

New Report: Most Small Businesses Save Significant Sums Through HR Outsourcing

By Bruce McCracken, Business Writer



In a research study of 515 clients of professional employer organizations (PEOs), dramatic results reaffirmed the value of outsourcing non-core business processes such as human resources (HR) and benefits administration to a service provider.

Researchers at the University of South Carolina, the State University of West Georgia, and Temple University conducted the 2002 research. The National Association of Professional Employer Organizations (NAPEO) and the Society for Human Resources Management (AHRM) sponsored the study, entitled, "HR Outsourcing and the PEO Industry: A Survey of Client Reactions."

The study found 68 percent of the buyers reported significant savings by outsourcing HR to a PEO. Most of the savings generated were the result of reducing the time their staff spent on HR functions. In addition, 89 percent of the respondents (averaging 21 employees) said that utilizing a PEO produced average savings of nine hours per week. That translates into \$600 per employee annually, on average.

A professional employer organization is an outsourcing service provider that contractually assumes and manages HR and employer risks for small to mid-sized businesses. Those responsibilities include employment tax, payroll, health insurance, retirement savings plans, and other employee benefits.

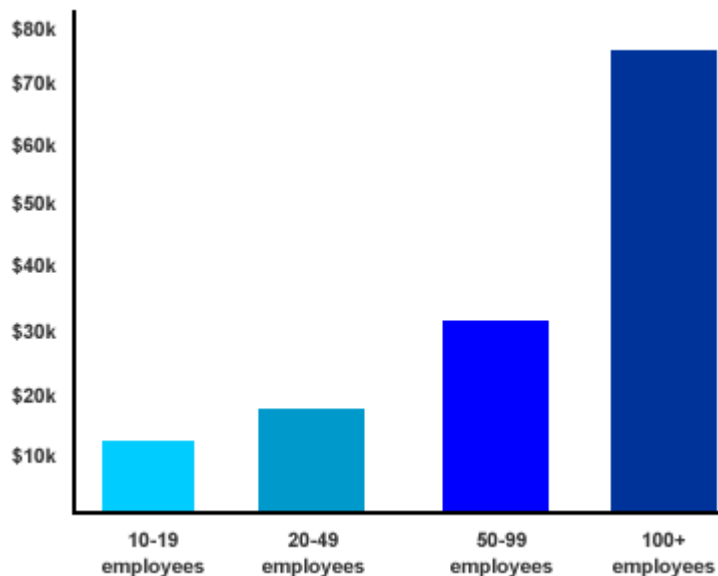
The Internal Revenue Service acknowledges that a PEO may be the employer for federal income and unemployment taxes. Many states statutorily recognize PEOs as the employer or co-employer for purposes of workers' compensation and state unemployment insurance taxes.

Outsourcing HR Cuts Administrative Time Consumption

As an employer of record for many small firms, a PEO can leverage costs on an economy of scale and provide expertise that the small to mid-sized firms could not otherwise attain. The Small Business Administration submits that aggregating 500 employees can cut employment-related costs by 40 percent.

Saving time produces these gains. "Employment-related issues often require substantial managerial time. However, in smaller firms, a manager's time is a limited resource that must be used wisely. PEOs free up key managers so that they can focus on more revenue-producing activities for their firms," says Dr. Thomas Gaines, associate professor at the State University of West Georgia and a member of the research team.

When broken down according to the number of employees, the annual cost savings were as follows: 10 to 19 employees - greater than \$10,000 per year; 20 to 49 - \$18,000 per year; 50 to 99 employees - \$32,000 per year; 100 or more employees - \$78,000.



Virtually all of the clients in the survey reported relying on the PEO for payroll and a large majority said they wanted the PEO to handle benefits and workers compensation. Managing safety programs and legal compliance programs are also outsourced at significant rates.

Satisfaction rates are high; eighty-six percent said that they were satisfied using a PEO while another 81 percent were significantly pleased with the quality of the programs provided. Two-thirds of the respondents stated it was PEO quality rather than price that mattered most.

Carl Kleimann, president of [1st Odyssey Group, Inc.](#), a PEO headquartered in Euless, Texas, points out that every hour his clients save through outsourcing is another hour they have to focus on their profit-producing activities. He says clients are happy to escape the task of learning about human resources, a business that is foreign to most entrepreneurs. In addition, it is difficult for a small business to have staff members involved in non-revenue producing tasks. "Also, most small businesses do not have HR departments, so the learning curve is going to be much more extensive," says Kleimann, who is also president of NAPEO.

Outsourcing Provides Objective Legal Expertise

Rules and regulations are a big driver. Dr. Peter F. Drucker, Marie Rankin Clarke Professor of Social Science and Management at Claremont Graduate University in Claremont, California, wrote in the February 1, 2002 edition of the Harvard Business Review that "the driving force behind the emergence of the PEOs, I would argue, is the growing burden of rules and regulations for employers. Between 1980 and 2000, the number of U.S. laws and regulations regarding employment policies and practices grew about 60 percent, from 38 to 60."

PEOs typically provide employment practices liability insurance (EPLI) that protects the entity, owners and management in the event of litigation.

Kleimann adds that the more intimate work environment of the smaller enterprises favors outsourcing. "It is often difficult for management to be objective and focus on issues. Owners and managers in smaller businesses often have stronger ties to their employees. They also don't have the formal training to deal with some of the more technical HR issues," he explains.

Gainey adds, "Issues such as wrongful termination and discrimination are often highly disruptive in small firms because of limited managerial experience in handling them. However, the expertise and objectivity offered by PEOs often allows management to resolve these issues "in a timely and effective manner."

Enabling a Business to Take Care of Business

The research suggests that HR outsourcing continues to grow. "Because outsourcing frees up managerial time, offers expertise not available inside many firms, and often results in substantial cost savings, it is simply an alternative that firms must consider if they wish to remain competitive," says Gainey.

Drucker asserts that, "PEOs free up managers to focus on the business rather than on employment-related rules, regulations, and paperwork. To spend up to one quarter of one's time on employment-related paperwork is indeed a waste of precious, expensive, scarce resources."

Lessons from the Outsourcing Journal:

- The increase in legal requirements is a pivotal reason why small to medium-sized businesses decide to outsource their HR functions to a PEO.
- Sixty-eight percent of buyers reported significant savings by outsourcing to a PEO.
- Buyer satisfaction with a PEO is high: 89 percent.

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