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PEO Clients in the COVID-19 Pandemic: Follow-Up Analysis

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Acknowledgment

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Introduction

Professional employer organizations (PEOs) provide comprehensive HR solutions for small and mid-sized businesses. These services frequently include payroll, employee benefits, HR, workers' compensation, risk management, and more. In white papers released in previous years, we have found PEO clients enjoy a wide range of improved financial and non-financial outcomes relative to their peers who do not use PEO services. These benefits include higher business survival rates, higher growth rates, lower employee turnover, and higher employee satisfaction.

The COVID-19 pandemic has provided a new set of challenges that all businesses have confronted over the last year and a half. This white paper explores the effect that PEOs have had on business outcomes for their clients over the course of the pandemic to date, building on findings in the 2020 NAPEO white paper that undertook a short-term analysis of PEO impacts during the initial months of the pandemic.

In particular, this paper explores how PEO clients have fared from early 2020 through July 2021 across a range of different measures in the following broad categories:

- Business operations;
- Changes in employment; and
- Success in accessing major government support programs.

Overall, we found that, as of July 2021, PEO clients are doing better in each of the three categories, as discussed in additional detail in the sections below. As a result, PEO clients are also in a stronger position for future long-term success than other comparable small businesses.

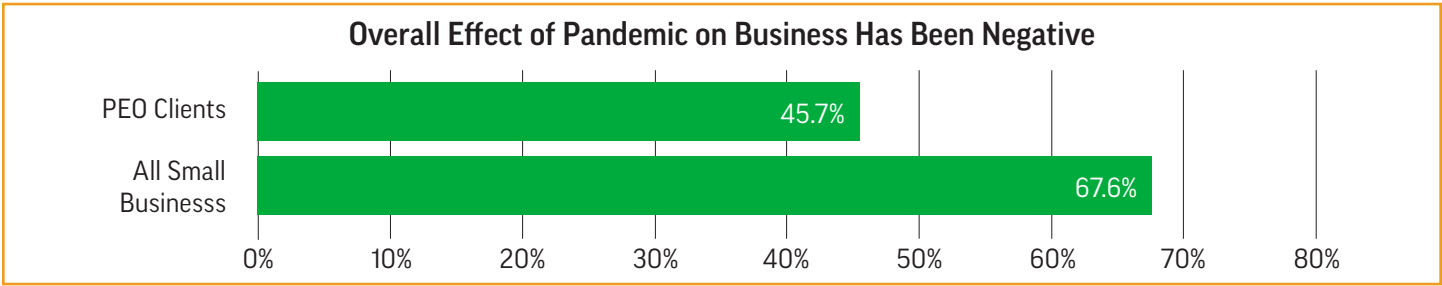
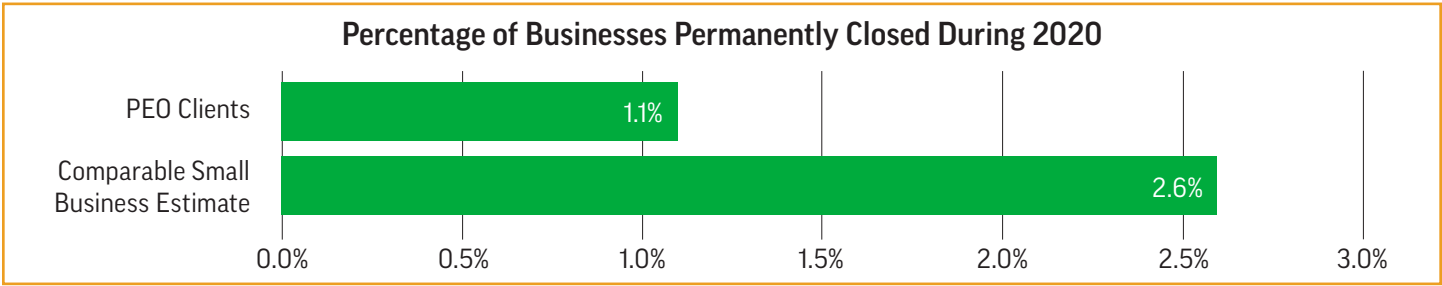
The discussion in this paper explores in additional detail multiple metrics in each of these categories, typically comparing data on PEO clients to the best available information

Summary

Since the pandemic, relative to comparable small businesses, PEO clients:

- Are 58 percent **less likely** to have permanently closed;
- Are 32 percent **less likely** to have seen a negative overall effect on business from the pandemic;
- Are 82 percent **more likely** to have business operations back to normal (or better);
- Have had employment **grow** by 6 percent since early 2020 (compared to a 1 percent decline for comparable small businesses);
- Have a rate of employment growth over the last 6 months that is 81 percent **higher**;
- Are 18 percent **more likely** to have had their 2020 PPP loans forgiven; and
- Are 71 percent **more likely** to have received PPP loans in 2021.

on comparable small businesses. Full technical information on all data sources and calculations is included in the "Technical Notes" section at the end of the paper.



Business Operations

Business Closures

The extent to which PEO clients have been able to stay open for business and avoid permanently closing is a key summary measure of the benefits of being a PEO client. Many PEOs have high-quality information on the closure rate among their clients.¹ On average, 1.1 percent of PEO clients in January 2020 had permanently closed by December 2020.

After initial concerns that business failures due to the pandemic would be widespread and even catastrophic, analysts are now beginning to determine that rates in the economy as a whole² may not have been as high as originally feared.³ Perhaps the most credible estimate of the extent to which the pandemic affected business closure rates is in a paper released by the U.S. Federal Reserve, which used related data to calculate a rough

estimate that in 2020, firm closure rates were 25 to 33 percent higher than normal.⁴

In 2018, the most recent year for which reliable business closure data is available from the Census Bureau's Business Dynamics Statistics, the closure rate among all small businesses comparable to PEO clients in size⁵ was 2.1 percent. Adjusting this "normal" rate conservatively by using the Federal Reserve estimate (selecting its lower estimate of a 25 percent higher rate of firm closures) yields a comparison figure of 2.6 percent of permanent closures during 2020 for businesses that were of comparable size to PEO clients.

The closure rate among PEO clients was thus 58 percent lower than the closure rate of other comparable small businesses (1.1 percent for PEO clients versus 2.6 percent for all small businesses). This ratio is almost identical to the ratio observed in last year's white paper, suggesting that PEO clients continued

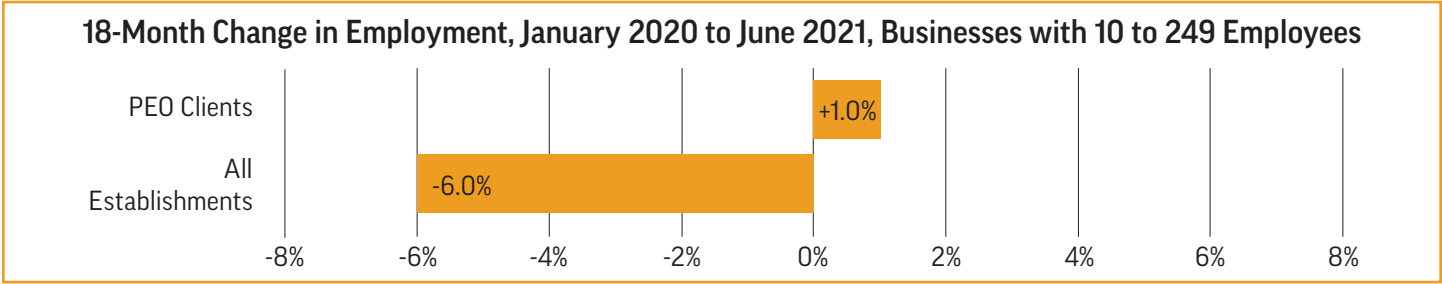
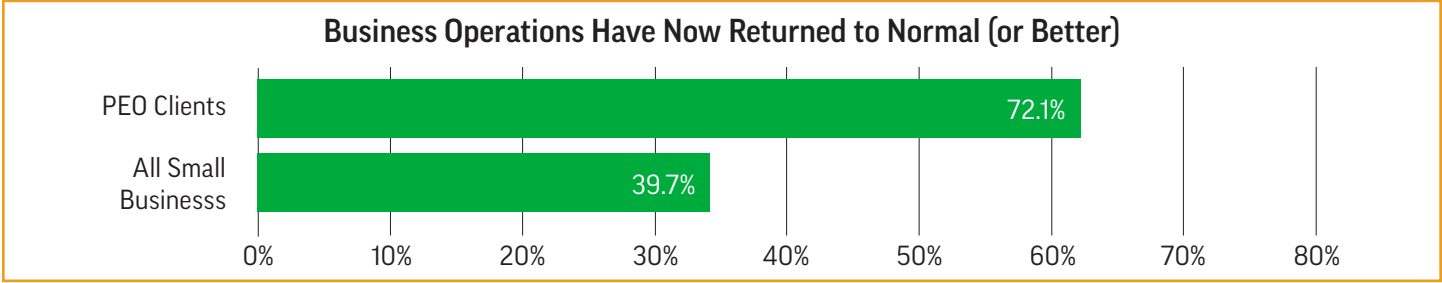
1 For purposes of this metric on PEO clients, as well as all other metrics included in this paper based on data we collected directly from PEOs, we used data only from those PEOs that reported they were "very confident" or "confident" in the specific data reported.

2 Direct and reliable comparison data are currently unavailable, as data on business closures are released with lengthy time lags (for example, perhaps the best data source on firm "deaths" is the U.S. Census Bureau, which will likely not release full 2020 data until 2023). Hence, there is currently no official data on business closures during the pandemic. To calculate an appropriate comparison, we instead adjusted historical data for the effects of the pandemic, using an estimate from the U.S. Federal Reserve Board, as described in the text.

3 Separately, there is evidence of a significant increase in business startups in the United States during the pandemic (see this article, <https://www.piie.com/blogs/realtime-economic-issues-watch/startups-boom-united-states-during-covid-19>, for example), although this would not affect data on business closures.

4 Leland Crane, *et al.*, "Business Exit During the COVID-19 Pandemic: Non-Traditional Measures in Historical Context," U.S. Federal Reserve Board, Finance and Economics Discussion Series 2020-089.

5 For the most accurate comparison, it is important to take size into consideration, as the general category of "small business" includes two extremely small firm categories (1 to 4 employees and 5 to 9 employees) that are less commonly represented among PEO clients. These smallest firms have much higher business closure rates than other small businesses, and thus can significantly increase any overall small business average that includes firms of that size. For purposes of calculating an average that is appropriate for comparison with PEO clients, we used a weighted combination of business closure rates only for firms in the categories of 10 to 19 employees and 20 to 99 employees.



to enjoy a comparable advantage in survival even after the early months of the pandemic. Stated another way, small businesses overall were more than twice as likely (2.4 times as likely) to have permanently closed during 2020 than were PEO clients.

Overall Impact on Business

PEO clients are also less likely to have experienced an overall negative effect on their businesses due to the pandemic than other comparable small businesses (less than half reported overall negative effect as of July 2021).⁶ The number of small businesses reporting a negative impact is almost 22 percentage points higher than it is for PEO clients.

Business Has Returned to Normal Level of Operations

Similarly, PEO clients are more likely to have returned to a normal (or better) level of operations than other comparable small businesses. Almost three-quarters of all PEO clients (72.1 percent) had reached that level by July 2021, which is 32 percentage points higher than all small businesses.

Changes in Employment

Employment Change During Different Periods of the Pandemic

In addition to business operations, another key measure that reflects how a small business fared during the pandemic is the extent to which it lost or gained employees. We compared changes in employment levels since January 2020 for PEO clients versus changes for all small businesses in the U.S. economy.

For PEO clients, we calculated monthly changes in firm-level employment by using a large employee-level database made available for this analysis by Slavic401k, a provider of 401(k) retirement plans to PEO clients.⁷ We compared these changes in employment for PEO clients to U.S. Bureau of Labor Statistics (BLS) data on labor hiring and turnover, using data on business size to ensure that the comparison group matched as closely as possible the size distribution to PEO clients.⁸

The overall rate of employment change for employers with 10 to 249 employees for the 18 months from January 2020 to

6 Consistent with this finding, the average revenue change for PEO clients since January 1, 2020, was +1 percent. We were unable to find a reliable comparison number for this statistic, but data on average small business revenue changes since early 2020, previously reported by Opportunity Insights Economic Tracker (which is currently under revision), had been significantly lower than this.

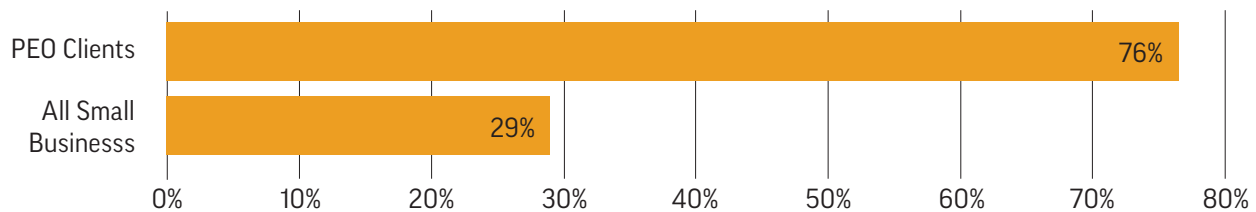
7 While we took a variety of steps in the analyses described below to ensure that the comparisons between the Slavic companies and the overall U.S. population were as valid as possible, it should still be noted that it is possible that Slavic clients are not representative of PEO clients as a whole. Because nearly all PEOs (98.6 percent, per NAPEO’s 2020 Financial Ratio & Operating Statistics Survey) offer some type of retirement plan to their clients, we are comfortable that the Slavic401k data are indeed reasonably representative of the clients of the PEO industry overall; this is true even if clients that offer retirement plans to their employees vary in other respects in comparison to the small percentage of clients that do not offer retirement plans.

8 One difference to note is that the PEO client size was measured at the firm level, while the comparison BLS data was measured at the establishment level. For both PEO clients and for small businesses overall, we calculated employment change separately for those businesses with 10 to 49 employees and for those with 50 to 249 employees.

Average Employment Change, January 2020 to June 2021, Businesses with 10 to 249 Employees

	PEO Clients	All Establishments	Difference
2020 January to June	-8.8%	-12.6%	3.8%
2020 July to December	4.8%	4.3%	0.5%
2021 January to June	5.6%	3.1%	2.5%
Cumulative Change (18 Months)	1.0%	-6.0%	7.0%

Have Significant Concerns about Finding Qualified Employees to Hire



June 2021 was a decline of 6.0 percent, whereas PEO clients in the same size group had an increase of 1.0 percent in their total employment during the same time period.

In general, both PEO clients and small businesses overall saw pandemic-related declines in employment levels during the first half of 2020, with overall job growth for both groups being positive in both six month periods that have followed. The specific numbers for each group during the three periods are quite different, however (see the table above).

Specifically, PEO clients suffered a lower rate of job loss (almost 4 percentage points lower) during the first half of 2020 than did other comparable small businesses. In addition, PEO clients experienced a higher rate of job growth between July 2020 and June 2021, with the largest gains (relative to other small businesses) occurring in the first half of 2021, when employment growth among PEO clients outpaced that of small businesses overall by 2.5 percentage points. Combined, PEO clients and their employees experienced fewer job losses in the first months of the pandemic and larger job gains during the past year of the pandemic.

Current Hiring

Interestingly, PEOs clients are currently much more likely to have significant concerns about finding qualified employees to hire than are other small businesses: 76 percent versus 29 percent. Similarly, they are more likely to be unable to fill open positions for three months or longer than are other small businesses: 53 percent versus 24 percent.

We believe these findings reflect the fact that employers who are growing more rapidly—and expecting future growth—are more likely to have job openings (as well as a larger number of

job openings) than those not growing or growing more slowly. As a result, PEO clients are likely experiencing more challenges in hiring qualified employees because they have grown at a faster clip than other small businesses over the last year.

These challenges in finding qualified employees have been, and are likely to remain, a significant challenge for which PEO clients will continue to turn to their PEOs for support and assistance in addressing.

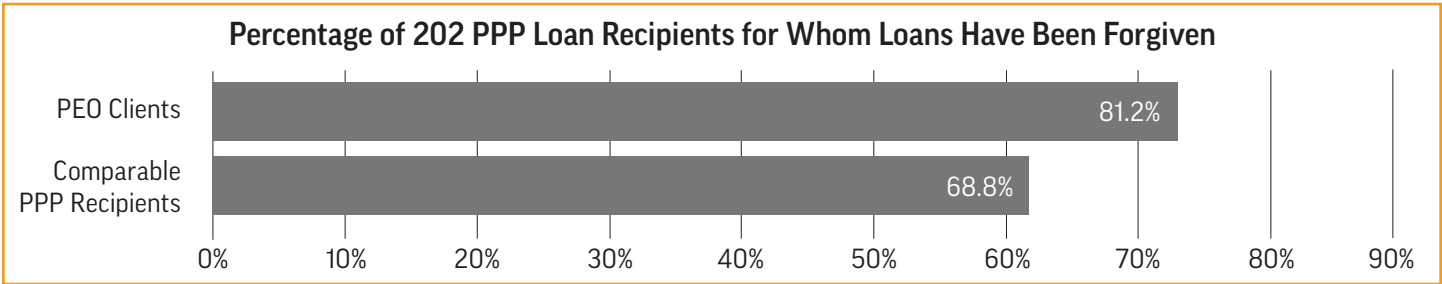
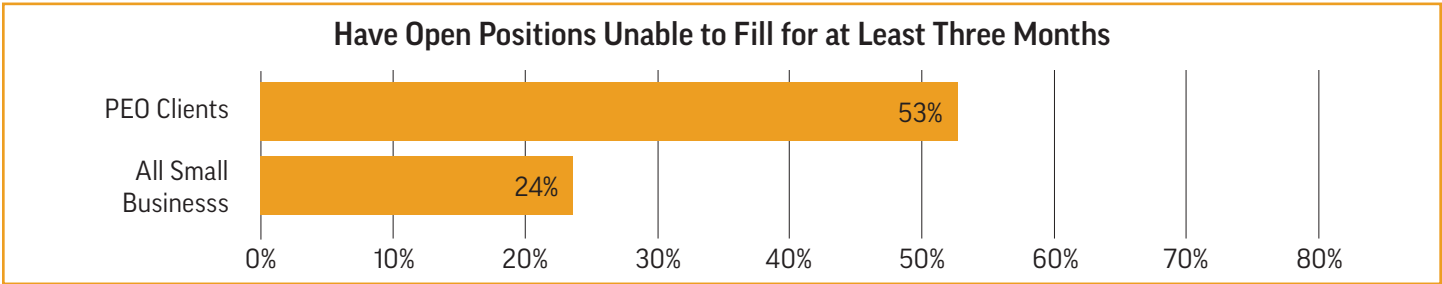
Accessing Major Government Support Programs

Two important programs the federal government created to help businesses survive the pandemic are the Payroll Protection Program (PPP) and the Employee Retention Tax Credit (ERTC). They have played a major role in assisting small businesses in paying salaries and other expenses and in retaining employees despite lost revenues and other disruption caused by the effects of the pandemic. The economic position of those businesses that have received benefits through these programs is stronger than it would have been without the assistance.

Applying for either of the programs, however, proved to be difficult, complicated, and time-consuming for small businesses. Since the first round of PPP loans was announced in April 2020, PEOs have invested significant time and effort to assist their clients in applying for benefits such as these.

Forgiveness of 2020 PPP Loans

In last year's white paper, we reported that PEO clients were much more likely to receive PPP loans in 2020 than other



comparable small business employers.⁹ Additional detail on the PPP program and the related support provided by PEOs to their clients in that regard is available in that white paper as well.¹⁰

In 2021, businesses that received PPP loans in 2020 were entitled to apply for and receive full forgiveness of these loans, provided that they completed the necessary loan-forgiveness application and certified they had used the full amount of the loan only for authorized uses.

As of July 2021, 81.2 percent of PEO clients that received 2020 PPP loans had been granted loan forgiveness. The rate of PPP loan forgiveness for comparable small businesses that received PPP loans was 68.8 percent. PEO clients were thus 18 percent more likely to have had their 2020 PPP loans forgiven.

Receiving 2021 PPP Loans

In 2021, the federal government funded another round of PPP loans to support small businesses through the pandemic, including both “first draw” loans for eligible businesses that had not previously received a PPP loan and “second draw” loans for eligible businesses that had received PPP loans in

2020.¹¹ The application process remained challenging and confusing and again required significant support from PEOs for their clients.

A total of 30.5 percent of 2021 PEO clients received PPP loans in 2021, compared to only 17.8 percent of all comparable small businesses. Hence, PEO clients were 71 percent more likely to receive 2021 PPP loans. As was the case in 2020, these loans will be fully forgivable for those businesses that use the full amounts of the loans for authorized uses.

The table at the top of page 6 consolidates PPP receipt data from both 2020 and 2021 and demonstrates that PEO clients have been far more likely than other comparable small businesses to receive these loans in each of the two years.

Employee Retention Tax Credit (ERTC)

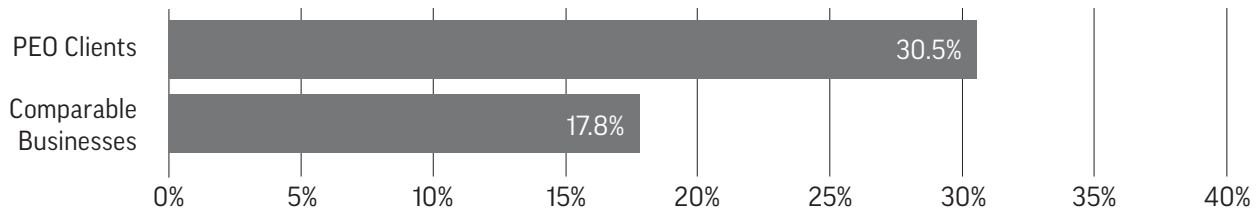
The Employee Retention Tax Credit (ERTC) is another major federally funded program designed to help small businesses and their employees weather the pandemic by encouraging employers to keep employees on the payroll. Those employers that are eligible for the ERTC can get a refundable payroll tax credit equal to a percentage of eligible wages.

9 For purposes of PPP analysis, comparable small businesses are defined to exclude “non-employer” businesses such as sole proprietorships, self-employed individuals, and independent contractors. These businesses are far less likely to be PEO clients. Their exclusion ensures that our comparative estimates are as conservative as possible, as those businesses were both less likely to receive PPP loans and slightly less likely to have their PPP loans forgiven than other small businesses.

10 “How PEO Clients Fared in the First Months of the COVID-19 Pandemic: A Comparative Analysis,” NAEPO white paper, September 2020.

11 Specific conditions applied to businesses seeking to apply for a second draw PPP loan: They must have received a first draw PPP loan and must have used the full amount only for authorized uses; must have no more than 300 employees; and must be able to demonstrate at least a 25 percent reduction in gross receipts between comparable quarters in 2019 and 2020. See <https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/second-draw-ppp-loan>.

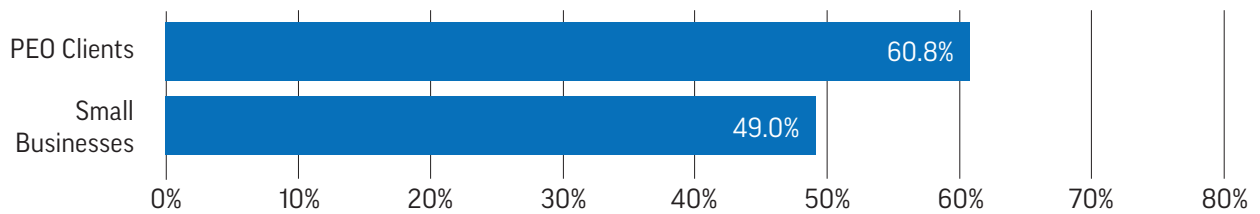
Percentage of Businesses that Have Received 2021 PPP Loans



Percentage of Employers Receiving PPP Loans, 2020 and 2021

	PEO Clients	Comparable Small Businesses	Increased Likelihood
2020	65.9%	30.1%	119%
2021	30.5%	17.8%	71%

At Least “Somewhat Familiar” with the ERTC



The rules for defining eligible wages and establishing an employer’s eligibility for an ERTC are complex and changed from 2020 to 2021.¹² Receiving the 2020 ERTC meant that most businesses were required to file an amended 2020 tax return. Moreover, the amount of ERTC for which an employer may be eligible is affected by the amount of any PPP loan(s) it has received. Hence, many small businesses would need some sort of outside expertise to successfully apply for these credits.

Because the ERTC has received less press coverage than the PPP, many small businesses are not aware of the program or its potential benefits to them. PEO clients are more aware of the program: 60.8 percent are at least somewhat familiar with the ERTC, compared to only 49 percent of comparable small businesses.

We found PEO clients were less likely to take ERTC credits in both 2020 and in 2021 than comparable small businesses (approximately 9 percentage points less likely in 2020 and 4 percentage points less likely in 2021).

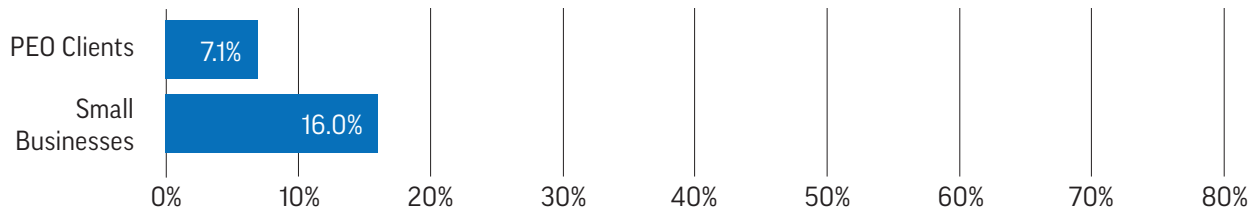
Two factors related to ERTC eligibility likely account for much of this difference. First, any business that received a PPP loan was initially defined as ineligible for the ERTC in 2020.

Because such a high percentage of PEO clients received PPP loans, the ERTC was therefore not available to most PEO clients based simply on the program’s initial eligibility criteria. This was changed retroactively as the ERTC was expanded and extended, although significant adjustments to an employer’s previous tax filings (some of which needed to be submitted by paper, rather than electronically) were necessary to achieve retroactive eligibility.

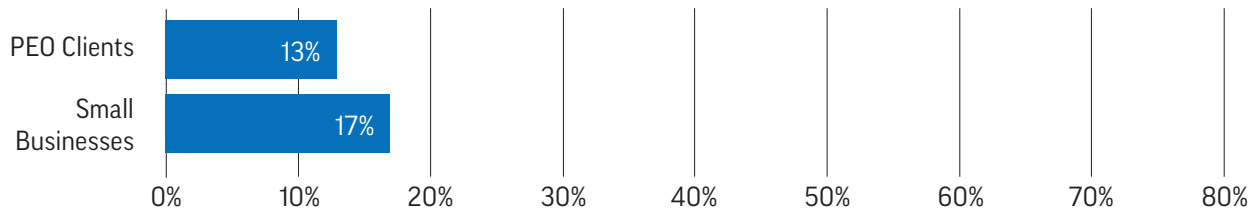
Second, to qualify for the ERTC in 2020, a business had to experience at least one quarter during which it had a revenue decline (compared to the same quarter in 2019) of 50 percent, while the PPP required a smaller (25 percent) decline. Because we know from other comparisons in this paper that PEO client businesses fared better in the pandemic relative to other small businesses, it seems likely a smaller percentage of PEO clients met the ERTC eligibility requirement compared to small businesses overall. Indeed, when the law changed again to require only a 20 percent revenue decline to qualify for the ERTC in 2021, the gap of usage rates (actual and planned) between PEO clients and other small businesses then closed significantly.

12 A succinct summary of the ERTC program can be found at <https://warrenaverett.com/insights/employee-retention-payroll-tax-credit/>.

Percentage of Businesses that Took (or Plan to Take) ERTC for Tax Year 2020



Percentage of Businesses that have Taken (or Plan to Take) ERTC for Tax Year 2021



Technical Notes

Sources of PEO Data

We used two primary data sources for information on PEO clients: a survey of PEOs on a variety of data related to their clients, and a large anonymous employee-level data file shared by Slavic401k, a provider of retirement plan services to PEOs.

PEO survey: McBassi conducted a survey of PEOs in late July 2021. We received a total of 78 replies from separate PEOs, with clients that collectively employ a total of 1.7 million employees (worksites employees or WSEs). Those PEOs ranged in size significantly, so for analysis purposes, we weighted the data to reflect equally two factors: PEO size (measured by number of WSEs) and separate PEO respondents.

All questions included either a specific associated 5-point-scale question on “how confident are you in the data you reported for that item?” or a “do not know” response option. In this analysis, for the first set of questions, we used only data for which respondents reported being “very confident” or “confident” (the two highest responses to the confidence questions), and for the second set, we omitted all “do not know” responses. To ensure that data were not affected by a small number of outliers, all means were calculated after omitting the top and bottom 10 percent of responses. Some questions provided ranges of possible answers (e.g., “increase of 10 to 19 percent”); for analysis purposes, the midpoint of each range (so, 14.5 percent for the “10 to 19” range) was used in calculating averages.

All categories included in the survey are reported in this paper, with the exception of data related to the Restaurant

Revitalization Fund (RRF), because only a small percentage of PEO respondents had sufficient numbers of restaurant clients to be able to provide data on their use of the RRF program.

Slavic401k data: We used the data shared by Slavic401k to calculate employment changes across PEO clients (please see the footnote earlier in this paper for discussion of the extent to which Slavic401k data can be considered representative of PEOs in general). For each client in the data, employment counts are defined as the number of different employees who received at least one paycheck in a given month. Employment change is calculated for each client firm by taking the percentage change in employment count for each pair of months (e.g., January to February) for which data are available. Overall averages are calculated on a monthly basis as the average percentage change for all firms for which change data are available, weighted by number of employees in the preceding month (so percentage change in employment from January to February is weighted by number of employees in January).

Data were not calculated for firms with missing data in at least one of the two months needed to calculate changes for a given month. As a result, the final overall averages were adjusted downward to include the full estimated negative effects on overall employment from permanently-closed businesses (1.09 percent of PEO clients based on the PEO survey). This is because the format of the data from Slavic401k did not allow us to distinguish permanent business closures from other businesses that may have had missing data for reasons such as not reporting data for a month, ending their relationship with their PEO thus discontinuing their 401(k)

plans, and other potential causes of missing data. In addition, a small percentage of outliers were omitted from the data (this conservative change had the effect of making the final data on average employment changes for PEO clients slightly more negative).

Sources of Comparison Data

In general, we sought to compare PEO client data to overall data on small businesses in the U.S. economy, although the specific definitions of “small business” varied somewhat across metrics. In all cases, we sought the comparison that was closest to the PEO client data we were using.

We know that the impact of the pandemic varied widely across industries. For example, businesses in the leisure and hospitality industry suffered more than many others, while there was a somewhat lesser impact on businesses in professional services. PEO clients come from across the full spectrum of small business types, so we are confident that overall small business averages are the most appropriate comparisons. When industry breakdowns were available, we did check industry-level data and consistently found that even industries less affected by the pandemic (professional services, financial, etc.) still had comparison data that indicated they experienced significantly more negative effects from the pandemic than were experienced by PEO clients as a whole.

Permanent business closures: The best source of firm-level data is the U.S. Census Bureau Business Dynamics Statistics (BDS) database, broken down by firm size. As described in the text, we weighted the data to match as closely as possible the size distribution of PEO clients and adjusted the most recent available data (2018) on annual “firm deaths” based on estimates in a Federal Reserve study of “excess business exits” during 2020.

Business revenues and overall impact on business: U.S. Census Small Business Pulse Survey (the most recent results are from July 12 to July 18, 2021, and use the survey question listed as “Overall effect”). The comparison includes the percentage of respondents selecting “large negative” or “moderate negative” overall effect on business.

Business has returned to normal level of operations: U.S. Census Small Business Pulse Survey (the most recent results are from July 12 to July 18, 2021, and use the survey question listed as “Expectations”). The comparison includes all respondents selecting “This business has returned to its normal level of operations” and “There has been little or no effect on this business’s normal level of operations.”

Employment change during different periods of the pandemic. Bureau of Labor Statistics Job Openings and Labor Turnover Survey (JOLTS) (series IDs JTS100000000000002HIR, JTS100000000000002TSR, JTS100000000000003HIR, JTS100000000000003TSR), combined by subtracting monthly total separations from monthly total hires for size classes 10 to 49 employees and 50 to 249 employees for January 2020 to June 2021.

Current hiring: Businesses having trouble finding qualified employees were those listing that issue as one of the top three challenges in the ADP Research Institute Quarterly Small Business @ Work survey, June 2021.

Businesses with open positions they have been unable to fill for at least three months is from the quarterly CNBC/SurveyMonkey Small Business Index survey from Q2 2021 (survey dates April 19 to April 26).

PPP loans: Data on 2020 loan forgiveness are from public information provided by the U.S. Small Business Administration (SBA), calculated only for business types in typical PEO client categories, which increased the overall forgiveness rate from 66.6 percent to 68.8 percent. As noted above, comparable small businesses are defined to exclude “non-employer” businesses such as sole proprietorships, self-employed individuals, and independent contractors. These businesses are far less likely to be PEO clients. Their exclusion ensures that our comparative estimates are as conservative as possible, as those businesses were both less likely to receive PPP loans and slightly less likely to have their PPP loans forgiven than other small businesses.

Data on 2021 PPP loan approvals are based on data reports available from the U.S. Small Business Administration as well as raw data from SBA on all PPP loans, which allowed us to calculate the number of loans by business type, which was used to calculate the appropriate comparison for PEO clients. As noted above, we excluded business categories that are significantly less likely to be PEO clients.

Employee Retention Tax Credit (ERTC): Comparison data on ERTC awareness and usage are from National Federation of Independent Business (NFIB) COVID-19 small business survey (April 2021), Q8 to Q10 on ERTC.



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

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About NAPEO

The National Association of Professional Employer Organizations (NAPEO) is The Voice of the PEO Industry.™ NAPEO’s 250 PEO members provide payroll, benefits, workers’ comp, regulatory compliance assistance, and other HR services to more than 173,000 small and mid-size businesses employing 4 million people. Our members account for more than 90 percent of the industry’s \$254 billion in revenue. An additional 250 companies that provide services to PEOs are associate members of NAPEO. For more information, please visit www.napeo.org.



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