

The Issue: How to Design and Tailor Effective SLAs for HR Outsourcing

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Service Level Agreements (SLAs) are an important and ubiquitous tool to manage any outsourcing relationship. It is imperative, however, that buyers tailor SLAs to the goals and requirements of specific outsourcing efforts. SLAs are far from a “one-size-fits-all” governance tool. Relative to human resources outsourcing (HRO), this means developing SLAs specific to the process areas outsourced (e.g., payroll, benefits administration) and ensuring performance and costs are tracked at an appropriate level, typically the sub-process level. Buyers must tailor SLA programs to support the intent of the HRO deal (cost reduction, process improvement, etc.) and ensure they drive – as a component in the overall outsourcing management and governance program – service provider performance in the desired direction. Finally, buyers must use caution when comparing or benchmarking SLAs across organizations, or even business units within the same organization, given the inherent challenges in normalizing results for different HR operating models and processes to avoid “apples to oranges” comparisons.

The Details

Service level agreements (SLAs) are a commonly used tool to manage relationships with third-party service providers. Buyers also can use SLAs in a shared services environment or even within an organization that wants to more formally

manage internal service delivery efforts. Outsourcing buyers polled in an EquaTerra market research study conducted in 2Q06 ranked SLAs second in importance (see Figure 1) as a means of tracking service provider performance, behind only actual versus budgeted cost levels.

Tracking Service Provider Performance

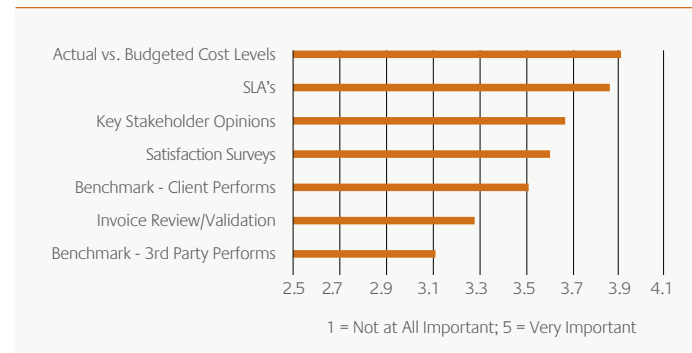


Figure 1

Many outsourcing buyers, however, do not fully understand exactly what SLAs are – or should be – and how to deploy them as a key component of an overall outsourcing management and governance program. Buyers also must ensure that SLAs are defined at a meaningful level of detail and what is tracked provides relevant information about the outsourcing effort’s true performance. A real cost is associated with defining, building and managing SLA programs, so it is important that buyers ensure SLAs add value, are not done for their own sake, or create a false sense of security about the outsourcing engagement’s performance and its delivery on the original goals.

Buyers embarking on a service level management program must first define service levels. EquaTerra describes them as a defined measure to assess service performance against predetermined objectives. This involves several components:

- Service Level Agreement (SLA): Defines the service level mechanism
- Service Level Objective (SLO): The actual measurements
- Critical Service Levels (CSL): “First among equals,” correlates to performance directly impacting business results
- Service Level Failure (SLF): Missing an SLO, usually measured monthly
- Service Level Default (SLD): Missing an SLO repeatedly, or missing a CSL

Service levels are important for a variety of reasons and perform many roles in an outsourcing effort, including:

- Aligning service provider behavior with customers’ expectations. This is an area where SLAs often breakdown for buyers. For example, service levels are being met (e.g., costs are in line) but key buyer stakeholders expecting performance improvement and innovation from outsourcing are disappointed when they are not delivered. It is critical, therefore, that SLAs drive service provider performance in a way that supports the overall intent of the outsourcing deal.
- Measuring the quality of the service being provided.
- Serving as a management governance tool to provide operational information on service provider performance supporting the overall governance program.
- Auditing performance to ensure contractual and regulatory compliance goals are being met.
- Providing direction for performance improvement.

Buyers must ensure that the service level program developed reflects the specifics of the process areas being outsourced. SLAs for IT outsourcing, for example, can provide a starting point and framework for HRO, but extensive customization often is required. The following are some key elements of HRO SLAs:

- Payroll
 - o Payroll Input Timeliness: Percentage of payroll files provided by the buyer to the service provider by the payroll processing deadline for the applicable payroll cycle.
 - o Payroll Accuracy: Percentage of payroll activities completed without errors.
 - o Payroll Reconciliation Accuracy: Percentage of general ledger and bank account reconciliations completed correctly and in accordance with policy.
- Benefits
 - o Open Enrollment Timeliness: Percentage of employee benefits enrollments requested by the buyer and completed by the service provider within the applicable open enrollment period.
 - o Benefits Interface Performance: Measures reliability of interaction with third-party partners for benefits, including interfaces delivered on time with exception rates and within acceptable parameters.
 - o 401(k) Deduction Feed: Measures accuracy and timeliness of data feed to the 401(k) provider.
- Recruiting
 - o Timeliness: Percentage of requisitions filled within a given timeframe, which depends on the requisition type.
 - o Candidate Short List: Percentage of approved job requisitions for which the service provider presents a short list of qualified candidates within the prescribed timeframe.
 - o New Hire Packet Timeliness: Measures timeliness of completion and delivery of new hire packets.
- Call Center
 - o Average Speed of Answer: Percentage of calls answered by a contact center analyst within the allowable time period, which may increase or decrease from pre-outsourcing levels depending on deal intent (i.e., reduce costs versus improve service).
 - o Call Abandonment: Percentage of calls to the contact center abandoned by a caller:
 1. After the caller’s selection of a voice recognition unit (VRU) option that requires answering by a contact center analyst, or
 2. After the VRU completes its menued message, but before the call is answered by a contact center analyst.
 - o First Call Resolution: Percentage of calls to the contact center resolved to the caller’s reasonable satisfaction on the first call to the contact center, excluding:
 1. Calls for ad-hoc service requests, and
 2. Calls requiring level-two or level-three support.

The following table illustrates sample SLA metrics and benchmarks from EquaTerra engagements for the select payroll sub-processes:

Title of Table

Service Level Metric	Metric Description	Formula	Min. Low	Min. Median	Min. High	Target Low	Target Median	Target High
Payroll Input Timeliness	Percentage of payroll files that are provided by Client to Service Provider by the payroll processing cut-off time for the applicable payroll cycle	# payroll files provided on time/ Total # of payroll files provided	99%		99%	99%	99%	100%
Payroll Accuracy	Percentage of payroll activities that are completed without errors	# of salary payments paid without error/ Total # of salary payments paid within the period	97%	99.5%	99.5%	98.30%	99.70%	100%
Payroll Input Accuracy	Percentage of employee payroll files that are provided by Client to Service Provider without errors	# of payroll files that are submitted to the Provider without errors/ Total # of payroll files submitted to the Provider	99%		99%	99%	99%	99.8%
Legal Directive Timeliness	Percentage of Legal Directives that are complied with by Service Provider within the required time frames	# of Legal Directives that are complied with within the required time frame/ Total # of Legal Directives complied	98%	99%	100%	99.5%	100%	100%
Payroll Reconciliation Accuracy	Percentage of General Ledger and bank account reconciliations that are completed correctly and in accordance with policy	# of GL and bank account reconciliations that are completed without error/ Total # of GL and bank account reconciliations that are completed in the measurement period	98%	98.75%	99.5%	99.5%	100%	100%

Figure 2

SLAs also must mirror the outsourcing engagement’s goal. If a key goal is process improvement, SLAs must reflect and measure progress toward that goal and not just track cost reduction-related metrics, for example.

How are Buyers Responding?

HRO buyers are becoming more sophisticated about the use of SLAs. They often still struggle, though, in defining workable SLAs tailored to specific processes. Even if buyers are not actively using or pursuing HRO, it can prove beneficial to begin defining key metrics that measure HR performance, gain consensus on those metrics and the current and desired levels, then put a tracking program in place. Key to this program is defining a process to act upon the knowledge gained from the SLA program and use it to improve performance, not just create consternation within the organization. Buyers should use any existing SLAs as a starting point for other outsourcing efforts and then work to tailor them to HR and HRO.

Buyers also need to focus on assessing SLAs and SLA programs of candidate HRO service providers. While SLAs are a key component of outsourcing management and governance, buyers often de-prioritize them in the service

provider selection process. This can create challenges when buyers start to implement SLA programs during the transition process. Also, buyers should seek to learn from the service provider’s experiences related to SLA metrics and best practices. Buyers and providers may debate SLAs, but should gain a consensus on the type, use and process for SLAs overall.

Buyers also must ensure they have a manageable number of SLAs in place that track an appropriate level of detail and reflect the outsourcing effort’s ability to meet its stated goals. They should use caution when looking outside their organization to define appropriate SLA components given the many unique attributes of an outsourcing engagement.

How are Outsourcing Service Providers Responding?

Service providers should come to the table with established SLA programs and metrics. Working to ensure that SLAs developed reflect the intent of the outsourcing deal, they should help the buyer position SLAs as a valuable tool to make the outsourcing process work and not as a source of aggravation. The same EquaTerra Market study cited previously found room for improvement in buyers’

perceptions of the quality and value of service providers' SLA programs (see Figure 3) as a component of overall service level management efforts.

Satisfaction: SP Service Level Management

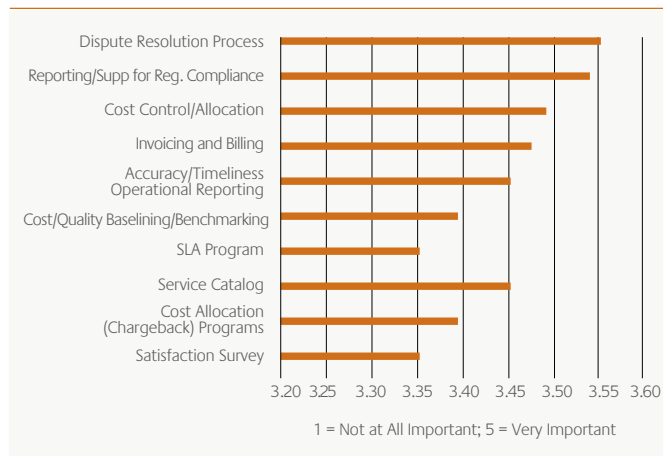


Figure 3

The Advisor Perspective – Critical Points to Consider

Buyers must consider several key factors to create quality service level programs:

- Select meaningful metrics that have business impact and actually can be measured.
- More metrics aren't always better; easy-to-measure but relatively unimportant measures are distracting and those metrics buyers cannot capture are irrelevant.
- Determine the business purpose of the service levels and business results desired from the outsourcing effort.
- Based on the business purpose, develop a specification that supports measuring that business purpose. This involves defining the following components:
 - o Calculation mechanics
 - o Data sources and elements
 - o Reporting cycle
 - o Target levels
- Develop the process and associated policies and procedures to manage and act upon SLA results, including dispute mediation and escalation procedures, and process improvement programs.
- Use caution when comparing SLAs to peer organizations.

Buyers must have the specification "accepted" by the service provider, key buyer stakeholders and governance management personnel. They can then implement an SLO and monitor it to ensure successful implementation.

Conclusion

SLAs are an important component in an outsourcing buyer's overall service level management and outsourcing management and governance programs. Buyers need to ensure that SLAs measure the right metrics required to truly track the performance of an outsourcing effort and the service provider, as well as track whether key goals are being achieved. To do so, buyers must make certain SLAs are tailored to specific processes that are outsourced and provide adequate levels of detail. They also must confirm that processes are in place to review, respond to and drive improvement actions from SLA results. Buyers should ensure they adequately assess service providers' SLA philosophy, process and program as part of their outsourcing due-diligence efforts. Buyers also must keenly analyze the attributes of peer organizations whose SLAs are used for comparative purposes.

About EquaTerra

EquaTerra sourcing advisors help clients achieve sustainable value in their business processes. With an average of more than 20 years of experience in over 600 global transformation and outsourcing projects, our advisors offer unmatched industry expertise. EquaTerra has in-depth functional knowledge in Finance and Accounting, HR, IT, Procurement and other critical business processes with advisors throughout North America, Europe and Asia Pacific. Our people are passionate about providing objective, conflict-free advice to our clients, which has fueled our exponential growth over the past three years. We help clients achieve significant cost savings and process improvements with outsourcing, internal transformation and shared services solutions. **It is all we do.**

If you have questions about this report or would like to learn more about how EquaTerra can help your organization address the points and opportunities discussed, please contact Lowell Williams, Brad Everett or Stan Lepeak.

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