The benefits and challenges of professional employer organizations (Part I)

Life is messy. It often feels acutely so for you as a small business owner. But even as metastatic regulatory growth pushes you toward ever bigger messes, thankfully, the marketplace has developed ways to simplify some of the nastiest complexities. Professional employer organizations, offering simplified HR management solutions, are a prime example, blossoming into an $8 billion dollar industry for good reason.

Small employers just don't have the time and resources to handle every aspect of running a business under intense local, state and federal scrutiny and demands. The advantage of PEOs is that they have the specialized HR knowledge to handle the employment relationship more efficiently.

As with most everything, we are a society where experts are increasingly plugged in to perform specialized functions generalists can't do without taking their hands off the controls. With a full complement of services, the PEO can serve as your team of HR specialists, taking on the burden of being the employer, of recruiting, hiring, compensating, running payroll, benefits, worker's compensation and unemployment insurance administration, and even handling the exit process. They also offer your employees access to retirement plans, one of the most compelling reasons to engage them.

Top four reasons to contract with a PEO:

1) Reduced administrative work
2) Purchased expertise in laws and regulations
3) Reduced liability
4) Access to group retirement plans

When considering hiring a PEO, the first question, of course, is how much control you want to give up. The second question is what the services cost. We will address this first issue in this article and the second one in Part II of the series.

First, let's lay out some definitions:

PEO (Professional Employment Organization): defined as a co-employment relationship, wherein the PEO becomes the official employer of record. Almost all liabilities fall on the PEO, except for safety and compliance issues, which still cross over to the employer's purview. PEOs generally serve companies that are small, up to 50 employees.

ASO (Administrative Services Organization): a more limited form of PEO. ASO services are enfolded into any PEO arrangement, but an ASO agreement can stand alone as well. ASO services include payroll and tax compliance, and serving as consultant to help source appropriate HR and benefits administration services.

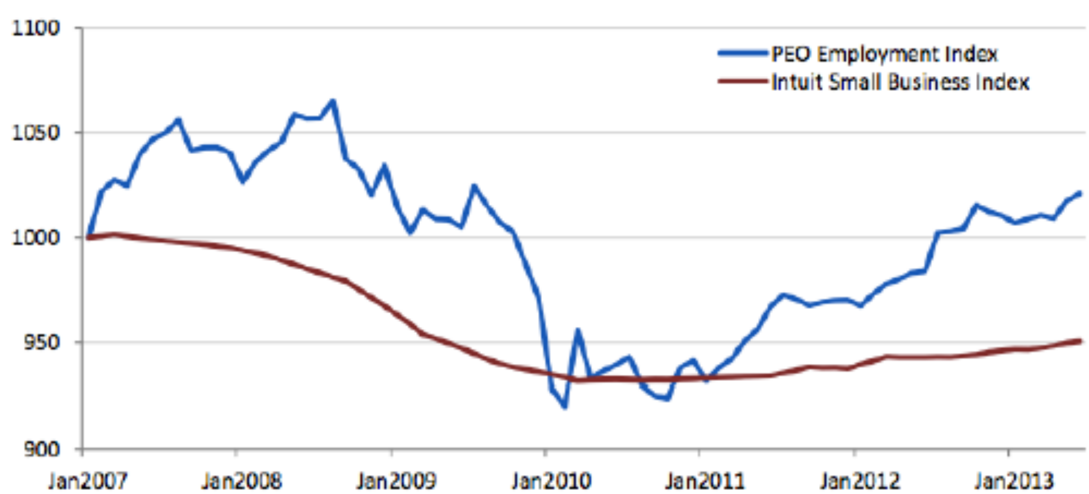
An ASO does not employ your people directly; you are still the employer of record, and bear the attendant liabilities. ASOs also serve the smaller employers.

HRO (Human Resource Outsourcing): offers a variety of services that can be purchased individually to supplement an in-house HR department. HROs are typically used by somewhat larger organizations (200+ employees).

Handing over the reins: What is the best decision for my company?

There are still small employers who elect to handle all their HR tasks in-house, but it is a shrinking number. 250,000 small and midsized businesses today use some form of PEO, covering 2.5 million employees. An independent study by McBassi & Co. (commissioned by the National Association of Professional Employer Organizations) found that employers who use PEOs fared significantly better than their peers, as measured by their employment growth.

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



McBassi & Co, Sept, 2013

One of the strongest arguments for a PEO is the access to a defined contribution retirement plan. According to a Towers Watson study, 47% of employees cited retirement benefits as very important to their decision to stay or leave an employer. Yet a small size limits companies' capacity to set up a meaningful 401(k) plan.

Companies that have relatively high turnover, average or above average worker's comp premiums, and whose business success is not intimately tied to cultural cohesion may be the biggest beneficiaries of a full PEO relationship.

Others should consider the full range of available options. For example, if your company has low turnover and low worker's compensation rates, you may not stand to gain from joining a pool. If your company thrives on a family feeling, you may want to maintain tight control on the recruiting and hiring process, and have a company manager as the "go-to" contact for many employment-related issues. In other words, maintaining the direct employment relationship may be critical to keeping loyalty alive. If this describes your company, consider using an HRO for advice or an a la carte approach to services through an ASO.

In Part II of this series, we will examine how to select the right PEO, ASO and HRO company based on costs and services .

Sources:

https://www.inphilanthropy.org/sites/default/files/resources/Working Smarter - PEOs Fuel Small Business Growth.pdf

http://www.journalofaccountancy.com/issues/1999/jul/katz.html

http://www.businessnewsdaily.com/8117-best-professional-employer-organizations.html

http://peo-services-review.toptenreviews.com

http://www.businessnewsdaily.com/2391-outsourcing-human-resources.html

http://cdn2.hubspot.net/hub/92986/file-28391003-pdf/PEO_ebook_final_draft.pdf

http://www.solidbusinesssolutions.com/hr-news/abcs-peos-asos-and-hros

http://www.psmin.com/Blog/tabid/150/articleType/ArticleView/articleId/2024/The-Value-of-a-PEO.aspx

http://optimumhr.net/napeo-study-offers-important-insights-into-peo-value/

https://www.towerswatson.com/en-US/Insights/IC-Types/Survey-Research-Results/2011/12/The-New-Governance-Landscape-Implications-From-the-2011-Towers-Watson-US-Retirement-Plan-Governanc

http://www.hri-online.com/blog/the-numbers-are-in-peos-do-help-small-businesses-grow