

Teaching Case

USMCo Payroll System

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Abstract

The General Manager, Steve Gunderson, is currently charged with leading the decision on whether to outsource the payroll function of the USMCo (UltraSonic Machining Co) organization or to purchase a system and hire a full-time, experienced payroll staff member to manage the details of payroll for the company. There are differing opinions of stakeholders in the business units, and a staff member could lose their job. The objective USMCo is trying to meet is to have a payroll system that works correctly, minimize risk of entering wrong information, reduce the costs of running the payroll processes, and provide more time to the current HR staff for their more impending duties. Financial services and HR have differing views on the solution based on their desired outcome and needs. Steve has the goal of streamlining processes and making sense of the business objectives.

Keywords: outsourcing, payroll, manufacturing, system selection

1. INTRODUCTION

It was the fall of 2012 on the morning of the World Famous Sausage Festival of Forestville, Ohio and Steve Gunderson was looking out his window, watching people pour into the fairgrounds while they were enjoying the beautiful weather outside. Steve, the General Manager of UltraSonic Machining Co. (USMCo), a manufacturer of semiconductors, has had great success since becoming General Manager five years ago. He was making great strides in getting the company to operate in lean manufacturing along with significant process improvement. Steve now found himself charged with approving one of the possibilities for a new payroll system. The current system wasn't working correctly.

The recent issue that triggered this evaluation was the current payroll cycle where all employees were given their paycheck prior to the Sausage Festival, along with a ticket to attend, and a note saying that Payroll incorrectly reported all employees' W-2's for 2011. This would require everyone to refile their personal state and federal income tax returns. The company agreed to pay the expense for any tax preparation needs and this would not be a small expense for the company. USMCo needed to determine if they should continue to invest time and money on improving their current in-house payroll system or if they needed to outsource the process to improve payroll system performance.

2. COMPANY HISTORY

Buckwald Ultrasonics started over 30 years ago as a small family-run business that specialized in ultrasonic machining technologies. Ultrasonic machining, also known as ultrasonic impact grinding, is a machining operation in which a vibrating tool oscillating at ultrasonic frequencies is used to remove material from the work piece, aided by an abrasive slurry that flows freely between the work piece and the tool (see Exhibit 1).

In 1971 James Buckwald started a machine operation in his garage. He was fascinated with ultrasonic machining. While testing the capabilities of this technology he discovered that it could be used to machine hard brittle material such as glass or sapphire. He then started to machine glass, automotive sensors, and

engineered ceramics for companies that saw benefit from the ultrasonic machining process.

In the early 1980's the company outgrew the family garage and a manufacturing facility was built on Camden Road. Marg Buckwald, a graduate of a local University, became more involved in the business and took over the human resource department. Steve Pickle, a shift manager, was promoted to manage operations. Marg wanted the business to be stable and to provide employees a secure job while Steve was interested in growing the business and taking on risk. By the end of the 1980's, the company had increased to approximately 30 employees with revenues of \$15 million (see Exhibit 2). James Buckwald retired and gave dual control of the business to Steve and Marg.

By the mid 1990's, ultrasonic machining was being applied to silicon, a material used by the fast growing semiconductor industry. Silicon, the second most abundant material in the earth's crust, was an ideal material to use in the machines that produced computer chips. Computer chips require precise regulation of voltage to manipulate data. According to the Cornell Center for Materials Research, silicon is ideal because it can be made into either an effective insulator or a semiconductor, both essential for controlling electrical current.

It was determined that a 100,000 square foot plant was needed to keep up with the growth from Silicon Valley. Revenues nearly tripled compared to the previous decade and the company's rate of growth concerned Marg. Steve assured her that there was little risk and was able to persuade her to invest in an additional plant.

During the 1990's, Buckwald had been purchasing silicon material from a German supplier rather than in-house production. Steve, confident he could capitalize on making the material in house, convinced Marg that buying a machine to produce silicon was the next step for the company. By the year 2000, Buckwald was successful in producing silicon material. They estimated they would need five incremental machines to meet the customer demand and to stop purchasing from an external supplier.

In 2005, the company started to outgrow the current manufacturing plant and underestimated the number of machines it needed to produce

silicon by three times. By this time one major customer, SmallFast Inc, accounted for over 80% of Buckwald's \$100 million in revenue. Marg felt the risks were starting to be too high and did not know if they would be able to raise the needed funds to expand the plant, let alone the additional growers.

3. ACQUISITION OF BUCKWALD (USMCo)

SmallFast Inc was also concerned with the Buckwald's ability to grow. As a result, SmallFast Inc started buying silicon parts from another supplier. This move by SmallFast Inc turned out to be disastrous because they received lower quality materials. They quickly realized how critical Buckwald was to its supply chain and some type of action needed to occur to mitigate their supply risk. Buckwald was a sole supplier for SmallFast Inc and a critical component to their business processes. SmallFast Inc came to the conclusion the best option to mitigate the risk was via acquisition in order to vertically integrate this portion of the supply chain. In December 2006, Buckwald was acquired by SmallFast Inc for approximately \$100 million. Steve and Marg left the company for retirement shortly after the acquisition to pursue other opportunities. SmallFast Inc changed the name from Buckwald to USMCo.

4. NEW MANAGEMENT

After the acquisition, Steve Gunderson took the role of General Manager (GM) responsible for all aspects of USMCo business including manufacturing, production, engineering, procurement, quality control, line management and product development. He joined the company with more than 20 years of applicable global leadership experience and a solid technical and operational background. In his previous position, he was the Global Division Vice President and General Manager of Roofers Powder Products. Prior to that, he held a variety of leadership positions at other Fortune 1000 companies. He earned his MS Degree in Engineering from a large state university.

Steve had immediate gains shortly after starting as the GM. One of his first focus areas was in production where the production floor was transitioned from work centers to manufacturing cells. Before this transition all similar machines and processes were grouped together. For

example, all CNC machines¹ were in one area. The transition created an area where a family of items were produced and contained the machinery needed to process the item through several stages. After this was implemented the company embarked on a lean journey modeling the Toyota Performance system. Inventory on hand before the journey was nearly 6 months to a year in some areas. After the manufacturing cell and lean improvements, inventory decreased to 30 days. With the changes in the manufacturing process gaining traction and starting to show real improvements, Steve knew that there were several administrative areas that needed the same attention and the most pressing of these was payroll processing.

Steve's key accounting employee was Rob Carter. Rob had been brought over to the company when Steve joined shortly after the acquisition. Rob is a CPA and has years of accounting experience with manufacturing companies. Rob had been briefed multiple times regarding the current payroll issue and need for a new system, however Rob was not 100% on board with the need for a new system - he needed to be convinced with data. Rob was one of the key approvers of the new payroll system, so it was important that the team got his buy-in and passion.

5. OLD PAYROLL SYSTEM

When USMCo (then Buckwald) purchased and implemented Unicorn Payroll Pro in 2002, it was a top of the line payroll system. However, ten years later it was no longer supporting the company's needs. The most immediate problem was the amount of manual entry that was required to keep the system up to date. Tax tables could not be uploaded into the software and needed to be manually adjusted with any changes. This was not only a time consuming job, but the potential for error was high. To ensure compliance, it was part of the payroll

¹ CNC Machining is a process used in the manufacturing sector that involves the use of computers to control machine tools. Tools that can be controlled in this manner include lathes, mills, routers and grinders. The CNC in CNC Machining stands for Computer Numerical Control.

clerk's job to check for any changes in tax tables from all taxing authorities, federal, state and local. Compounding this issue was the payroll clerk was not an expert in payroll. She knew how to use the Unicorn software and the basics of payroll, but did not have any background in the many compliance and tax issues that were needed. Unicorn Payroll Pro was also now obsolete software and no longer supported by the software provider and could not be updated to meet USMCo's needs. The software was experiencing very slow processing times and at times would completely freeze and have to be restarted. When this happened, any unsaved data, like a payroll that is in the middle of being entered, could be lost.

In addition, USMCo needed a system that could transition to a paperless check stub, could track benefits and Paid Time Off (PTO) and would also allow for employee self-service online. Employee self-service would allow employees to log onto the system and make changes to their direct deposits or tax withholdings, or to view their benefit accruals. Placing that responsibility in the hands of the employees would free up a significant amount of time in payroll processing and have available time to be used on more strategic tasks. Unicorn Payroll Pro did not have the capability to handle any of these transitions.

6. CONFLICTING VIEWS

After meeting with Human Resources and Finance, Steve realized that the only thing anyone agreed upon is that the current payroll system was no longer viable. Currently, there was a finance clerk/payroll specialist, Kathy, who reported to the Controller, but really worked in the HR department using Unicorn Payroll Pro to process payroll. The clerk was not a payroll expert and problems, such as the costly incorrect W2s, were likely to continue as long as this position was staffed at a clerk level and not with a highly trained payroll administrator.

On the surface, it seemed like a simple set of options: buy a new system or outsource. Steve was finding out that there was not an easy answer. Whether they decide to buy or outsource, the future of Kathy at the company was not certain. In either case, it was questionable whether she would have enough work to justify her salary. Were any of her other duties critical functions and could they be moved to someone else within the company? If they

decided to let Kathy go, who would be the process owner for payroll? Even with an outsourcing option, someone had to transmit the data to the provider and act as a liaison.

The HR benefits administrator, Tammy, wanted to hire a new payroll administrator that had the expertise to handle all the reporting requirements. She also wanted to install a new payroll system that had all the functionality to handle the new requirements the company required. By hiring a payroll administrator and having a system that could track benefits and PTO, Tammy would be able to spend more time evaluating benefits programs and ensuring that the programs were the best fit and value for both the company and the employees. Currently, Tammy was spending so much time tracking benefits and PTO, answering employee questions about their benefits, and helping Kathy with the payroll, that she had little time left over to do a thorough evaluation on current programs and research new programs.

With the looming Affordable Care Act deadlines, Tammy needed all the extra time she could get. A system that could track benefits with a self-service feature for employees and a payroll administrator that was qualified to handle the remaining employee inquiries and problems would free up a significant amount of time to concentrate on trying to mitigate potentially costly changes in healthcare. Tammy also knew from past experience that even with an outsourced payroll provider, there can still be significant time needed to input the payroll data to the provider and the providers often charge based on the number of employees. She knew that as the company continued to grow it will become more costly to process payroll. She felt that outsourcing was not the most advantageous option. As the company grew, it would become more cost efficient to have payroll processed in house. Tammy also knew that even with a self-service feature, there would still be employees with questions and there would still be payroll errors to be dealt with and all those issues would be directed to her.

The HR Manager, Linda, however, was in favor of outsourcing payroll to a third party provider and letting Kathy go from her position. The HR manager felt that there were not enough employees in the company to warrant hiring a payroll administrator and upgrading to a new in-house system. She thought that a new system that would meet their requirements would be far

more costly than the cost of outsourcing the payroll. Outsourcing providers could meet all the system requirements that USMCo needed and payroll was their core competency. Outsourced providers had the expertise to manage all payroll functions and to stay up to date with all tax and compliance issues. Once payroll is sourced to an outside provider, the Company's payroll processing requirements are to only send the employee hours to the provider. These hours would be gathered by the department managers and should take someone a small amount of time to input for processing. The provider systems could eliminate the need to track benefits and PTO manually and the self-service feature would alleviate the amount of employee questions being directed to the HR department. Linda felt that the time needed for managing payroll would be minimal and that Kathy would no longer be needed.

Susan, the Finance manager, agreed with Linda that the outsourcing option would be the most cost efficient solution, but disagreed over the future of Kathy, the finance/payroll clerk. In addition to the payroll processing, Kathy was also a backup for accounts payable, accounts receivable and the front desk. Susan thought Kathy should be kept on staff to maintain the status as a backup and to be the payroll point person to the outsource provider. Susan agreed with Tammy that while an outsource option would help to alleviate the problems and diminish the workload of the payroll clerk; it would not eliminate the need for a payroll clerk. Susan also agreed that Tammy could not be the point person for the entire payroll because she was well aware of the large cost associated with the company's current health care. Tammy should be using her expertise to try and mitigate future costs rather than sending payroll information to a provider. The question for Susan was whether or not Kathy would have enough work to justify her salary with a diminished payroll job.

7. PAYROLL CHALLENGES

The Unicorn payroll system has several challenges associated with it. As discussed, proper legal compliance is not in place with the errors reported in W-2's, and needs to be fixed ASAP. USMCo could face fines from the IRS if this misreporting issue was not promptly fixed. In addition to compliance, there are operating and performance issues with Unicorn. Unicorn is antiquated and no longer has active support

available. In addition, USMCo does not have an in-house expert that can work through the challenges of Unicorn. Kathy is a finance coded employee that HR wants to remove from her position - and is only a clerk and does not have payroll expertise. However, the Accounting department sees the benefit of having a liaison between HR and Accounting in order to ensure there is proper finance representation in the process.

The HR and Accounting organization has started dedicating time and effort at evaluating the various options. There are clear pros and cons for each option that both organizations felt very passionate about with supporting legitimate reasons. See Exhibit 4 for a comparison of costs between Unicorn and outsourcing. However, Rob Carter was not engaged in payroll system conversations and did not participate in the meetings. His disengagement created more effort for the team as data collecting and effort continued to grow in order for HR and Accounting to influence Mr. Carter to recommend the "right" decision to Steve.

8. CONCLUSION

Steve knew that a tough decision lay ahead of him in determining the future of the payroll systems for USMCo. He needed to be sure that the future payroll system, whether it was kept in-house or outsourced, would meet the current and future expanding needs of the company. The new processes needed to have significantly less manual upkeep, be easily updated with federal, state and local taxes, have improved processing times, have greater reporting functionality and be able to provide an employee self-service function. After hearing the opinions of multiple people in Finance, Accounting and HR, Steve knew that his decision wasn't as simple as deciding which option USMCo should pursue to fix their payroll problems. Steve also needed to determine which department would maintain the ownership of the payroll function and what should be done with the current payroll/finance clerk, Kathy.

As Steve looked out his window at the hordes of people at the Sausage Festival and thought about how they recently broke the news to their employees about the payroll error, he knew he needed to make a change, and fast. Steve was certain that USMCo could not have another year of payroll errors that would cost the company additional money to resolve and potential fines

from the government for inaccurate taxes being withheld. He decided that a decision would be required by the end of the week to present to the various departments along with the pros and cons of this approach. Steve would outline the ownership of the system and as a result employee's responsibilities would change. He had a tough week ahead of him and knew that he unfortunately wouldn't have enough time to attend the Sausage Fest this year.