

WHITE PAPER

BENEFITS ADMINISTRATION — THE IMPACT OF OUTSOURCING ON THE TOTAL COST OF OWNERSHIP

Sponsored by ADP

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EXECUTIVE OVERVIEW

Executives are constantly looking for ways to evaluate the performance of corporate functions with regard to cost, service, quality, and risk. Benchmarking with similar companies is one way they attempt to do this. The challenges faced with benchmarking are many, however, as benchmarking becomes difficult if:

- Companies don't use the same methodology for accounting for all costs,
- Some companies spread a function across organizational units, and others centralize,
- Some companies outsource a function while others perform the same function in-house, and
- Companies don't have an industry benchmark to use as a point of reference.

Through the use of the Total Cost of Ownership (TCO) model of accounting, these challenges can be overcome.

SOURCING ANALYTICS performed a TCO study of the costs of delivering health and welfare benefits administration and compared the costs of in-house administration to the costs of outsourcing to Automatic Data Processing (ADP). The results of this study reveal that on average, the cost per employee with outsourcing is less than the cost of performing benefits administration in-house (\$199 vs. \$165).

Moreover, the average cost per employee when outsourcing while utilizing an ADP employee call center for support is less than the cost of outsourcing without the call center (\$182 vs. \$151).

This study appears to be the first of its kind which specifically quantifies the costs of benefits administration. While many studies have documented the costs of healthcare in general, none have been found related to administration.

This white paper will document the study which was sponsored by Automatic Data Processing, Inc. (ADP). It will describe the methodology used and report in detailed fashion the following key findings:

- Outsourcing benefits administration is, on average, less expensive than in-house administration.
- Companies including employee call center services in the outsourcing arrangement experience lower average TCOs than companies outsourcing administration service alone without call centers.
- The cost relationships described above are seen across company-size groupings.
- The cost relationships described above apply regardless of benefit program complexity.
- Despite the lower average cost, this study finds that companies outsourcing benefits administration are much more likely to use Web-based, employee self-service technology than companies administering benefits in-house.

Study Purpose

SOURCING ANALYTICS was commissioned by ADP to perform a survey of companies with more than 1,000 employees. The purpose of the study was to:

- Define the TCO components for health and welfare benefits administration,
- Determine the total cost of health and welfare benefits administration, and
- Compare the costs of in-house administration to the costs of outsourcing to ADP.

Data Collection

In order to gather the data necessary to complete the study, SOURCING ANALYTICS designed an independent survey tool, which was distributed during the second quarter of 2005. Survey recipients included senior executives in charge of benefits administration. All survey responses were received on or before July 31, 2005. Client participants provided information about their internal costs in addition to outsourcing fee information provided by ADP. All survey participants received a personalized report containing study and individual results.

Data Normalization

In order to assure that all TCOs were calculated in the same manner, SOURCING ANALYTICS gathered cost information in its component parts. As part of the survey, detailed descriptions of the components were provided. As a result, SOURCING ANALYTICS was able to verify individual pieces of cost for accuracy. Data that fell outside of a normal distribution was reviewed with the respondents and was either corrected or noted as exceptional with no change. No changes to data were made without the respondent's knowledge and direction.

For the study, a generally accepted definition of TCO was used:

- Initial system installation cost (amortized over three years)
- Cost of last significant upgrade (amortized over three years)
- Labor costs for administration (salaries and loads)
- Non-labor costs for administration (corporate overhead, facilities, third party, etc.)
- Labor costs for maintaining systems (salaries and loads for IT professionals)
- Non-labor costs for maintaining systems (overhead, facilities, maintenance contracts, etc.)
- ADP fees (for ADP clients).

Embedded in this methodology is the commitment to collect all costs regardless of administration delivery model. The survey was designed to collect in-house costs together with external costs, whether for outsourcing fees, consulting fees, system fees, etc., resulting in TCO calculations which are consistent across the survey group.

ABOUT THE STUDY – METHODOLOGY

What is Health and Welfare Benefits Administration?

The definition of health and welfare benefits administration was critical to the collection of information for this study. Differing opinions as to what constitutes administration are used in the marketplace. For purposes of this study, administration was defined as follows:

- Determining eligibility for a set of benefit plan types,
- Communicating eligibility and plan options to employees,
- Managing enrollment for benefits at hire,

- Managing enrollment for benefits upon a status change,
- Managing enrollment for benefits at annual enrollment,
- Managing the flow of data to the network of carriers/benefit providers, and
- Managing the flow of benefit deduction information to the payroll system(s).

The types of plans considered included the standard health & group benefit plan types.

For the purposes of the study, the following benefit plan types were considered:

- | | |
|--|---|
| ■ Medical | ■ Supplemental LTD |
| ■ Dental | ■ Accidental death & dismemberment |
| ■ Vision/hearing | ■ Personal liability |
| ■ Basic employee life | ■ FSA (health care accounts) |
| ■ Short-term disability (STD) | ■ FSA (dependent care accounts) |
| ■ Supplemental STD | ■ Commuter benefits |
| ■ Long-term disability (LTD) | ■ Long term care |
| ■ Supplemental life
(employee, spouse, dependent) | ■ Voluntary benefits (homeowners,
auto, pre-paid legal, pet insurance) |

Study Demographics

- 36 companies participated in the study.
- 20 companies administer benefits in-house.
- 16 outsource to ADP.
- Average company size is 5,700 employees.
- Average benefits eligible population is 4,155 employees.

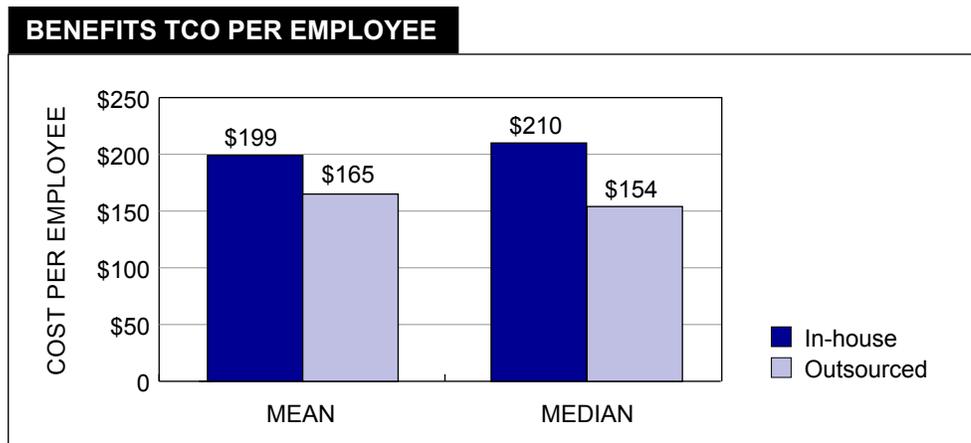
KEY FINDINGS AND ANALYSIS

The Average TCO for Benefits Administration

The average TCO for benefits administration proved to be less for companies outsourcing to ADP than for companies who administered benefits in-house. The average in-house TCO was \$199 per employee per year.

The ADP clients participating in the study had an average TCO of \$165. On average, the outsourced TCO was 17% less than in-house TCOs.

The difference in average medians was even more pronounced: \$210 vs. \$154, for a 27% lower average median for companies outsourcing to ADP.



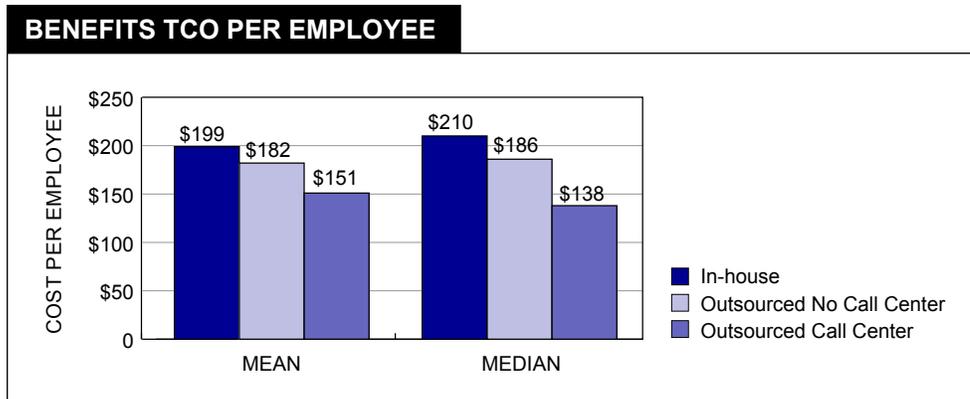
This study provides the first true benchmark of administration costs. Many will not be surprised that outsourcing can provide a savings versus in-house administration, but it is certainly not guaranteed. Indeed, there were companies in the study both well above and below the averages for both service delivery models.

The Cost Effect of Outsourced Call Center Solutions

This study provides insight into how the manner of outsourcing can have a significant impact on TCO. If we delve deeper into the group outsourcing to ADP, we note that 44% of them did not contract for employee call center support, while 56% did.

We calculated separate average TCOs for the group that used ADP call center services and for the group that did not. What we found was notable. Companies including employee call center services in the outsourcing arrangement experienced

lower average TCOs than companies outsourcing without call centers. The average TCOs were \$182 vs. \$151. The medians were \$151 vs. \$138.



From this we can not only conclude that outsourcing can provide savings versus in-house administration, but that more comprehensive outsourcing solutions provide even greater cost savings opportunities. The greatest savings — outsourcing engagements with call center — was 24% less, on average, than in-house administration.

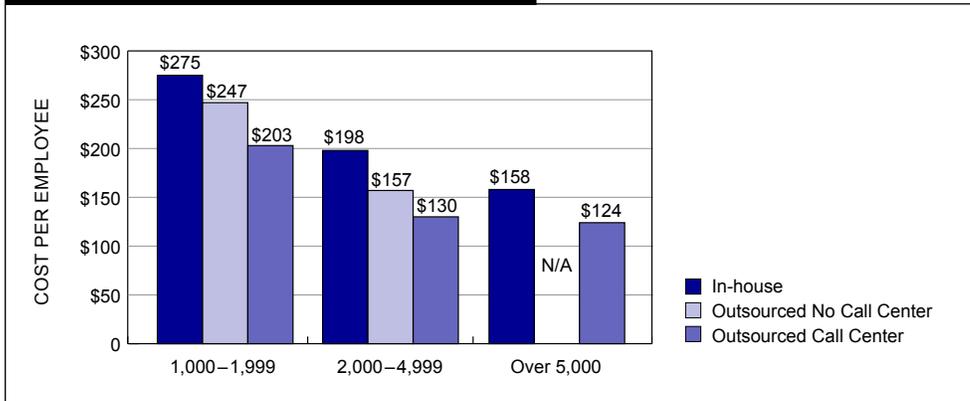
The Cost Effect of Company Size

It is generally accepted that outsourcing of any administrative function has the potential to be cost effective, depending upon the size of the company that may outsource and the nature of the services to be outsourced. For some administrative functions, small companies may benefit the most. For others, only large companies can take advantage of outsourcing.

To better understand this dynamic in relation to benefits administration, we analyzed the effect of company size on the average TCOs. For these purposes, company size was defined by benefit-eligible employees. Companies were grouped in ranges of 1,000 to 1,999; 2,000 to 4,999; and 5,000 and above.

We found that the cost relationship between in-house, outsourced, and outsourced with call center remained true. The three groups demonstrated the same relative cost relationship across each of the differing size groupings.

AVERAGE TCO BY COMPANY SIZE INCLUDING CALL CENTER SERVICES



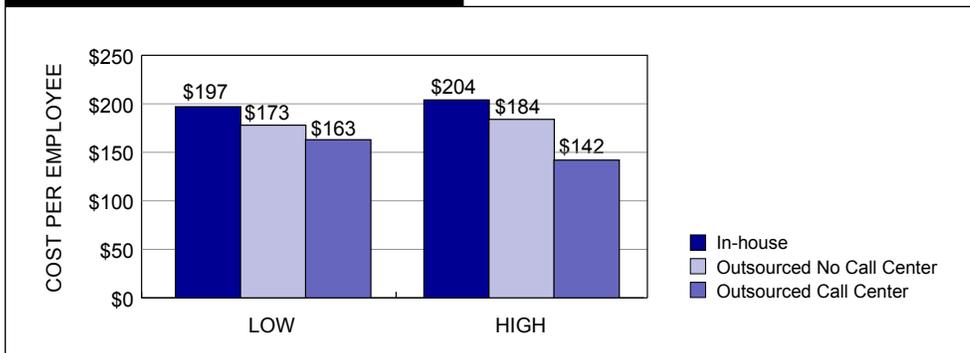
Within each of the company size groupings, we see the outsourcing TCO is lower than in-house administration. We also see that outsourcing with call center is the least expensive.

Note that all of the companies in the study that outsourced to ADP with more than 5,000 benefit-eligible employees chose to utilize call center services.

Especially interesting is that companies in the 1,000 – 2,000 employee range still benefit from utilizing outsourcing and call center services. Companies in this group have average TCOs 26% less than the in-house group of the same size and 17% lower than outsourcing without call center.

The Cost Effect of Complexity

AVERAGE TCO BY COMPLEXITY



Generally, one would believe that the more complex a benefit program is, the more difficult and expensive it is to administer.

But what exactly defines complexity? For the purposes of this study, we define complexity as of the number of plans in a program, plus the number of data exchanges required to report to carriers, etc. When scored in this fashion, the average complexity of the study group was determined to be 35.8 “complexity points.” The median complexity is 28 complexity points. For ease of comparison we categorized all companies with a complexity score of 30 or higher as high complexity. All those with 29 or fewer complexity points were categorized as low.

What we found was that higher complexity programs were, on average, more expensive to administer, but not for programs that were outsourced to ADP with call center. Although some of the cost decrease may certainly be attributable to larger sized companies, we don't see it in the other groups.

It appears that economies of scale are achieved in the ADP outsourcing engagements that are particularly useful for highly complex plans. We can speculate that more complex plans require greater degrees of employee assistance, which is best provided in a call center environment. Outsourced call centers, with their accompanying technology, allow for significantly lower average TCOs for highly complex plans.

Cost savings associated with outsourcing are not confined to highly complex plans, however. Even in the lower complexity group, we see the now-familiar cost relationship between in-house administration, outsourced administration, and outsourced with call center. This may come as a surprise to some. It is generally believed that smaller plans with low complexity can be more efficiently administered in-house; this study shows that is not necessarily the case.

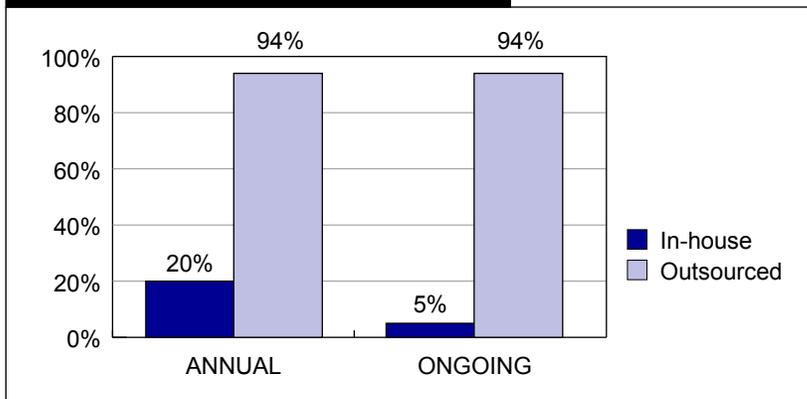
Also interesting to note is that on average, study participants outsourcing to ADP had programs that were 38% more complex than companies that administer in-house.

The Services Factor

A common challenge related to benchmarking of costs is that service level variance between companies cannot be easily accounted for. As related to this study, for instance, can we speculate that in-house administration offers employees a higher level of service, thereby increasing cost? The study data would indicate otherwise.

In fact, Web-based services (a service offering generally believed to be a service enhancement) are more likely to be available to employees of companies that outsource to ADP. For open enrollment, employee of companies outsourcing to ADP are four times more likely to have this service. For ongoing changes and new-hire enrollment, ADP clients are eighteen times more likely to have Web-based services.

PERCENTAGE OF COMPANIES OFFERING WEB-BASED SERVICES



Study group findings demonstrate that outsourcing is not only more cost effective on average, but also that additional services are offered to companies that outsource.

The Cost of Compliance

The survey tool was developed to solicit costs related to compliance with Sarbanes-Oxley. Unfortunately, the vast majority of survey respondents were unable to quantify these compliance costs. In some cases, only company-wide costs were gathered, but segregation for benefits administration was unavailable.

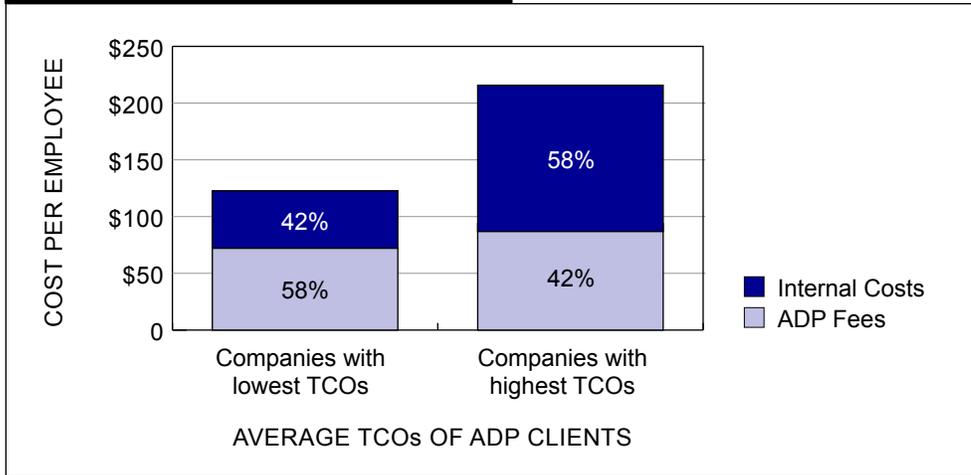
As a result, the TCOs reported in this study do not include compliance costs specific to Sarbanes-Oxley.

We do know, however, that for companies that outsource to ADP, reliance upon their Type II SAS 70 review by an independent auditor can mitigate some of the costs related to Sarbanes-Oxley. How much cost reduction a company can obtain will depend upon the company's individual auditors and their policies.

Effective Outsourcing

The study revealed an interesting phenomenon: TCOs for companies that outsource varied greatly. The variance was a function of the percentage of total cost represented by ADP fees. When ADP fees represent a low percentage of total cost, TCOs tended to be higher. Quite possibly, companies that outsource do not always maximize the reduction of internal costs.

RELATIONSHIP OF TCO DRIVEN BY ADP FEES VS. COMPANY COSTS



We see that the eight ADP clients with the highest TCOs have, on average, 58% of their costs coming from internal sources. For the eight ADP clients with the lowest TCOs, we see that only 42% of their total cost comes from internal sources.

The average TCO for the eight companies with the lowest TCOs is roughly half the average TCO of the other eight companies.

This suggests that there is a “best practice” in the manner of outsourcing. Companies that outsource or are considering outsourcing should look carefully at the future state to assure maximum economic value from outsourcing. The eight study companies with the highest TCOs could all probably lower costs even further with careful review of the internal processes kept in place and their corresponding staffing models.

CONCLUSION/RECOMMENDATIONS

Companies that either outsource or are considering outsourcing of benefits administration should carefully review their current and future costs in order to assure maximum value and avoidance of surprises.

We can see from the study results that outsourcing of benefits administration to ADP can provide lower costs for all companies. Regardless of size or complexity, we see that costs are, on average, lower for companies that outsource. Additionally,

outsourcing to ADP can provide enhanced service levels through Web-based annual enrollment and ongoing change management.

The reader may certainly make some conclusions about costs in the broader outsourcing market, but this study did not capture costs for clients of other outsourcing providers.

While the study shows that outsourcing can provide significant reductions in the overall cost for health and welfare benefits administration, those cost savings are not guaranteed. Effective outsourcing requires oversight and review.

Process management can start with understanding the costs of an administrative function. Indeed, such an understanding can lead to targeted process improvement. Understanding total cost of ownership, instead of isolated costs, provides the best measure for process improvement and benchmarking.

ABOUT SOURCING ANALYTICS:

Founded to assist providers and their clients in supporting the HR services relationship, SOURCING ANALYTICS analyzes, quantifies, recommends, and monitors solutions that enable companies to optimize their HR/benefits/payroll service partnerships.

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