Chapter 8

Cost Justifying HRIS Investments
MEASURING HUMAN RESOURCE EFFECTIVENESS: WHY DO IT?

• Market the function
• Provides accountability
• Demonstrate contribution to bottom line
• Cost justify HRM programs
• Tie to strategic planning
IDENTIFYING HRIS VALUE

• HR moving from being a cost center to profit center (Cascio, 2000)
• Traditional financial measures not sufficient – Many HR outcomes are intangible, eg. Employee engagement
• Direct (hard) & Indirect (soft) benefits
• Implementation costs: Direct (h/w, s/w, customization); Indirect (lost productivity)
• Timing of benefits (short & long term)
EVALUATING HUMAN RESOURCE PRACTICES: APPROACHES

• Audit approach – Key Indicators
  reviews outcomes of HR functions
  benchmarking

• Analytic approaches – best practices
  1. determines whether program had intended
     effect/impact: Fitz-Enz
  2. estimates costs / benefits of program utility analysis:
     (CBA)
HRIS COST BENEFIT ANALYSIS

• Language of business is dollars & HR should learn this language
• HRIS CBA: Comparison of projected costs & benefits
• Covers full suit of HRIS functionality (transactional/ traditional/ transformational)
• HR Metrics: Absence rate/ Cost per hire/ Healthcare costs/ HR Expense factor/ Human capital ROI & value added/ training costs/ turnover costs/ OHS costs...
• Compare costs/ value within & outside
JUSTIFYING HRIS COSTS

• Risk Avoidance strategies
• Organization Enhancement Strategies: Increased revenue or reduced costs due to new/improved HRIS
• Evolution: Manual to automation; web applications; further improvements will have incremental not radical benefits; Value add is seen as more important than cost reduction but how to measure it?
### GUIDELINES TO SUCCESSFUL CBA

(Table 8.1)

<table>
<thead>
<tr>
<th>Key</th>
<th>Description</th>
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<tbody>
<tr>
<td>The objective is improving organizational effectiveness.</td>
<td>The objective of any HRIS CBA is not to purchase specific hardware or software. The objective is to improve organizational performance.</td>
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<tr>
<td>Be honest with yourself.</td>
<td>Start each analysis with an open mind, not an investment to justify.</td>
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<tr>
<td>Focus on functionality, not products.</td>
<td>The analysis should focus on the improvement in organizational functionality that is to be achieved. Start with that functionality, and let it lead to the product. Don’t start with the product and attempt to identify ways to justify its purchase.</td>
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<tr>
<td>Estimate benefits first.</td>
<td>Examine costs only after you have completed the analysis of benefits.</td>
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<tr>
<td>Know your business.</td>
<td>This means really understanding what your business is and how your current processes allow your organization to accomplish its objectives. Understand the dynamics of your current processes and where potential for improvement can be found. Understand organizational politics.</td>
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<tr>
<td>Develop the best estimate possible.</td>
<td>Don’t be overly optimistic or conservative. Develop the best estimate you can with the data available to you. This is the core of making the business case.</td>
</tr>
<tr>
<td>Separate the development of CBA estimates from questions of how best to package the analysis to justify a final decision.</td>
<td>The questions involved in developing an accurate CBA and attempting to determine how best to justify a choice to organizational decision makers are two separate processes. The latter involves choices about which sources of value should be included in the business case to be presented to decision makers. These are determined by the relative comparisons of costs with the magnitudes and types of revenue sources. Decisions about how to package the analysis for decision makers should be pursued only after a thorough analysis based on best estimates of all benefits and costs has been accomplished.</td>
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HRIS CBA INVESTMENT ANALYSIS

• Requires three basic pieces of information
  – (1) sources of costs and benefits,
  – (2) an estimated dollar value for each cost and benefit item, and
  – (3) the time when the organization will incur each cost and receive each benefit.
<table>
<thead>
<tr>
<th>Benefits</th>
<th>Revenue enhancement</th>
<th>Direct (Hard)</th>
<th>Indirect (Soft)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1 New revenue</td>
<td>2 Improvement potential</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(new sales)</td>
<td>(better decision making)</td>
</tr>
<tr>
<td>Cost reduction</td>
<td></td>
<td>3 Direct costs</td>
<td>4 Potential costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(canceled vendor contracts)</td>
<td>(saved staff time)</td>
</tr>
<tr>
<td>Costs</td>
<td>New implementation costs</td>
<td>5 Out-of-pocket costs</td>
<td>6 Indirect costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(software, service agreements)</td>
<td>(increased technical support needs)</td>
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## EXAMPLE OF AN E-LEARNING CBA MATRIX

(Table 8.2)

<table>
<thead>
<tr>
<th></th>
<th><strong>Direct (Hard)</strong></th>
<th><strong>Indirect/Contingent (Soft)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue enhancements</strong></td>
<td>Conducting custom e-learning training module development for other organizations</td>
<td>Better customer service leading to increase in repeat sales</td>
</tr>
<tr>
<td></td>
<td>Sales of locally developed learning modules or programs</td>
<td>A more agile organization able to respond rapidly to market changes</td>
</tr>
<tr>
<td><strong>Cost reductions</strong></td>
<td>Reduced travel expenses</td>
<td>Improved training effectiveness through customization and just-in-time delivery = faster</td>
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<tr>
<td></td>
<td>Reduced facilities costs (e.g., for room and equipment rentals and refreshments)</td>
<td>learning curve, less lost productivity while waiting for training, and right amount and</td>
</tr>
<tr>
<td></td>
<td>Reduced requirements for paper-based training materials and teaching aids</td>
<td>type of content</td>
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<tr>
<td></td>
<td>Reduced expenses for instructor fees or salary and benefits costs (if internal)</td>
<td>More agility, able to disseminate new cost-reducing best practices more quickly</td>
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<tr>
<td></td>
<td>Reduced costs for replacement workers if trainees are required to be away from their work</td>
<td>Reduction in turnover (41% of employees will look for another job within 12 months due to poor training and education; with good training and education, this percentage drops to 12%) and in absenteeism</td>
</tr>
<tr>
<td><strong>Costs of implementation</strong></td>
<td>Installation support</td>
<td>Increased use of end-user help desk</td>
</tr>
<tr>
<td></td>
<td>Training administrator</td>
<td>Courseware redevelopement</td>
</tr>
<tr>
<td></td>
<td>Software fee/license development</td>
<td>Lost productivity during conversion to new system</td>
</tr>
<tr>
<td></td>
<td>Courseware</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Software support</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Courseware purchase</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Analyst/administrator</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bandwidth fees</td>
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ESTIMATING INDIRECT BENEFITS

1. Estimating benefit magnitude

2. Mapping benefits to cost or revenue changes

3. Converting magnitude estimates to $s
   - Eg., Estimating the value of ‘exit interviews’ in reducing turnover
# APPROACHES TO ESTIMATING BENEFITS (TABLE 8.3)

<table>
<thead>
<tr>
<th>Approach</th>
<th>Description</th>
<th>When to Use It</th>
<th>Advantages/Limitations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct estimation</td>
<td>Direct (&quot;gut level&quot;) estimates of the relationship of the potential benefits to the estimated costs of engaging in an investment</td>
<td>Best when costs are not large&lt;br&gt;Appropriate when attempting to gain compliance or mitigating extreme risks&lt;br&gt;When substantial direct cost reduction or revenue enhancements exist</td>
<td>Quick and low cost to perform&lt;br&gt;May not provide data that contain sufficient detail for use in monitoring implementation effectiveness or to perform follow-up analyses&lt;br&gt;Highly dependent on the expertise of the decision maker</td>
</tr>
<tr>
<td>Benchmarking</td>
<td>Using benchmark data from other firms to estimate the potential benefits and costs that are likely to result from the purchase of HRIS functionality</td>
<td>Superior to direct estimation when costs are large&lt;br&gt;When the organization either has limited experience or no data concerning the area of functionality</td>
<td>Allows the organization to develop more precise estimates than direct estimation based on the collective experience of other organizations&lt;br&gt;Average estimates of outcomes may not generalize to the target organization</td>
</tr>
<tr>
<td>Internal assessment</td>
<td>Analysis based on specific internal assessments of actual costs and likely benefits (e.g., activity-based costing)</td>
<td>When costs are high and benefits are not obviously dramatically larger than costs&lt;br&gt;When the organization has the assessment capabilities in place to gather the appropriate data</td>
<td>Provides the most precise estimates of the baseline costs and current performance of existing processes against which to compare potential improvements&lt;br&gt;May increase both costs and time required to make decisions</td>
</tr>
<tr>
<td>Mix and match</td>
<td>Using combinations of these approaches</td>
<td>When different amounts or sources of information are available for different types of costs and benefits (e.g., most likely scenario)</td>
<td>Permits the organization to use the best methods available</td>
</tr>
</tbody>
</table>
GENERAL CATEGORIES OF COSTS OF HUMAN BEHAVIOR IN ORGANIZATIONS

- Turnover
- Absenteeism and sick leave
- Effects of Smoking in Work Place
- EAP & Wellness programs
- Employee attitudes
- Labor contract costing
- Recruiting
- Selection
- Job Performance
- Training
- Career Development
COSTING THE EFFECTS OF SMOKING

- Incremental Absenteeism
- Incremental Medical care
- Incremental Morbidity and premature morbidity
- Incremental Insurance
- Incremental On-the-job time lost
- Property damage and depreciation: Burns & odors
- Reduced Maintenance
- Involuntary smoking – 2\textsuperscript{nd} hand smoke
COSTING EMPLOYEE TURNOVER

• 3 components of costing employee turnover
  – Separation Costs
  – Replacement Costs
  – Training Costs
SEPARATION COSTS

• The four components of separation costs are as follows:
  – Exit Interview
    • Interviewers time
    • Termination time
  – Administrative Functions Related to Termination
    • Removal of employee from payroll
    • Termination of employee benefits
    • Turn-in of company equipment
  – Separation Pay
    • Severance packages
  – Increase in Unemployment Tax
REPLACEMENT COSTS

• Replacement costs consist of eight components:
  – Communication of job availability
  – Pre-employment administrative functions
  – Entrance Interviews
  – Testing
  – Staff meetings
  – Travel and moving expenses
  – Post employment acquisition and dissemination of information
  – Medical examination
METHODS FOR ESTIMATING THE VALUE OF INDIRECT BENEFITS: EMPLOYEE TIME SAVED

• Average Employee Contribution (AEC)
  – baseline contribution value by jobs that is consistent with the actual financial performance of the organization.
  – AEC = (Net revenues – Cost of goods sold)/No. of employees

• Individual employee differences (variance) in work outcomes
  – variance differences are produced by a large number of individuals holding equivalent positions
  – basis for utility analyses for developing contrasting cost-benefit ratios
PROBLEM AVOIDANCE: KEEP IN MIND THESE THREE ISSUES WHEN DOING A CBA

• DO NOT ignore HR’s more strategic role in improving organizational effectiveness

• CAREFULLY EXAMINE YOUR COST AVOIDANCE AND MAKE SURE WHICH ARE DIRECT AND WHICH ARE INDIRECT – document your assumptions for later use.

• Be sure that value estimates assigned to time saved are reasonable