

Employment Outsourcing Models

Toward Better Compliance Management
in an Ever-evolving World

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Introduction

With many changes and advances in the HR function recently, it continues to evolve and take a more planned and strategic approach. However, the administrative burden involved in these changes continues to slow down the success rate of strategies. These administrative challenges become more acute and amplified when businesses expand rapidly or revamp their workforce structures to accommodate temporary workers.

In recent years, HR has undergone dynamic shifts in its roles, functions, and overall impact in shaping organizations. This shift has increased the complexities involved and to address these complexities, enterprises should partner with a service provider that can deliver the requisite human resources and administrative support.

Global/local expansion and addressing talent shortage are the primary motives for organizations to outsource HR administration services. Organizations wanting to expand their presence into new markets for competitive advantage or looking to gain access to a wider talent pool will end up incurring a substantial cost, coupled with risks and challenges of setting up a new entity in the geography and recruiting & onboarding employees.

Engaging with an employment outsourcing firm will provide enterprises an opportunity to test markets cost-effectively. The service provider will help businesses run and manage their operations smoothly by reducing the burden on the HR function, offering its expertise on country-specific regulations, as well as the ability to assess employee needs.

Additionally, such providers assist enterprises in hiring the right talent for the job, thereby helping in reducing the talent gap. The sourcing firm leverages its broad network of candidates and connections to present the client with qualified applicants based on the client's requirements. This helps enterprises find the right balance within their workforce mix to meet evolving business demands.

In this research, we study the following topics:

- Prominent employment outsourcing models – PEO, EOR, and staffing
- Key adoption drivers, services offered, and vendor landscape for different employment outsourcing models
- Key enterprise considerations
- Future market outlook

Employment outsourcing models

The pandemic brought global mobility to an unexpected halt, and it became increasingly necessary for enterprises to develop a strategy to hire and manage a globally diverse workforce. This further highlighted the need for employment outsourcing services, leveraging which businesses can gain access to required expertise in the fields of workforce management, payroll processing, and employee benefits.

As employment legislation, payroll, compliance, and even tax laws vary greatly from one country or state to another, enterprises face difficulties in successfully running a business while remaining compliant with local laws. Partnering with employment outsourcing providers helps reduce risks and liability while improving productivity, as outsourcing partners hold all necessary licenses, insurance, and registrations to employ and process employee transactions.

Based on the relationship between the service provider, employees/workers, and the enterprise client, an employment services outsourcing provider may fall into one of the below categories:

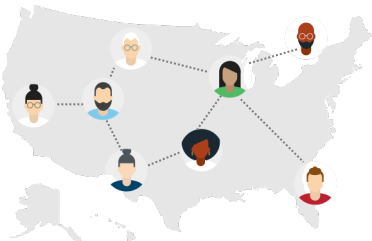


- **Professional Employer Organization (PEO):** In this model, the provider acts as a co-employer and is responsible for HR-related employer activities. This model is predominantly used for permanent employees but may occasionally be used when dealing with temporary employees
- **Employer of Record (EOR):** EOR is quite similar to PEO but is prominent outside of the US. It helps businesses engage with local and overseas workers. Providers in this space usually work with permanent employees but may occasionally assist organizations in hiring contingent workers
- **Staffing:** These providers help enterprises fulfill their temporary staffing needs and work with the candidates as well as the enterprise client to identify the best-suited candidate/s for a job

Exhibit 1 on the next page showcases the different employment services outsourcing service provider models.

Partnering with employment outsourcing providers helps reduce risks and liability while improving productivity, as outsourcing partners hold all necessary licenses, insurance, and registrations to employ and process employee transactions.

EXHIBIT 1**Snapshot of different models**

Source: Everest Group (2021)

Employment outsourcing model	Use case	Responsibilities and liabilities
PEO 	Small firms looking to expand in the US with limited HR resources and in need of HR outsourcing services for a state where no legal entity is present.	Assumes responsibility for the administration of time-consuming HR-related tasks such as payroll, benefits, compliance, and taxation; as a co-employer, PEO becomes as liable as the enterprise for the transactions it manages.
EOR 	Organizations seeking global expansion opportunities outside of the US; similar to a PEO with prevalence outside the US.	Handles payroll processing, tax deposits & filing, and employment contracts & paperwork; since an EOR is the actual employer, the liability lies with the EOR firm.
Staffing 	Organizations looking to hire temporary workers for short- or long-term projects; in certain cases, enterprises may source candidates in-house and require outsourcing services for managing administrative responsibilities.	Recruits employees and assigns them to organizations to fill in for worker absences, temporary skill shortages, seasonal work, and specific projects; the candidate is an employee of the staffing firm, and, hence, the liability lies with the staffing firm.

Professional Employer Organization (PEO)

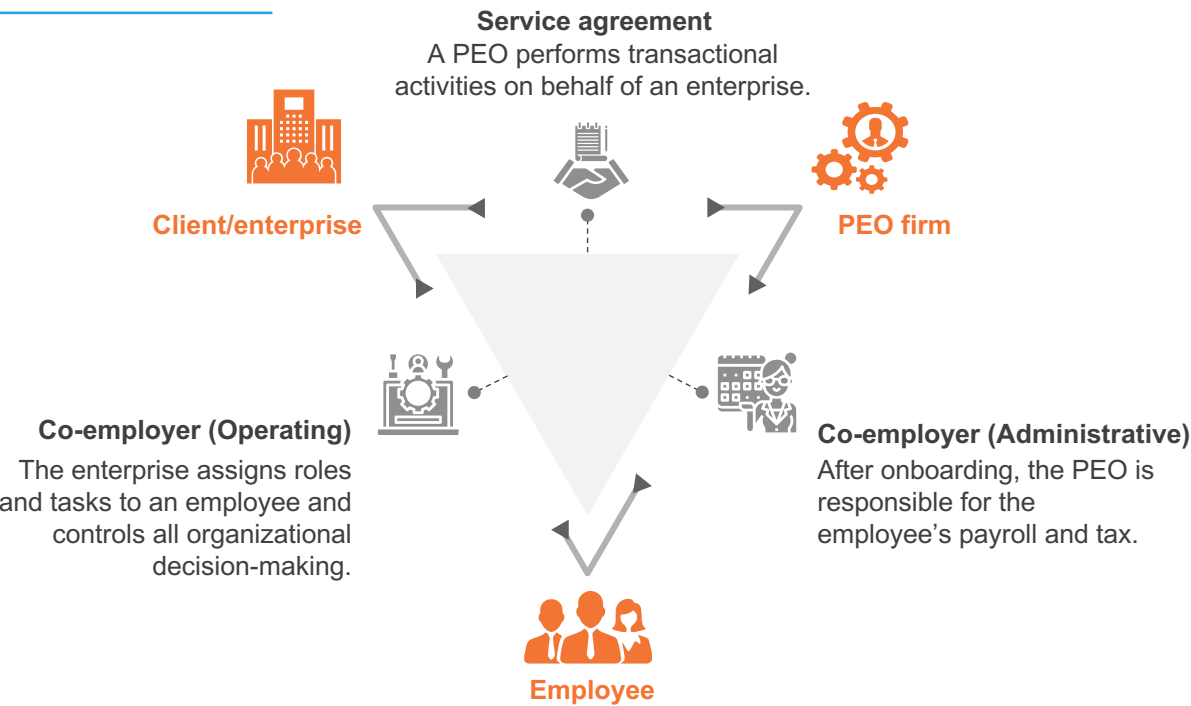
The National Association of Professional Employer Organizations (NAPEO), a non-profit firm that creates awareness about the PEO market, defines PEOs as service providers that offer HR solutions for small- and mid-sized companies. A PEO allows for the transfer of enterprise liability; each co-employer is responsible for certain employment obligations.

The enterprise administers the employee's day-to-day activities and tasks, while the PEO provides HR support so that companies can overcome operational obstacles to be more productive and gain a competitive edge over larger competitors.

The PEO model primarily exists in the US due to differing state laws and compliance regulations and helps companies expand their footprint across the country.


Exhibit 2 on the following page illustrates the relationship between an enterprise, a PEO firm, and an employee.

EXHIBIT 2
Relationship between an enterprise, a PEO firm, and an employee
Source: Everest Group (2021)




Key adoption drivers
The key drivers for PEO adoption are listed in Exhibit 3.


EXHIBIT 3
Key drivers for adoption of PEO
Source: Everest Group (2021)




Decreasing liability
As organizations engage with employees at multiple locations, it becomes necessary to ensure compliance with state laws. Since a PEO takes care of any compliance and legal issues that may arise, it reduces the enterprise's liability.




Evolving HR mandates
Enterprises looking to offload pressure on the HR function, engage with PEOs as they help reduce the burden of evolving HR mandates and dynamically changing regulations in different US states.



Attracting and retaining talent
When enterprises partner with a PEO, they can provide an extensive range of benefits to their employees. The partnership helps promote the organization's brand, attract new talent, and reduce attrition.



Reducing cost pressure
COVID-19 has hit the world economy hard and business owners are considering outsourcing their non-core functions to reduce the increasing cost pressures. As PEOs offer employee benefits at a lower cost, they were able to provide additional support to employers during these times.



PEO service offerings

While a PEO can provide a host of HR and related services, and leading PEOs offer end-to-end HR services, including data collection & reporting and consultative services & support, the services most often included in a PEO contract are:

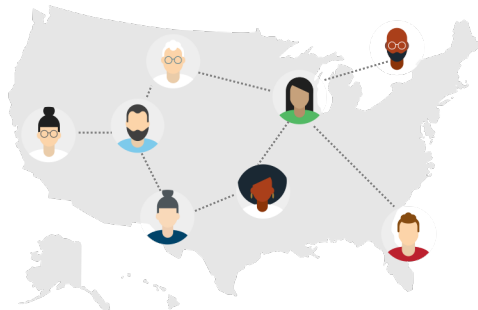
- Payroll services, including payroll processing and tax filing
- Employee benefits & insurance and pension & retirement plans/packages
- Compliance assistance regarding workplace & government compliance and legal support for the protection of employees and the enterprise
- Other HR services, such as recruiting, onboarding, compensation planning, and training & development

Vendor landscape

The sector’s longevity has enabled multiple players to flourish which can be classified into two categories based on the services offered.

Exhibit 4 depicts the PEO vendor landscape.

EXHIBIT 4
PEO vendor landscape
Source: Everest Group (2021)



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	Pure PEO players	HR and talent service providers
Key characteristics	<ul style="list-style-type: none">• These vendors provide only PEO-related services such as payroll & tax administration, employee benefits, workers’ compensation & risk management, and compliance & training• The major players in this space also leverage technology to bolster PEO operations. The platform delivers solutions for time & expense management and payroll & taxation	<ul style="list-style-type: none">• These players operate in the broader HR space and offer a host of services such as recruitment, onboarding, and consultative services, apart from those provided by a PEO firm• As they have expertise in a wide range of services, these providers often operate as an HR outsourcer and/or payroll provider
Vendors	<div>ENGAGE PEO</div> <div>TriNet Ambitions Realized®</div> <div>Inspurity Inspiring Business Performance®</div> <div>WorkSmart SYSTEMS</div>	<div>ADP</div> <div>BBSI</div> <div>CoADVANTAGE®</div> <div>PAYCHEX</div>

Partnership ecosystem

PEO firms also partner with other vendors with expertise in areas such as health and business insurance, legal services, employee benefits, Learning & Development (L&D), and HR software and tools. Some of these partnerships may also leverage staffing services, including recruitment and candidate screening.

Partnerships with firms such as Allstate Benefits, Bright Move, and Mercer help PEOs deliver better quality services and offerings to their clients/enterprises and ensure that the HR outsourcing tasks are handled by best-of-breed providers.

Employer of Record (EOR)

The next most prevalent employment outsourcing model is EOR, also known as global/international PEO or Global Employment Outsourcing (GEO), which is a third-party organization that undertakes the responsibility to pay an employee (permanent or temporary) on behalf of another company. The EOR is locally situated with an entity set up in that country and helps organizations expand into new markets without local infrastructure, along with providing compliant in-country payroll services and benefits.

While the EOR might be the registered employer, it does not have any management role vis-à-vis the employee's day-to-day tasks. It is solely responsible for hiring and onboarding employees, remitting salaries, carrying out taxation, delivering benefits owed, and extending in-country HR support. The actual employer (enterprise client) assigns tasks to employees and is the key decision-maker for activities related to compensation. An EOR can also help enterprises post an M&A activity to ensure that the transition is smooth for both the entities and the employees.

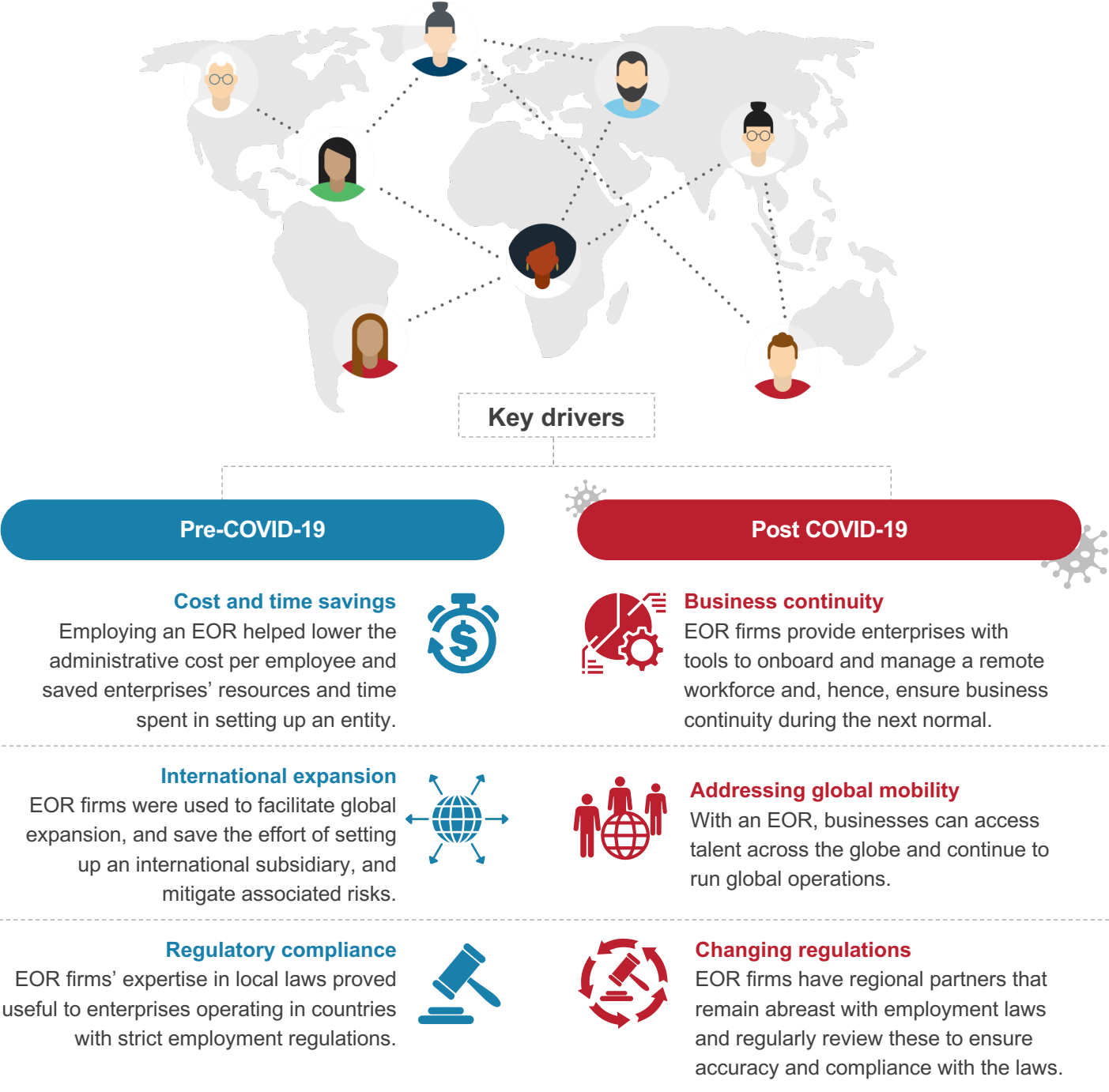
An EOR arrangement is primarily used for permanent employees, but it can also be leveraged for temporary workers, including independent contractors. An EOR may sometimes be involved in hiring local talent for the organization, as an in-house service or via a formal partnership with a staffing agency to provide recruitment and onboarding services to the enterprise.

Exhibit 5 on the following page lists the drivers of EOR adoption and compares them with the drivers before the pandemic.

An EOR assumes all responsibility to manage employees' onboarding compliantly without an existing onsite entity. This reduces the administrative burden and mitigates risk for the company.

Key adoption drivers

EXHIBIT 5
Comparison of drivers of EOR adoption pre- and post-pandemic
Source: Everest Group (2021)



EOR service offerings

The key services offered by EORs are listed in Exhibit 6.

EXHIBIT 6

Major services offered by an EOR

Source: Everest Group (2021)



Compensation and benefits

Offer workers' compensation and employee benefits based on country norms.



Compliance

Provide support on country-specific regulatory and compliance matters.



Entity setup and support

Help enterprises set up a global entity quickly and compliantly.



Payroll and HR administration

Manage global payroll, tax, and other HR-related services.



Talent acquisition

Tackle various aspects of talent acquisition, such as screening, onboarding, and off-boarding.



Visa and immigration services

Leverage relocation and immigration services and help with documentation and related services.

The EOR landscape and partnership network

As the EOR market is highly fragmented, it can be categorized based on the end clients served and/or industry. While several broad-based EOR firms serve both large and small businesses and cater to multiple industries, certain specialized EOR firms, such as MBO Partners and Innovative Employee Solutions, cater to the needs of freelancers and Independent Contractors (ICs), while firms such as The Team Companies serve clients from the advertising and entertainment industries.

Exhibit 7 included in the next page depicts the EOR vendor landscape and partner ecosystem.

EXHIBIT 7
EOR vendor landscape and partner ecosystem
Source: Everest Group (2021)

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EOR providers often partner with other providers in the HR outsourcing space and offer administrative services. These partners may also provide compliance and advisory services to clients and may fall into one or more of the following categories:

- In-country or local staffing providers
- Legal and accounting firms
- Insurance and benefits companies

Additionally, EOR providers may have partnerships with players in the HR technology space for leveraging solution capabilities such as Human Capital Management (HCM) and payroll solutions for their clients.

Staffing

A staffing agency/provider works with an enterprise to understand its hiring and skill requirements. Based on this information, the agency sources and screens candidates and is responsible for coordinating with the enterprise as well as the candidate/s. The selected candidates are employed as temporary workers, and the staffing agency is responsible for managing payroll and other HR-related services for the employee.

In contrast to EOR, which is solely responsible for payroll and compliance, a staffing vendor also oversees the employee’s development by offering training and opportunities. The agency also gathers feedback from the recruiter and assists job seekers to work on

their areas of improvement. Typically, staffing agencies offer temporary jobs, but, depending on client needs, they can provide candidates permanent jobs too. The hiring relationship can be categorized as one of the following:

- **Short-term hire:** fulfills clients' immediate requirements for a project in terms of a specific/specialized skill set (for example, any seasonal and/or temporary jobs)
- **Long-term hire:** possible when the client is planning a long-term investment or devising a growth plan or when an employee is on an extended leave of absence (such as maternity)
- **Temp-to-hire:** involves hiring a temporary worker on a trial basis; if the enterprise is satisfied by the performance delivered, the worker is hired full-time and becomes the client's permanent employee

Key adoption drivers

Exhibit 8 lists the key drivers for staffing services adoption.

EXHIBIT 8

Drivers of staffing services adoption

Source: Everest Group (2021)



Need for skilled talent

Enterprise clients want to ensure that they are employing the best candidate for the job. Staffing firms address this need by supplying employees who fulfill the specific requirements of a project.



Demand for managing temporary workers

With the evolving workforce landscape and changing skill requirements, the demand for temporary workers has been on the rise; however, most enterprises lack the ability to manage temporary workers compliantly, and, hence, the demand curve for staffing firms has been steep.



Cost and time savings

Engaging with a global staffing firm helps enterprises reduce HR, payroll, and administrative costs so that they can focus on the core business functions.



Risk mitigation

Due to COVID-19, there have been some major changes in employment laws, especially regarding contract termination. With staffing, this situation can be avoided, as the engagement is usually short, and the employee is registered with the in-country staffing agency.



Staffing services offerings

As staffing firms operate as the actual employer, they manage employees across the entire hire-to-retire cycle. Staffing agencies conduct hiring (candidate screening and selection) and other HR services for temporary workers, including onboarding, training, generating employment contracts, managing employment taxes, compliance, and legal procedures.

Staffing vendor landscape

Staffing firms can be categorized based on the range of services they offer. They could be broad-based staffing firms providing placement and staffing services across multiple professions, roles, and industries. Additionally, some specialized staffing firms provide staffing services for specific industries, such as IT and healthcare. Some staffing agencies, such as Randstad and Kelly Services, also operate in the IC evaluation and management space, offering similar services for independent contractors. Some of the leading HR and talent service providers, such as those in the managed services, talent management services, and Recruitment Process Outsourcing (RPO) space, also offer staffing services.

Exhibit 9 showcases the staffing vendor landscape.

EXHIBIT 9
Staffing vendor landscape
Source: Everest Group (2021)

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Key enterprise considerations

While PEOs, EORs, and staffing agencies have become an essential part of the HR ecosystem, as they offer multiple benefits to both enterprises and employees, they may at times face certain limitations when performing the required services. Thus, enterprises should be aware of their requirements and be wary of potential pitfalls. To realize the full potential of their partnerships with different market participants, enterprises should consider the following factors:



Legal risks

Cross-country agreements usually carry the risk of severe fines in case of a regulatory slip by any of the parties involved. In case of an EOR and similar models, the EOR firm is held responsible for such an error; while in the case of a PEO or the co-employment model, though the enterprise has reduced liability, it is still involved in legal proceedings.



Fraudulent activities

Since these models involve multiple stakeholders – the client, the service provider, partners, and employees – there is a higher chance of fraudulent activities between the several transactions made by the provider to the employee or vice-versa.



Communication challenges and lack of transparency

Due to the large number of stakeholders involved, communication has proved to be a key challenge in the entire process, as is the inability to maintain transparency in terms of the phases and steps involved and the work assigned.



Data privacy and security concerns

As these firms handle sensitive data related to both employees and enterprises, a robust security system is needed to protect the entities from confidentiality breaches. Any contract with a PEO, an EOR, or a staffing agency should follow data privacy laws and ensure that there is no related liability risk or data loss.

The road ahead

There is increasing urgency for enterprises to provide HR and other services cost-effectively to employees worldwide. Complexities around employment laws, HR administration, and the impact of COVID-19 have further necessitated action on this front. Consequently, service providers are working to improve their breadth of services, as well as the tools used to deliver these services.

The market has experienced increased activity and investments from organizations across industries. As the market grows, it will be interesting to see how it evolves over time along the following lines:



Regulations

Regulatory shifts are the key drivers for the market's growth and the COVID-19 pandemic has had an important play in this regard. Regulatory changes with an impact on the employment market have boded well for PEOs, EORs, and staffing agencies in recent times.

As the industry continues to grow, regulations are bound to increase and will, in turn, fuel the demand for these services and outsourcing partners.



Sophisticated tools and robust applications

As the market is evolving, providers are developing tools that are more reliable and offer greater personalization. With an increasing number of core HR outsourcing providers entering this space, the tools will become more intuitive and sophisticated to improve productivity and drive innovation.

Additionally, providers are also exploring next-generation technologies, such as automation, Artificial Intelligence (AI), and Machine Learning (ML), to execute certain functions that were earlier managed manually, and this trend is expected to continue.



Mergers & acquisitions and partnerships

In hopes of improving their market position and broadening the scope of services offered, more and more leading providers will partner with or acquire smaller specialized vendors, as has been the case in the past.

For example, in December 2018, Paychex, with expertise in payroll and benefits, acquired Oasis Outsourcing to advance its leadership position in the HR outsourcing space. Similarly, in April 2020, Randstad and AMN Healthcare joined hands to deliver talent solutions for workforce needs in the healthcare industry.



Evolving models

As the needs of enterprise clients evolve, employment outsourcing models will likely evolve to reflect these changes. EOR firms have already started offering services such as training & development, which they typically did not offer earlier. Such shifts and changes are likely to continue.



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