

purchased Computer Payroll Company and Infinisource (COBRA and FSA administrator) acquired Priority Pay.

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

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

The financial model

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

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

This formula impacts the market in several ways. As a method of differentiation, benefits brokers have been subsidizing some of these services as a way to attract new business for the past 10 years. (I will not discuss rebating laws here. That is an

other article.) If you are a payroll company or some outsourcer, and you are losing business to a firm providing "free" payroll, you have one of two choices. Either you can get the firm subsidizing the payroll to subsidize your payroll, or you need to get access to the bucket of money subsidizing payroll.

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

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

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

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

What should a broker do?

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

First, brokers must acknowledge that, in the small to mid-sized employer market,

many employers value the integrated technology and outsourced services more than benefits advisory services.

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

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

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

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

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

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

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