A Journey of Good Sense and Good Results

The “new normal” for public sector organizations is about doing more with less. The need for services hasn’t decreased; in fact, in many cases, demand has increased dramatically. At KPMG, we work with public sector clients every day to enhance their services/spend ratio – helping agencies be good stewards of taxpayers, contributors, and citizens’ hard-earned money. As such, we help our clients identify and evaluate all options for delivering human resources (HR) services in the most effective and efficient means possible. Here, we discuss HR and how the new normal affects the function and its delivery of services to employees. In a companion paper, we discuss new thinking in information technology (IT).

In recent years, public sector organizations have stepped up their exploration of alternative service delivery models for business support functions. A sour economy has led to significant budget cuts across government and not-for-profit organizations everywhere. It also has encouraged public sector executives to look at less costly and more effective ways of supporting the operations. The concept of shared services has emerged as a popular and value-driven option.

Public sector organizations have adopted and expanded their use of alternative delivery models over the past decade. While cost reduction is always top of mind, many in the public sector view shared services as a key means to fundamentally improve services delivery to internal users, as well as change the mindset for how HR brings value to an organization.

As shared services expands, its usage and organizations seek a wider array of benefits, both cost- and service-focused, three questions are commonly asked:

- Is there a standard journey for shared services deployment in HR?
- What benefits are HR leaders seeking and realizing through their use of this service delivery model?
- What are the lessons learned, and how can public sector organizations use them to accelerate their own journeys?

To address these questions, KPMG has undertaken an ongoing research initiative to analyze the organizational impact of HR shared services on a number of leading public sector organizations.

Research findings reinforce the KPMG position that adopting, deploying, and expanding shared services is a never-ending journey. The initial benefits are typically cost savings resulting from economies of scale and scope, better leverage of technology, standardized business processes, expanded use of performance metrics, and a reduction in the number of people required to deliver services. The destination and longer-term benefits typically are a moving target dependent on changing needs and conditions. They run the gamut from further cost savings to enhanced process performance, higher quality services, and overall business improvement.
Key Research Summary

In the spring of 2012, KPMG interviewed several HR leaders in the public sector. Three actions stood out as being critical to organizations driving greater HR optimization through the use of shared services:

- Other functions, such as IT, had gone through consolidation and shared services deployment phase. HR was seen as the next “logical” group to transform.
- The executive branch supported constructing a vision, as well as supporting implementation at all levels of government.
- Budget cuts in the 2008–09 timeframe necessitated new and more efficient ways of delivering services. Streamlining HR processes and management was seen as one starting point.

Key Findings

Go big or go home: HR shared services often get “stuck” below their desired levels of delivery scope and excellence. It was critical to consolidate HR management as quickly as possible into one shared services organization, especially for large agencies. Only one state, where HR shared services faltered, adopted a very incremental approach focusing only on the smaller agencies.

Short- and long-term vision must be balanced: There is an immediate need to get to shared services critical mass as soon as possible since enthusiasm, funding, and sponsorship can be rolled back at any time. The successful implementations took roughly two years to complete.

The greatest hurdles are man-made: Deliberate underfunding by agencies or legislatures, union conflicts, and lack of communications among all stakeholders are the primary reasons for failed shared services initiatives.

Show me the money: As governments struggle with funding issues, shared services/outsourcing can visibly cut costs. Public sector institutions should keep constant vigil on all value drivers from a cost-benefit and efficiency perspective.

Automation is a critical part of the process: The most successful HR shared services organizations had IT and applications development front and center in their plans for automation and process redesign. The following quotes underscore the importance of this critical success factor.

“We streamlined and automated transaction functions so that we can add value where it is most important. We are strategic HR business consultants. Shared services freed up the time to allow us to take on this role. You need IT and information systems in place before you even start shared services. You have to be on a central system for the HR ’apps’ and the data warehouse. You start with this and then do the organizational design,” noted James Honchar, Deputy Secretary of Human Resources and Management, Commonwealth of Pennsylvania.

“We have a very sophisticated applications system for HR. This makes centralization of processes possible,” said Jeff Herring, Executive Director for the Utah Department of Human Resource Management.
KPMG focused on three primary areas during this research initiative. These include:

- Evolution of shared services journey—what are the drivers and best paths to optimization?
- Governance and organizational imperatives—what works and what doesn’t?
- Enablers and barriers—what needs to be overcome?

**Evolution of the Shared Services Journey for HR**

Almost without exception, the first step to optimization was placing HR managers (who previously were located within specific agencies) into a centralized HR organization. Generally, these managers have two reporting relationships—one to the agency heads and the other to the enterprises’ chief HR officer. With the change in reporting relationship to a centralized organization came many of the transactional services that had previously been managed by each agency (employee records and information access, enrollments, payroll, training, etc.).

This centralization of staff processes and services allowed two radical transformations. The first is standardization and improvement of service delivery across the entire organization and the orient of HR managers to focus on value-added services such as employee mediation, manpower planning, executive training, etc. Centralization of staff also allowed for greater process standardization and specialization of experience among HR managers, which increased effectiveness, lowered cost, and added value. Figure 1 shows the migration of shared services organizations. There is an “outside in” orientation when the organization starts its journey and an “inside out” focus on transaction and value-added services delivery with maturity.

“We started the process by bringing 170 professionals from the field into the central office. Their first job was to do a major classification effort as an underpinning for greater standardization,” explains Jeff Herring.

“One of our longer-term goals was to align competencies where departments could share HR professionals and they could then specialize. This has added a significant value-added component to HR delivery,” noted James Honchar.
Governance

Typically, shared services start as top-down organizations where decision making is centralized within shared services, sponsored by the executive branch that includes agency management (both business and technical) for policy and operations decisions. Over time, decision-making authority is shared with agency management (the CIOs and agency heads). Day-to-day responsibility for managing outsourcing contracts and activities always remains with shared services management, adhering to strict reporting and accountability responsibilities.

There is generally a logical split of delivery between local and centralized services; for example, day-to-day labor relations functions reside in the agencies. This is a conscious decision that is made when the shared services organization is established. Through centralization, HR managers have more policy-making responsibility, because there are standardized frameworks and boundaries for them to use.

“Because we are all under one roof, we could put together policy teams around recruitment, compensation, etc. We turned over keys to the castle to the field managers once they were centralized by giving them input into policy decisions. This allowed us to get greater buy-in and give them central support for local decisions by having a single source of data to make decisions,” said Jeff Herring. “Centralization of data is huge. You just can’t tell stories anymore; you have to provide models. Centralized shared services supports this use of business intelligence. It drives our workforce planning.”
Case Study: State of Utah

Background:
Before 2006, every department in the state had its own HR department. Policy was set on a statewide basis; however, the 30 state agencies would each comply differently with the policies. There was a change of administrations in 2007, and a decision was made to consolidate IT and HR and move to a shared services delivery model.

Objectives of shared services:
The initial objective was to increase overall effectiveness as well as provide more specialized experience in HR. Fiscal considerations became more critical in the 2008–09 timeframe.

Scope of project:
One hundred seventy professionals became part of the central HR department. It was then possible to put policy teams together around recruitment, compensation, etc. All employee communications (benefits processing, payroll, employee inquiries, etc.) were centralized into a resource center in 2010.

Benefits:
Reduction of roughly 20 percent of staff. The other critical benefit is the centralizing of all data and the development of a data warehouse/business intelligence platform to assist in HR and manpower planning. However, the data followed the HR employees into the shared services organization.

Lessons learned:
IT and information systems need to be in place before beginning HR shared services. It is important to continuously improve the infrastructure and tools to help managers do their jobs better. Keeping some functions decentralized is important, especially as it relates to employee relationship interaction.
Case Study: State of Pennsylvania

Background:
HR shared services started in 2009, but the state started looking at this in 2005. A $4 billion deficit drove everyone to look at where they could save. Cost reduction was the catalyst driven from the executive office.

Objectives of shared services:
The first objective was to consolidate HR staff where possible in the agencies themselves. The second was to eliminate dedicated staff in smaller agencies and handle their needs on a centralized basis including training, recruiting, etc. The third objective was to standardize all policies and procedures.

Scope of project:
Pennsylvania took a hybrid approach with HR managers having a dual reporting relationship to agency heads and to the head of HR. In 2010, it started an HR services center that:
- Took over all transactional activities for employee life cycle for all agencies
- Organized an employee services center to handle all inquiries regarding payroll, health benefit enrollment, deferred compensation etc.

While training and development is still handled mainly by the agencies themselves, a centralized computer-based training function was implemented.

Benefits:
The main benefit, aside from saving roughly $3.5 million per year in operating costs, is to have greater cross-agency collaboration. This allows the pooling of resources to save money, and shared services was the catalyst. In addition, error rates have gone down substantially and over- and underpayments have decreased significantly.

Lessons learned:
While phasing implementation may have been easier, the concern was that the project would never have gotten off the ground with an incremental approach. “Pulling the Band-Aid off” and moving right to consolidation of the largest agencies was the most efficacious path. With determination and focus, the preponderance of the organizational and process changes were made in about one year.

Another lesson learned is to have the structure in place so that the transition negotiations are not undertaken separately with each and every agency, possibly necessitating multiple integration approaches. Even with a directive from the governor, there was resistance to the changes by the agencies.

The final lesson is to not cut too much. It was estimated that a reduction up to two times greater was feasible; however, it was decided that this approach would cause too much disruption and loss of support from the agency heads.
Doing More With Less

As shared services environments mature, there is an imperative to continue to drive economies of scale. The question organizations ask is, “How can shared services reduce staff within the service centers themselves for transactional services while at the same time expanding services at increasingly lower costs?” An example is onboarding—how can an organization get the most paperwork and processes done before the employee walks in the door? This will ultimately increase productivity, not just for shared services, but for the organization as a whole.

The other key imperative is to implement shared services quickly. In the case of the Commonwealth of Pennsylvania, it set a 13-month timetable, with the biggest agencies coming online first. Shared services had top-down leadership in place, and if it had been forced to negotiate the inclusion of each and every agency, the initiative would never have gotten off the ground. Even with a directive from the governor, the shared services organizations still had considerable pushback from agencies.
Lessons Learned

There are seven important take-aways emphasized across all of the study participants. These lessons serve as a roadmap for shared service deployment initiatives:

**Cut enough, but not too much:**
One organization reduced staff by 70 employees and could have cut two times this if had been more assertive. However, it needed to get buy-in quickly, so it needed a budget catalyst and not a sledgehammer.

**Invest in IT applications:**
HR infrastructure and process improvements help ensure service delivery integrity. Focus on developing infrastructure for data and tools for managers.

**Have a sophisticated applications system for HR:**
This makes centralization of processes possible. IT and information systems need to be in place before you even start—at minimum, a central system for the HR applications and the data warehouse. Start with this, and then move to the organizational design. Follow up with centralized transaction processing.

**Take on big projects, but implement in small-sized portions:**
This shows progress. The State of Utah did employee services first and then the on-boarding piece.

**Move up the value chain as quickly as possible:**
Transaction services pay the bills for shared services, but value-added services convince internal stakeholders.

**Use shared services as a way to centralize all data gathering and analysis:**
Performance management is as much about data as it is about effective processes and rules.

**Consider outsourcing, but weigh the true incremental costs before making a decision:**
In many cases, facilities are a sunk cost, and the true incremental costs for shared services are mainly variable. An outsourcing provider usually charges for all fixed and variable costs. The state of Pennsylvania provides HR services for $79 per employee per year on a variable cost basis. It is doubtful an outsourcer could match this rate if overhead costs were included.
The Research Construct

In February and March 2012, KPMG and its research partner, Market Probe, conducted a series of in-depth interviews with HR executives in a cross-section of states: Utah, Georgia, and Pennsylvania. These managers were asked detailed questions on shared service and outsourcing deployment.

The respondents were either heads of shared services and outsourcing or the head of HR with state or organization-wide responsibility. Most have been in their present roles for over 3 years, and have more than 10 years of overall HR management experience.

All the participating organizations started their global business services deployment less than five years ago.

The main goal of this research study is to understand how the use of shared service and outsourcing is driving HR optimization within these major governmental agencies. As part of this goal, we examined the organizational, process, and governance framework as well as the key drivers, benefits, and lessons learned in shared service and outsourcing.