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TipsOnTechnology | BY JOE MARKLAND

Payroll firms, PEOs and BPOs have got it right

Why should you care about these vendors? Because they're taking your business.

As an adviser to benefits brokers in the HR, benefits and payroll technology and services industry, I conduct educational Web seminars on various topics and invite brokers across the country to attend. Whenever we present a Web seminar topic that includes Paychex or ADP conducting business in the benefits business, our phones light up and Web seminar attendance increases threefold.

Brokers say, "I just lost this or that case to one of these payroll vendors," and they ask if they should start selling payroll. Payroll administrators will call and say, "We are 'broker friendly' and are looking for broker-partners to distribute our product or service" to help slay the 800-pound gorillas.

Somewhere along the way, these payroll companies have become "public enemy No. 1" to some benefits brokers. A natural response by brokers in this new competitive environment is to partner with some other payroll administrator. However, does that really solve the brokers' problem of losing business to a payroll vendor, or are there other issues at hand? Before providing potential solutions to this problem, let's examine what the problem really is.

In the employers' world, managing HR, benefits and payroll has become much more complex. New laws, new benefits and a more dynamic work environment with part-time employees, shared jobs and more and more remote employees adds to the administrative burden on HR professionals and increases compliance risks. In addition, the current economic environment that has created layoffs in human resources departments has reduced internal capacity and substantially increased transactions resulting from the layoffs. This has internal staff looking for help in an environment where budgets are tight.

Therefore, the problem in most firms is not just in benefits administration or payroll administration, but also within the whole HR environment. Employers recognize this problem and are looking for solutions. A common approach is to streamline processes by integrating technology and services and enabling employee self-service via the Web. A recent Towers Perrin survey supports this claim; it reveals that the top three HR service delivery issues are (1) cost; (2) need for HRIS system; and (3) systems integration.

> Many of these third-party providers recognize that employers, especially those in the small to mid-market, **value their services more than they value brokerage services.**

Integrating technology

Most employers track employee information that they deem necessary and perform transactions around this data. For example, employers track the benefits an employee has and enroll a person in benefit plans. Employers track vacation days and process vacation requests. I have seen employers track employee information in anywhere from one to five systems ranging from Excel spreadsheets to sophisticated HR systems.

I define integrated technology as either a single system that stores all HR, benefits and payroll information or multiple systems that move data back and forth to eliminate duplicate data entry. For employee self-service, accessing one system to see all pay, benefits and time-off information is much more user friendly. An even better system could integrate with third-party platforms to give employees access to additional information such as FSA and 401(k) balances without signing into another system.

Integrated services

Most employers outsource common HR-related services like payroll, 401(k) administration, COBRA administration and FSA administration. Other services include HR consulting and compliance, eligibility management, benefits billing administration and, at times, an employee call center. The concept of "integrated services" means consolidating more and more services with fewer or even a single service provider. Creating a single point of contact simplifies the administration of HR substantially.

Vendors

Many vendors have responded to the market demand for integrated HR, benefits and payroll technology and services, including professional employer organizations, business process outsourcers and administrative service organizations. While PEOs often perform all HR and payroll functions in a co-employment relationship, BPOs and ASOs perform some or all of the outsourcing services in a non-employer relationship. There are thousands of companies in the U.S. that act in this capacity. Many of them recognize the need to expand their technology and services to provide single source solutions. Some have built their own solutions, others extended their reach through acquisition. For example, since 2007, Paychex (payroll) acquired Benetrac a benefit enrollment system, CBIZ (benefit broker and outsourcer) purchased Computer Payroll Company and Infinisource (COBRA and FSA administrator) acquired Priority Pay.

In addition, many of the leading HR and payroll technology vendors, including Sage Software and Ultimate Software, have added benefits enrollment to their platforms on their own. Most other PEOs, BPOs and ASOs lease integrated technology solutions from third-party vendors.

Two of the nation's leading PEOs and/or BPOs are Paychex and ADP. While many benefits brokers view them as payroll vendors, in reality they are fully integrated HR, benefits and payroll technology and outsourcing firms providing services that are in high demand by employers. Paychex's PEO services approximately 432,000 employees, while ADP's PEO generated $279.2 million in revenue in 2008.

The financial model

Some of these firms also act in the capacity of a benefits broker. For the record, both ADP and Paychex have developed broker partners for distribution of their outsourced services and technology.

In order to understand the behavior of some of these outsourcing firms and their potential impact on benefits brokers, it is important to recognize the financial model of providing these services. For an average 50-person firm, the benefits brokerage commissions can be four to five times the cost of providing payroll services for the same firm. COBRA and FSA fees combined can be one-fifth of the brokers' commission. The cost of an integrated HR and benefits system is about one-fourth of the brokers' commission. An employer can purchase payroll, COBRA, FSA, and 401(k) administration along with an integrated technology solution for approximately two-thirds of the cost of brokers' commission.

This formula impacts the market in several ways. As a method of differentiation, benefits brokers have been subsidizing some of these services as a way to attract new business for the past 10 years. (I will not discuss rebating laws here. That is another article.) If you are a payroll company or some outsourcer, and you are losing business to a firm providing "free" payroll, you have one of two choices. Either you can get the firm subsidizing the payroll to subsidize your payroll, or you need to get access to the bucket of money subsidizing payroll.

Using the same scenario, imagine you are an HR consultant providing HR audits for a fee. Many brokers have HR consultants on staff and provide this service for free in exchange for a broker-of-record letter. Should HR consultants now get into the brokerage business? Many have.

Many of these third-party technology and services providers recognize that employers, especially those in the small to mid-market, value their services more than they value brokerage services. In many states with limited medical insurance options, the advice about which of the three medical insurers they should choose is not a difficult task and therefore has little value. Brokers know this, and they have been using other ways to differentiate themselves for years. If you were one of these outsourcing vendors and could triple your per-client revenue by adding brokerage services, you might consider the move, too.

Back to firms such as Paychex and ADP. In fiscal year 2009, Paychex's net income has declined by 5%. However, their health and benefit services revenue has increased by 79%. While ADP forecasts a 1% to 2% revenue growth in fiscal year 2009, their PEO revenue is expected to increase 12% to 13%.

Similarly, Trinet, one of the nation's largest PEOs, has seen a 40% revenue growth year-to-date compared to the same period last year. Statistics like these convince me that other HR, benefits and payroll technology and outsourcing services firms may enter the benefits brokerage business.

What should a broker do?

To compete, brokers have to change. Business as usual will lose business.

First, brokers must acknowledge that, in the small to mid-sized employer market, many employers value the integrated technology and outsourced services more than benefits advisory services.

Second, brokers need to create a full-service image by: (1) adding some services such as eligibility management and maybe billing consolidation services; while (2) partnering with third parties to add more complex services such as payroll, FSA administration and HR consulting services.

It is important that a broker not partner with a firm that has the same problem it does. For example, if the market is demanding integrated HR, benefits and payroll technology, partnering with a payroll administrator whose technology is payroll-only may not solve the problem. Many brokers partner with benefits technology vendors that have little or no HR and payroll capabilities. Both of these positions leave the broker vulnerable to the competition.

The good news for brokers is that these third parties have already established a market where they charge fees for these services. Brokers who enter the space need to not only add services, but also seriously consider a financial model that allows them to operate this business without subsidizing services with commissions.

This is something that does not happen overnight. It will take time and planning.

While many brokers perceive payroll companies as competitive threats and feel the need to jump into the payroll business, it is really not the payroll component that is the problem. Brokers do not need to beat these firms in the payroll business. The competition comes from firms that offer benefits-related administrative services that are integrated with HR and Payroll that employers deem to be more valuable.

The bottom line is that when benefits brokers get beat by payroll firms, they aren't getting beat because they don't have payroll. They get beat because the other vendor has better benefits services. **EBA**

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