

Introduction to Professional Employer Organizations (PEOs)



As Businesses Grow, Time Becomes A Premium Commodity

As a businesses grows, employers often find that employee management tasks and HR responsibilities begin to consume more time, infringing on revenue-producing activities and marketing functions. In these types of scenarios, a Professional Employer Organization can be useful in helping small- or medium-sized businesses provide human resources services like staff training, employee benefits, legal expertise, and management functions.

What is a PEO?

Professional Employer Organizations, commonly known as “PEOs,” are companies that manage human resource functions on behalf of the employer, allowing the organization to focus on doing what it does best: providing the goods or services that make up its central business.

PEOs typically enter into a co-employment arrangement with the primary business, under which the third-party provider becomes the official employer for tax and insurance purposes. The PEO will handle a range of employer responsibilities, liabilities, and personnel services. In most cases, the provider will serve as the “employer” of several client companies, making it possible for them to offer lower premiums on health insurance and group rates on other employee benefits.

A PEO will usually charge a percentage of total payroll expenses plus the employer’s cut of Medicare (in the U.S.) and employment insurance withholdings. They also generate some income from discounted group insurance plans – by securing insurance rates for its entire group of “employees,” they can mark up those insurance rates while still offering small client companies a better rate than they could have gotten on their own.

Enlisting the services of a PEO makes it possible for many businesses to grow faster and generate a profit more quickly, without having to become experts on tax laws, staffing, payroll details, or other HR functions. A PEO offers time-tested expertise in all of these areas, allowing the company to focus on their core products and services while the third-party provider takes care of the administrative details.

Services provided by a PEO may include:

- High-quality employee training
- Payroll deposits and processing
- Employee benefits like insurance, health care, dental coverage, student scholarships, accounting, and long-distance programs
- HR and staffing resources
- Tax advice
- Legal expertise and protection
- Administration and paperwork

A PEO can save small business significant time, money, and the frustration of having to organize all of these services for themselves. Typical results include improved employee satisfaction and retention of value-adding employees.

History of PEOs

As early as the 1940s, companies in the United States began offering “employee leasing,” which included similar services to today’s PEOs. In the early 1970s, Martin Seller expanded on the concept by leasing the employees of a California doctor’s office in exchange for providing payroll and other HR functions.

By 1985, there were nearly 300 “staff leasing” companies in the United States alone, and that number grew rapidly in the following decades. The sharp rise in the price of employee health insurance created a boom in staff leasing in the late 1980s and early 1990s, and these companies began to assist their client businesses with the increasing paperwork load and insurance regulations. By the early 90s, thousands of staff leasing companies and PEOs existed across the United States, and the legalities governing these firms were a major focus in state courts.

After a decline in 2003, the PEO industry surged stronger than ever, with between two and three million employees governed by third-party HR providers in 2007. Most of the companies hiring PEOs have fewer than 50 staff members.

Who Uses PEOs?

Any company that has employees can benefit from the services of a PEO. Most companies seek assistance when their needs for payroll services, employee benefits, or training outgrows the business owners’ capability to handle everything themselves. Companies seeking improved staff benefits, specialized training, automatic payroll deposits, insurance discounts, tax or business law expertise, and/or the ability to retain higher-quality employees in their field can benefit from the services of a third-party HR provider.

Some business owners are concerned that they may give up control of their business by using a PEO. In fact, the opposite is true—by taking care of the day-to-day operational tasks and employee management, a PEO frees up executives and managers to focus on core business functions.

PEOs are especially valuable to small- and medium-sized business that would have trouble securing the best rates on medical or dental insurance plans. The other primary value of a provider is in managing the administrative tasks of a growing business.

Choosing a PEO

When selecting the best PEO to meet your organization's needs, be sure to consider the following:

- Does the PEO offer the services you need, in the way that will best suit your company? Make a list of your required services and make sure the provider is able to fulfill those needs.
- Does the provider have a good track record? Do they provide verifiable references? It's well worth taking the time to investigate a PEO before signing a contract. Consider the provider's professional practices and whether they have been independently audited and certified by legitimate agencies in your region.
- Does the provider have expertise in your specific field? The background and experience of the PEO's staff and directors is critical in determining whether they will be the right fit for your business.
- How does the PEO make money from its services? Make sure you are comfortable with their rates and operating procedures before hiring them.
- Does the agreement regarding services and your co-employment meet your needs? The agreement should explicitly detail your respective roles and duties, and you should feel comfortable with all included clauses.

A PEO can be a powerful tool for boosting the success of a small business. By streamlining payroll, tax functions, employee benefits, and paperwork, a third-party HR provider can significantly improve efficiency and profitability.

