

An Economic Analysis: The PEO Industry Footprint in 2018



Laurie Bassi and Dan McMurrer
McBassi & Company

September 2018

An Economic Analysis:

The PEO Industry Footprint in 2018

Laurie Bassi and Dan McMurrer, McBassi & Company

September 2018

Professional employer organizations (PEOs) provide comprehensive HR solutions for small and mid-sized businesses. Payroll, employee benefits, HR, workers' compensation, and risk management are some of the many services PEOs provide to businesses across the country. As the research in our previous white papers has shown, those businesses enjoy a better chance of survival, higher growth rates, lower employee turnover, and higher employee satisfaction.

PEOs produce these benefits for their clients by providing them with a broad array of cost-effective HR offerings. This enables their clients to concentrate on growing their businesses, while offering superior benefits and HR practices to their employees. As a result, PEO clients are able to provide their employees with a better value proposition, and employees respond in kind by helping their employers grow their businesses.

Given the win-win proposition that PEOs create for employers and their employees, it is no surprise that as awareness increases, PEOs are becoming a large and growing force. This paper provides new, definitive measures of the current size, scope, and footprint of the PEO industry.

At the end of 2017, the 907 PEOs in the United States employed a total of 3.7 million worksite employees (WSEs), who were paid a total of \$176 billion. These employees worked for approximately 175,000 different PEO clients. The discussion that follows elaborates on these findings.

The methodology used for this research is summarized in the second half of the paper. In a nutshell, first we used multiple sources to identify all PEOs operating in the United States. We then calculated the total size of the industry, using best available methods to estimate the size of individual PEOs when limited or no data was available. Finally, we used available data on year-over-year changes in size among individual PEOs to estimate changes in the size of the industry since 2008.

Please note: The methodology used throughout is intentionally conservative. It is likely, for example, that some small number of PEOs were not included in the sources available to us and thus were not included in the industry size estimates. To the extent this is the case, the actual industry size would be underestimated accordingly.

Contents

2

Size of the PEO Industry

3

How We Made the Calculations

4

Calculating Industry Size

6

Calculating Changes in Industry Size

8

About McBassi & Company

Size of the PEO Industry

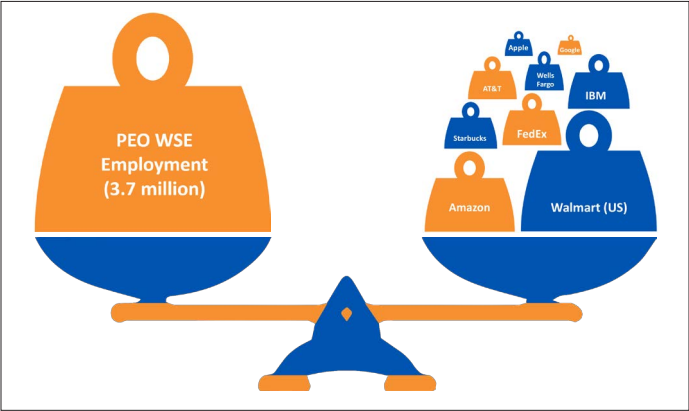
The 3.7 million WSEs employed by PEOs earned a total of \$176 billion. They represent 12.1 percent of all employment by private sector employers that have 10 to 99 employees (chosen because this is the size range of most PEO clients)¹ and 2.4 percent of civilian employment in the United States.²

The total employment represented by the PEO industry is roughly the same as the combined number of employees for Walmart (United States only), Amazon, IBM, FedEx, Starbucks, AT&T, Wells Fargo, Apple, and Google.³ Those companies include the two largest retailers, the largest technology company, the largest transportation

company, the largest telecommunications provider, the largest financial services firm, the largest specialty restaurant chain, plus the two most highly valued firms in the world based on stock market valuation.

The PEO industry's 175,000 clients represent 15 percent of all employers with 10 to 99 employees.⁴

There are 907 PEOs in total. In terms of context, the five largest PEOs account for an estimated 43 percent of the PEO industry's 3.7 million WSEs. The next 25 largest firms account for an additional 22 percent of the industry's WSEs.



PEO Industry at a Glance: Comparative Total Employment

Change Since 2008

Between 2008 and 2017, the number of WSEs employed in the PEO industry grew at a compounded annual rate of 8.3 percent, based on applying "same-

Key Statistics

- \$176 BILLION** 2017 annual wages paid to WSEs
- 175,000** Number of PEO clients
- 907** Number of PEOs in 2017
- 8.3%** Annual compounded growth rate of # of PEO WSEs
- 14 TIMES HIGHER** PEO WSE growth rate, relative to growth rate in employment in US economy overall

- 1 Based on comparison of PEO WSEs with U.S. Bureau of Labor Statistics data on employment level by firm size for 2017 at www.bls.gov/web/cewbd/table_ftxt. For the purpose of these calculations, we used firms with 10 to 99 employees.
- 2 Based on comparison of PEO WSEs with total employed civilian labor force from the U.S. Bureau of Labor Statistics Current Population Survey, www.bls.gov/cps/cpsaat01.pdf.
- 3 Because it is difficult to obtain employment breakdowns by country for most large publicly traded companies, all numbers except Walmart are for worldwide employees. Walmart data is from <https://corporate.walmart.com/newsroom/company-facts>; data for all other companies is from Yahoo Finance, (accessed August 7, 2018, with numbers based on companies' annual public reporting). Company-specific employment is as follows: Walmart (US) 1,500,000; Amazon 580,000; IBM 370,000; FedEx 290,000; Starbucks 280,000; AT&T 270,000; Wells Fargo 250,000; Apple 100,000; Google 90,000.
- 4 Based on comparison of PEO clients with total number of firms with 10 to 99 employees from U.S. Bureau of Labor Statistics, www.bls.gov/web/cewbd/table_g.txt.

store" sales estimates. Figure 1 shows overall industry growth from year to year, with the dotted line representing the linear trend since 2008.⁵ The compounded annual growth rate of the PEO industry is roughly 14 times higher than the compounded annual growth rate of employment in the economy overall during the same period.⁶

The best available evidence indicates that the actual number of PEOs has been relatively stable over the past few years (907 in 2017), with the number of newly formed PEOs being approximately offset by the number of PEOs that have merged, been acquired, and/or gone out of business.

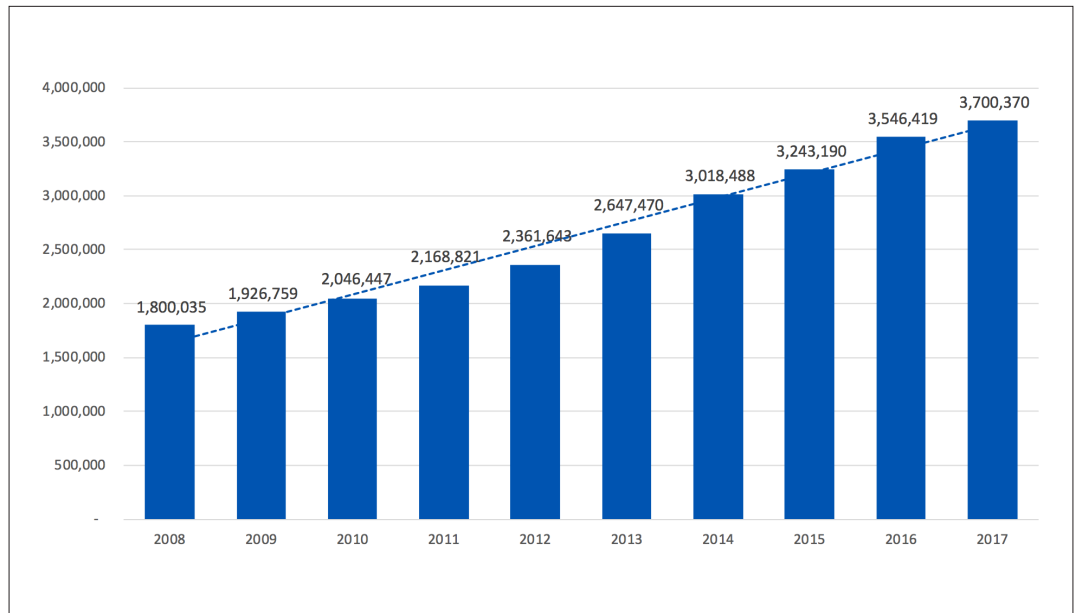


Figure 1: Estimated number of WSEs covered by PEOs from year to year, 2008 to 2017.

How We Made the Calculations

This section provides additional background on how we calculated the summary statistics provided in the previous section, as well as additional details and breakdowns on some of the specific statistics.

The methodology used for this paper was wholly different from the methodology employed for our 2015 NAPEO white paper on the industry footprint. This analysis was built through an exhaustive assessment of data down to the individual PEO level, drawn from a variety of sources (many of which included business-sensitive



5 This estimate is based on calculating annually "same-store" PEO growth rate (i.e., growth for those PEOs for which we had data for both the current year being calculated and the previous year). Hence, this estimate excludes any specific growth effects of PEOs that were involved in mergers or acquisitions, as well as the impact of the formation of new PEOs, and the departure of PEOs that went out of business. Because the data for the same-store calculations come from NAPEO members' 941 filings from 2008 to 2017, the estimate also assumes that the extent to which NAPEO members are representative of the PEO industry as a whole has remained roughly constant during those years.

6 The PEO growth rate compared to the growth rate in employment (0.6 percent compounded annual increase) from the U.S. Bureau of Labor Statistics (Current Population Survey) at www.bls.gov/cps/cpsaat01.xlsx.

information provided under condition of confidentiality). We view this as a definitive look at the current size of the industry given all available data.⁷

Calculating Industry Size

We used the five-step process described below to calculate the size of the PEO industry.

1. Identify all PEOs in the industry;
2. Estimate their relative size using available data on:
 - WSE wages; and
 - # WSEs;
3. Use established ratios (NAPEO member data and NAPEO's Financial Ratio and Operating Statistics (FROS) Survey were the two sources from which these ratios were drawn) to make analytically responsible estimates of wages and/or number of WSEs by PEO, as necessary;
4. Check and validate existing data; and
5. Adjust underlying data that has varying periodicity (quarterly, annually, point-in-time) to account for employee turnover, ensuring consistency across data sources and making possible both a point-in-time estimate of total WSEs (to compare with the size of the national labor force) and an annual total for WSE wages.

Step #1—Identify all PEOs in the industry

We created a consolidated database of PEOs by combining PEO lists from the following sources:

- Current NAPEO members;
- Employer Services Assurance Corporation (ESAC)-accredited members;
- NAPEO/ESAC-created list of additional PEOs, derived from sources including state databases;
- PRISM HR client list;
- Slavic 401(k) clients; and
- McBassi PEO benchmarking survey.

We removed from the combined list those companies that we deemed unlikely to be current PEOs. Firms meeting the following criteria were removed (67 total were removed):

- No email address *and* letter mailed to physical mailing address was returned to sender as undeliverable (34 companies);
- Company name is inconsistent with PEO work *and* review of website or other online information also suggests company is not engaged in PEO work (32 companies); and

⁷ It is also useful to note that the size estimates from this analysis are quite consistent with the 2015 estimates after accounting for annual growth in the industry since that previous analysis.

- Company directly informed us via email that it is not a PEO (one company).

Step #2—Calculate the size of PEOs identified in Step #1 for which there is known data (465 PEOs)

We used the following information and data sources:

1. NAPEO Form 941 data (quarterly wages, WSEs);
2. McBassi PEO benchmarking survey (annual wages, point-in-time WSEs);
3. Clients of McHenry Consulting and/or Stonehenge Insurance (WSEs);
4. ESAC-accredited members (annual wages, WSEs; broken out for only PEOs that are not NAPEO members and for whom we therefore did not have 941 data);
5. PRISM HR clients (aggregated WSEs; adjusted to eliminate double-counting of PEOs for which data are available from other sources);
6. Size information provided by Dan McHenry on selected other PEOs (WSEs); and
7. Slavic 401(k) clients (includes WSEs for retirement plan participants only; adjusted accordingly).

We are grateful to the following individuals for their invaluable assistance in the preparation of this research report: Craig Babigian of PrismHR, Kerry Brooks and Jane McCoggins of the Employer Services Assurance Corporation (ESAC), Denise King of NAPEO, Dan McHenry of McHenry Consulting, Troy Reynolds of Stonehenge Insurance Solutions, and John Slavic of Slavic401K.

Step #3—Use established ratios to estimate missing data as necessary

- A. We estimated missing WSE # or WSE wages for the 235 PEOs for which direct data was available for only one of the two key measures (i.e., those PEOs that are not NAPEO members or did not participate in the McBassi PEO benchmarking survey). In most cases, we applied what we believe to be the best available data source: the ratio of \$36,688 in wages per WSE for the 177 NAPEO firms for which we have both 2017 wages and WSE numbers (this is drawn from 219 firms, from which we eliminated the top and bottom 10 percent to remove the impact of outliers).
- B. We estimated the size of PEOs identified in Step #1 for which we have no specific data by applying the following estimates to the remaining "unknown" PEOs (442 PEOs):
 - 775 WSE per PEO—based on FROS "smallest firms" (fewer than 1,500 WSEs) mean (based on the assumption that most of the "unknown" PEOs would fall into the smallest size group); and
 - \$36,688 per WSE—based on the same NAPEO ratio listed in Step #3A.

Step #4—Check and validate existing data

We adjusted certain data for specific PEOs based on what seemed to be erroneous data entry (identified typically by extreme outliers on wage/WSE ratios).

Step #5—Adjust underlying data that has varying periodicity

We also used U.S. Bureau of Labor Statistics data from the Job Openings and Labor Turnover Survey on total monthly job separations (i.e., a measure of job turnover) to adjust the annual (ESAC) and quarterly (NAPEO) WSE numbers to represent point-in-time estimates. (In other words, because quarterly and annual counts of a PEO's WSEs would be higher than the number of WSEs at any single point in time due to turnover in job positions, we adjusted the quarterly and annual numbers for turnover.)

Final size estimates

After completing the five steps listed above, our final estimates for industry size are:

- 3,700,370 WSEs represented at a single point in time (Q4 2017) by PEOs⁸
 - This is 2.4 percent of 2017 civilian employment in the United States
- \$176,088,387,916 in wages for those WSEs⁹
- 907 PEOs¹⁰
- 174,545 PEO clients¹¹

Calculating Changes in Industry Size

Underlying data

We used Form 941 wage data on NAPEO members to calculate same-store changes in wages for each year from 2008 to 2017 (same-store refers to any PEO that was in business for two consecutive years within that period).

As noted in Footnote 5, making these estimates back to 2008 requires some important assumptions. Importantly, it excludes any specific growth effects of PEOs that were involved in mergers or acquisitions, as well as the impact of the formation of new PEOs and the departure of PEOs that went out of business. Because the data for the same-store calculations come from NAPEO members' 941 filings, the estimate also assumes that the extent to which NAPEO members are representative of the PEO industry as a whole has remained roughly constant from 2008 to 2017.

Here's how the change estimates were calculated: We used Form 941 wage data (from 2008 to 2017, excluding 2010, which was unavailable) on NAPEO members to calculate same-store changes in wages for each year from 2009 to 2017. For example, we calculated changes in total wages from 2015 to 2016 for each PEO for which we have valid data in both 2015 and 2016, and then took the average across all available PEOs for those years in order to identify the change rate for the industry

⁸ This is the aggregated total of all WSEs across the PEOs in our database. (It includes a total of 2,488,151 WSEs among NAPEO members, representing 1.6 percent of 2017 civilian employment in the United States.)

⁹ This is the aggregated total of all wages across the PEOs in our database.

¹⁰ Count of all PEOs in our combined database.

¹¹ Calculated by applying the 2017 NAPEO Financial Survey average of 21.2 worksite employees per client to the total number of worksite employees represented by PEOs.

overall in 2016. The number of PEOs for which we had data available to calculate same-store changes in a given year ranged from 175 to 250.

Data for any PEO that was flagged by NAPEO as having been involved in a merger/acquisition for at least one of the two years in the pair was not included in calculating average changes for any year affected. For example, a company involved in a merger in 2016 was excluded from calculating 2015 to 2016 changes and also from calculating 2016 to 2017 changes.¹²

There were notable outliers in the data across all of the years. To reduce/eliminate their impact, we excluded the top and bottom 10 percent of the distribution when calculating means.

Adjusting for the effects of inflation

We then adjusted these calculations to account for the annual rate of wage inflation in the economy as a whole. For example, if average same-store wage growth was 9.0 percent, but wage inflation in the US overall was 2.0 percent, then the adjusted same-store PEO wage growth was 7.0 percent.

The results show an industry with an average compounded annual growth rate of 8.3 percent from 2008 to 2017, with specific annual inflation-adjusted wage growth rates shown in Figure 2.

The change is positive in all years (ranging from 4 to 14 percent annually) indicating that the industry has grown each year included in the analysis. Although the growth rate in 2017 fell below the average growth rate for 2008 to 2017, the average growth rate over the entire period was increasing slightly over time (see the dotted trend line below).

By iteratively applying the annual change data to number of WSEs (starting with our current estimates for 2017 and then working backward),¹³ we are able to estimate

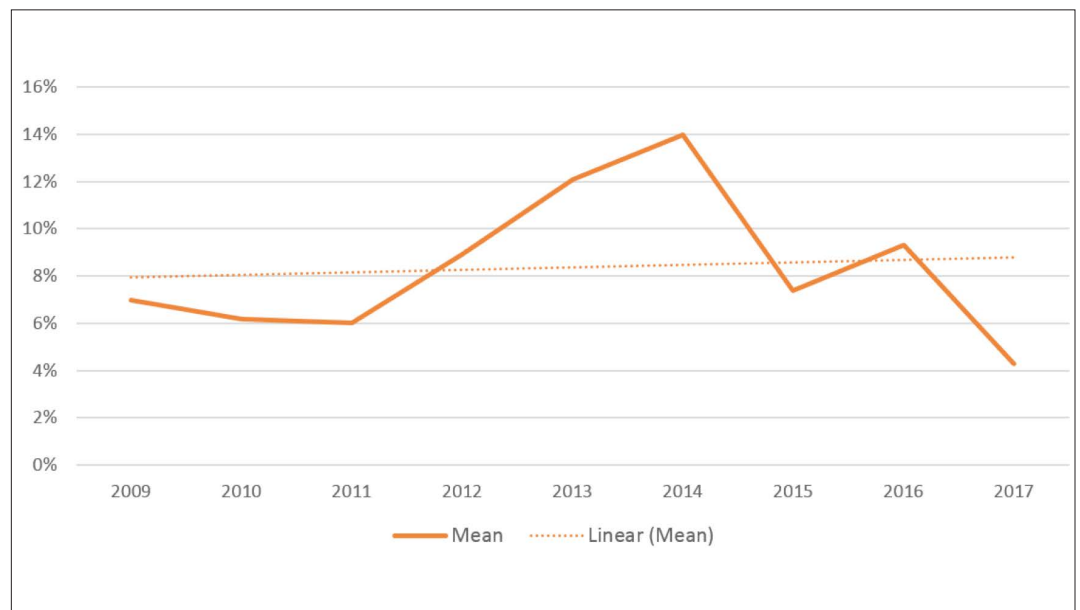


Figure 2. Mean growth rate and trendline, WSE inflation-adjusted wages from previous year.

¹² NAPEO also flagged several other PEOs as having been involved in a merger/acquisition, but with year unknown. These PEOs were excluded from all year-pairs.

¹³ We applied the 2017 inflation-adjusted change rate to the 2017 estimate for number of WSEs to estimate total WSEs in 2016. We then applied the 2016 inflation-adjusted change rate to that 2016 estimate to calculate 2015 WSEs, etc.

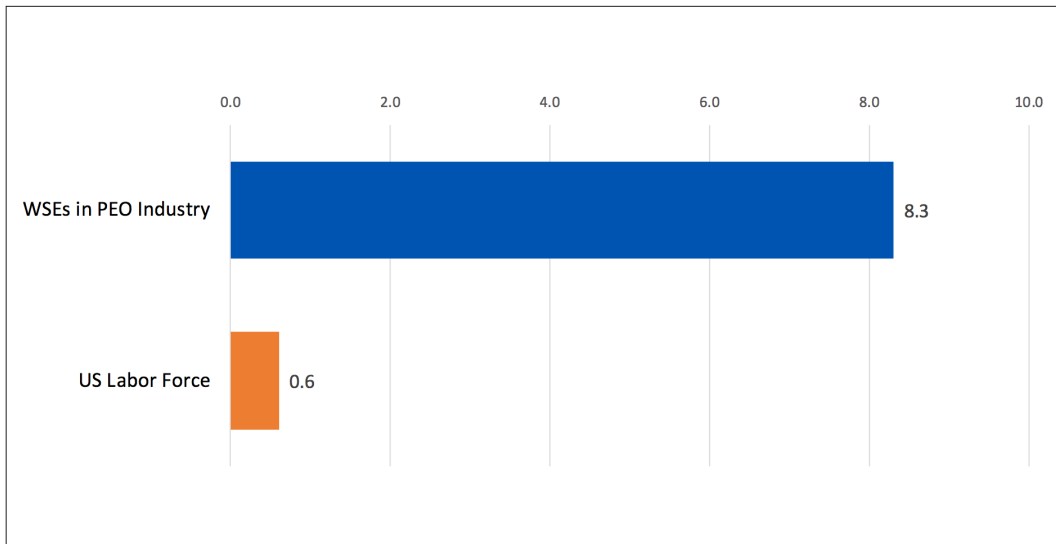


Figure 3. Compounded annual growth rate of WSEs in the PEO industry, 2008 to 2017.

same-store PEO WSE growth from 2008 to 2017, yielding the results shown in Figure 1. (It should be noted that, in a separate analysis, we examined actual WSE growth for same-store PEOs for 2016-2017. This analysis yielded a comparable estimate of WSE growth for 2016 to 2017 as the one we derived from using the wage-based growth calculations back to 2008.)

As seen in Figure 3, the compounded annual growth rate of WSEs in the PEO industry significantly exceeds the growth rate of the U.S. labor force overall. The 8.3 percent rate in the PEO industry is almost 14 times higher than that of the overall labor force.

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.”

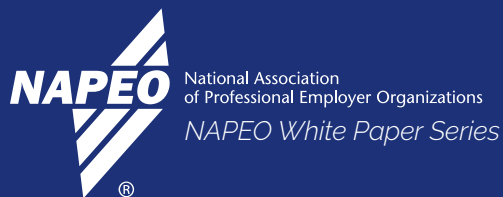
About the Authors

Dr. Laurie Bassi is CEO of McBassi and a global leader in the field of applying analytics in the world of HR. Bassi is the author of more than 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, McMurrer focuses on researching the relationship between organizations’ work and learning environments and their business results. He holds an M.P.P. in public policy from Georgetown University.

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 \$136 to \$152 billion in gross revenues. NAPEO has some 250 PEO members that provide payroll, benefits, and other HR services to between 156,000 and 180,000 businesses employing between 2.7 and 3.4 million people. An additional 200 companies that provide services to PEOs are associate members of NAPEO. For more information, please visit www.napeo.org.



National Association of Professional Employer Organizations

707 North Saint Asaph Street

Alexandria, VA 22314

703/836-0466

www.napeo.org

September 2018