KENT FOOD SERVICE PAYROLL – A MAKE OR BUY DECISION

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ACADEMIC ABSTRACT

Kent Food Service (KFS) is a family owned and operated 100-year-old food service business. KFS currently processes all of its employee wage payments via an in-house payroll department and is considering the benefits and costs associated with outsourcing this business process. KFS’s Human Resources Director is interested in any cost reduction benefits achieved by outsourcing payroll; however, production and service quality is essential, as is maintaining the “Cornerstone Values” by which the company operates.

EXECUTIVE SUMMARY

KFS is a family owned and managed foodservice distributor, maintaining its competitive position in the market with double-digit growth and billions of dollars in sales revenue each year. While the firm is well-established and financially sound, it has always encouraged innovation and change in order to continue its long history of growth. Consequently, it is currently considering outsourcing its in-house payroll production.

The case illustrates a classic “make or buy” decision with a twist. KFS’s situation is unique because of the non-manufacturing nature of the potentially outsourced process and the unique values-centered cultural characteristics of the organization. KFS is considering farming out its payroll process to Aurora, with which it already has a close relationship. Based on information furnished to KFS, it seems as though Aurora will be able to accommodate KFS’s basic payroll process requests at a seemingly lower cost. Yet the case indicates that there are other “costs” to be considered, like employee satisfaction and reduced flexibility. KFS’s culture and values, as well as the exceptional performance of its current Payroll Department suggest that outsourcing may not be the best option for the company. Students are encouraged to analyze the monetary gains as well as the non-monetary losses that may be anticipated as a result of outsourcing the payroll process. The case illustrates how lower costs are not always the most important determining factor in making an outsourcing decision.
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Introduction

As Greg Scott, Kent Food Service (KFS) Treasury Management Director, rounded the corner to his office on Friday morning, he could see Carol Nathan already pacing inside waiting for him. He knew she was there to discuss the latest developments in their payroll process analysis. When Carol, KFS’s Human Resources (HR) Director, had first contacted him, he was skeptical about the analysis. KFS had always internally housed its payroll process, but now Carol was interested in the benefits of contracting the payroll function with an outside vendor instead.

“Morning, Carol,” Greg exclaimed. “Greg, we need to discuss the package we just received from Aurora – it looks great! Let’s do some thorough analysis this afternoon; it looks like Aurora may save us a bundle!” Greg agreed to the afternoon meeting and started to phone the others on the team.

While the line rang, he couldn’t help but feel this was a waste of valuable time. Carol had been enthusiastic about an article she just read in her latest copy of Human Resource Executive detailing a local firm’s substantial cost savings achieved through the use of outside vendors to process payroll. This was the first time that a function within the company had ever been considered for outsourcing. Greg knew, however, just what the Kent family wanted for their employees in terms of payroll service… and he didn’t want to believe that their current processes could be beat in the upcoming meeting’s comparative analysis.

Carol did bring up some valid points, however, that were worth some consideration. Greg would have a tough afternoon, analyzing the payroll process, which he was so heavily involved in, and carefully investigating the benefits provided by each method before his final recommendation could be made.

Company History

As one of the largest privately-held foodservice distributors in North America, Kent Food Service was family owned and managed. Headquartered in Traverse City, Michigan, it operated in the US from Marquette to Miami, as well as from coast to coast in Canada. Kent Food Service was founded in 1897 by Henry Zerfas, initially as an egg and butter delivery service. Later, the firm was taken over by his son-in-law, Ben Kent, and three generations later, it was still owned and operated by the Kent family. KFS also had a long history of success, surpassing the $5 billion sales mark in 2007 and continually achieving double-digit growth.

Culture

Not only was KFS family owned, it was managed with strong family values. Its signature “Cornerstone Values” (see Exhibit 1) were prominently displayed throughout its many offices and were a part of daily work life. Holding a close relationship with its employees, customers and suppliers, KFS continually operated as if each was a member of a large extended family. The Kent family credited its firm’s success to the high quality of its products, the innovations it effected in the food service industry, and, especially, the dedication of its employees. Regarding
the latter, KFS took great pride in its employees, encouraging new ideas, training, employee involvement, and growth, enforcing the idea that “Everyone is Important.” Furthermore, executives were deeply involved with daily operations, often forming effective relationships with their many employees.

**Payroll Process/Department Overview**

The KFS payroll department, centralized in its Traverse City headquarters, employed nine people in total (one full-time manager, and six full-time and two part-time employees). Most payroll employees were seasoned veterans, having worked with KFS, on average, for nine years. Considering the fact that payroll was a fundamental element of employee satisfaction, KFS issued paychecks on a weekly basis and the Kent family felt that it was of the utmost importance for employees to be promptly paid for their valuable time worked with the company.

KFS’s payroll operations on Mondays and Tuesdays focused mainly on data input and wage and hour calculation. On Wednesdays, wage records went through a final review before checks and direct deposit payments were processed and printed, with employees receiving their pay on Thursday and Friday through KFS’s unique Mail Services Department.²

The Wednesday operations were of most interest to Greg and Carol’s team since its functions were the ones that were potentially considered to be outsourced. After the Payroll Department’s Wednesday morning final review, specialized payroll reports were generated and check printing was begun on specialized check stock with the KFS logo and a Kent family member’s signature. Checks were printed in a private, locked room on two highly sophisticated printers. These printers were owned by KFS and required expensive toner and ink in order for the printed account information to be read by banks’ sophisticated computer systems.

As checks were printed, they were immediately run through a folder/sealer and were sorted by a payroll staff member who oversaw the process, which took an average of five hours. While this equipment was expensive to maintain and operate its use and associated cost was shared by the KFS Accounts Payable department, which processed vendor payment checks on a daily basis. KFS’s Finance Services department, which generated company note statements quarterly, also shared the equipment. Both Accounts Payable’s and Finance Services’ printing needs would continue to be done in-house with the shared equipment.

**Additional Processing**

In addition to processing weekly payroll, the Payroll Department also produced various manual checks (mainly error corrections) on three other days of the week. These were essential to maintaining the Kent family’s vision of prompt payment to its valuable employees, who were not expected to wait a full week for an administrative mix-up or management omission. Furthermore, the department would run other payroll cycles in addition to the weekly paychecks. KFS, valuing the importance of its staff, often paid monthly, quarterly and annual bonuses or incentives. These payments were often printed separately from the weekly paychecks, since most managers enjoyed handing bonus checks to employees directly. Managers also preferred to use those opportunities to make the awards more personal, almost as a way of saying “Thanks!”
Another important function of the Payroll Department involved extensive reporting. Payroll provided managers with various wage reports on demand, tailored to individual managers’ specifications. Managers relied heavily on the information provided by the department when making inter-department hiring decisions, which was a frequent occurrence at KFS.

Special IT Considerations

KFS had a long tradition of technological advancement, supplying its staff with cutting-edge equipment and building state-of-the-art facilities. This practice had extended into payroll processing as well. KFS had several in-house/custom-built systems which interfaced with its current Enterprise Resource Planning (ERP) system, which were necessary to effectively process payroll. Thus, Greg recognized that it was vitally important that any outside vendor’s software was compatible with KFS’s internal systems.

Further, not only did the Payroll Department utilize advanced technology to aid its payment processes, but it also extended the technological benefits to its customers, the KFS employees. KFS offered the use of an employee self-service portal, which allowed employees to log on to the company’s intranet and, among the various functions, track payment history, change a primary address, and make a direct deposit change. The introduction of this service had been readily accepted, since it made information immediately available to employees, offered a quick and easy way for them to update their personal records, all the while saving the Payroll Department hours of manual processing time.

Complex Pay Structures

KFS encompassed a variety of job types, including hourly, salary, commission only, and a mix of any two. The pay structure of KFS’s sales and driver force was the most complex. Sales representatives’ pay was based on such factors as the amount of new customer business generated and sales volume of the KFS brand. Drivers’ employee pay was also complicated, since it incorporated the number of miles driven, the number of stops, the total trailer weight and the number of trailer changeovers.

While these pay structures were intricate, the Payroll staff prided itself on its expertise on each one. Often immersing themselves in the unique details, the payroll members usually became excellent resources for employees and managers alike who had questions. The payroll staff consistently monitored these systems and their payment generation before weekly paychecks were printed or deposited, catching processing mistakes before payroll was completed and effectively avoiding check errors. This factor of the payroll process was vital to not only accurate record-keeping, but employees’ satisfaction and confidence in the company.

“Wow, there are certainly a lot of factors we need to consider,” mulled Greg as he jotted his list of payroll needs to discuss with Carol (see Exhibit 2).
Efficiency/Performance

A comment on the department’s efficiency from Laura Ford, Payroll Manager, indicated just how efficient the Payroll Department had been throughout the years: “Since I took over the Payroll Manager role seven years ago, the number of employees we process each week has more than doubled from roughly 3,500 to over 7,000. But throughout that time, we’ve only needed to hire one additional part-time employee.” These efficiencies had been achieved largely through various process improvements, such as automating manual processes and promoting electronic employee payment options like direct deposit and checkcards.3

The Payroll Department, indeed, had a solid history of outstanding performance. Winners of the J&P cup, a performance/excellence-based company award, in 2002 and 2004, the department prided itself on delivering exceptional service and maintaining a rigorous cost structure. Payroll staff members occasionally worked late, worked holidays, or even from home in order to ensure that all employees were paid accurately and on time. KFS employees had even been observed, on Thursday morning especially, stopping a payroll staff member and thanking her/him for the check received in their mailbox or bank account for the week. (See Exhibit 3)

Aurora Inc. Service Offerings

Aurora Inc. provided employer-related business process solutions, focusing on Payroll, Human Resource Management, and Benefit Administration. KFS already had a close relationship with Aurora; it completed KFS’s company-wide tax filings for the Internal Revenue Service. At the start of the project, Carol had contacted the company’s Aurora representative, Derek Muller, who had been eager to put together a proposal of services offered to KFS. His summary of services that Aurora could provide for KFS (see Exhibit 4), was received by e-mail within a few hours. In the text of his message, Derek assured Carol that this was an excellent option for KFS: “The time-consuming effort poured into payroll processing may be robbing KFS of resources that could be better committed to core competencies, and as a matter of fact, payroll is the most commonly outsourced company function in the US!” At the time, Carol felt like she had stumbled upon something that should have been evaluated long ago.

In planning for her afternoon meeting with Greg and the project team, Carol discovered additional benefits realized by using Aurora’s payroll services:

\[I \text{ had only been focused on efficiencies and variable costs associated with the check printing processes, but Derek brought a few other issues to the table. I never considered the complex regulatory environment that wage payments must adhere to. The Department of Labor regulations are complex and always changing, and the risks associated with non compliance can be tremendous. Likewise, the multi-state tax environment KFS operates in has become quite cumbersome. Local tax laws vary greatly and tracking these almost requires the full-time attention of one payroll staff member. By using a resource like Aurora, KFS could save precious time and also mitigate the risk related to administration’s errors, benefiting both the company and the employees.}\]
Furthermore, Aurora had prepared a helpful table (Exhibit 5) listing all of the costs estimated to be displaced if KFS chose to use Aurora’s services.

Basically, Aurora would handle all check printing, reporting and tax administration and preparation services. KFS payroll employees would still be needed for data entry, additional deductions, payment changes, decision-making and all other general prepayment processing. After Aurora printed KFS’s regular weekly payroll or any special payroll cycles, checks would be distributed via US Mail (charged to KFS) either directly to employees or to KFS offices. This function was of particular concern to Greg:

_I know guaranteeing paycheck receipt by Friday each week will be a major challenge. We currently sort checks Wednesday after they’ve been printed and send them down to Mail Services to be placed on a truck the same evening. Aurora is planning to print checks Wednesday afternoon which wouldn’t arrive at our headquarters until sometime Thursday, setting us one day behind. About half of our employees wouldn’t receive their checks until Monday, and I don’t even want to think about sending employees’ checks individually through the U.S. Mail!_

Additionally, Aurora offered some standard payroll reporting options and any customization would result in extra incurred costs. Manual checks could also be processed by Aurora, as long as KFS’s payroll members had the check information submitted by noon each day. Internet-based employee self-service access, with similar functions to KFS’s current custom-made program, was also included in the Aurora proposal.

According to the analysis provided by Aurora, KFS could potentially save $250,000 per year in payroll processing costs.

**Outsource or Not?**

The functionality of Aurora’s payroll process proposal sounded adequate, not without a substantial cost incurred, however. Greg wondered how much of their current payroll costs would really be eliminated since all check printing equipment would still be kept and used by other departments and most payroll employees would still be needed to process payroll information and make important decisions. It seemed that Aurora would be able to accommodate most of KFS’s basic payroll needs, like extra payroll cycles and some manual check processing. Greg questioned, however, if the level of service provided in house could be maintained by Aurora. KFS employees were used to customized service and care in regards to their weekly pay, and may be unsatisfied with any change that would diminish this service. Greg also knew that the potential for KFS’s future growth must be considered. KFS had been expanding rapidly in the last few years, with two acquisitions alone adding another 1,000 employees. He had to wonder if the internal KFS payroll team could sustain their excellent reputation at a higher processing volume. However, Carol was right about saving a substantial amount of time on tax and wage law compliance. He also thought of the licensing fees on the use of their current payroll processing software, which would be eliminated by working with Aurora.
Greg stuffed the project analysis paperwork in his briefcase and headed out the door, knowing the challenge that lay ahead of him before his meeting with the board on Friday morning.

ENDNOTES

1 This case (disguised) is based on discussions with Kent Food Service personnel during the summer of 2007.
2 KFS Mail Services reliably delivered company mail at no extra expense via product truck delivery routes.
3 KFS checkcards safely store payments until the employee is ready to use it. Money is easily accessed at any ATM, bank, or used to make purchases at thousands of retailers nationwide.
Exhibit 1

Cornerstone Values

KFS Cornerstone Values keep us focused on “what’s important in life” as we serve customers and work with employees.

Customer is King

Networking Organization

Initiative, Teamwork, Decision-Making

Everyone is Important

Focus on Individual Excellence

Rewards for Performance

Financial Incentives, Recognition

"War Room Mentality"

Low Cost Producer, Emphasis on Results

Integrity

Customers, Employees, Suppliers

Philosophy of Sharing

Ideas, Profit Sharing
Exhibit 2
PAYROLL NEEDS

1 Weekly Volume
   a) 7,300 employees paid per week

2 Weekly Payroll
   a) Ability to pay for prior week’s work

3 Direct Deposit Credit
   a) First Financial bank customers – Wednesday payment receipt
   b) Other bank direct deposit participants – Thursday payment receipt

4 Check Distribution
   a) Friday receipt by employee

5 Funding
   a) Currently fund as payments are presented

6 Interface with Following Systems
   a) Time & Attendance
   b) Driver Comp
   c) Warehouse Comp
   d) Sales Comp
   e) Lawson – G/L
   f) Aurora Tax
   g) Company Note System
   h) Duluth Retirement system

7 Special Check Cycles
   a) Ability to issue manual checks
   b) Scheduling of “off” payroll check runs

8 Company Processing
   a) Ability to process payroll for Multiple “Tax Companies” in payroll run

9 Garnishment Capabilities

10 Access Controls
    a) Appropriate security structure

11 W/H Tax Capabilities
    a) Currently use DHS Tax System

12 Processing Time and Availability
    a) System processing to meet time deadlines
    b) Ability to finish payroll administrative tasks to met deadlines
    c) System “up time”

13 Data loads
    a) Ability for data input uploads

14 Time-Off Accrual
We treat all of our customers, both internal and external, with respect and try to help them in any way we can. As can be seen by some of the many e-mails we receive, we work hard for our customers.

-Thank you so much for taking the time to look this over. I appreciate your feedback and the changes that you made. It helps us all in the end! Thanks again so much…and YOU ARE THE BEST.

-Thank you for the thoughtfully worded and timely response.

-Thanks for your efforts in making these roll-outs happen. They would not happen without you!

-We SO owe you one

-Thank you all for the huge effort last night. I know some of you had to stay VERY late. With your efforts, payroll will be out on time.

-Thanks for explaining it… you are the best! I do want to say thank you for always being so helpful every time I have ever needed anything. I sincerely appreciate it.

-You’re the BEST!!! You saved me from mutiny!

-As always, you’re awesome!

-You are there because you’re the best and by being the best you make my job easier. Thank you.

-You are 100% error free so we won’t have that problem. What I admire about you the most is when something is not right you come to me first… with others I would be the last to know… You are very professional and know how to communicate and that is number one.

-Thanks, you always exceed my expectations!

-You rock – thanks for your support on the new system.

-Please convey our gratitude to everyone in your department…you guys are awesome and do an incredible job of getting us our dinero. I figured a thank you was somewhat overdue.
Exhibit 4
Aurora Functionality for Kent Food Service

Service Component
Hosting Services
• Aurora provides the HR, Payroll, and Benefits software, all required licenses, servers, databases, application engineers (version upgrades and maintenance), inbound and outbound interfaces, nightly backups, and disaster recovery services.

Employee Self Service
• Employees can use the Aurora self-service portal to access general company directories, maintain personal profile information, review current and historical pay stubs and W-2’s, manage W-4 deductions, edit direct deposit banking account information, retrieve time off banks.

Payroll Services
• Gross to Net Processing at Aurora
• Payroll Preview feature to review results
• Print payroll checks and direct deposit vouchers
• Checkcard with employee convenience checks**
• Payroll output reports on paper and/or CD-ROM
• Federal, State, and Local tax deposits and filings
• W-2 processing
• Wage Garnishment Calculations and Payments
• Tax Credit Services (WOTC, Welfare to Work…)
• Check Reconciliation and Positive Pay
• General Ledger & Time and Attendance Interface
• Ad hoc Check and Reports creation feature**
• All vendor feeds to Third Parties (example - 401k)
• No employee call center (KFS handles employees)

**Requires payment of additional fees
Exhibit 5
Costs Displaced by Aurora Outsourcing Solution

Please find listed below a sampling of items that are costs displaced by the utilization of an Aurora outsourced solution versus an in-house set up:

<table>
<thead>
<tr>
<th>Component</th>
<th>Comment</th>
<th>Annual Cost Displaced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual ERP Maintenance Fees</td>
<td>Fee charged for software support, compliance updates, tax table updates, check printing software maintenance, …</td>
<td>$350,000</td>
</tr>
<tr>
<td>IT Infrastructure and Support of ERP System</td>
<td>FTE’s required to support the current software, performing upgrades, servers maintained, database fees, disaster recovery support, system interfaces, …</td>
<td>$400,000</td>
</tr>
<tr>
<td>Overhead Costs</td>
<td>Check stock, printers, envelopes, banking fees, 3rd party fees</td>
<td>$250,000</td>
</tr>
<tr>
<td>Payroll, Benefits, and HR FTE’s</td>
<td>Aurora performs certain tasks on your company’s behalf (garnishment processing, benefits processing, tax credit processing, unemployment claims processing …)</td>
<td>$350,000</td>
</tr>
<tr>
<td>Checkcard functionality eliminating check distribution fees</td>
<td>Aurora provides our payroll customers the “transcheck” feature that allows an employee to write a check to themselves and cash it fee free at a number of retail locations including Wal-Mart. Thus, the Aurora checkcard can be mandated and you can have a “check-less” payroll process.</td>
<td>$55,000</td>
</tr>
<tr>
<td>Self Service</td>
<td>The utilization of employee and manager self service provides significant savings. A variety of tasks will be automated (W-4 profile change, benefits open enrollment, direct deposit change, employee transfer, performance reviews, …)</td>
<td>$350,000</td>
</tr>
<tr>
<td>Tax Credits</td>
<td>Aurora could assist with identifying tax credits (examples: WOTC, Welfare to Work, Sales and Use). These credits are not fully utilized by your organization today.</td>
<td>$275,000</td>
</tr>
<tr>
<td>Sarbanes Oxley Compliance</td>
<td>The average cost to perform an in-house SAS 70 Certification (internal staff and external auditors) per system is high. All Aurora systems are SAS 70 Type II compliant &amp; are rechecked each year.</td>
<td>$225,000</td>
</tr>
</tbody>
</table>
Benefits Premium Reconciliations
Aurora’s benefit enrollment and premium reconciliation system notifies vendors of what you are paying based upon our records of who is enrolled. Our average customer saves 1% on their annual premiums.

Cost Avoidance
Your organization will not be required to purchase any more upgrades to your in-house system

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TEACHING NOTE

Executive Summary
KFS is a family owned and managed foodservice distributor, maintaining its competitive position in the market with double-digit growth and billions of dollars in sales revenue each year. While the firm is well-established and financially sound, it has always encouraged innovation and change in order to continue its long history of growth. Consequently, it is currently considering outsourcing its in-house payroll production.

The case illustrates a classic “make or buy” decision with a twist. KFS’s situation is unique because of the non-manufacturing nature of the potentially outsourced process and the unique values-centered cultural characteristics of the organization. KFS is considering farming out its payroll process to Aurora, with which it already has a close relationship. Based on information furnished to KFS, it seems as though Aurora will be able to accommodate KFS’s basic payroll process requests at a seemingly lower cost. Yet the case indicates that there are other “costs” to be considered, like employee satisfaction and reduced flexibility. KFS’s culture and values, as well as the exceptional performance of its current Payroll Department suggest that outsourcing may not be the best option for the company. Students are encouraged to analyze the monetary gains as well as the non-monetary losses that may be anticipated as a result of outsourcing the payroll process. The case illustrates how lower costs are not always the most important determining factor in making an outsourcing decision.

Teaching Goals and Objectives
The case considers an important make or buy decision when a company is looking to decrease costs in a fairly standard process environment. The company is both family owned and employee/family focused, and wants to choose the right decision to benefit both the company and employees. The case illustrates the payroll department’s operations strategy and performance levels in order to provide insights into how the well the department has customized its services to meet the needs of the firm. The main goal of the case is for students to carefully analyze the pros and cons of the outsourcing decision, weighing both cost-related and non-monetary factors, along with unique considerations. Some specific objectives include:
1. Identify characteristics of processes which make them good or bad candidates for outsourcing
2. Analyze financial and non-financial costs and benefits associated with outsourcing
3. Identify criteria key to an outsourcing decision

**Courses for which the Case is Intended**

The case is intended to be used in an upper-level, undergraduate course in operations management. It would be especially suited to courses in which management of service operations is a key focus. Other courses that may benefit from the case would include Family Business or Small Business Management.

Before using this case students should be studying operations management specifically outsourcing. The case should be discussed in approximately 50 minutes, with approximately 3 hours of preparation.

**Discussion Questions and Answers to those Questions**

**Q1. Discuss the criteria most important to Greg when making his recommendation.**

The following are some factors important to the make or buy decision, in no particular order.

1. Payroll flexibility
2. Payroll report availability
3. Aurora’s fit within KFS culture
4. Costs
5. Timeliness of check delivery
6. Software compatibility
7. Aurora’s capabilities in reference to complex, customized pay structures
8. Possible elimination of burdensome regulatory environment maintenance
9. Maintenance of low error rate

**Q2. What factors of the KFS payroll process make it a good candidate for outsourcing?**

Outsourcing is a great option for functions that are highly standardized and are not a key component of a firm’s competitive advantage or core activities. Outside providers that specialize in the function in question are potentially more efficient and better at performing the tasks, arguably supplying a more enhanced product. According to Chase, Jacobs and Aquilano’ the following characteristics of a process may also indicate that outsourcing is a good option:

- High/unpredictable costs
- Anticipated demand fluctuations
- Vulnerability to risks
- Little access to specialized skills/knowledge

Consider the following reasons specific to KFS:
Standardization: Payroll is a necessary function in all businesses, all governed by the same set of regulations and practices. Generally speaking, payroll is a very standardized process across all industries. Aurora processes payroll for thousands of other firms, and the application to KFS’s payroll production would likely be very similar.

Tax Regulation Compliance: Operating throughout the country, KFS is required to comply with multiple state tax regulations. According to the case, these regulations vary greatly by state and even by locality (City, County, Township). Staying abreast of and implementing constant tax changes can be extremely time-consuming and prone to errors (if not kept up-to-date). An outside vendor (like Aurora) whose core business focus is in the application of these regulations and already provides these services to thousands of businesses in all states has a considerable advantage over KFS’s in-house payroll department, even considering their self-acquired expertise. For example, Aurora may apply local tax changes to thousands of customers while KFS may have to apply them to only a handful. Aurora may also be more likely to apply the changes in a timely fashion and with less error. Further, students should be reminded that any errors can result in substantial costs in penalties and interest from the IRS; consequently, Aurora may hold the potential to reduce this risk.

Federal Department of Labor Regulation Compliance: Again, the application of federal labor laws is extremely standardized, yet complex and constantly evolving. Tracking and properly applying these regulations can prove to be extremely burdensome for an operations like KFS whose core specialty is not payroll processing. In contrast, a firm like Aurora has the potential to increase the level of accuracy in the application of these laws, thereby reducing KFS’s risk of non-compliance.

Existing Relationship: KFS already has a constructive relationship with Aurora, a company that is already familiar with some of its operations. This prior knowledge may help the transition flow more smoothly if the payroll process is outsourced, and may also help KFS negotiate more favorable terms of the agreement.

Anticipated Growth: KFS is a rapidly expanding company, and if continued growth is anticipated for the future, it may be beneficial to use an outside vendor particularly if KFS feels its current payroll staff would be unable to meet the demands of sharp rises in volume.

Changes in the Technological Environment: Payroll processing involves the use of intangible information. With the soaring popularity of electronic data exchanges in the past ten years, information transfer is almost effortless. Transfer of payroll documents and processing data makes outsourcing even more advantageous.

Q3. What factors of the KFS payroll production make it a bad candidate for outsourcing?

Processes which are the basis of a firm’s competitive advantage should likely remain within the organization. Additionally, relationship-specific products are more easily produced in house as are those that require much industry specific expertise. Again, Chase, Jacobs and Aquilano suggest a few other reasons firms should consider keeping processes within the firm:
• Risk of loss of proprietary information
• High degree of relationship specific assets/processes
• Outsourcing options are not a good fit with company culture
• High degree of product customization
• High degree of department integration with other areas of the firm.

Consider the following factors specific to KFS:

**High customization:** KFS demands a rather high degree of customization in terms of payroll production. Late employees’ and managers’ requests for changes are expected to be accommodated and KFS’s frequent manual check of production and special bonus payroll cycles are necessary. An outside provider may not be able to facilitate these requirements, or only at a high cost. Also note that it is important for managers to be able to personally distribute bonus checks and thank employees. This would most likely not be available through Aurora’s payroll solution. In general, the more uniqueness involved in a business process, the less value an outsourced solution will deliver.

**Complex Pay Structure:** KFS salespeople’s and drivers’ employee pay is based on a relatively complex, unique structure. If this function was transferred to an outside party, the likelihood of missed errors generated in employee checks may potentially increase. KFS’s employees benefit from the internal payroll staff’s extensive knowledge of the pay structure which yields little error. Payroll employees are currently able to catch mistakes and verify accuracy only moments before payment is produced, which would not be available if payroll is outsourced. Erroneous paychecks only hinder employee satisfaction and may deteriorate trust in the company.

**Proprietary Information:** Considering the fact that KFS is a family owned, privately held company, it tends to be fairly secretive about its operations and financial information. KFS may be bothered by the release of private payroll data to an outside source.

**Culture:** KFS’s culture plays a significant role here. KFS has never outsourced a business function in the past and the importance of its Cornerstone Values may be influential. KFS demands a lot from its payroll function and expects a lot of extra specialization which may not be a good fit with an outside vendor like Aurora.

**Q4. Review the displaced costs in Exhibit 5. Is it feasible that all of these costs can be avoided?**

**Labor:** Aurora estimates the reduction of four full-time employees in its analysis, generating a substantial cost savings. Since outsourcing payroll production only involves the actual check printing and distribution process, it is unlikely that KFS’s payroll would be able to function with such a drastic labor cut as the table suggests, particularly if staff members will be needed to speed up processing in order to receive the printed checks from Aurora to ensure employee payment receipt by Friday. Also, the staff members would still be needed to for data entry, employee assistance and daily decision-making. The processes eliminated would be equivalent
to the operation of the printer and sealer on Wednesday, which equates to only about 5 hours per week, and most of the tax administration work.

**Self Service:** Aurora asserts that KFS will save on manual processes like W-4 tax form changes and direct deposit account changes through the use of its online employee self-service function. However, this function is already available to KFS employees via the company’s intranet, which would still continue to be used even if payroll was outsourced, since it provides employees with other benefits information beyond payroll.

**Q5. Determine some of the benefits KFS would gain by outsourcing their payroll.**

**Focus on core competencies:** If KFS chose to outsource payroll and realized a substantial cost and time savings as Aurora suggests, the firm could redirect the resources applied to payroll processing to other core areas of the business. KFS could place more focus on core competency areas like product development or customer sales service.

**Fixed costs vs. variable costs:** Replacing in-house payroll production with an outside vendor helps to turn fixed costs (e.g., printer maintenance, IT support) into variable costs through Aurora user fees. A larger share of variable costs may help with budgeting and cost analysis.

**Access to superior knowledge/skills:** Aurora undoubtedly has a more advanced knowledge and skill set in regards to payroll processing. KFS employees may benefit from its sophisticated knowledge with more accurate checks and access to better payroll functionality.

**Q6. Determine some of the benefits KFS would lose by outsourcing payroll.**

**Reduced distribution benefits:** KFS currently distributes all of its hard-copy paychecks or paystubs through its intercompany mail system via product trucks en route to KFS stores or branches. This distribution system is completely cost-free and is very efficient and reliable. The use of Aurora for payroll production would increase costs generated through postage fees to ship checks either to individual employees or only to KFS headquarters.

**Personalized Reporting:** KFS managers’ heavy reliance on payroll reports to make budgeting and employment decisions is an important consideration. Most reports are custom-designed to the requestor’s specifications which would not be available through Aurora, or only at an additional cost.

**Flexibility:** Also, the KFS Payroll department provides a very specialized service to employees, always accommodating special requests in order to benefit the employee. Often managers will send late payment approvals to add in just before checks are printed, as well as many other special requests which are dutifully obliged. The availability of this option would likely be eliminated by working with Aurora.

**Check payment Delays:** Some question still exists as to whether Aurora will be able to supply paychecks in time for employees to receive payment by Friday each week, mostly due to transportation issues.
Q7. Discuss the importance of KFS’s culture in regards to payroll production.

KFS’s focus on employee satisfaction should seriously be considered. Prompt employee payment, exceptional employee service by the payroll staff, and the specialized nature of the payroll production process all contribute to exemplifying KFS culture. From the information in Exhibit 3, one can conclude that KFS employees are very satisfied with the Payroll Department. There may be a real unquantifiable personal factor in regards to the internal department. Employees may really enjoy the fact that they are able to walk down the hall to pick up their paycheck or have a question answered or a report generated by on-site staff. The Payroll Department performance has instilled confidence in employees which could likely be a contributing factor to why KFS attributes its success to its dedicated employees, then, arguably a competitive advantage. Bear in mind, also, that all other KFS business functions are processed in-house. This outsourcing option may be a substantial deviation from KFS’s Cornerstone Values.