The Importance of Third-Party Providers in the PEO Model

Determining Provider Capabilities

Rob Comeau

The PEO model is a hybrid of outsourcing and consulting provided to small and medium-sized businesses (SMBs). Ironically, a PEO itself also outsources some of its scope of offering to third-party providers. A PEO's scope of offering consists of internal elements combined with outsourced functionalities. The combination of internal and external capabilities makes up the full value proposition presented to the SMB.

Each PEO has variations in its scope of offering. Even PEOs with similar offerings may differ internally in how they execute their value propositions. Regardless of what is executed internally versus which aspects are delivered via a third party, partnering with top third-party providers is essential for an effective value proposition.

Typically, most PEOs provide this standard offering: human resources services, safety services, workers' compensation, health benefits, employer practices liability insurance (EPLI), payroll processing, technology, and retirement programs. Of these eight services, five involve third-party providers (workers' compensation, health benefits, EPLI, technology, and retirement vehicles). A PEO is generally involved with third-party providers in administering and supporting these five areas, but third-party providers most certainly have an impact on the offering a PEO provides to its clientele.

Evaluating Third-Party Providers

There is a very simple way to analyze and grade a third-party provider. The capabilities, financial factors, level of service, and cooperation of the provider become an extension of the PEO itself. If any of these areas are not at a desired level, the PEO value proposition loses value. If the value prop loses value, it may result in a reduction in new business, higher client attrition, lower profit, and price increases. The ultimate result is reduced revenue and profit growth.

Considering that a third party's capabilities, financial factors, level of service, and cooperation influence a PEO's profitability, it is important to review each section individually.

Capabilities

A service provider's capabilities may be defined as the provider's quality, features, and ability to deliver. In other words, what can the partner offer, at what level of quality, and can it consistently execute upon its offering? When comparing service providers for a function, the three aforementioned areas are essential in determining the value of the partnership. The fourth element is pricing. Ensuring a fair price with a service provider protects profit today. Ensuring the service partner achieves the first three elements protects profit tomorrow. One final thought is to ensure that the capabilities of the provider resonate with the PEO's client base. A provider may be outstanding, but if the PEO's client doesn't see value in the offering, it may be a misaligned partnership.

Financial factors

With many third-party relationships in the PEO world, both the PEO and the third party have an influence on pricing. For example, with technology providers, PEOs often receive a pricing break as the PEO scales. Moreover, with insurance carrier partners, the PEO's loss ratios and size play roles in the type of offering the PEO may secure along with the rates it is charged.

When a PEO selects the appropriate service provider and performs well internally, mutual gain is achieved and a symbiosis occurs. A PEO that has superior loss ratios with insurance protects the carrier's bottom line. As a result, the PEO may receive rate reductions on future premiums. This reduction in overhead may result in greater profit for the PEO. In contrast, a PEO that has poor client selection and risk mitigation strategies coupled with a carrier whose claims adjusters are overworked may result in poor loss ratios and subsequent rate increases. Neither party benefits from the latter and the clients also suffer a negative financial impact.

Level of service

The level of service a third-party provider provides may impact both the PEO internally and its clientele. If the third party has direct contact with the SMB, the level of service provided is a direct reflection on the PEO itself. If a PEO has a high standard of service with its clientele, but the client experiences poor service with the third party, the PEO brand equity suffers. During the sales process, the client didn't individually select all of the third-party providers it may work with—it selected the PEO. It is the PEO's responsibility to ensure its service partners are performing to the same standard as the PEO itself.

Poor service may impact a PEO internally as well. If a PEO has difficulty reaching a service provider or the service provider has a poor response time, it will reflect poorly on the PEO and frustrate the PEO's internal employees. An SMB expects timely responses. If a PEO is hamstrung on replying to a client due to a slow turnaround time with a service provider, the SMB will ultimately put the issue on the PEO.

Cooperation

William Edwards Deming, who is famous for the processes and philosophy that helped Japan become the world leader in automobile manufacturing after World War II, stresses the importance of cooperation as an essential function of business. In the PEO model, considering that five of the eight key elements often involve third-party providers, cooperation is essential. It is so important that some PEOs hire internal professionals to act as liaisons between third-party providers and the PEO. These liaisons may come in the form of insurance claims advocates, internal adjusters, or internal IT professionals.

Conclusion

When the aim of the PEO and the service provider is aligned, and each has complementing capabilities and similar service standards, the result is mutual financial gain and happy SMB clients. Every service provider will make mistakes. Every PEO will make mistakes. Evaluate the consistency and magnitude of the mistakes when reflecting on the relationship. Is a mistake an anomaly or the norm? Most important is how the service provider addresses the mistake—that will give insight into the longevity and value of the relationship. A PEO that has partnered with third-party providers who align with the PEO's vision, scope, and values will ultimately be a more efficient and profitable PEO. ●

Rob Comeau is CEO of Business Resource Center, Inc., Rancho Santa Margarita, California.