PEO INSIDER

PUBLISHED BY THE NATIONAL ASSOCIATION OF PROFESSIONAL EMPLOYER ORGANIZATIONS®

COVER STORY

TEAMWORK HR

20 YEARS OF HELPING SMALL BUSINESSES THRIVE

Alanna Smith, Heidi Corrigan, Jennifer Kramm, Terri Beaudette, Cheryl Maddox, and Michelle Nystrom

THIS MONTH'S FOCUS

M&A UPDATE

M&A Activity

Interest in the PEO Space

Buying & Selling

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Why I Will Never Sell My PEO
Britt Landrum, III, SPHR

Never is a very strong word! I always stay away from using superlatives because we never know what the future will hold. While I cannot foresee a time when we would ever sell the PEO division of LandrumHR, the unexpected (and uninvited) is always a possibility.

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Please note: We are sorry this issue of *PEO Insider* has been delayed. Our printer has been impacted by the labor shortage and supply chain issues, which have caused challenges in producing the magazine. We are working to resolve these delays as soon as possible. We thank you for your patience and understanding.

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STAFF
PUBLISHER
NAPEO
CEO/PRESIDENT
Patrick J. Cleary
EDITOR
Stephanie Oetjen
LEGAL EDITOR
Nicholas P. Kapiotis, Esq.
DIRECTOR OF ADVERTISING, SPONSORSHIPS, & EXHIBITS
Nancy Benoudiz
703/739-8169
nbenoudiz@napeo.org
DESIGN
Beyond Definition

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NAPEO'S MEDALLION PARTNERSHIP PROGRAM
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LIVE MEETINGS, NEW PEOPLE, & A BRIGHT FUTURE

BY BRUCE CORNUTT

On the last night of the 2021 NAPEO Annual Conference & Marketplace in San Antonio, Andy Atsaves of Artex Risk Solutions and I were chatting, and at some point during the conversation, he made the comment, "I'm just not in conference shape." That was so true! I had an absolute blast seeing everyone, but by the last night, I was dragging too. Perhaps it was from trying to cram 18 months of not seeing folks into three days or just the fact that I've not been on the road as much as normal, but I was pleasantly exhausted on the flight back into Birmingham. It was wonderful seeing old friends and making new ones, and I'm anxious for more in-person gatherings.

Speaking of in-person gatherings, I encourage you to make plans to join with your industry colleagues at our planned meetings throughout 2022. The conversations and stories about how our industry played such a large role in helping businesses weather the different stages of the pandemic had a tremendously energizing effect on those of us gathered in San Antonio. I was glad to see new people there who were new to the industry and eager to learn about providing services to businesses in their communities. IMHO, there's never been a greater time for new entrants into the space. There's an enormous population of businesses within the general PEO target audience that have never heard the story of how PEOs impact operations and value for small and mid-size businesses. I'm hopeful hundreds of PEOs spring up over the next few years to reach this market potential. Maybe they'll show the rest of us how to stop playing keep-away-take-away with businesses already using the PEO model and start chasing the universe of business owners who need what PEOs do so well every day.

On the topic of keep-away-take-away, I'll take the liberty to expound a bit. It's common practice for PEO client lists to make their way into general circulation. It's all too common for salespeople using lists to focus on selling against PEO A and extolling the virtues of PEO B instead of prospecting for business owners who've never adopted the model. I know that's not going to change. There are legitimate reasons a client changes PEOs to find a better fit, and there are areas of the country where market penetration is high enough to warrant competitive action. I get it. But, we'll be better off as an industry when we stop rewarding those taking the easy route, hire and train sales talent, and focus on educating new prospects and increasing market penetration. Sorry… pet peeve. I'll stop for now except for this: When we hit 85 percent market penetration in the 10 to 99 market, I'll be sure to apologize if I offended anyone. Until then, as my grandmother would often say, "I've said my piece."

My hopes for PEOs are high and I am firmly convinced we are only standing on the other side of the door from an amazingly bright future for our industry. Time to turn the knob. ■

> *IMHO, there's never been a greater time for new entrants into the space. There's an enormous population of businesses within the general PEO target audience that have never heard the story of how PEOs impact operations and value for small and mid-size businesses.*

BRUCE CORNUTT
2021-2022 NAPEO Chair
President & CEO
Lyons HR
Gadsden, Alabama

HEALTHCARE BENEFITS

COST-CUTTING VERSUS IMPROVING BENEFITS

As employers are facing an estimated 4.7 percent increase over 2021 costs in health benefits costs next year, the percentage of employers opting to shift costs to employees has dropped to 38 percent, from 47 percent the year before. Employers are recognizing that affordability is a real issue and are looking at strategies to remove cost barriers. This is according to Mercer's National Survey of Employer-Sponsored Health Plans 2021, which also found that healthcare use and spending is returning to pre-COVID levels.

Mercer's recent Health on Demand survey found that the great majority of employees who tried telemedicine during the pandemic intend to continue using it. Telemedicine use grew from 9 percent of employees in 2019 to 17 percent of employees in 2020.

JOB STRESS

PRESSURE TO CHANGE JOBS

Many American workers are feeling the pressure as the pandemic continues through its second year, and many say they intend to leave their jobs within a year, according to the American Psychological Association's 2021 Work and Well-Being Survey. Findings include:

- 59 percent reported experiencing negative impacts of work-related stress, with 56 percent citing low salary, 54 percent citing long hours, and 52 percent citing lack of opportunity for growth or advancement.
- More than four in 10 workers said they plan to switch jobs in the coming year, which could impact many industries already facing a shortage of workers, particularly the hospitality and healthcare sectors.

HAPPY ANNIVERSARY!

PAYCHEX CELEBRATES 50 YEARS

Paychex President and CEO Martin Mucci rings the Nasdaq opening bell in honor of the company's 50th anniversary. NAPEO board member Frank Fiorille is third from the left.

In honor of the company's 50-year anniversary earlier this year, Paychex President and CEO Martin Mucci visited the Nasdaq MarketSite in Times Square, New York City, to ring the opening bell.

Paychex Business Solutions, LLC, has been a NAPEO member since 2006. VP Risk Management, Compliance, and Analytics Frank Fiorille serves on the NAPEO Board of Directors.

CENTRAL STAFF SERVICES

FROM PEO CLIENT TO PEO STAFFER

Sensory Solutions of Long Island, Inc.

Larry Ryan is the director of sales and marketing at Central Staff Services (CSS) in Mount Sinai, New York, but he came to first know the PEO as a client, not an employee. In April of 2019, Larry opened Sensory Solutions, a gym to provide sensory integration for children and adults on the autism spectrum. Larry and his team soon realized they needed someone to run the new company's payroll. His accountant suggested he look into PEOs, and that's when Larry met CSS President Georgia Perrone. He felt a personal connection right away and could tell Georgia and CSS cared about helping his business grow and succeed. Working with CSS also allowed Larry to offer benefits to attract top talent to support his gym's clients. Sensory Solutions fulfilled a critical need in Larry's community, so much so that within a year the gym had outgrown its original location. Larry recognized that CSS was a true partner and saw the value a PEO can bring to a business. That's why he asked if he could join the CSS team to spread the good news of PEOs and help other businesses flourish. Sensory Solutions is thriving more than ever today. CCC has been a member of NAPEO since 1993.

CONGRATULATIONS!

EXTENSISHR HONORED WITH STEVIE AWARDS & AS A GREAT PLACE TO WORK

NAPEO member ExtensisHR has been named the winner of two Stevie® Awards for Great Employers. The awards recognize the world's best employers and the human resources professionals, teams, achievements, and HR-related products and suppliers who help to create and drive great places to work. ExtensisHR was awarded:

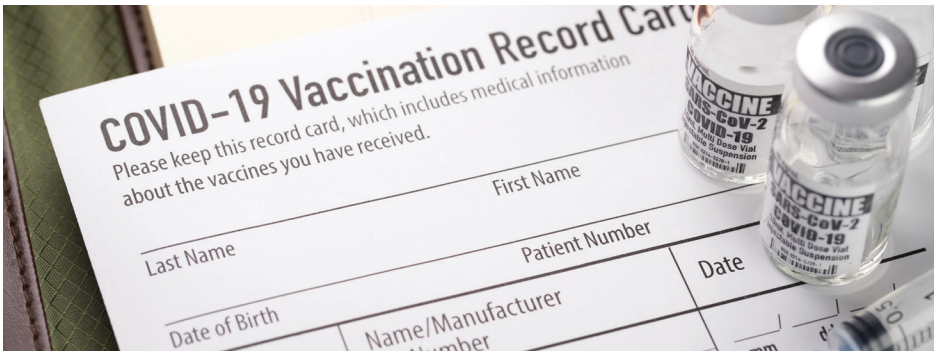
- The Silver Stevie® Award: Employer of the Year category, Business and Professional Services, acknowledging organizations that have been the best employers, as judged by employees, the public, and industry experts, since the beginning of 2020.
- The Bronze Stevie® Award: COVID-19 Response category, honored for the contributions of its organization and HR individuals who worked valiantly over the year to keep employees safe, healthy, employed, paid, and informed.

More than 950 nominations from organizations of all sizes in 29 nations were submitted for consideration in a wide range of HR-related categories. Over 70 professionals worldwide participated in the judging process to select this year's Stevie Award winners.

These awards follow ExtensisHR's 2021 Great Place to Work Certification,™ in which the company was recognized for its leadership, mission, and culture of innovation. ExtensisHR is committed to actively engaging employees through its "You, Supported" program, including onboarding activities, diversity and inclusion initiatives, employee appreciation, training and development resources, Fortune 500-level benefit plans and more. The company was founded in 1997 and joined NAPEO the same year.

VACCINE MANDATE

EMPLOYER ANXIETY



Recent research by SHRM (the Society for Human Resource Management) found most employers—90 percent—believe it will be somewhat or very challenging to implement the Biden administration's mandate that organizations with 100 or more employees require workers to be vaccinated against COVID or undergo weekly testing. Key findings include:

- 80 percent of organizations that meet the mandate criteria are concerned about the amount of time they will have to spend enforcing or tracking employees' vaccination or test status.
- 38 percent of those organizations cited retaining talent as the most challenging impact of the mandate and 89 percent believe some of their employees will quit their jobs due to the new requirements.
- 65 percent of respondents said their organizations cannot afford to pay for regular testing for unvaccinated employees.
- 82 percent that meet the mandate criteria said the requirements will make maintaining the morale and engagement of their workforces more difficult.
- Seventy-two percent of those organizations said the requirements will make maintaining regular business operations more difficult.

WHAT POTENTIAL EMPLOYEES WANT

COMPANY REPUTATION & ALIGNMENT WITH VALUES

Almost 85 percent of adults who responded to a recent survey said they would accept a lower salary to work for a company with a stellar reputation. Almost 80 percent said it's important to work for an employer that shares their views. These results—from an SCG Advertising + Public Relations survey—seem to indicate that businesses and other employers ignore employees' values and perspectives at their own peril.

The survey also found that 74.19 percent of respondents favor a position with a fair salary and vaccine policies they agree with, versus a higher salary and a vaccine policy in contrast to their own beliefs.

Indicative of how serious workers are about being content with and comfortable in their employment is the U.S. Department of Labor Statistics Job Opening and Labor Turnover Survey (JOLTS) report showing that a record 4.3 million Americans quit their jobs during August, equivalent to 2.9 percent of the entire U.S. workforce. ■

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ENSURE EVERYONE WINS WHEN YOU ACQUIRE A PEO

LESSONS LEARNED FROM MY PEO'S M&A EXPERIENCES

BY JOHN W. ALLEN

Buying another PEO is an expensive and time-consuming proposition. It can also be disruptive to both the buyer and the seller, and to their employees and clients. It's imperative that both sides do their due diligence, make sure there is a fit beyond the economics of the deal, and that the post transaction integration is completed with minimal hiccups.

When G&A Partners decided to accelerate our growth plans, we adopted a three-pronged strategy:

- Scale the sales organization to grow faster organically;
- Fold in accretive acquisitions to build critical mass and enter exciting new markets; and
- Provide astounding customer care to minimize customer churn.

Over the past 10 years, G&A Partners has made 14 acquisitions. Most turned out beautifully. A couple had disappointing outcomes. This article will profile some of those acquisitions and the lessons we learned along the way.

WANTED: A CULTURAL FIT & BETTER BENEFITS

Sellers aren't always going to choose the highest bidder when deciding to whom they should sell their PEOs. For some, the business they are selling is part of their legacy,

HIMY

Sellers aren't always going to choose the highest bidder when deciding to whom they should sell their PEOs. For some, the business they are selling is part of their legacy.

and they want to ensure the firm that purchases it will continue to take good care of their employees and clients. At G&A, we want the same thing.

For one of our larger acquisitions, the owner was experiencing some issues that were prompting him to exit the business and cash out. He chose G&A because there was a cultural fit—we were on the same page when it came to how to service clients and how to take care of employees. He wanted to find a PEO buyer that was very committed to customer service and that provided high-touch, high-tech services. The buyer had to be willing to retain his employees and take good care of them. That aligned well with our intentions. We kept all but a couple of his people, and we were able to provide better technology, better benefits, and better service to his clients.

WANTED: AN EXIT FOR ONE PARTNER, A FUTURE FOR ANOTHER

In one of our earlier acquisitions, we purchased a small firm run by a father and son. The father wanted to exit the business and the son wanted to become part of a thriving PEO that would help him grow its presence in the Intermountain West. We structured a deal in which we bought the company, the father exited, and the son retained a minority interest in the business, becoming our regional vice president. When we acquired their book of business, we replaced their self-funded health benefits plan with a fully funded plan, so we eliminated that risk and provided better benefits and better technology as part of the transaction. He went from three employees servicing 600 worksite employees (WSEs) and outsourcing payroll, to where we are now—50 corporate employees in that region with 10,000 WSEs. That's just the kind of significant growth the son had hoped to achieve. He's moved up in our organization as well—from being the regional vice president to G&A's chief operating officer.

A few years after we acquired this company, we acquired another PEO with two owners. Once again, one owner wanted to exit while the other owner wanted to stay involved. She is now our vice president of HR services and has been a tremendous asset to G&A Partners. At the time of the acquisition, her firm had 33 employees. We kept 31 of the 33 and most are still with us eight years later. That was one of the keys to exceptional client retention.

WANTED: THE ABILITY TO FOCUS ON OTHER BUSINESSES

We have made two acquisitions in which the owners wanted to focus on other business interests or investments. One seller owned a large staffing company and a small PEO. We had chased some business together, so when the owner decided to focus his time and resources on growing his staffing company, he reached out to us to sell his PEO division. We quickly agreed on a price and then spent most of our time leading up to the transaction talking about how we would assimilate his employees into our nearby office and how we would continue to provide the same level of service to his clients. For both him and G&A, taking care of his employees and his clients was just as important, if not more so, than the economics of the deal.

WANTED: A VIABLE FINANCIAL PARTNER

We have made four acquisitions involving companies in some form of distress. In two situations, the owners were at a crossroads and we were able to structure a transaction that brought closure and folded the businesses and their employees into the G&A family. In two other situations, the PEOs were struggling financially and needed a viable financial partner. We structured these acquisitions in a way that allowed the sellers to satisfy their financial obligations and become part of a larger organization with deeper pockets. The real challenge came after closing, as we had to quickly change mindsets, processes, and systems so we could collectively avoid the mistakes that led to their problems in the first place.

CREATING A WIN-WIN-WIN -WIN SITUATION

There's lots of competition out there—a lot of PEOs that are trying to acquire other PEOs. The whole process of negotiating terms and conditions among the veritable parties is certainly a challenge, but it must be a win for everybody involved—for the buyer, the seller, their employees, and their clients.

Buyers spend a lot of money on an acquisition, so they've got to be able to get a return on their investment. How do they do that? Some will feel the recourse is to cut a bunch of people, and that can potentially impact client retention, which can then lead to burnouts and payouts. Buyers should evaluate that very carefully. You must be able to create that win-win-win-win situation or it's not going to work long-term.

Offer a fair purchase price and make sure the deal makes sense—not only between the buyer and seller, but also for the employees and the clients. Then, put a lot of work and communication into the transition. When you do, you'll engender trust, confidence, and faith. Everyone wins.

There is no guarantee an acquisition will be successful. But at G&A Partners, we have applied the principles set out above and taken in the lessons we have learned with each acquisition along the way to grow with passion and purpose. Our approach has led to great outcomes in most cases and adjustments where needed. We look forward with zeal to the acquisitions we will make in the future using this tested formula. ■

JOHN W. ALLEN

President and CEO
G&A Partners
Houston, Texas

THE CHANGING LANDSCAPE OF THE PEO INDUSTRY DUE TO M&A

BY WANDA J. SILVA AND JAMES MACK

The past 18 months have been interesting for the world, the United States, and the PEO industry. Almost everyone has felt the results of the COVID pandemic both personally and professionally. We hope we have felt and seen the worst of it and we can return to some level of normal shortly.

It should be no surprise, then, that the PEO industry, as well as mergers and acquisitions (M&A) and consolidation, have also been through a significant amount of change. In this article, we will explore some of the recent trends in acquisitions and the current state of affairs, and look forward at what we might see happening in the next two to three years.

Since the mid to late '90s, the PEO industry has drawn a certain level of attention from Wall Street, private equity (PE), and other moneyed players. From BBSI going public in 1993 to the acquisition of a Florida PEO in '96 by Paychex, to Vincam (private equity-backed at the time) merging with ADP and Insperity (Administaff) going public in '97, the industry has had a combination of large public and private companies, mid-sized companies, and local PEOs that provide a variety of services and service models to the small and mid-size employer market. The 2000s saw continued and increased activity with other companies going public, private equity taking stakes in a number of companies, and strategic PEOs acquiring smaller PEOs. The industry survived the recession of '08 to '09 and has continued strong steps to capture more worksite employees (WSEs) (4 million), clients (173,000), and percentage of employers with 10 to 99 employees (15.3 percent), according to the NAPEO website.[1]

RECENT TRENDS & CURRENT STATE OF AFFAIRS

Where did that leave the industry during COVID? Working hard to help struggling industries. Fortunately, the clients that used PEOs had markedly better results than those that didn't, including being 58 percent less likely to permanently close, 82 percent more likely to have business operations back to normal, and 18 percent more likely to have had their Payroll Protection Program (PPP) loans forgiven, according to NAPEO's September 2021 white paper.[2] This all adds up to stronger PEOs that survived a terrible time in U.S. history. In the midst of this, there were several transactions that closed in early 2021, including an Alabama PEO buying a Florida PEO, a Florida PEO buying an Alabama PEO, a Texas PEO buying a Tennessee PEO, and two PEOs taking on private equity partners/owners. Those are the transactions we know about from press releases. It appears that the interest in transactions in the PEO industry was relatively unaffected by COVID and we expect that to continue as 2021 ends.

One of the trends we see at this time is both strategic and private equity buyers being willing to pay a slightly higher price. This trend is for well-run, quality of gross profit PEOs that have one or more of the following attributes: geographic advantages/position, solid financials, sound risk management practices, and strong sales processes and teams. New private equity firms are looking for platform companies upon which to build. Private equity firms with established platforms are looking for those tack-on acquisitions that extend geographic reach, add PEO-level healthcare benefits plans, bring on talented management team members, or add sales engines from either internal salespeople or well-established broker relationships.

A second trend we are seeing is the larger private equity-backed PEOs aggressively looking for more transactions to help them grow even faster. In some cases, it is because their PE backer changed; in other cases, it is because the overhang (cash not currently being deployed) at the PE firm needs to be put to use, with record-low returns on cash sitting in banks. This will be even more prevalent as we get into 2022, as interest return rates show no sign of improving.

Finally, there is still considerable attention being given to an all-but-certain capital gains tax rate increase that will have an effect on the PEO M&A market. It will depend on the amount of the increase (estimates range from an additional 5 to 19.3 percent) and the effective date. That increase can either have an accelerating effect on deals (close by 12/31/21) or a limiting effect, as some owners may choose to hold on to their companies until better deals come around or the rate changes again in the future.

THE FUTURE

What does the future hold? If the past is any indicator of the future, the future for deals looks extremely bright. Deals have happened almost every year for the past 25 years, in good times and in down times.

As a result of many transactions over the years, however, the industry has a

One of the trends we see at this time is both strategic & private equity buyers being willing to pay a slightly higher price. This trend is for well-run, quality of gross profit PEOs.

bit of a barbell shape to it. The top five to 10 PEOs size-wise in the country have about 50 percent of the total WSEs in the industry. There is a bit of a gap in the number of PEOs in the 15,000 to 75,000 WSE range. Then there are numerous PEOs in the space below that. We believe that the space of PEOs with fewer than 15,000 WSEs is the one that will garner the most attention, have the most activity, and have the most deals from a seller standpoint.

In addition, technology, infrastructure, and people investments will play a large role in how many transactions occur. As we all know, reaching certain critical mass WSE sizes requires making substantial investments that some owners may not be willing/able to make, and the better decision may be to sell the PEO. This will primarily affect the 1,000 to 5,000 WSE space. Getting over that 15,000-WSE hurdle can be difficult as well, and some owners may reach the same conclusion.

A number of PEO owners are on their second PEO ride. At the 2021 NAPEO Annual Conference & Marketplace in September, it was amazing to see quite a few familiar faces of owners who we know from much earlier conferences, still attending and still owning their second PEOs. A number of them may decide to sell in the next few years. Likewise, a number of PEO owners who sold in the past three to five years may be coming off of their non-competes and could be looking to get back into the space. The industry definitely tends to have a "draw you back in" quality.

We also are looking at some synergistic aspects between the PEO and insurance spaces. Several PEOs have their own captive agencies for client-level plans. The insurance agency space is having its own tremendous M&A activity level lately, with a high volume of transactions occurring and several large agencies rolling up 200 to 300 small agencies. It is something to be aware of and watch over the next few years.

Finally, we continue to see a trend of people starting new PEOs, as they see the tremendous value to bring to clients and personally to the owners. At the NAPEO conference, 35 PEOs were recognized for having joined NAPEO in the past 12 months. A large number of these PEOs were started in the past two to three years. Just like when a forest is harvested and new trees are planted to take their places, the PEO industry also has its own method of building bigger, brighter, and better than before. We don't see that changing and look forward to continued activity and growth. ■

1 www.napeo.org/what-is-a-peo/about-the-peo-industry/industry-statistics.
2 www.napeo.org/docs/default-source/white-papers/september-2021-peo-clients-in-pandemic-white-paper.pdf?sfvrsn=9f2c36d4_10.

WANDA J. SILVA

Managing Director
FOCUS Investment Banking
Founder
Silva Capital Solutions, Inc.
Marietta, Georgia

JAMES MACK

Managing Director
TAAG Financial Institutions Group, LLC
Livonia, Michigan

INTEREST IN THE

PEO SPACE

MARKET OVERVIEW & BUYER PROFILES

BY ROB COMEAU

The M&A landscape in the PEO industry has been in a state of consolidation for more than 10 years. The COVID pandemic put a temporary halt on many transactions in early- to mid-2020. In Q3 of 2020, deal flow began to rebound, and as of 2021, many deal multiples appear to be at or above pre-2020 levels. The market is very active with a combination of industry veterans and new entrants.

Buyers include public and private PEOs, private equity firms, and family offices (a family office is a privately held company that manages investments and wealth for a wealthy family, with the goal of growing and transferring wealth across generations). As multiples have risen to pre-COVID levels and sometimes beyond, there are a number of variables to look to as drivers behind this recent surge.

Some of these variables include supply and demand issues, increased competition, necessity for capital deployment, increased awareness of the PEO space, industry whitespace (low penetration rate), access to cheap capital, need for scale, and predictable value creation strategies with low revenue volatility for investors.

This article will offer an overview of the common buyers we see within our industry and provide insight into their buying drivers. As we comb through the various buyers, please note one common theme: A buyer is trying to maximize the return on investment post-acquisition. This aim influences deal mechanics (i.e., earn-out provisions, equity rolls, employment contracts, and non-competes), growth initiatives, investment timing, pricing, and post-acquisition strategy.

BUYER PROFILES

The buyer profiles identified at the beginning of this article were public and private PEOs, private equity firms, and family offices. Buyer types have commonalities and differences in their

The market is very active with a combination of industry veterans & new entrants. Buyers include public & private PEOs, private equity firms, & family offices.

approaches. I'll review these potential buyers to gain a clearer insight into drivers and initiatives.

PEO Buyers: Private & Public

PEO buyers may come in the form of private, public, or investor-backed PEOs. I'll review investor-backed PEOs later in this article. For this section, I will focus on private and publicly traded PEO buyers. Often, private non-investor-backed PEO buyers are smaller than publicly traded PEO buyers. Due to the size differential and potential capital restraints, privately held PEO buyers often look for strategic regional acquisitions. Geography often plays a factor in a privately held PEO's acquisition strategy. Neighboring states to the acquirer's headquarters and/or desired emerging markets may, to an extent, dictate the private PEO's search parameters. Once a geography has been identified, the private PEO typically looks for commonality with its acquisitions. Commonality may include client segmentation, insurance platforms, similarity of offering, and technology.

If a privately held PEO identifies a potential target, it often reviews the impact of the acquisition in nearer-term focus, meaning will making the acquisition improve profits, service offering, geographic expansion, sales, or third-party options? If the acquisition will not yield results in the near term, the acquisition may not be consummated. Privately held PEOs may not have the

same access to capital as investors and therefore need to ensure that the acquisition will yield a suitable return in an acceptable time frame. Privately held PEO buyers also may be more opportunistic than investors, which means they will only move on potential acquisitions at a time when the deal makes sense. This is in lieu of having acquisition strategies within a specified time frame like the investment horizon of an investment-backed PEO.

Publicly traded PEOs typically have more access to capital than their private counterparts. However, publicly traded PEOs are graded by investors quarterly. Therefore, the publicly traded PEO must balance the long-term strategic advantages of an acquisition with the quarterly impacts the acquisition will have on organizational profitability and shareholder returns. Publicly traded PEOs may choose to make acquisitions for several reasons. Some of these drivers are innovation, geography, scale, higher profit, and synergies. Smaller acquisitions made by publicly traded PEOs often are sought out for innovation or possibly geography, whereas larger acquisitions are typically done for scale, profit, and geographic expansion.

Investors: Private Equity & Family Office

PEO investors typically fall into two categories: private equity and family office. As with any investment opportunity, the acquirers are seeking a suitable return on the capital they deploy. A distinct difference between private equity and family office is the investment horizon. A private equity firm often has a three- to seven-year investment horizon (although we've seen shorter and longer). A family office may have a longer investment horizon.

The difference in timing can be linked to the number of investors within each model. A private equity has many investors within each fund, whereas a family office may have only one or in the case of a multi-family office, several. However, the number of investors at a family office is much smaller than a private equity. Therefore, a family office, assuming the investor(s) agree on an investment horizon, may hold an investment for longer than the private equity. Typically, this means that a private equity investor may be more active with acquisitions in a short amount of time than a family office.

Ultimately, the driver behind activity in the market is led by the return multiple an investor seeks coupled with the performance of the assets under its control. If an investor seeks a four-times return on capital deployed, it can do so through organic growth of its current assets coupled with acquisition growth of new assets. If the asset under control has anemic growth, the investor is forced to grow through acquisition. If the asset under control has strong organic growth, the investor can be more selective with its acquisition strategy. Investment firms answer to their investors. If a private equity wants to raise additional funds, its needs to show a track-record of favorable returns. If a family office wants to satisfy its investor(s), it too needs to show favorable returns.

FINAL THOUGHTS

I hope this article illustrated some of the common drivers behind the different types of investors within our industry. As you will note, while every acquirer desires a positive return post-acquisition, the emphasis on the timing of the return differs based on the investor. A privately held PEO is opportunistic in identifying an acquisition that will improve the acquirer's PEO. A publicly traded PEO buys for various reasons but must be cognizant of the profit timing to satisfy earnings per share (EPS) on a quarterly basis. A private equity buyer answers to a host of investors and needs to illustrate a favorable return in line with forecasted investment horizon parameters. A family office needs to show a favorable return based on its investor's expectations and timing. Understanding the timing of acquirers helps potential sellers understand the potential roadmap for their PEO post-acquisition. ■

ROB COMEAU

Chief Executive Officer
Business Resource Center, Inc.
Rancho Santa Margarita, California

MINIMIZING RISK FOR PEO INVESTORS

BY FRANK HUANG, FCAS, MAAA AND DANIEL S. MCHENRY

Investors interested in the PEO industry commonly want an overview of the risks facing PEOs. While it is impossible to cover every material risk for every possible transaction in 1,000 words, we accept the challenge and will attempt to cover common risk themes as in-depth as possible.

WORKERS' COMPENSATION

One of the biggest risks for an investor in a PEO lies in the PEOs workers' compensation (WC) program.

Generally, PEOs address their WC exposures either through a guaranteed cost (GC) program or a deductible program. With a GC program, the PEO pays a premium to an insurer to transfer all WC claims first-dollar on an unlimited basis to that insurer. With a deductible program, the PEO pays a lesser premium (relative to the GC premium) and retains losses in an agreed upon deductible layer, and transfers losses excess of the deductible to the insurer.

In both financing approaches, the magnitude and trend of ultimate losses is important, but the trend is *more important* under a deductible program. Thus, the *amount of deductible layer*[1] *losses is the first risk* we bring to your attention. The ultimate amount of losses in the layer, and how it trends, can have a significant impact on earnings before interest, taxes, depreciation, and amortization (EBITDA) and pro-forma projections, and thus valuation.[2]

The *second risk is that WC liabilities are not appropriately reflected in accounting*. There are two common areas where accounting can go awry. The first issue is the accrual method of the unpaid WC liabilities. The PEO's net WC liabilities within the deductible need to be estimated and carried as a loss liability. The second issue relates to the accounting of the collateral that is held by the carrier. It is not uncommon for deals to be scuttled due to inaccurate accounting in these two areas.

The last group of WC risks lies in the *PEO's understanding and appropriate management of the retained loss liabilities*. Strong client evaluation, pricing, claims management, and safety programs are important for all PEOs, but more important for PEOs in higher risk verticals than PEOs only writing lower-risk, white-collar worksite employees.

HEALTH BENEFITS

Healthcare risk is similar in concept to WC risk in that it can be financed away or retained (e.g. on a minimum premium plan). Just like WC risk, health benefits risk is greater when it is retained, which heightens the importance of how the program is being managed.

While the risks are many, it is worth noting that all of them can potentially be converted to be financially advantageous.

The first risk in this area lies in *client evaluation* especially for new business. Who is doing the client evaluation, and how are they doing it? It is not uncommon for this person to see his or her function connected only to sales and not to risk mitigation, which can result in a myriad of negative consequences.

Another important risk is *risk tiering*,[3] or differentiating price between clients such that there is adequate pricing at the client level but also at the aggregate level. Not doing so can result in clients with better experience being overcharged, leading to departures. This can potentially lead to greater stress on pricing remaining clients, and potentially to aggregate inadequacy. Over time, this could result in rate increases by the carrier(s), which have the potential to impair sales efforts.

The last risk worth noting is in *benefit plan design*. Unlike WC, which has statutorily defined benefits, PEOs have the opportunity to align the needs and desires of their clients and co-employees with specific product options. The better that alignment, the greater the enrollment and participation, which can help minimize claim volatility and adverse selection.

NON-INSURANCE OPERATIONAL RISKS

In addition to workers' compensation and health benefits, a third general category of risk lies in the PEO's non-insurance operations. While there are too many to cover, we briefly address a few notable ones:

- **Management**
  - How likely is the executive team to achieve investors' short-term and long-term goals?
  - Will they sign employment agreements, and will the sales force sign strong restrictive covenants before the acquisition?
- **Client Portfolio**
  - What is the composition and trending of the client portfolio?
  - Are there adequate administrative fees? *A rule of thumb for a healthy PEO is if the PEO will meet investor goals with just administrative fees.*
- **Sales**
  - Long-term impact of enterprise value based upon organic, broker, or combination models.
  - Effectiveness and economics of sales force.
- **Competition**
  - Understanding the competition and how the PEO compares.
  - Understanding potential disruptors.
- **Valuation**
  - Understanding the market and how to compete in an auction process with the consolidators that have an advantage of synergy.

CONCLUSION

While the risks are many, it is worth noting that all of them can potentially be converted to be financially advantageous. For example, if retained WC and/or healthcare benefits costs are less than what an insurer might charge to assume those risks, then the PEO and its clients benefit. The proper identification and treatment of these risks will improve an investor's likelihood of success and maximize return on the investment. ■

1 PEOs involved in transactions generally are in deductible programs rather than GC programs.
2 Because of the potential impact on valuation, it is important to engage a credentialed actuary who is, at a minimum, experienced in workers' compensation, and preferably also experienced in PEOs.
3 It should be noted that, as with both WC and health benefits, analytics are increasingly playing a role in helping drive accurate pricing.

FRANK HUANG, FCAS, MAAA

Senior Consulting Actuary
Merlinos & Associates
Peachtree Corners, Georgia

DANIEL S. MCHENRY

Business Advisory Group Practice Leader
McHenry Consulting
Orlando, Florida

Buying AND SELLING

THINKING LIKE A BUYER

HOW TO BE A BETTER SELLER

BY FRANK FONTNEAU

An entrepreneur selling his or her business represents years of hard work, sacrifice, and financial and emotional investment, which can be a stressful and daunting task for any business owner. For a large proportion of owners, this is the first time they or their teams have been through an exit process. Anxiety and fear are common emotions when contemplating an exit, but most of this unease can be eliminated through educating yourself about the exit process. Even more important is preparing your company to both maximize the value at exit and minimize the chances of a false start or failed transaction.

It is never too early to begin exit planning and preparation and never too late to start. Plan for your exit as your company evolves and update your plan over time.

Exit planning and preparation largely employ the same core functions and characteristics as annual strategic planning, including forecasts, staff planning, growth initiatives, and profit maximization. The biggest difference, and a key point to consider, is that your business will be evaluated from the buyer's point of view. Considering your company from this perspective allows you to truly identify what matters most to buyers because they are the ones who will ultimately assign a value and complete a transaction.

THINKING LIKE A BUYER

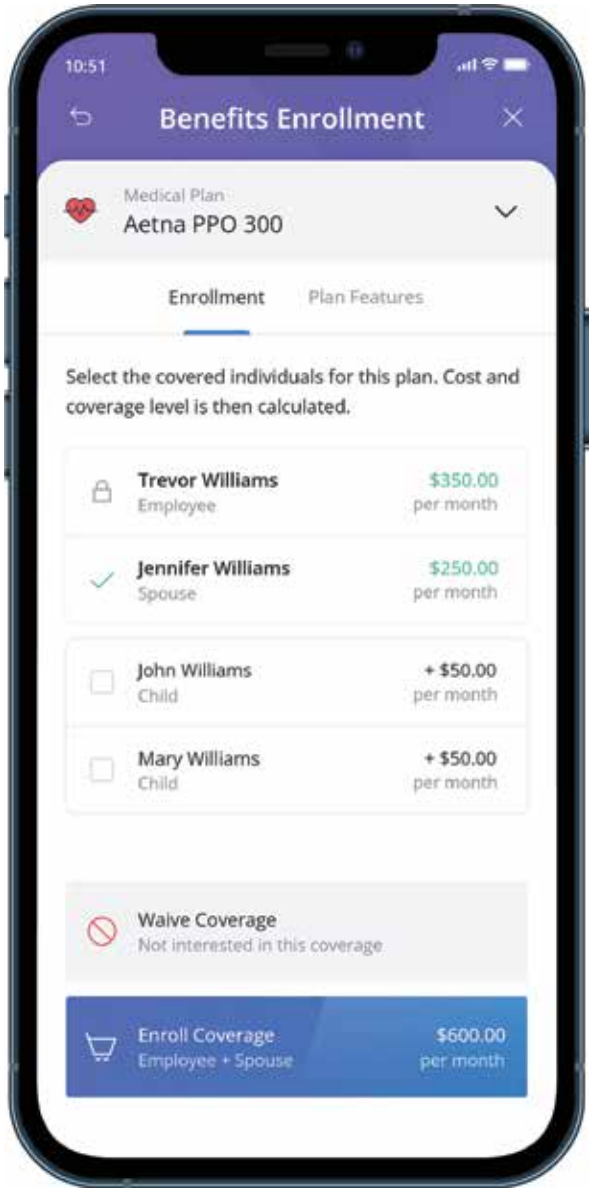
First, you need to determine the buyer, which is commonly a group of individuals who are looking to deploy capital to acquire a business that will produce a significant return for themselves and their shareholders/investors. No matter what, potential buyers are only going to complete the transaction if they feel that doing so will produce a result that exceeds their required rate of return. The most important thing to remember is that to maximize the value of your PEO, you need to make buyers believe they are maximizing their eventual return.

Buyers generally fall into two buckets: financial buyers and strategic buyers. Financial buyers are largely private equity groups in which the buyers have raised money from others and are seeking to acquire and grow the business to generate returns from cash flow and the eventual exit. Strategic acquirers are generally existing PEOs. To further confuse matters, these existing PEOs may be backed by private equity groups. While this may be a difference without distinction, what truly differentiates the buyer type is if the buyer has an existing PEO or is looking to make its first investment in the space.

PLATFORM OR TUCK IN?

Potential buyers with existing PEOs can be more flexible with the acquisition because they can more easily generate return by integrating your PEO with their existing PEO(s). In this type of transaction, the buyer is looking to increase the value of the combined entity by increasing revenue and profitability, in addition to considering how your business fits with the existing business. This means your client profitability and retention, along with how your business operates and the markets it serves, will be the largest drivers of valuation.

Buyers looking to make their first acquisition in the space will want to buy a "platform," meaning they are looking for a PEO that can support organic sales growth along with growth from the acquisition of other PEOs. This means the buyer is looking for a complete business that has shown good growth and checks all the boxes to support future growth. The more boxes your PEO checks, the more interest, the easier the transaction, and the higher the valuation.



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Exit planning & preparation largely employ the same core functions & characteristics as annual strategic planning, including forecasts, staff planning, growth initiatives, & profit maximization.

CHECKING BOXES TOWARD AN OUTLIER VALUATION

Common factors platform buyers are looking for include:

- Strong first and second tier management team;
- Scalability of your processes and systems;
- An organic sales engine;
- Acquisition considerations;
- Insurance programs; and
- Financial results.

All buyers have different criteria and weigh factors differently based upon their situations and understanding, but the overriding factor is determining how they will get a significant return. Private equity investors are likely targeting a two- to three-times return on the investment.

CONSIDERING AN EXIT

After you have considered the merits of your PEO and realistically assessed your business from the potential buyer's point of view, you can confidently explore an exit. At this point, it is time to build a team to assist with a potential transaction. Roles you will need to fill are:

- **Investment banker or broker (transactional advisor):** You will need someone to work on your behalf to help develop the presentation about your company, identify potential investors, and negotiate on your behalf. This is a key role and the individual or group should be working alongside you and your management team to set an achievable strategy.
- **M&A attorney:** This individual or firm should have experience with transactions directly, and PEO experience is a definite plus.
- **Personal wealth advisor:** Selling your business will significantly change your personal finances. You must be prepared to understand your financial position after the money clears, taxes are paid, and whether you do or do not continue to work for some period of time.
- **Tax advisor:** This individual will help you determine if the transaction will affect any personal or business tax situation.

- **Financial services:** You will need to work with your auditors/financial team to prepare for both strategy and diligence.

Having this team in place is a plus for buyers, as they are concerned with good communication and accurate information. They will appreciate a well-run process. Having a committed team available to assist will help assure them you can close a transaction.

THE PROCESS

Every sales process has nuances, but ultimately you and your transactional advisor will market your company to a list of potential buyers who will gain access to increasing levels of company information during a confidential process. This process begins with the buyer expressing interest, progresses to a letter of intent, due diligence, and the negotiation of a purchase agreement before culminating in a sale.

During this time, the buyer will be reviewing your company and comparing it to its investment criteria and other potential investments, which will include taking the information received and systematically building an investment case. In general, this investment case includes reviewing the merits of the business, the potential return, and the risks with their respective mitigation strategies.

Just as you have a team to support your exit process, the buyer has internal and external teams to support the transaction, including analysts to help develop the financial model, internal or external operational and financial specialists to help with due diligence, and a network of industry veterans to provide expertise and strategy.

MARKETING YOUR COMPANY

All sales start with a seller and a buyer coming together. With the scarcity of PEOs and the interest in the space, it is common to see buyers broadly marketing their intent to purchase PEOs directly to business owners. Whether you are marketing to buyers or buyers are courting you, everything you say or do from this point forward will impact the exit process.

LETTERS OF INTENT & DUE DILIGENCE

Before you receive any letters of intent, you will have confidentially shared financial and operational information to enable the buyer to estimate value. The buyer will be comparing and consolidating all this information. Therefore, it is important that the data aligns with what is shared at this phase and what will be shared in due diligence.

Once you execute a letter of intent with a buyer, a period of diligence will begin. You will need to satisfy the buyer's requests for information and complete diligence. Access to data and a thorough understanding of the details of your business will help you shine at this point, as will the competency of your team.

The biggest thing to understand from the buyer's perspective during the diligence process is that the buyer doesn't really know or understand your business yet and will form opinions based upon the information you provide, how you provide it, and what you cannot provide.

Buyers will ask for things that may not make sense or feel relevant, which may indicate a lack of understanding on their part. Be patient, be prepared to provide details, and ensure that your team is communicating with the buyers to understand the asks and guide the process.

CLOSING THE DEAL

Once the buyer feels like it can financially benefit from the acquisition and the risks have been mitigated or signed off on, it will be ready to close. Just like you and your team, it will be relieved and looking forward to the future.

A lot of questions should be answered well before this point, including major ones such as what your role will be moving forward and the strategy post-acquisition. Your financial plan should be set and your team members should be confident in their roles moving forward.

How easy or painful it was to get here and the amount of cash consideration you are walking away with is largely determined by the marketability of your business and your level of preparation. ■

FRANK FONTNEAU

Principle
RVR Consulting Group
Winter Park, Florida

WHY I WILL NEVER SELL MY PEO

BY BRITT LANDRUM, III, SPHR

Never is a very strong word! I *always* stay away from using superlatives because we *never* know what the future will hold. Seriously though, these past 18 months have taught all of us that it is good to prepare and make plans. However, the most well-intended strategic planning may not always prepare you for what happens next. We must have the ability to pivot and modify plans, if necessary. While I cannot foresee a time when we would ever sell the PEO division of LandrumHR, the unexpected (and uninvited) is always a possibility.

When someone asks me how long I have worked in the "family business," oftentimes I tell them 51 years. That's how old I am, and that happens to be how long ago (1970) my father started the company. From the time I was a child, I was enthusiastically hanging out and spending my free time with my father at his downtown office. I grew up observing the critical role he played in the formation of the PEO industry and establishing the legal foundation in Florida, which has been expanded upon and modeled throughout the country. I played lots of sports and lots of music growing up, and our family temperament (ups and downs) revolved around the health of our privately held business.

There was a brief period when I considered performing music full-time and possibly teaching, but I knew I would miss the ever-changing excitement and evolution of our company and the PEO industry. Although the spectrum is vast and unique with each PEO, I love the solutions we provide small and mid-size businesses. For example, I teach high schoolers the fundamentals of business in our local community. When asked what our company does, I tell them (in simple terms) that we are like the sanitation workers of the business world. In other words, we take care of the garbage that most business owners and operators simply do not want to deal with. Other clients choose to partner with us to assist them with providing an enhanced experience for their workforces.

I love our team at LandrumHR, our national association (NAPEO), and our accreditation association (ESAC, the

Employer Services Assurance Corporation). The people involved are (in a very literal sense) the best friends I have on the planet. Even though in NAPEO and ESAC we are competitors by day (technically speaking), we all have similar struggles and we collaborate effectively to provide solutions and help resolve them.

Moreover, our company's size, breadth, and longevity make us a niche player within the industry that provides us with many strategic advantages that would be extremely difficult to replicate. I will continue to use those advantages to expand our company and provide unique solutions for customers within our space. To that end, we have turned away several acquisition prospects over the years because they were only interested in maximizing their dollar value. However, in my view, we are the perfect fit for sellers when they care most about their internal employees and retaining their client bases. Due to our private ownership, we can make decisions based upon what is best in years to come, rather than what will provide the best return for the immediate quarter.

In college, I attended a very large state school (FSU), then transferred and graduated from a small liberal arts school (Oglethorpe University). So, I know and understand the advantages and disadvantages of being both smaller and larger. I enjoy providing the "Goldilocks" solution in the PEO space for clients that want much of the technical ability the larger players provide, while still having the personal contact and customization smaller PEOs provide. I plan on delivering those same unique, customized solutions for our clients as long as they are valued in the market, and therefore, do not plan on *ever* selling our PEO! ■

Our company's size, breadth, & longevity make us a niche player within the industry that provides us with many strategic advantages that would be extremely difficult to replicate. I will continue to use those advantages to expand our company & provide unique solutions for customers within our space.

BRITT LANDRUM, III, SPHR
Chief Executive Officer
LandrumHR
Pensacola, Florida

TEAMWORK HR

20 YEARS OF HELPING SMALL BUSINESSES THRIVE

BY CHRIS CHANEY

A passion for growing businesses, helping people, and serving the community are the bedrock principles of Redding, California-based Teamwork HR. Heidi Corrigan leads this 26-person team with an energy and enthusiasm that keeps her team motivated to excel and serve clients.

The company's success is owed in part to its deep roots in the local community, which allow Heidi and her team to form strong relationships with businesses all over Redding. This was never truer than during the pandemic, when Teamwork HR offered free webinars and guidance about COVID rules and relief programs to all local businesses, whether they were clients or not, and quite literally kept their community in business.

Teamwork HR celebrates 20 years in business this year and shows no sign of slowing down; the boutique PEO is focused more than ever on helping clients navigate the complex world of work.

HUMBLE BEGINNINGS

Teamwork HR's roots trace back to Heidi's days working for a staffing company. As that business grew, a need for in-house HR expertise became apparent. Because the company's clients were also struggling with the same HR-related headaches, Heidi thought it made smart business sense to offer HR services too.

"We saw more and more small businesses struggling with what we called alphabet soup from a regulatory standpoint," Heidi remembers. "It had a negative impact on their enthusiasm to be small business owners. We understood what they felt so we started offering HR services and eventually evolved into a PEO."

PEO was not a totally unfamiliar concept to them, but they didn't understand the nuances of co-employment, so learning the key differences between being a co-employer and just an employer was challenging.

"When we first started, it seemed easy because we had been in the staffing world, but setting up deduction codes and figuring out our workers' compensation policy was tough," Heidi explains.

However, given California's onerous employment regulations, they knew they had a strong value proposition. Heidi and the business partner who formed the PEO with her shared a small 400-square-foot office with just one phone they passed back and forth. They made a good team because Heidi had experience in HR and benefits and her partner had an accounting and safety background.

Like many entrepreneurs, they felt the first client was the most important. They literally walked up and down streets knocking on doors, trying to explain how they could help businesses grow and thrive.

In 2003, just two years after getting into the PEO business, Heidi would leave the staffing company and solely focus on PEO. Yet in 2009, she re-entered the staffing business and today she leads O2 Employment Services, which encompasses Teamwork HR (PEO) and O2 Staffing.

SMALL TOWN CHARM, BIG CITY SERVICES

Redding, California, is in the northern part of the Golden State and home to about 80,000 people. The rural landscape of northern California has a much different feel than the big cities that dot the state. Redding is a close-knit community that values relationships. Most of Teamwork HR's clients are local to the northern California region, but a few have expanded and opened offices elsewhere.

Teamwork HR describes itself as a boutique PEO that takes a very hands-on approach with its clients. Team members visit client sites regularly to work with worksite employees, and some client employees still fill out onboarding paperwork in person at the Teamwork office.

This personal touch is a big part of the Teamwork HR identity and comes from the close-knit group of people who make up the company. Another unique aspect to Teamwork HR is that nearly the entire company is women, 25 out of 26 to be exact. Heidi says this didn't happen by design, it's just the way things have worked out over the years.

"We're all very similar: Nurturing, passionate, and connected to our community. We're really like a bunch of sisters who have a lot of fun but work hard, too," she says. "A lot of us are the primary bread

winners in our families, and we help each other a lot with things like babysitting and house sitting."

Heidi goes on to say that she's been fortunate to find such a great people to work with. In the hiring process, she's aware of how important the company culture is so she looks for dynamic applicants who share the same values and goals as her team does.

Humility and friendliness are big components of the Teamwork HR brand. Employment laws and rules are complex topics that often tell a business what it can or can't do. Heidi and her team try hard to approach these issues with clients as offering guidance and healthy recommendations rather than strict edicts they must follow. Teamwork HR acts like a partner with clients instead of distant advisors.

"I always ask new prospects if they want to continue being in business for themselves, but not by themselves," Heidi says. "Nine out of 10 say yes. We get to help entrepreneurs have healthy businesses and grow."

As the business of being in business has only become more complex, Teamwork HR has grown and continues to attract more and more business owners who have come to see that relying on a PEO is a no brainer.

Being heavily involved in the community has contributed more to the company's growth than anything else, Heidi believes. It's allowed the company to demonstrate that it cares about the people running the business and is truly vested in their success. It also helps create a positive culture within Teamwork HR that makes people want to stay with the company and attracts top talent.

> *The company's success is owed in part to its deep roots in the local community, which allow Heidi and her team to form strong relationships with businesses all over Redding.*

THE PANDEMIC: INTERTWINING GOALS

The COVID pandemic really intertwined Teamwork HR's main goals of helping businesses grow and serving the commu-

Top to bottom, left to right: Director of Human Resources Terri Beaudette, Regional Director Michelle Nystrom, Director of Finance Alanna Smith, Director of Operations Jennifer Kramm, Director of Safety Services Cheryl Maddox, and CEO Heidi Corrigan.

nity. Like many business leaders, Heidi's first priority was to equip her team with the tools and resources they needed to work remotely. They then went to work helping clients, doing their best to relay all the new information that was issued hour-by-hour.

Teamwork HR partnered with the local chamber of commerce to offer free webinars to the public about various COVID-related programs, rules, and requirements. Like many PEOs, Teamwork HR guided clients through the Payroll Protection Program (PPP) loan process. This is where the company's existing community relations with local banks became a lifesaver.

"We understood what information the banks would need for PPP loans, and banks even came to us to ask who they should work with," Heidi says.

Teamwork HR also organized a Facebook group that functioned as a community message board where local businesses could post information about modified operations, services, and specials. A member from Heidi's team would actually hold Facebook Live video sessions on location at local restaurants and businesses to help the owners tell their stories, advertise how they were open, and tell the community how they could support them. Many businesses in Redding are thriving today thanks to the dedication of the Teamwork HR team.

Of course, Teamwork HR participates in many other community-related activities, including organizing the largest community donation drive of the year, Give Redding.

"Every year we run Give Redding, which raises money for One Safe Place and the Good News Rescue Mission," says Heidi. "These organizations serve underprivileged families and victims of domestic violence. The event attracts many local businesses and people donate clothing, food, toys, and other goods for these shelters."

Teamwork HR is also the proud sponsor of a local Little League team and local sporting events. Heidi even had the distinct honor of running the snack bar for several seasons.

"Supporting our community shows our clients that we are invested in their growth and gives the community the opportunity to get to know us in a deeper

way," she says. "Clients trust us with the most critical parts of their business, so it's important that they know, like, and trust our team. Growing our community helps all businesses, which helps us and shows our staff we are dedicated to providing them the best possible place to live, work, and play."

GROWTH & NEW CHALLENGES LIE AHEAD

As hard as the last year and half has been, it's also been a growth driver for many PEOs. This is true for Teamwork HR. More businesses have become aware of just how hard it is to handle the business of being in business, which makes the value proposition of a PEO stronger.

Heidi and her team know this and have enjoyed a lot of growth and success as of late. However, this brings challenges, too. Remote work is more common now, which means worksite employees have started spreading farther and farther away. As a hands-on PEO, this trend goes a bit against Teamwork HR's culture, but the company knows it's a trend that will only accelerate.

The ongoing worker shortage also poses challenges, with more and more businesses requesting staffing services. Unfortunately, there just are not enough qualified applicants.

Heidi expects Teamwork HR to keep thriving as businesses realize that the best way to tackle these issues is to outsource HR to her team of trusted, knowledgeable experts. With a strong, fun, and smart team behind her, the next 20 years should be just as good as the last. ■

CHRIS CHANEY

Member Communications Manager
NAPEO
Alexandria, Virginia

FEDERAL APPEALS COURT PUTS FINAL NAIL

IN COFFIN FOR BUSINESS-FRIENDLY JOINT EMPLOYER RULE

BY JOHN M. POLSON, ESQ. AND MARTY HELLER, ESQ.

Laying to rest any doubt that employers would continue to enjoy a business-friendly interpretation of the standard to determine joint employment status, a federal appeals court recently put the final nail in the coffin of the Trump-era attempt to shield businesses from being considered joint employers in a wide spectrum of circumstances. This move clears the way for the current administration to cement into place a broad standard that captures a wide swath of business arrangements into the "joint employer" category. Nothing much is changed in the short term—the business-friendly standard had been on ice since a New York federal judge struck it down in September 2020 and on death watch since the new Department of Labor (DOL) proposed rescinding it altogether in March and formally pulled it in July—and businesses have been operating under the standards previously set by courts around the country since then. Now, you can anticipate that the DOL may take further regulatory action to return to standards similar to the Obama-era approach to joint employer status. What do you need to know about this October 29 court order?

WHERE HAVE WE BEEN?

By way of quick background, many businesses across the country celebrated in March 2020 when the DOL's new joint employer rule took effect. It created a four-part test to determine whether a business is equally liable for obligations under the Fair Labor Standards Act (FLSA), assessing whether the entity in question actually exercises its power to:

- Hire or fire employees;
- Supervise and control work schedules;
- Determine rates and methods of payment; and
- Maintain employment records.

The key to this updated new rule for many businesses was that they must actually exercise—directly or indirectly—one or more of these factors to be considered a joint employer, not just reserve the right to control.

The rule was only in effect for six months before a New York federal court judge struck down nearly all of the effective portions of the rule. He concluded that the DOL's new rule had "major flaws" and did not comport with the FLSA—mostly because it "ignored the statute's broad definitions" and inappropriately narrowed the definition of "joint employer." Specifically, the judge held that the rule's requirement that an entity actually *exercise* control

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over a worker to be deemed a joint employer conflicts with the FLSA, and that control is merely one factor courts and the DOL have and should continue to review.

NEXT BLOWS STRUCK BY THE DOL EARLIER THIS YEAR

With a new administration in the White House, it was no surprise when the DOL proposed formally rescinding the rule in March, indicating it was "unduly narrow" and ran contrary to many judicial decisions from across the country. That announcement from the DOL did not advocate for any specific standard to be applied, nor even describe a possible new standard. Instead, the agency said it would take public comments before determining its next steps. In July, the agency formally rescinded the rule.

WHAT HAPPENED?

Before the DOL unveiled any proposed new standard, the Second Circuit Court of Appeals jumped in. It was assigned the task of hearing the appeal of the September 2020 ruling that struck down the Trump-era version of the rule. The appeal was originally filed by the DOL, but a consortium of business advocacy organizations stepped into the government's shoes once the Biden administration assumed control of the agency to take up the fight.

In a terse one-paragraph order released Friday, the court concluded that the DOL's move to rescind the Trump-era rule was procedurally sufficient to kill off the appeal. It essentially concluded that the legal challenge was moot because the agency no longer supports the business-friendly version of the rule, and that the business consortium could not sufficiently breathe life into it. It ordered the matter to be returned to the lower court and instructed the judge there to formally dismiss the action once and for all.

WHAT'S NEXT?

There appear to be no further steps for the challengers to take, and you can pronounce the business-friendly interpretation dead once and for all. The runway is now cleared for the DOL in the coming months to issue a new proposed joint employer rule—which will undoubtedly have much more in common with the

Obama-era standards than anything we saw from the Trump DOL. In terms of what you can anticipate from the new DOL in the near future, you can look back to a January 2016 interpretation—"Joint employment under the Fair Labor Standards Act and Migrant and Seasonal Agricultural Worker Protection Act"—for an idea of what to expect. This Obama-era guidance signaled that organizations engaged in multi-participant arrangements—such as outside-party management, joint ventures, staffing services, employee leasing, temporary help, subcontracting, certain kinds of "job sharing," and dedicated vendors or suppliers—were directly in the DOL's crosshairs. The agency essentially said that it wanted to put as many of them as possible on the hook for any alleged wage and hour violations filed under the FLSA.

Again, Friday's court order doesn't result in any specific or immediate changes to the law. PEOs should prepare for coming sea change in enforcement and review current business practices, service agreements, onboarding, and other templates for compliance and potential joint employer issues. ■

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This article is designed to give general and timely information about the subjects covered. It is not intended as legal advice or assistance with individual problems. Readers should consult competent counsel of their own choosing about how the matters relate to their own affairs.

JOHN M. POLSON, ESQ.
Partner
Fisher Phillips
Irvine/Los Angeles, California

MARTY HELLER, ESQ.
Partner
Fisher Phillips
Atlanta, Georgia

RISK MANAGEMENT & INSURANCE ISSUES

BY FRANK HUANG, FCAS, MAAA

At the end of 2020, management consulting firm McKinsey & Company surveyed 899 C-suite executives about the impacts of the pandemic on business operations. One of their conclusions was that the pandemic had accelerated the adoption of digital processes by three to seven years, with B2B firms like those in the PEO space on the higher end of the spectrum.

I too have observed an uptick in initiatives by PEOs, with a particular focus in the area of risk evaluation for both workers' compensation (WC) and health benefits (HB). This trend is likely driven by the desire of firms to grow their client bases while improving speed to market and confidence in expected net revenue. While there is a wide variety of potential risk evaluation models, I'd like to touch briefly on the present state, two commonly adopted approaches, and one that I affectionately call the "Holy Grail" of models. For all but the last model, I will primarily speak through a WC lens, although the concepts can be applied to other coverages.

PRESENT STATE

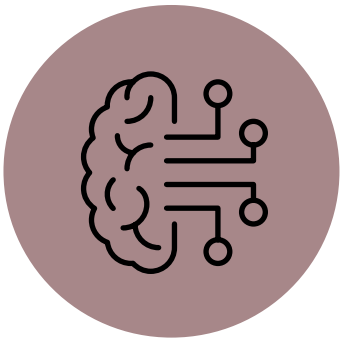
The present approach to evaluating risk in the PEO industry is too often one of least resistance and/or legacy philosophies. In my experience, this includes approaches as simplistic as beating the price of the incumbent or incorporating claims data in a way that may have been initiated years ago by someone who is no longer with the firm (e.g., the proverbial "black box" that no one understands). While the former appears the riskiest and depends on the accuracy and relevance of the incumbent's price, the latter may actually introduce more risk by suggesting an accuracy or rigor that is not actually there. For example, it is not uncommon to find outdated assumptions or incomplete model designs when reviewing a PEO's current model.

One of the models currently being adopted by PEOs has actually been used by many insurance companies for decades. This model uses traditional actuarial methods to estimate losses on an ultimate basis based on the mix of historical payroll, but also actual historical claims experience when credible.

AN ACTUARIAL STEP UP

One of the models currently being adopted by PEOs has actually been used by many insurance companies for decades. This model uses traditional actuarial methods to estimate losses on an ultimate basis based on the mix of historical payroll, but also actual historical claims experience when credible. The model considers a variety of factors when determining how much weight to give to historical experience, including, but not limited to, the size of the prospect and how many years of experience have been provided.

AI: NOT JUST FOR SELF-DRIVING CARS & FACIAL ID



We're used to encountering artificial intelligence (AI), or at least the application of AI, every day on our phones, in apps, on streaming services, and even in medicine. However, there are some more obscure but creative uses, according to a recent article by Rob Dods on the Medium website:

- Helping create new perfume scents, use alternative formulas, and develop efficiencies and environmentally friendlier processes;
- Identify and classify poetry and even write poetry based on learned patterns;
- Help athletes and coaches analyze performance by tracking movement of key points on athletes' bodies and predicting them in 3D; and
- Assess food for contamination and freshness to reduce food waste.

PREDICTIVE ANALYTICS

Where the actuarial-based model is arguably more intuitive but slower to produce a decision and/or risk assessment, a model driven by predictive analytics and artificial intelligence (AI) is less intuitive and quicker to produce a result. This is because such models do not need all the historical data required of an actuarial model and instead use a database of historical outcomes to predict a risk level. For example, where the traditional actuarial model may have required five years of loss runs and payroll reports in state and class code detail, a predictive model may only require more summarized attributes of the prospect to then draw upon the database of outcomes.

THE NEXT GENERATION OF RISK EVALUATION MODELS

In my experience, many PEOs evaluate the risk of prospects and existing clients by looking at each risk area independently. For example, a prospect may appear to have low WC risk but high HB risk such that the PEO chooses not to write the account, even if the potential WC benefit offsets the HB risk.

The next generation of risk evaluation models applies the predictive/AI-driven approach from the prior section to all risk sources simultaneously, thus considering the collective risk of the prospect. From this vantage point, PEOs can potentially improve speed to market and better match their risk appetite with that of a prospect. My understanding is that very few PEOs are currently using such an approach, with the largest PEOs most likely to be closest to its adoption. Such

an approach may become commonplace within the next three to five years.

SOME FINAL THOUGHTS

While it's simplistic to say that smaller firms are at the lower end of the spectrum of sophistication while larger firms are experts in predictive analytics, the reality is much less black and white. I've seen some of the largest firms use relatively rudimentary approaches and smaller firms be huge proponents and users of predictive analytics/AI.

What is becoming clearer is that those in the PEO industry have been nudged into greater adoption of analytics thanks to the COVID pandemic. Firms that adopt early will reap the benefits, with "fast followers" hoping for similar outcomes and minimal negative adverse selection.

POST SCRIPT RE: ANALYTICS/AI FIRMS

Not surprisingly, there are a number of consulting and analytics/AI firms providing their services to those in the PEO industry, each touting a custom-tailored model specific to your firm's needs. Take the time to vet out their claims by asking straight-forward questions. For example:

- How well do they understand the PEO model?
- What will their model provide?
- How did they obtain the data that is being used to train their models?
- How similar is that dataset to your intended use?
- What type of predictive/AI model is being used?

On this last note, many firms will be reluctant to share such proprietary details, but it is helpful to know as much as possible what engine is under the hood of the car you are buying: a 4.0 L V8 or a 1.2 L 3-cylinder. ■

1 www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/how-covid-19-has-pushed-companies-over-the-technology-tipping-point-and-transformed-business-forever.

FRANK HUANG, FCAS, MAAA
Senior Consulting Actuary
Merlinos & Associates
Peachtree Corners, Georgia

> *Those in the PEO industry have been nudged into greater adoption of analytics thanks to the COVID pandemic.*

SELLING A PEO
A PROCESS PRIMER

BY STEVEN NIGRO

Investment bankers sell companies by running a "sales process." This process includes becoming knowledgeable about a company's business, finances, and operations followed by analyzing that information, preparing marketing information, evaluating and contacting the buyer market, reviewing and negotiating offers, conducting due diligence, and negotiating the transaction documents. And then the transaction closes.

I think I got it all there, but I have 850 more words to go so let's dig deeper and perhaps simplify, if not demystify, this process and provide a roadmap for maximizing your PEO's value and increasing the probability of closing a transaction.

Let's start by thinking outside the box, or in this case "outside the process." If sellers thought of selling long before the process begins, investment bankers' jobs would be significantly easier. Establishing protocols, standardizing information, collecting data, and documenting processes around a potential sale—long before that sales process starts—will increase the likelihood of success in the form of certainty to close as well as an uptick in valuation.

To do this, let's think backwards from the process and prepare from there. I'll describe each part of the process and then provide some advice about how to proceed.

THE PROCESS

Gathering & Analyzing Company Information

The objective here is for the banker to familiarize him or herself with your PEO to best position and present you to buyers. Financial, organizational, sales and marketing, employee, and operational information is gathered.

Preparing the Confidential Information Memorandum (CIM)

This is a detailed profile of your PEO. It starts with an overview and then provides a business description including key operating statistics, investment considerations, founder and key personnel biographies, market information, and financial information.

Evaluating & Contacting the Buyer Market

It is not difficult to create a list of potential buyers for your PEO, but give careful consideration to finding the right match. Investment bankers are in touch with financial and strategic buyers and should have a firm view of their investment appetite. Then they should explore what you, as a seller, want from the transaction. It's then that you select those buyers whose appetites match yours.

As for "contacting" these buyers, we mean first introducing your PEO on a no-name basis, signing a non-disclosure agreement (NDA), and furnishing the CIM. Typically, the investor will contact the investment banker with commentary and questions. The banker might at that point provide valuation and structural guidance and communicate seller desires and preferences. There are times during this phase when a management call or meeting makes sense.

Evaluating Potential Offers

Some buyers pass on the opportunity. But enough about them. Interested buyers will typically make an initial offer in the form of an indication of interest (IOI). These are broad expressions typically with a valuation range. They typically provide a basis for narrowing the investor pool to a select few and beginning a second round of discussions. During that time, buyers and sellers get to know each other and compare goals and objectives. This is done in management meetings where you (as the PEO seller) discuss your business in person.

This part of the process culminates with the letter of intent (LOI) that

contains a more precise description of the proposed deal terms. It is this document that forms the basis for choosing the buyer. As a note, since the pandemic began, face-to-face interaction between buyer and seller has been a challenge. Dinners are better than Zoom calls.

Performing Due Diligence/ Quality of Earnings

This is the confirmatory part of the process. Buyers dig in asking for detail about all aspects of the business. They review and get comfortable with the accuracy of the information provided that formed the basis for their offer. Your investment banker will help you through this, setting up and maintaining a data room and fielding additional inquiries. It is also your time to get to know the buyer team better; to understand its approach and thought processes.

Definitive Documentation

This phase involves translating intents, objectives, value, and structure into purchase agreements, employment agreements, and other deal documentation. I can assure you issues will arise and be resolved. While not as fun as the rest of the process, your attorneys and investment banker will guide you through this phase.

THINGS TO START NOW

As promised, here are some ideas you should start now, pre-process. First, instill a process in your organization to create a data room and populate it, say quarterly, with the information an investment banker will ask for. Review it periodically asking whether this fully describes your PEO.

Next, prepare your own confidential information memorandum and keep it current. Combine your marketing materials, financials, and biographies. Prepare a description of your business that draws on the information you are accumulating. In the memorandum, craft a section called "Core Competencies

and Investment Considerations." These are paragraphs describing "why you?" This document evolves and you are likely to learn a lot about your business by doing so.

Start to think about what you want as seller, what you want for your employees, and what you want post-deal. There are loads of alternatives. You may want to continue to build in a larger organization or it may be time for an exit.

Finally, speak to an investment banker. Speak to one because it is never too soon and it's my guess that investment bankers might be more than happy to provide advance guidance and market intelligence in the hope that when you do sell, you might engage them. ■

KNOW THY PEO

NAPEO's 2021 Financial Ratio & Operating Statistics Survey is an invaluable benchmarking tool for your PEO. The report includes an executive summary and financial ratios covering:

- Volume;
- Profitability;
- Liquidity; and
- Coverage.

Operating statistics include:

- Benefits;
- Pension plans;
- Sales;
- Client service;
- HR;
- Payroll; and
- Technology.

Data is presented for a variety of company size categories and spans eight-plus years of data. *Note: This report is free to all PEO member companies who complete the survey, new PEO members, and associate members.*

STEVEN NIGRO
Managing Partner
TAG Financial Institutions Group, LLC
New York, New York

ILLUSTRATION © NOUNPROJECT

10 WAYS MARKETING & SALES CAN TEAM UP TO BUILD A ROBUST SALES PIPELINE

BY DEAN MOOTHART

Traditionally, many PEOs have relied on their sales teams to generate leads and build sales pipelines to support company revenue growth objectives.

Many organizations are finding that this model isn't sustainable in this challenging post-COVID business environment. The sales team's prospecting efforts are yielding fewer and fewer meetings with new prospects. This results in fewer proposals being presented, fewer deals closed, and ultimately, anemic (or even flat) revenue growth.

SALES CHALLENGES

Cold calling has always been a numbers game. It used to be that a salesperson could make 100 dials to talk to 10 prospects and schedule three meetings. It's still a numbers game, but the numbers are just getting bigger. Today, salespeople have to make more and more calls to talk to fewer and fewer qualified decision-makers. There is a myriad of reasons for the decline in prospecting performance, but the two most significant are virtual workers and technology.

Virtual work environments are making it more challenging to locate and connect with decision-makers. It's no longer a given that you can call a switchboard and get transferred to a decision-maker. The executives PEOs are targeting are no longer in their offices. Instead, they're working from their dining room tables, cars, or even coffee shops. Further, even if they're in the office, ubiquitous technology like voice mail, caller ID, and email spam filters are making it easier for prospects to avoid salespeople.

MARKETING & SALES TEAMWORK

Just because prospecting is more challenging doesn't mean that salespeople should stop their prospecting and networking efforts. However, for PEOs to maintain consistently robust sales pipelines, it's time to work smarter. Marketing needs to offer additional support. Below are 10 ideas marketing should be deploying to help supplement the pipeline development activities of the sales team.

Help your prospects find you online by creating and publishing keyword-optimized thought leadership content (blogs, eBooks, case studies, whitepapers, webinars, etc.).
Your content should be educational, informative, and position your company and sales team as subject matter experts.

Map your content to the various stages of your buyer's journey.
This requires that you change your focus from selling your prospects to helping them. Many decision-makers don't understand what a PEO is or the value a PEO can have on their businesses. They're

in the awareness stage, and they need to be educated. Whitepapers, eBooks, and webinars can be beneficial. Prospects in the consideration stage are actively evaluating solutions, so checklists, buyer guides, and one-pagers can help. The final stage is the decision-making stage. You can help your prospective client by providing case studies and return-on-investment (ROI) models.

Remove friction from the sales process by providing relevant calls-to-action (CTAs) for your website visitors.
Take your prospects "by the digital hand" and escort them to the next best step in their buying journey with suggested resources. Then capture insights and intel for your sales team by embedding lead capture forms into your CTAs.

Your online content and resources are only as effective as the audience who finds it and consumes it.
Be active on social media to promote the content, build an audience, drive traffic, and generate leads.

Execute email campaigns to your known universe of prospects and referral sources to promote newly published content and CTAs.
This includes prospects who have "gone dark" or even previously told you "No." It's amazing how a new resource with fresh insights can breathe life into old dead leads.

Not every lead you or your sales team generates will be ready to buy.
Remembering to periodically touch base with them can be overwhelming. Leverage technology to instill discipline into the process. Automated workflows will help you nurture "not-ready-to-buy-yet" leads over weeks, months, and years to ensure they don't fall through the cracks.

Every industry and every company think they're different and special.
Identify target vertical markets so you can convey customized messaging that communicates your unique value and allows you to take advantage of your firm's proven success.

Many PEO salespeople simply don't know what to say to a prospect who hasn't responded to their first email and voice mail message.
They waste countless hours crafting and composing the next sure-hit message. Help them save time by creating customizable one-to-one email/voice mail templates and sequences that sales can use to communicate with target prospects and facilitate the first meeting.

Cold calling often feels like you're trying to 'boil the ocean.'
If sales team members are investing time in outbound prospecting, help them target their efforts to increase the likelihood of success. Deploy tools that provide the sales team insight into who is engaging with your company digitally—opening your emails, visiting your website, etc. This level of intelligence can help your team prioritize its prospecting activities and warm up cold calls.

Don't do any of this in a silo.
You can avoid the typical finger pointing between sales and marketing if you engage the sales team in the lead generation planning process. Involve team members in strategy discussions, brainstorming campaigns, and content ideas. When they're involved in the process, they'll be more likely to provide feedback that will help optimize future marketing performance. ■

SALES STATS

Knowing these statistics, says an article by Brian Williams, PhD, on the Brevit website, can help you improve your sales performance:

Most customer interactions—**92 PERCENT**—occur over the phone;

You need to try **EIGHT COLD CALLS** before you reach a prospect, on average;

A good chunk of business—**30 TO 50 PERCENT**—goes to whichever salesperson responds first;

SOCIAL MEDIA USE BOOSTS SALES: 78 PERCENT of sales professionals who use social media sell more than their peers;

Customers who say they would provide referrals: **91 PERCENT**. Salespeople who ask for referrals: **11 PERCENT**.

DEAN MOOTHART
Director, Client Solutions
LeadG2 by The Center for Sales Strategy
Tampa, Florida

UNUSUAL LABOR MARKET FLATTENS PEO INDEX AGAINST GDP

BY JOHN J. SLAVIC

The PEO Employment Index comprises 149 PEOs, 2,000 PEO worksites, and 160,000 worksite employees. It measures the expansion or contraction of PEO worksites through the bi-weekly census data that is collected through the 401(k)-contribution process. Unlike many economic reports that consist of survey data and consequently can be somewhat subjective, the PEO Index is real-time data of actual hiring and terminations at the worksite level. Historically, the PEO Index illustrates the PEO advantage for small and medium-sized businesses over the unemployment rate. The index has highly correlated with this year-after-year. This correlation is intact, as you can see from Figure 1.

Figure 2 illustrates the correlation between the index and gross domestic product (GDP). The value of this correlation is predictive. Because of the strong, although not perfect, correlation, the index now demonstrates some uncorrelated behavior, as you can see by the flattening of the index, while GDP continues to strengthen.

There are several possible explanations for this unexpected flattening, all of which have to do with the highly unusual labor market following the COVID shutdown and delta-variant upsurge in recent months. First, many small businesses at the lower end of the wage spectrum, such as hospitality and leisure, had a difficult time hiring when federal government relief checks kept many people at home. It's quite difficult for small businesses to compete in the labor markets with the virtually limitless resources of the federal government, hence hiring is very difficult.

FIGURE 1. PEO CLIENT COMPANY PERFORMANCE COMPARED TO UNEMPLOYMENT, 2016 THROUGH 2021.

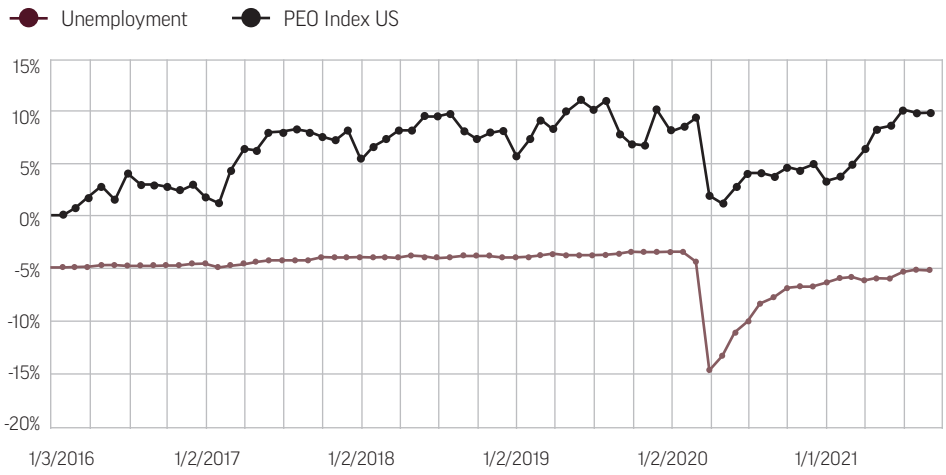
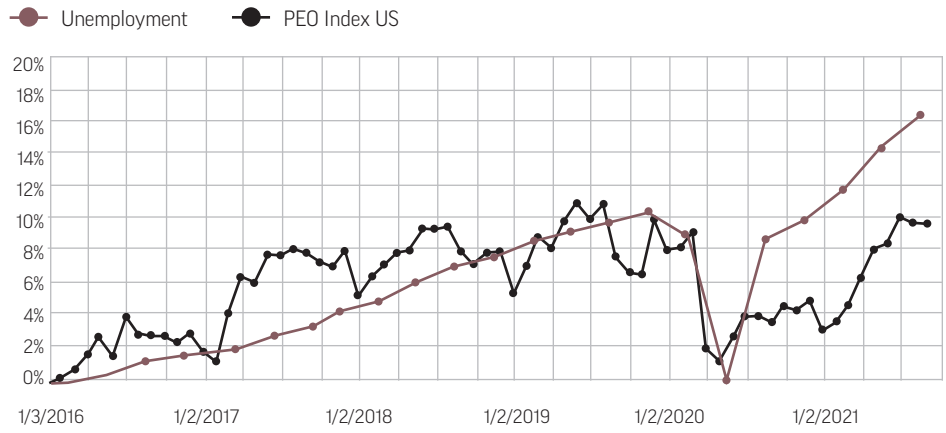


FIGURE 2. PEO CLIENT COMPANY PERFORMANCE COMPARED TO THE GDP, 2016 THROUGH 2021.



Second, the pandemic has caused a widespread exit from the labor markets. Here are two examples: According to the U.S. Bureau of Labor Statistics, women have left the workforce at four times the

The pandemic has accelerated ambient trends already present in the work environment in pre-pandemic years.

rate of men and are not looking to return; and "Baby Boomers" have opted for earlier retirement than previously planned. Consequently, the labor force has shrunk, making the supply of workers less and making their pay more.

Third, the pandemic has accelerated ambient trends already present in the work environment in pre-pandemic years. Remote work has changed the job selection process for the worker and the hiring process for the business. Essentially, this dynamic has weakened the employer/employee relationship, making job-switching far more prevalent. This factor combined with job requirements becoming far more tech-oriented makes hiring especially difficult in this environment. This challenge represents an opportunity for PEOs to deliver a new value proposition to small and mid-size businesses. ■

The PEO Employment Index is based on the census data of 9,000 PEO worksites, 160,000 worksite employees, and a cross-section of 125 PEOs. This data is collected weekly, compiled quarterly, and then weighted and processed to create the index. Wage, retention, and hiring and firing data are measured worksite-by-worksite, creating a gauge by which the strength of PEO client companies is measured.

JOHN J. SLAVIC

CEO & President
Slavic401k
Boca Raton, Florida

AD INDEX

Artex Risk Solutions, Inc. 52

Barrow Group, LLC 35

Enterprise HR 44

McHenry Consulting 41

PEO Velocity by Compass/PRM 33

Poster Guard® Compliance Protection 11

PrismHR 37

Pro Software, LLC 6

Slavic401k 2-3

Stonehenge Insurance Solutions, A Gallagher Company 40

SUNZ Insurance Company 9

ThinkWare Corporation 51

U.S. Risk, LLC 38

Worklio 26-27

Boldface type indicates NAPEO Medallion Partner

ROLLING WITH THE CHANGES

BY PAT CLEARY

For those few brave souls—other than Christina Nelson—who wade through my column every month, you've read about how our world here at NAPEO has changed, as it has with all of you. When asked during the Board of Directors retreat in July "What has the pandemic changed?" board members, to a person, said they ventured into areas they hadn't previously worked in, and they and their staffs were all working very long hours to be responsive to their clients.

To that, we at NAPEO would add that we had to change the way we delivered information and education. Long content with in-person meetings, we had to pivot to the virtual world. You've probably heard me say that in 2019, we did 13 webinars, with an average of 100 people per webinar. In 2020, by March we had done more than that, with an average of 500 people per webinar. Indeed, on the first tranche of webinars about the Coronavirus Aid, Relief, and Economic Security (CARES) Act and the Payroll Protection Program (PPP), we were routinely putting 1,000 people on every webinar, shattering turnout records with every new session. Between 2019 and today, our database has swelled from 3,500 to 6,500 souls—not quite a doubling, but a pretty significant increase. Through it all, the number of our stalwart staff has remained at 18.

In 2019, we also undertook a review of our dues structure, honchoed by Mark Perlberg. Ultimately, the board unanimously approved an update to our dues rates to take effect in 2022.

Back to the retreat: During our discussion, the board acknowledged the significant increase in the load on the staff here and urged us to add some bodies, which we intend to do. At our board meeting in December, we will present a budget to the board that will increase our headcount by a few in areas where we desperately need bandwidth, not the least of which is in meetings and in government affairs. When you go online to calculate your dues (**napeo.org/membership/dues-calculator**), you may notice a slight increase. But I want to say two things very clearly: First, every penny of your dues is put into growing this industry, by promoting it and by removing barriers to growth; and second, as I said at our annual meeting, speaking about my team here—and not me—they are worth every penny. I have never been more proud of them than I was in 2020 and 2021. They worked very long hours and we delivered content immediately, so you could respond to the barrage of questions from your clients. And, it worked. In the white paper released at our conference in September, you see how much better PEO clients fared during the pandemic than small businesses overall.

> *Between 2019 and today, our database has swelled from 3,500 to 6,500 souls—not quite doubling, but a pretty significant increase.*

That was thanks to you, and thanks to our team getting you the info you needed as fast as we possibly could.

In my 10 years here, I have seen this industry grow little by little. But stepping back, we see spectacular growth over the last decade, with the same number of staff. We need to prepare for more growth and we need to staff for a growing and vibrant industry.

With your help, we'll do exactly that. ■

PAT CLEARY
President & CEO
NAPEO
Alexandria, Virginia

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- Variance Processing for Anomalies
- One Click Payroll Processing

Interactive Process Communication
- Multiple Approval Processing
- Robust Notification System for Entire Process
- Easy Dashboard view for Progress Tracking

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