time of the outsourcing relationship lengthens.

The study identifies some common reasons companies decide to outsource. Cost reduction was the most commonly cited motivation, but the study also finds that, over time, companies realize a number of other benefits from HR/benefits outsourcing. Executives surveyed say they found value in the access their companies gain to vendors' expertise and currency in HR/benefits issues, reduced compliance burdens, and enhanced levels of employee service.

Most executives say they view HR/benefits outsourcing as a good investment, based upon the expertise and expanded capabilities it provides compared with the cost of developing similar capacities internally.

The study also finds that HR/benefits managers gain greater control of most of their plan management and administrative operations through outsourcing. This increased control is achieved through improved accuracy and timeliness in processing and reporting, as well as more consistent and convenient delivery of service to employees.

Among other findings, the study reveals the importance of selecting the right outsourcing partner, especially in terms of shared organizational values and the vendor's ability to provide a comprehensive range of solutions.

## THE CURRENT STATE OF OUTSOURCING

### Outsourcing is gaining acceptance in corporate America

For most large companies, the question is no longer about whether they should outsource. Of 264 large companies that initially responded to the invitation to participate in the study, 190 of them (72%) report that they currently outsource at least one HR/benefits function. Among this group of respondents, almost all say that they outsource at least part of the administration of their defined contribution (DC) plans (86%) and health and welfare plans (91%), and that they have been doing so for an average of nine years.

Large numbers of respondents say they also outsource, either fully or partially, a variety of other HR/benefits functions, including defined benefit (DB) plans (61%), payroll administration (40%), and recruitment and full-time staffing needs (40%).

The newest trends in outsourcing are in the areas

of alternative compensation programs (66%), such as stock plans, stock options and other executive compensation packages, and temporary staffing (60%). The study finds that the outsourcing of these functions has been in place for an average of only four to five years.

### METHODOLOGY

The Fidelity-sponsored study, "HR and Benefits: The Next Outsourcing Wave," was conducted during the late fall of 2002 by Evanston, Illinois-based Richard Day Research, Inc. (RDR). RDR conducted the study among finance executives and HR/benefits decision makers at companies with 5,000 or more employees. After the firm conducted in-depth qualitative interviews with individual decision makers at 12 companies to gain insight into key issues affecting HR/benefits outsourcing, RDR selected 202 respondents from 190 companies that currently outsource to complete the quantitative portion of the study. Clients of Fidelity Employer Services Company made up 27% of the respondents.

Of the participating companies:

- 48% had 10,000 or more employees
- 54% had revenues of more than \$1 billion
- A variety of industries were reflected, including manufacturing, services, retail and wholesale trade, and financial services

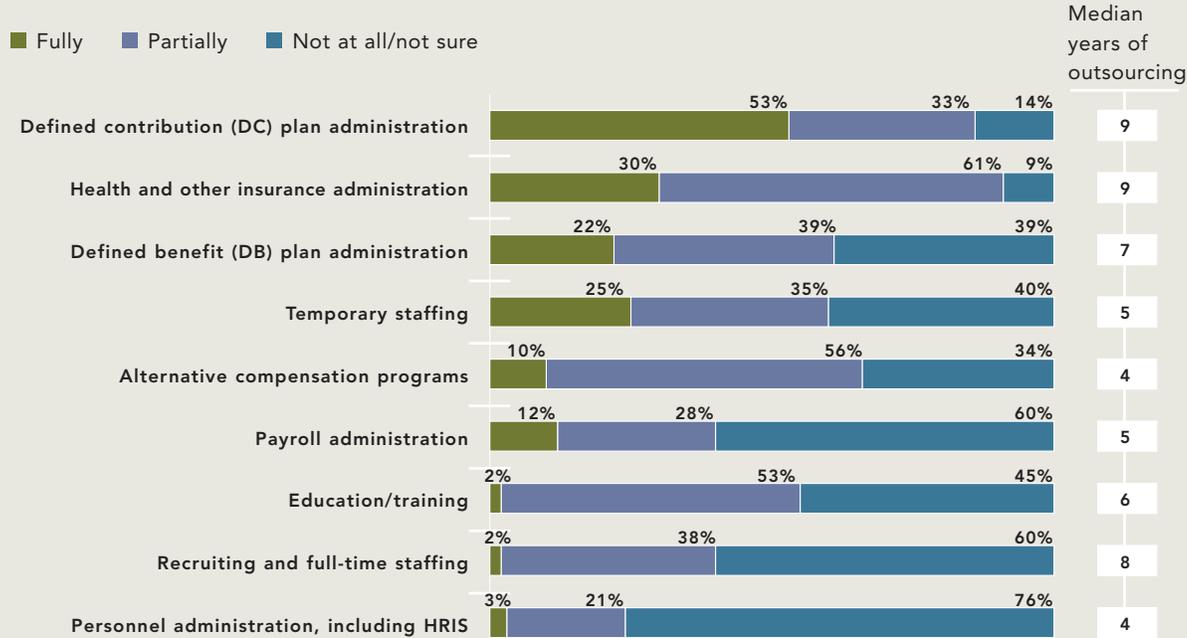
Of the respondents:

- 85% had sole or shared decision-making authority for outsourcing decisions; the balance had direct influence
- 44% were either at the senior executive level (26%)—defined as CFO, COO, treasurer, controller, or executive or senior vice president—or at the vice president level (18%)
- 27% were at the director or assistant vice president level

The source for all charts within this report is the Fidelity-sponsored study, "HR and Benefits: The Next Outsourcing Wave," which was conducted during the late fall of 2002 by Evanston, Illinois-based Richard Day Research, Inc. (RDR).

## OUTSOURCING IS GAINING ACCEPTANCE IN CORPORATE AMERICA

Figure 1: Companies outsourcing HR/benefits functions (n=190)



### Satisfaction with outsourcing is extremely high, and the longer the outsourcing relationship exists, the higher the level of satisfaction

Nearly all respondents (93%) report that they are satisfied with their outsourcing experiences, with more than one in four (29%) saying that they are “very satisfied.” Relative newcomers to outsourcing (those with one to five years’ experience) are slightly less satisfied, although only one in 10 respondents express any level of dissatisfaction. The study demonstrates that over time, as difficulties are addressed, satisfaction levels improve. Of veteran outsourcers (six or more years’ experience), only 3% express any level of dissatisfaction.

Similarly, more than four out of five decision makers (87%) say that outsourcing either met or exceeded their expectations. But again, the study shows that time makes a difference: The newest outsourcers were more likely to express disappointment, with 23% saying that outsourcing fell short of their expectations, but only one-third as many veteran outsourcers (8%) say that it had not met expectations.

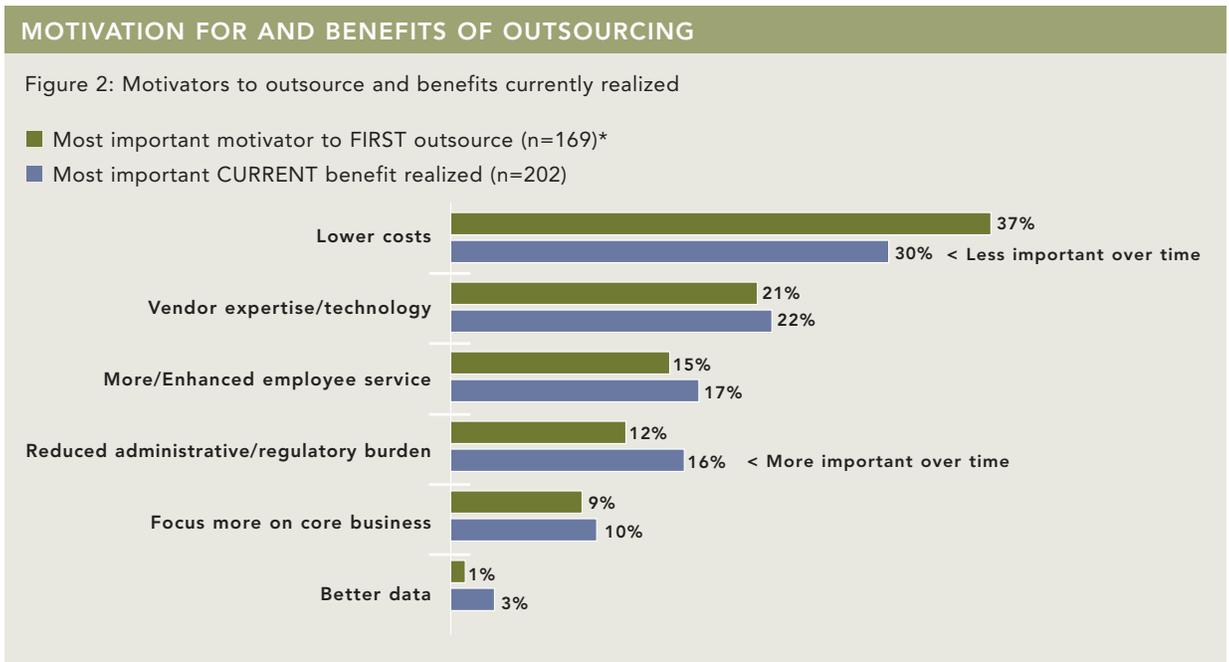
## WHAT MOTIVATES COMPANIES TO OUTSOURCE?

### Pressures place challenges on HR/benefits executives and managers

Maintaining high levels of HR/benefits service is essential for companies to help maximize the value of their benefits programs. However, executives say there are many pressures that place challenges on their ability to deliver that high-level service and expertise.

Four of five study respondents overall (84%) say that lowering costs and/or improving efficiency are major pressures facing their HR/benefits operations in general. Other pressures associated with the HR/benefits function include ensuring regulatory compliance (78%), satisfying internal demands for accurate and timely reports (66%), and maintaining currency with new technology and systems integration issues (66%).

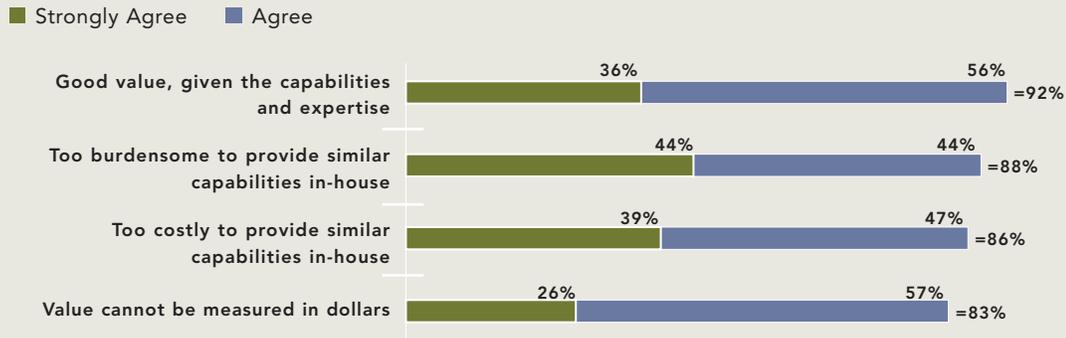
Attracting and retaining employees (67%) also is identified as a major challenge, especially among the senior executives surveyed. Meeting service requests from employees is the least frequently mentioned pressure (51%), possibly because so many companies already have outsourced that function.



\*Only respondents with sole or shared decision making authority were asked this question.

## THE VALUE OF OUTSOURCING

Figure 3: Percentage of respondents agreeing with various aspects of outsourcing's value (n=202)



### Outsourcing isn't only about reducing costs; adding value also is a compelling motivator

While respondents cite cost containment/efficiency as their biggest pressure, it is not the primary reason most companies seek or continue to outsource. Slightly more than one-third (37%) of respondents say "cost reduction" is the most important initial motivator for outsourcing. However, fewer than one-third (30%) cite cost reduction as the most important current benefit. As illustrated in Figure 2, this suggests that companies shift their focus over time to the other "value-added" benefits offered by outsourcing.

Half of the sample indicate that outsourcing lets their company focus more on core competencies. Yet as few as one in 10 cite reallocation of resources as the most important reason to outsource initially or to continue doing so.

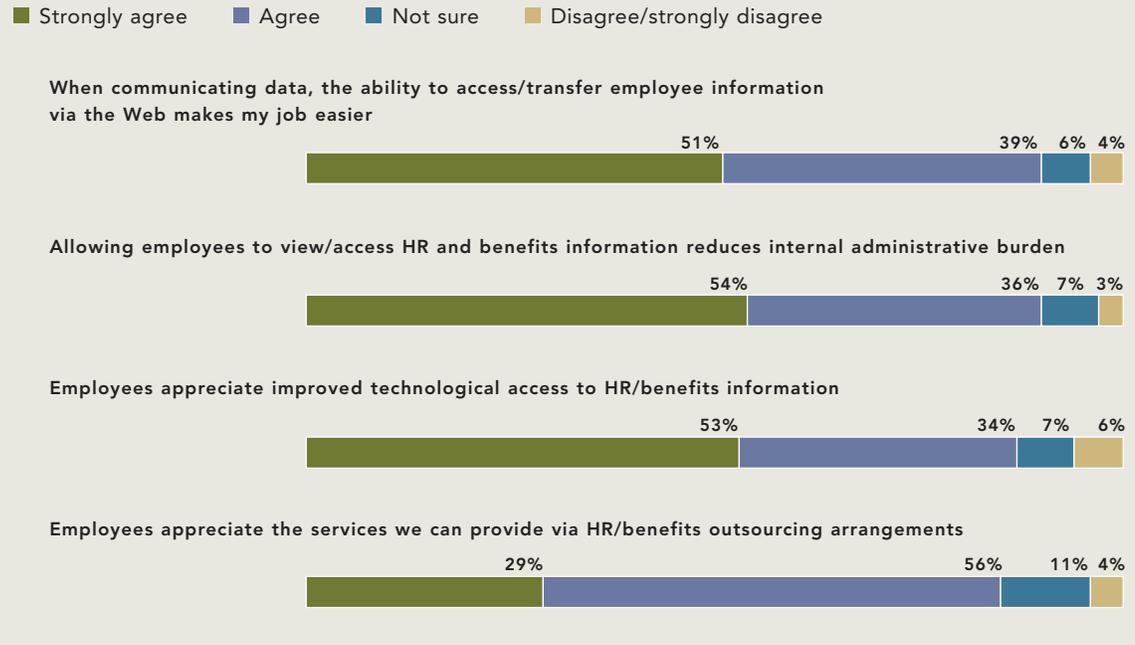
### The benefits of outsourcing are realized by employers and employees alike

As illustrated in Figure 3, the vast majority of study respondents (92%) agree that a vendor's superior capabilities and expertise deliver significant benefits for their organization, particularly in terms of improved services and better access to information. The majority of respondents indicate that it would be too burdensome (88%) and/or too costly (86%) for their organizations to provide comparable HR/benefits capabilities internally.

The study also suggests that the more HR/benefits functions a company outsources, the more likely it is to recognize these benefits, both for its employees and its internal HR/benefits organization.

## OUTSOURCING HAS BENEFITS FOR EMPLOYERS AND EMPLOYEES

Figure 4: How decision makers perceive the benefits resulting from outsourcing (n=202)



6

According to the survey results (Figure 4), about nine out of 10 respondents agree that outsourcing:

- Facilitates data transfers via better Web-based technology;
- Reduces administrative burden by giving employees direct, self-service access to their own HR/benefits information; and
- Offers employees better technology channels to their data and benefits information (e.g., via the Internet or automated phone system), which they appreciate.



**LESSON LEARNED >** Outsourcing provides resources and expertise to enhance employee servicing, and allows more focus on core business

Insights from finance, human resource, and benefits decision makers on **opportunities gained**:

*“The major (reasons to outsource) are the technology, systems, and resources that we don’t have in house. It’s very expensive to turn over employees. We want to be able to give them a good level of service, especially on the group health side... If it costs us to outsource and offer that kind of service, then that’s the price of doing business. We do it because it makes sense—it’s cheaper for us to buy that expertise on the outside than it is to do it in house.”*

*“We found it less expensive to borrow or outsource this expertise in a lot of areas, as opposed to building it in house. For instance, we have a wonderful software application, but we would really need to build out a lot of the benefit administration functionally on it. It would also mean a full-time programmer or operations person just to run it. We feel we can do it less expensively if we outsource it to an entity that is already doing it for multiple customers, who has the economy of scale.”*

*“You should concentrate on those activities...that are the nature and core of your business, and outsource those activities that are not revenue generating. Within a cost-effective mode, get rid of those things...We’ve gotten away from being involved in the transactional activity on a fairly large employee benefit plan, and we spend more time on projects that have larger payback to the corporation.”*

## OUTSOURCING IS SEEN AS A GOOD INVESTMENT

As cited earlier, reducing or controlling costs drives the initial outsourcing decision for more than one-third (37%) of the study's respondents. For many others, the issue is more complex. For them, cost control is not the sole factor driving their decision to outsource; their decisions involve the perceived longer-term benefits of outsourcing and its relative investment value. These evaluations take into consideration the technology, service capabilities, and overall expertise offered by outsourcing vendors versus the capital and staffing resources it would take to develop comparable systems and services internally.\*

Given this significant focus on value, it is not surprising that a large majority of executives (70% to 96%, depending on function) say they consider outsourcing to have been a good investment for their organizations. This is especially true of the outsourcing of defined contribution plans, with 96% of executives saying it was a “very good” or “somewhat good” investment. The same is true for health and welfare programs, with 91% saying it was a “very good” or “somewhat good” investment, and for defined benefit plan administration, with 90% citing outsourcing as a “very good” or “somewhat good” investment.

The study also reveals that investment quality was especially important to top-level and senior management—i.e., those dealing with more financial/strategic decisions. As shown in Figure 5, these executives are more likely to say that outsourcing is a “very good” investment, particularly for defined benefit plan and payroll administration. Additionally, the study suggests that the perceived value of outsourcing as a “very good” investment becomes clearer the longer a company outsources.

\*The majority of companies (about 60%) that conducted a formal cost/benefit analysis prior to outsourcing said they compared the cost of outsourcing with the cost of developing similar capabilities internally.

### VETERAN OUTSOURCERS FIND OUTSOURCING A VERY GOOD INVESTMENT

Figure 5: How decision makers rate the return on their outsourcing relationship

% very good investment	DC (n=149)	H&W (n=142)	DB (n=95)	Payroll (n=43)	Alternative Compensation (n=55)
Top level and senior management	75%	55%	55%	50%	48%
Directors and managers	76%	52%	40%	26%	50%
Veteran outsourcers (6+ years)	82%	58%	62%	53%	53%
Newer outsourcers (1–5 years)	72%	40%	32%	32%	37%

## NOT ALL COMPANIES MEASURE RETURN ON INVESTMENT (ROI)

Figure 6: Companies measuring return on investment (ROI)

### Before outsourcing implementation

	DC (n=138)	H&W (n=132)	DB (n=87)	Payroll (n=39)	Alternative Compensation (n=52)
<b>Yes</b>	51%	56%	41%	49%	35%
<b>No</b>	28%	21%	28%	23%	40%
<b>Not sure</b>	22%	23%	31%	28%	25%

### After outsourcing implementation

<b>Yes</b>	18%	23%	9%	12%	12%
<b>No</b>	70%	63%	70%	58%	69%
<b>Not sure</b>	12%	14%	21%	30%	19%

### But not everyone regularly measures ROI

Nearly half of those surveyed say they conducted a return-on-investment (ROI) or other formal cost/benefit analysis prior to their decision to outsource. About three-quarters of these respondents say they performed these analyses internally, and one-quarter of them indicate they had hired a consultant to provide an ROI analysis. Only about one in 10 asked a vendor to do such an analysis.

Among companies that did not perform an ROI analysis, about one-third to one-half (depending on the function outsourced) say they chose not to do so because cost was not a critical factor in their

outsourcing decision. Says one respondent to the qualitative survey, “I don’t think we were looking for savings; I think we were looking for efficiencies, and if savings came along with it, that was fine.”

The study also reveals that the true long-term cost savings of outsourcing are seldom known or measured, as less than one-third of the companies studied had done any formal analysis since implementation. Of these companies, an ROI analysis was done typically within one to two years of implementation.

**LESSON LEARNED >** Outsourcing is an investment that enhances service delivery without incurring dramatic increases in infrastructure expenses

Insights from finance, human resource, and benefits decision makers on **outsourcing returns**:

*“When we are trying to reduce health care costs or looking at a potentially new medical or life vendor or retirement plan, there are people who can focus on that strategic vision versus the administration. So it helps the company to continue to progress further, spend money wisely, offer good value types of benefits...things that the company can afford that ensure employees are retained.”*

*“Cost wasn’t our number one driver. We had a challenge before us and needed to maintain a certain level of service and make sure that our clients could be properly serviced. But in terms of the cost/benefit analysis, yes, we compared against the internal cost and what it would take [in terms of systems, programming, and facilities] to make that service happen internally...”*

*“Outsourcing is great. You don’t have to build the internal skills and technology. I think that if you’re looking for a way of providing increased services without incurring additional internal cost and maintenance of those programs, outsourcing is a good solution.”*



## OUTSOURCING DELIVERS ENHANCED CONTROL

### Decision makers say they gain greater control by outsourcing administrative functions

The majority of respondents surveyed say that for most aspects of their daily jobs they feel that outsourcing gives them *enhanced* control of their HR/benefits responsibilities, especially in those areas where they feel the most pressure. Of particular note, three of four (75%) say that outsourcing improves their control of regulatory and reporting requirements; 60% say they gain improved access to employee benefits data and (especially important to senior executives) more accurate and more timely HR/benefits reports; and more than half (55%) say they have more control over costs as a direct result of outsourcing. This enhanced control helps them better manage their plans and make more informed decisions.

### Concerns about lost control are limited and often vendor specific

Very few respondents (7%) say they have lost control as a result of outsourcing. Of that number, two-thirds report that they would prefer having more control over employee service delivery and communications, and the remaining third indicate a preference for more administrative control of data, reports, and staffing. Day-to-day managers of HR/benefits operations are twice as likely to cite losing touch with employee concerns as a drawback of the outsourcing process.

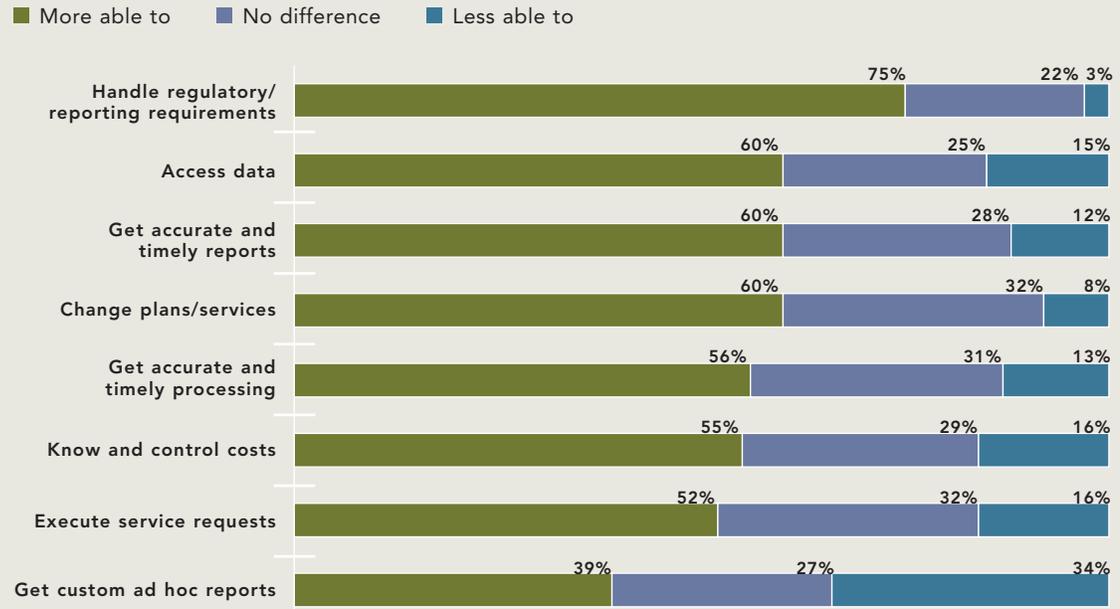
The small number of executives who say that outsourcing gives them less control cite problems with particular vendors as the primary source of their dissatisfaction, rather than problems with outsourcing in general.

Overall, the study reveals that executives at all decision-making levels, by a margin of three to one, clearly prefer having less of an administrative burden, even if outsourcing means ceding some control to a vendor.



## OUTSOURCING DELIVERS ENHANCED CONTROL

Figure 7: Change in control resulting from outsourcing (n=202)



Note that the only area where respondents indicate that control is not enhanced is in their more limited access to custom ad hoc reports. Even so, respondents are divided on this issue, with almost as many feeling they have gained more control in this area (39%) as those who say they have less (34%).



**LESSON LEARNED >** Shifting the burden of administrative processes to a vendor gives managers a greater span of control

Insights from finance, human resource, and benefits decision makers on **outsourcing and control**:

*“Ultimately, if you look at your job as being still responsible, you don’t lose control because you hold the other people accountable. And whether they’re employees of your company or an outsourced supplier, if you look at them the same way—which I personally do—and hold outsourced resources accountable just like they were sitting next door as an employee, then you still have control.”*

*“This really puts a lot more control on your benefits being administered much more consistently, which from a compliance perspective is good.”*

*“I’m still responsible, I still have control. What I’m giving up is hopefully just the routine, administrative burdensome tasks that go with performing it, but not the responsibility for getting it right. So, to me it’s just a way of allocating resources, and managers do that all the time.”*



## OUTSOURCING LEADS TO A SHIFT IN RESPONSIBILITIES

**For most decision makers, outsourcing represents a significant shift in job responsibilities, not only to more strategic activities, but also to more time spent on vendor management**

Four out of five respondents in the study indicate that the nature of their functional roles has changed significantly as a result of outsourcing, and that the amount of time spent on vendor management has increased as well. Most feel these changes are positive, however. For many, outsourcing frees them of the administrative burdens and day-to-day details of managing HR/benefits plans. Eighty-three percent report that this freedom allows them to add value by focusing more on strategic goals, such as managing benefits design and cost, or concentrating more effort on other initiatives to attract and retain top talent.

**Relatively few respondents report negative experiences with the outsourcing transition**

Half of the respondents say they expected a shift in responsibilities from direct plan administration to vendor management. About one-third say they did not anticipate this change in their role as a result of outsourcing. Most report that once outsourcing was implemented, they received training from their vendor (and sometimes from their employer) to ease the transition. About 20% of respondents in the study say they felt additional training of HR/benefits staff and employees, as well as better internal communication provided from either vendors or their own companies, would help ease the transition to outsourcing.

One in five (20%) report that the major drawbacks of outsourcing are related to the change it brings.

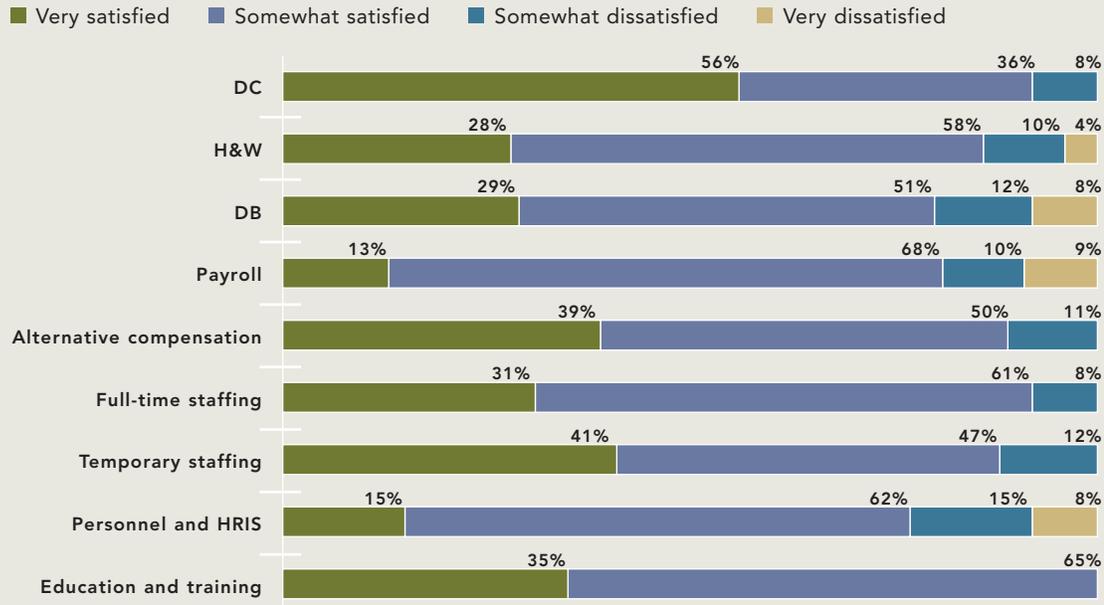
For example, slightly more than half of these respondents state that they feel they spend too much time managing vendors, especially when it comes to vendors following through on what was promised. Another one-quarter of this group of dissatisfied respondents complain of vendors that do not represent a good “fit” with their company in terms of shared cultures and values or knowledge of their business.

Despite the changes and adjustments that outsourcing entails, most of the decision makers surveyed say they have been satisfied with the transition and implementation processes. As shown in Figure 8, at least three out of four (77+%, depending on the function) indicate their satisfaction with implementation, including data and systems transfers, while nearly as many (72+%) state they are satisfied with the level of employee communication company wide (Figure 9), and even more (84+%) were pleased with staff communication within the outsourced unit.



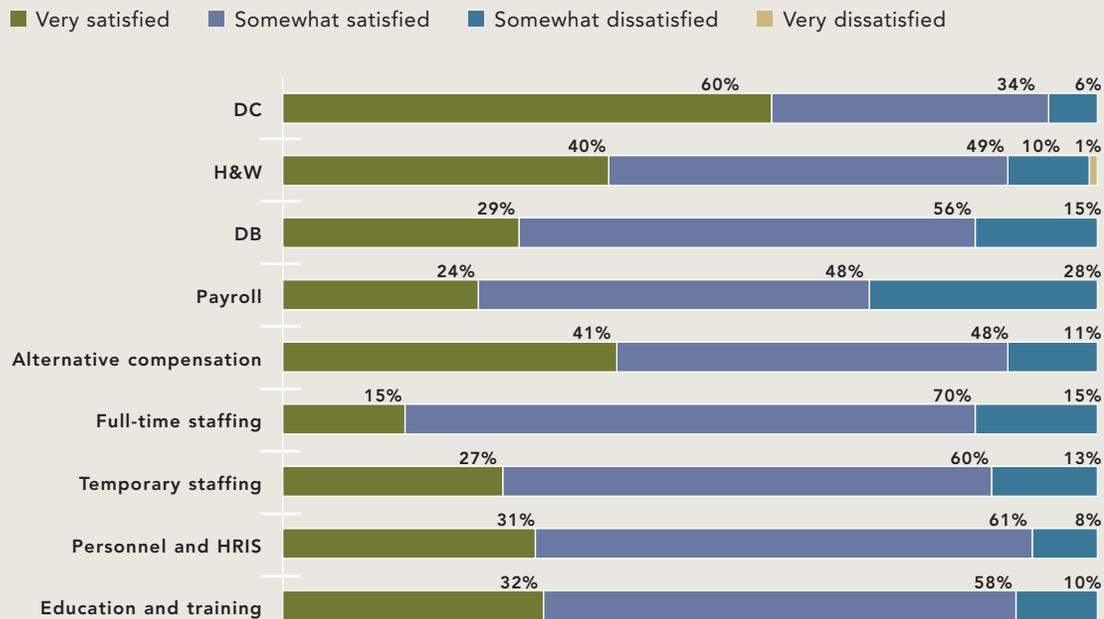
## STRONG SATISFACTION WITH OUTSOURCING IMPLEMENTATION

Figure 8: Satisfaction with outsourcing implementation



## STRONG SATISFACTION WITH EMPLOYEE COMMUNICATION

Figure 9: Satisfaction with company-wide employee communication

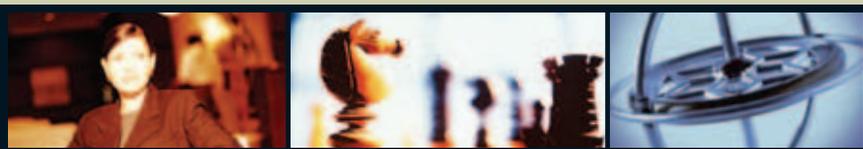


**LESSON LEARNED >** A good cultural fit with a vendor helps ease the transition to outsourcing and is key to its long-term success

Insights from finance, human resource, and benefits decision makers on **provider compatibility**:

*“A third party doesn’t necessarily maintain the same culture and same values as the organization because they are external. They don’t necessarily know how we want things done. It’s a continual challenge to get them to understand your plan, or your philosophies, or what you want done above and beyond the written [contract].”*

*“At the end of the day, if you’ve got the right vendor—and that’s the key point—you’ve got to have people who share your same values, a sense of urgency about resolving the employee’s problem, someone with the same customer focus that these are important people with serious problems. Assuming that you have the right vendor selection and you’ve got the right pricing on that contract, chances are that people that do it every day for a living are going to do it a lot better than you are.”*



**LESSON LEARNED > Finding a vendor that can provide comprehensive solutions enhances the effectiveness of outsourcing**

Insights from finance, human resource, and benefits decision makers on **provider effectiveness**:

*"I guess I would say that there is a great deal of effectiveness that can be gained by having a single source—in essence, one-stop shopping for your employee population. That they can always go to a single source and get their issues addressed. And get consistent information so you don't have one pocket of employees getting one bit of information and somebody else being told something else. You're able to streamline your processes and keep them consistent."*

*"One thing that you would probably want to do if you were an organization like we are...is to align your retirement plans administration together, i.e., your pension and your 401(k), with the same administrator. If you can throw your health and group benefits into that equation as well, that would be helpful. Having two different ones is cumbersome; there is some connection there, but still it's cumbersome."*



## CONCLUSION

The outsourcing of HR/benefits administration is a quickly evolving trend among the country's largest companies, and their level of satisfaction with their outsourcing experiences is proving to be consistently strong. As corporate America is constantly challenged to make the most efficient use of resources, corporate executives—and particularly those at senior management levels—view outsourcing the administration of their HR and employee benefits programs as a good financial investment, given the specialized expertise and expanded capabilities that outsourcing vendors provide. It is an investment decision that most would make again.

Over time, employer satisfaction is ultimately predicated more upon the relative value that outsourcing typically brings to the fore, including enhanced service quality, access to vendor expertise and currency on HR/benefits issues, assistance with regulatory compliance, and the ability to redirect internal resources. Companies generally place less emphasis on direct measures of cost reduction over time, although cost reduction is often the reference point for many companies' initial decision to outsource.

Management control of administrative processes is not lost through HR/benefits outsourcing. In fact, many executives feel they achieve greater levels of control of these processes through enhanced handling of compliance issues, better data accuracy and timeliness of reports, and more consistency in service delivery. Moreover, outsourcing helps relieve staff of administrative burdens, allowing them to focus more energy on strategic, value-added activities.

Finally, companies that partner with outsourcing vendors that share their cultural values and are able to provide comprehensive services for a full range of HR/benefits programs are the companies most satisfied with their overall outsourcing experience.



