



DMS Outsourcing Project

Business Case

Executive Summary



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INTRODUCTION

The Department of Management Services (DMS) contracted with MEVATEC to conduct a thorough business case analysis to determine the feasibility of outsourcing many of the State of Florida's human resource (HR), payroll, and benefits services. MEVATEC will apply their outsourcing expertise throughout the process of selecting a service provider, ensuring that the State is offered the best service for the best price.

Over the past several weeks, MEVATEC has worked intimately with DMS and the other impacted state agencies to gather and compile massive amounts of cost data to identify the State's HR, payroll, and benefits operating costs. As a result of this study, MEVATEC has determined that the State will save several million dollars. In order to take advantage of these potential savings, DMS and MEVATEC have completed many steps of this process. DMS released a request for information (RFI) to the private sector, which revealed that there are several companies qualified to provide the State the service needed. MEVATEC is 95% complete with developing the work description and evaluation scheme for the pending Invitation to Negotiation (ITN) expected to be released mid-March 2001.

In addition, DMS and MEVATEC are working closely with all agencies to address their questions and identify their concerns with HR, payroll, and benefits outsourcing. In fact, working groups have been formed to identify each agency's concerns, their processes, and their unique needs. This information is being used as the basis of the work description and the basis of a model HR residual organization.

Currently, the potential impacted agencies are working on a transition plan ensuring that the State maintains the necessary employees for the residual organization, while also ensuring that any potentially displaced employees are offered employment within the State or with the potential service provider.

OBJECTIVE

The objective of the DMS outsourcing project is to obtain a world-class service provider of HR, payroll, and benefits services. The current scope of the services impacts 1384 full time equivalent (FTE) positions across 30 agencies. The baseline scope of services includes:

- Time, attendance, and leave
- Basic recruitment services
- In-process services
- Employee record management
- Gross pay calculation
- Benefits and flexible spending account management
- Retirement enrollments
- State training (not agency specific)

BACKGROUND

An outsourcing study is one of three options the State of Florida has available to consider in its efforts to efficiently provide State services. The first option is to continue performing the services in the current environment at the current performance level. The second option is to replace the current hardware and software but retain the performance in-house. The third option is to consider outsourcing the services. The State has reviewed the first two options and considers them unacceptable for cost and performance reasons. This project reviews the third option - outsourcing.

Potential future in-scope customers include the 67 county health departments, State Courts Administrator and the Justice Administration Commission. If payroll production in addition to payroll preparation is outsourced, then the State University System, Legislature, and Auditor General potentially would be impacted.

BENEFITS OF OUTSOURCING

The State of Florida will receive a number of benefits from outsourcing the HR, payroll, and benefits services. The State will avoid the cost of rebuilding the current Cooperative Personnel Employment Subsystem (COPEs),¹ which estimates indicate would cost approximately \$65—90 million.² This benefit would free up an outlay of dollars for the State's other initiatives and agenda items. In addition, a successful outsourcing decision means the State would receive the HR, payroll, and benefit services at a lower cost than the current cost of in-house operations. Thus, the net savings would be equal to the cost avoidance of replacing COPEs plus the reduction in operating cost of HR, payroll and benefits services.

Furthermore, a decision to outsource will result in the vendor providing state of the art technology to perform the requested services. Vendors are able to provide state of the art technology as part of their service solutions because it is their core business. Consequently, the State can take advantage of cutting edge technology without having to pay the capital cost of building the technology; the result being that the State immediately improves performance and better serves its employees.

EXPECTED SAVINGS

Outsourcing decisions are made to generate savings and, in many cases, provide an immediate improvement in performance because of access to newer technology. These decisions are based on economic models, referred to as a business case analysis, which compares the cost of in-house performance to the cost of the outsource decision.

MEVATEC relied on a number of sources of empirical data to predict the savings the State of Florida will experience, including but not limited to, the Department of Defense (DoD), the Virginia Commonwealth Competition Council, and discussions with the

¹ See § 110.116, Fla. Stat. (2000) (formation of the personnel information system); see also § 215.94(5), Fla. Stat., (2000) (defining of COPEs functions).

² This number is extrapolated from the KPMG study performed for the FFMIS Board and Council as part of the IFMS study.

Outsourcing Institute. DoD reports, on average, a 31%³ savings experience against total operating cost and 43%⁴ savings in FTEs. The level of competition, the quality of the ITN, the evaluation issues, and the extent of the services outsourced are important factors that determine actual savings.

MEVATEC determined the "as is" cost of the State's associated operational expenses and the 1384 FTEs currently performing the HR, payroll, and benefits services across 30 Agencies as \$77,686,777. A detailed explanation of how the "as is" cost was developed is found in the section titled In-house Cost Data. When savings are calculated the "as is" costs are divided into three sections: (1) Residual Organization; (2) Savings Margin; and (3) Outsource Cost.

The residual organization is composed of the functions the State must continue to perform (i.e., those functions and activities that are managerial or policy in nature). For example, the residual organization will administer the contract, certify payroll and make hiring decisions—these type actions must remain with the State. Our experience is that the State must retain approximately 15% or less of the current FTEs to perform the functions of the residual organization. Thus, the remaining in-house cost of approximately \$66 million was used to predict the range of savings the State should expect when it outsources its HR, payroll, and benefit services. This analysis clearly suggests that the State will save several million dollars. Savings can be maximized by strategically planning the scope of the services to be outsourced; generally, the larger the scope then the larger the savings.

³ Center for Naval Analyses, Analysis of DoD's Commercial Activities Program, Dec 1996.

⁴ Department of the Air Force, Good News Report – 4th Quarter 00.

METHODOLOGY

In House "As Is" Cost Data

The business case in-house cost was developed using cost information retrieved from a number of sources. All cost data provided is actual cost for the fiscal year ending June 30, 2000. COPEs data provided personnel information and each agency provided actual cost data for the other cost elements identified in Figure 1. MEVATEC reviewed the data and used a number of techniques to formulate the raw data into a model that ensured costs were correctly composed. Developing the cost of in-house services was an iterative process with DMS requesting cost from the agencies or COPEs, MEVATEC reviewing the costs, and DMS and the agencies verifying MEVATEC's product as it was developed.

<u>Business Case for In-house Cost</u>	
Total Personnel Cost (1384 FTEs)	\$ 59,234,495
Material & Supply Cost	\$ 3,638,897
Facilities	\$ 1,314,007
Equipment	\$ 1,392,646
Telephones	\$ 510,402
Postage	\$ 551,128
Security	\$ 206,753
Archiving/Data Storage	\$ 23,260
Printing	\$ 565,202
Casualty Insurance	\$ 854,724
Training	\$ 21,055
Travel	\$ 709,903
Computer System Expense	\$ 6,834,034
Attorney Fees	\$ 514,912
Counseling	\$ 316,226
Other	\$ 999,131
TOTAL	\$ 77,686,777

Figure 1 In-House "AS IS" Business Case Model

Business Case Model

Sufficient data exists, as provided in this report, to predict sufficient cost savings to persuade the State to continue with the outsourcing analysis for obtaining a service provider. The next step is to determine the cost of vendor performance.

The complete business case model can be viewed as two sides of an equation:

Cost to the State for

In-house Performance verses Vendor Performance

Figure 1 provides the cost details for the in-house performance. Figure 2 provides the cost elements for the vendor cost of performance.

Vendor Cost	\$
Residual Organization Cost	\$
Tax Credit ¹	(\$)
Transition Cost ²	\$

¹ If the selected vendor resides in the State there potentially will be an increase in corporate taxes received. The taxes are considered a credit in the business case model.
² The State will incur cost to transition the service to the vendor.

Figure 2 Business Case Format for the Cost of Outsourcing

Acquisition Phase

To complete this business case model vendor costs are solicited. An ITN is developed and released to industry. MEVATEC will use a statement of objectives (SOO), which is a high-level statement of work that focuses on desired results or outcomes. Figure 3 provides a SOO example. Our acquisition strategy is two fold: (1) encourage innovation and (2) efficiency balanced with cost. Major tasks are defined by the critical, essential, and desired requirements. During the evaluation, vendor offers are reviewed to determine which offer is the best fit to perform the HR, payroll, and benefits services. A key evaluation factor is reviewing each offeror's potential for hiring displaced State employees assuming the State employees are not sufficiently satisfied with other State opportunities. Generally, offerors actively seek to employ incumbent employees because of their knowledge of the State processes, which results in a better transition.

Performance Objective: Provide on-line capability for authorized users to query system for information.

- Critical Objective: Security – limit access to authorized personnel within established parameters.
- Essential Objective: Pre-established reports.
- Desired Objective: User friendliness of flexible query capability.

Figure 3 SOO Example

Core Processes verses Inherently Government Responsibilities

During the development of the SOO all processes and activities are reviewed to determine which are of such importance to State operations to preclude a vendor from performing. HR working groups have identified initially the activities to designate government in nature (GIN). These activities are considered core responsibilities of the State and are not considered outsourceable. The vendors will only bid on those services deemed non-core (i.e., not GIN).

Outsourcing Decision

Once the vendor is chosen, the vendor's actual price is inserted into the business case model to more objectively determine the actual expected savings. At this point, the ultimate decision of whether to outsource is made. If an outsourcing decision is made, detailed transition and implementation plans are utilized to minimize any disruption to the services.