



Professional Employer Organizations: Fueling Small Business Growth

Information provided through
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Exploring the Impact of PEOs

In recent years, a series of broad economic changes, especially those related to technology and globalization, has dramatically shifted the competitive landscape for all companies in the economy. **Most of these changes are, at their foundation, directly related to an organization's people.** This means professional employer organizations (PEOs) – with their extensive array of HR services and employee benefits – are now uniquely positioned and have significant potential to help businesses better meet their challenges in the face of today's demanding economic conditions. This study explores the evidence to determine how PEO clients are faring relative to other companies in the economy.

Most employers know this in their gut, and a growing body of research confirms that so-called “human capital management” has been elevated to an essential organizational core competence that generates significant and sustainable competitive advantage. The best evidence that exists on the effects of better people management is based on the experiences of larger companies, but the lesson applies to companies of all sizes, who are all subject to the same economic forces and compete in the same marketplace. **For example, the strongest predictor of a company's probability of surviving for at least 5 years after its initial public offering is its level of investment in human resources.**¹ And the stock prices of “people companies” – those organizations that made *Fortune's* “100 Best Companies to Work For” list in at least 3 of the past 10 years – outperformed the S&P 500 by 99 percentage points over that period (109 percent versus 10 percent gain).²

Achieving sustainable competitive advantage through better management of employees is a huge challenge for even the largest and most sophisticated companies. But that challenge is even greater for small and mid-size organizations. And PEOs point to precisely that value proposition: they help their clients manage the “people side” of their businesses more effectively, avoiding compliance pitfalls and creating key benefits for the business and its employees, while simultaneously freeing up time for owners and executives to concentrate on growing their business by focusing on operations, strategy, and innovation. The existing evidence, summarized in this study, confirms this dynamic.

PEO Services and Benefits

Evidence indicates that PEO clients offer better benefits to their employees, offer a wider array of employee-related services, and are able to do this while saving money (money that can be redirected to grow the business).

Most PEO clients are small to mid-size companies. The average number of employees among PEO clients is less than 10. 3 Organizations of this size usually have only a “bare bones” HR functionality, which typically focuses on the most basic HR needs: hiring employees, getting them paid on time, and navigating the complex world of taxation (including FICA and FUTA) and other compliance requirements in an accurate and timely manner. PEOs typically take over these key HR responsibilities



The Bottom Line

- Although PEO clients are small, they are able to offer a broad array of benefits to their employees at lower cost than companies that don't use PEOs.
- Many of these benefits (e.g., retirement plans) have much higher participation rates among employees of PEO clients.
- These benefits play a major role in helping businesses attract and retain employees.
- The broad array of HR services offered by PEOs also makes it possible for executives to focus their attention on the core business.
- All these factors pay off: PEO clients have higher growth rates than other small businesses.

for their clients, administering employee payroll and benefits, personnel management, workers' compensation services, and monitoring and managing risk in these areas. At the same time, PEOs make available to their clients a broad array of additional employee-related services.

Broad Array of Services: More Services at a Lower Price

Despite this broad array of offerings, PEOs are able to provide these services at a lower cost than their clients would have to pay for more basic HR administrative services. For example, in 2011, PEOs' gross profit margin was \$1,187 per worksite employee; this figure represents the revenue remaining after all direct employee-related costs (salaries and wages, health or medical, FICA, etc.) have been paid. Out of its gross operating margin, a PEO must pay all of its own operating expenses. So, in essence, the figure of \$1,187 represents the amount PEO clients are paying for HR administration and all other services offered by their PEO.

There are no strictly comparable numbers available for non-PEO clients; the best available comparison for such companies comes from Bersin & Associates and puts HR spending at \$1,500 per employee within companies with fewer than 1,000 employees⁵ (No breakdown for smaller-size employers is available.) Given considerable economies of scale for larger companies in this group (since they can take advantage of their larger size to spread fixed costs over their entire employee population), this figure of \$1,500 almost certainly underestimates the cost for very small businesses which, as noted above, represent the primary clients of PEOs.

Table 1. HR service offering by PEOs, % offering ⁴

HR service offering	% of PEOs offering service
Compliance assistance on HR-specific regulations such as EEOC, FMLA	100%
Retirement plans for employees	98.4
Assistance with job description	98.4
Paid time off (PT) tracking and reporting	98.4
Customized employee handbooks	95.1
Background screening	95.1
Telephone consultation re: HR and personnel matters	95.1
Employee exit interview assistance	93.4
Pre-employment drug testing	91.8
Wage and salary compensation planning assistance	86.9
Performance review assistance/tracking	86.9
Recruitment/job placement	72.1
Employee surveys	70.5
Online training services for supervisors and employees	65.6
Personality testing	59.0
Turnover analysis and reporting	59.0
Professional licensing and certification tracking	45.9

Figure 2. HR administration costs, per employee

PEO Clients Grow Faster

Overall, the evidence described in the section above indicates that PEO clients spend less for more services and for greater expertise in HR service administration. If PEOs are successful in enabling small businesses to focus more directly on what it takes to succeed in a competitive marketplace, it follows that **PEO clients should grow faster than other comparable organizations, and indeed, this is what the evidence shows.** The number of workers employed by PEO clients has grown more quickly than a variety of key comparisons.

Figure 3. Employment growth, PEO clients versus small businesses overall, January 2007 (date of Intuit index inception) = 1000

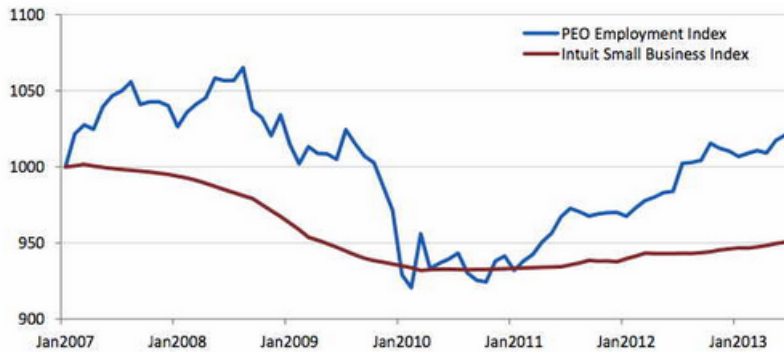


Figure 4. Employment growth, PEO clients versus U.S. employment overall, December 2004 (date of PEO index inception) = 1000

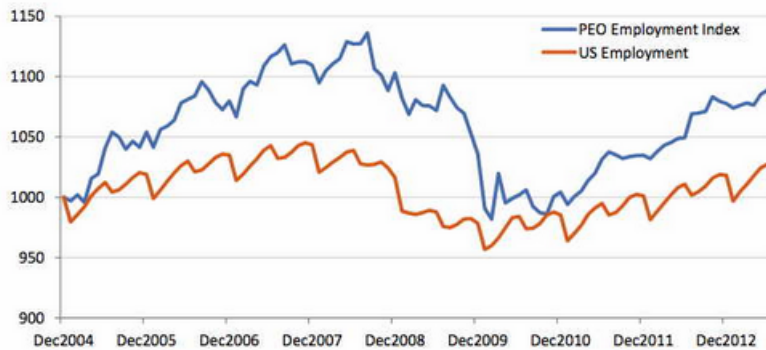
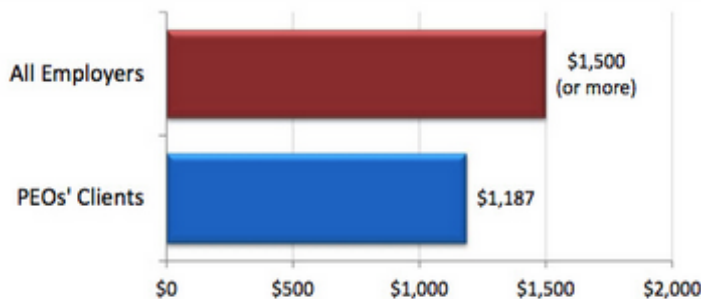


Figure 2. HR administration costs, per employee



Conclusion

Overall, therefore, the evidence on employment growth suggests that PEOs are making it possible for their clients to grow more quickly than their peers – both other small businesses as well as all companies throughout the economy. This can be attributed to a variety of PEO-related factors discussed in this study. PEO clients have access to a broader array of HR-related benefits and services. Yet they spend less on HR administration than similarly-sized peers, freeing up money that can be reinvested in the business. Some of the benefits PEO clients are disproportionately able to offer –such as employer-sponsored retirement plans – play a major role in helping businesses attract and retain their employees. This too can have a tangible impact on business success: it is easier to keep key high-value employees, while turnover-related costs are reduced. Finally, freed from many HR administrative burdens, executives and managers of PEO clients can focus more of their time on strategy and growth. These factors all combine to yield faster growth for PEO clients relative to other businesses.

About Peter E. O’Neil

Peter E. O’Neil is a Professional Employer Consultant for Oasis Outsourcing. He has been active within the small business employee benefits and human resources community for more than 20 years. He is a Certified Human Resource Generalist (CHRG) by The Society for Human Resource Management (SHRM). He is a Certified Senior Advisor through The Society of Certified Senior Advisors, and holds an insurance brokers license through the Commonwealth of MA. Peter received a Bachelors of Science degree in Business Administration from American International College.

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About Oasis Outsourcing Holdings, Inc.

Oasis Outsourcing is a Florida-based Professional Employer Organization (PEO) serving more than 145,000 employees and 4,700 clients nationwide. It specializes in providing human resources services, employee benefits, payroll and tax administration, risk management services and staffing solutions to small-and medium-sized businesses throughout the United States

About NAPEO

The National Association of Professional Employer Organizations (NAPEO) is The Voice of the PEO Industry™ and represents about 85 percent of the industry’s estimated \$922 billion in gross revenues. NAPEO has some 300 PEO members, ranging from start-ups to large publicly held companies with years of success in the industry, as well as some 200 service provider members. PEOs provide payroll, benefits, and other HR services to small and mid-sized businesses. Approximately 250,000 businesses and more than 2.5 million people are part of PEO arrangements. For more information about NAPEO, please visit www.napeo.org. You can also find us on Facebook at www.facebook.com/napeo and follow us on Twitter @NAPEO.

About McBassi & Company

McBassi is an independent analytics and research firm that helps clients create consistently profitable and enlightened workplaces. McBassi uses the language and tools of business – metrics and analysis – to build successful organizations by optimizing the power of their people. McBassi’s principals (Dr. Laurie Bassi and Dan McMurrer) are co-authors of *Good Company: Business Success in the Worthiness Era* (winner of the 2012 Nautilus Gold Award for Business/Leadership) and the *HR Analytics Handbook*.

About the Authors

Dr. Laurie Bassi is CEO of McBassi and a global leader in the field of applying analytics in the world of HR. Laurie is the author of over 90 published papers and books and was previously a tenured professor of economics and public policy at Georgetown University. She holds a Ph.D. in economics from Princeton University. Dan McMurrer is the chief analyst at McBassi. An analytics expert, Dan focuses on researching the relationship.

Endnotes

1 Theresa Welbourne, "Want to Make Money on IPOs? Learn About Companies' HR Management Strategies," Workforce Management (September 2010).

2 Boston Consulting Group/WFPMA, From Capability to Profitability: Realizing the Value of People Management (July 2012). This is not simply a case of "reverse causality." Rather, being a "people company" actually predicts future financial performance, even after controlling for the firm's past performance. In other words, this superior performance is not attributable to a firm's superior past performance.

3 This compares to an average of almost 20 for other companies. These figures are based on NCCI's analysis of its data on companies with workers' compensation policies (2007 Workers' Compensation Statistical plan data and Workers' Compensation Policy data, as reported to NCCI). Described in Harry Shuford, NCCI, "Don't Just Speculate, Investigate! The Story Behind the PEO Study," https://www.ncci.com/Documents/Story_Behind_%20PEO_Study-NCCI_AIS_2013.pdf (May 16, 2013), p. 17.

4 NAPEO, 2013 Financial Ratio & Operating Statistics Survey.

5 Karen O'Leonard and Stacey Harris, "Maximizing Your HR Spend," Human Resource Executive Online (June 2, 2011), <http://www.hreonline.com/HRE/view/story.jhtml?id=533338466>.
