

Why do some small businesses offer retirement plans?

Prepared for Bank of America

Research conducted by

C E N T E R *for*
RETIREMENT
RESEARCH
at **BOSTON COLLEGE**



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This report was prepared for Bank of America by the Center for Retirement Research at Boston College.

Introduction

Why do some small businesses offer retirement plans?

At any given time, only about half of private sector workers in the United States are covered by an employer-sponsored retirement plan, and few workers save without one. As a result, many households end up with no retirement savings and entirely dependent on Social Security, while others move in and out of coverage throughout their careers and end up with only modest balances in a 401(k) account.¹

Numerous studies have shown that offering a retirement plan is closely related to firm size; firms with fewer than 100 employees are much less likely to offer a plan than larger firms. As a result, observers tend to dismiss small firms as a source of future growth in coverage. In fact, though, a meaningful share of small businesses do offer retirement plans. The purpose of this study is to identify the characteristics of sponsoring firms and their employees to determine which small businesses may be more likely to offer a retirement plan in the future.

The discussion proceeds as follows. The first section describes the limited information available from data sets that focus on the firms. The second section summarizes the information about firm coverage that can be gleaned from nationally representative surveys of employees. The third section explores why small firms don't provide coverage. The fourth section compares the quality of the coverage provided by small firms to that of large firms.

The final section concludes that, while many small firms offer retirement plans, existing data sets provide relatively little information — beyond firm size, industry, wages and employee education — about their characteristics. Some additional information emerges from surveys into why small firms don't offer plans, suggesting that financial uncertainty and lack of employee interest are real hurdles. Respondents also suggest that plans are too costly, but companies are often either poorly informed or misinformed about costs. Next steps

should be two-fold. First, the nature of plan costs should be clarified and publicized. Second, the most comprehensive survey dates from 1998, so a new survey would be invaluable.



Limited information from firm-based data sets

Before discussing the data challenges, it's useful to provide the lay of the land in terms of firm size and number of workers. As shown in Table 1, firms with fewer than 100 workers account for the vast majority of businesses and 35% of private sector workers. (Although later data are available, 2019 is used throughout for consistency.)

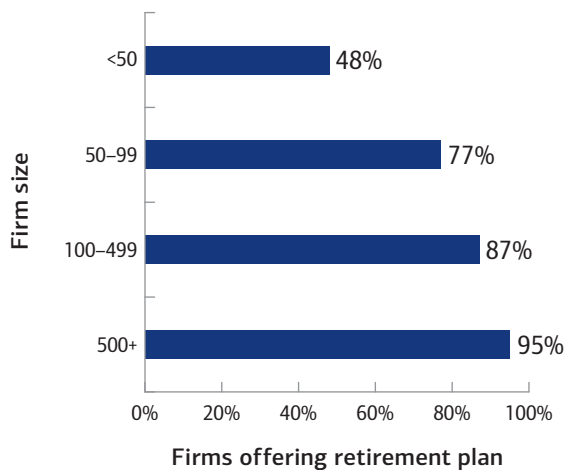
Table 1. Percentage of firms and of private sector workers by firm size, 2019

	Firm size			
	1–99	100–499	500–999	1,000+
Firms	97.5%	2.1%	0.3%	0.2%
Workers	35.1%	17.3%	7.0%	40.6%

Source: U.S. Bureau of Labor Statistics, *Business Employment Dynamics* (2019), Tables F and G.

The smaller the firm, the less likely it is to offer a workplace retirement plan. Ninety-five percent of the largest firms offer plans, while only 48% of the smallest firms do (see Figure 1).

Figure 1. Percentage of private sector firms offering a retirement plan, by firm size, 2019



Source: U.S. Bureau of Labor Statistics, *National Compensation Survey* (NCS) (2019).

Highlighting the characteristics of small firms that do provide coverage should be straightforward: Identify the small firms with and without plans and explore the extent to which various factors are related to coverage.

Several factors could affect a firm's decision to offer a plan:

- **Industry** — Small tech and law firms and others in the professional services industry may be much more likely to offer a retirement plan than a small retailer.
- **Average wage for the firm** — Presumably, higher-paid workers would have more ability to save and more interest in saving.
- **Health insurance** — Firms that offer other benefits, such as health insurance, may be more likely to offer a plan.
- **Firm age** — Newly formed businesses may be reluctant to offer a plan, but may see value in providing such a benefit as the company matures.
- **Financial performance** — A firm with strong profits is probably much more likely to offer a plan than a firm that is struggling financially.
- **Geographic location** — Small firms in urban areas or certain states may be more likely to offer a plan.

The problem is that no survey provides information on coverage by firm size in combination with other characteristics such as industry, age, average wage and provision of health insurance. The box below explains the limitations of a number of data sets explored for this project.

Alternative data sources explored

The following data sources were explored as sources for the analysis, but each contains several key shortcomings that prevent them from being fully useful.



Firm level

The Department of Labor's **Form 5500** offers a detailed view of plan finances and participation for firms offering a plan. The report, however, has limited firm-level information. For example, franchised industries are reported by headquarter location, and, by design, the report has no information on firms not offering a plan.

The Census Bureau's **Statistics of U.S. Businesses (SUSB)** doesn't contain information on retirement plan offerings but does provide information on compensation, total employment and the number of firms by industry, which, paired with coverage data from the Bureau of Labor Statistics' National Compensation Survey (NCS), can inform our analysis.

The Census Bureau's **Business Dynamics Statistics (BDS)** primarily measures annual job and firm creation and thereby contains information on firm size, age and industry. It doesn't provide information on retirement plan coverage, so the measures of firm maturity have limited application to our analysis. It's useful in offering insight into the overall firm universe but doesn't provide a unique advantage over other data sets.



Individual Level

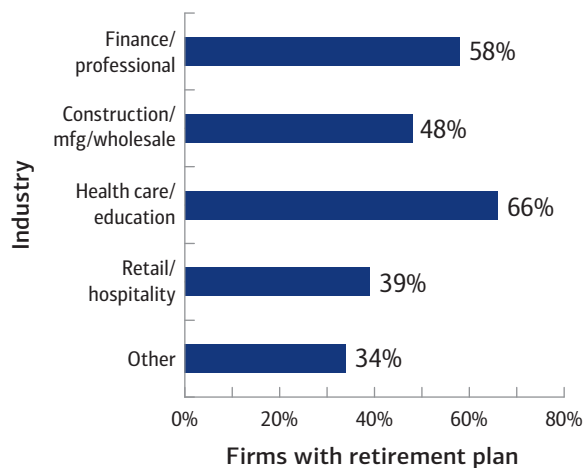
The Census Bureau's **Current Population Survey (CPS)** provides information on retirement plan coverage and participation for individuals, in addition to many demographic factors. However, since the survey's redesign in 2014, the CPS has consistently reported significantly lower levels of retirement plan coverage than all other surveys. Finally, this survey has extremely limited information on the characteristics of an individual participant's firm beyond its size.

The Federal Reserve's **Survey of Consumer Finances (SCF)** has detailed information on household finances and employment, including retirement plan coverage, balances and payouts. However, the survey design makes it difficult to distinguish between private and public sector workers, which is necessary for this analysis.

The one helpful firm-level data set, the NCS, which is the source of coverage by firm size, also provides coverage by industry (see Figure 2). (For simplicity, employment has been aggregated into five industry groups: finance and other professional and technical services [20% of private sector employees]; health care and education [19%]; construction, manufacturing, transportation and wholesale [23%]; retail and hospitality [23%]; and other, which includes the official "other" category plus agriculture, entertainment, and administrative support and waste services [16%].) The NCS, however, doesn't outline coverage by industry by firm size, making it impossible to say anything about the importance of industry for small firms.

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Figure 2. Percentage of firms with a retirement plan by industry, 2019



Note: The SUSB (2019) was used to weight industries to reduce the number of industry groups.

Source: The coverage data for each industry group come from the NCS (2019).

It turns out the only source for information about the types of small firms providing coverage is surveys of individual households.

Findings from employee data

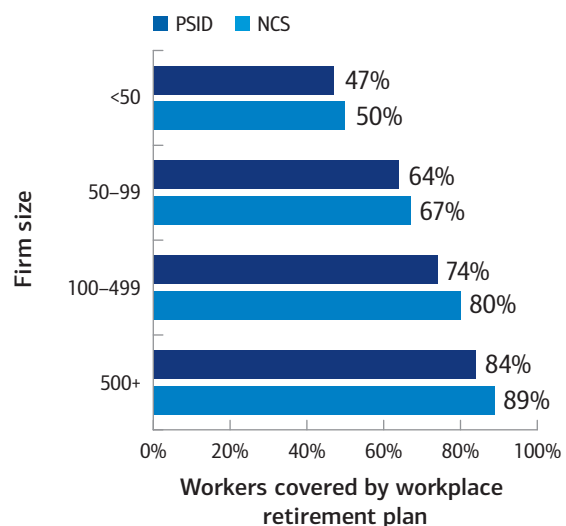
Two household panel surveys—the Panel Study of Income Dynamics (PSID) and the Survey of Income and Program Participation (SIPP)—provide information to identify some characteristics of small firms that offer retirement plans. The numbers reported below come from the PSID, although the SIPP produced comparable results.

The PSID asks the following questions regarding employment:

- Firm size
- Industry
- Whether eligible to participate in workplace retirement plan
- Whether participating in workplace retirement plan
- Years worked for employer
- Whether paid hourly
- Earnings

The starting point for the analysis is to determine whether the PSID shows the same pattern of increasing coverage by size. Indeed, the percentage of workers in the PSID with a workplace retirement plan increases sharply with firm size. The percentage is slightly below the numbers in the NCS (see Figure 3), which does ask firms how many of their employees are covered by a plan.

Figure 3. Percentage of workers covered by workplace retirement plan, by firm size (PSID and NCS)

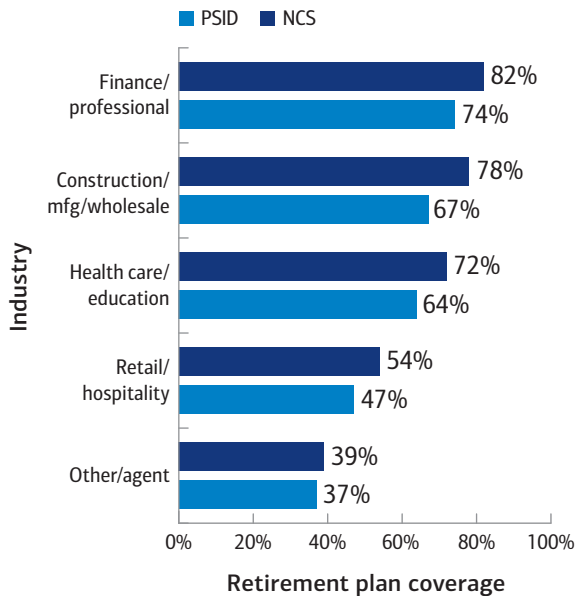


Sources: Institute for Social Research, *Panel Study on Income Dynamics* (PSID) (2019); and NCS (2019)

Similarly, the percentage of workers covered by industry from the PSID appears consistent with the percentage of firms offering coverage by industry from the NCS, although, as one would expect, the coverage rates are somewhat lower (see Figure 4). Not surprisingly, workers in industries that typically require a college degree, such as finance/professional or health care/education, have higher coverage rates. Similarly, industries with unions, such as manufacturing, utilities and construction, also have higher coverage rates. The retail and hospitality industry, by contrast, has among the lowest coverage rates.

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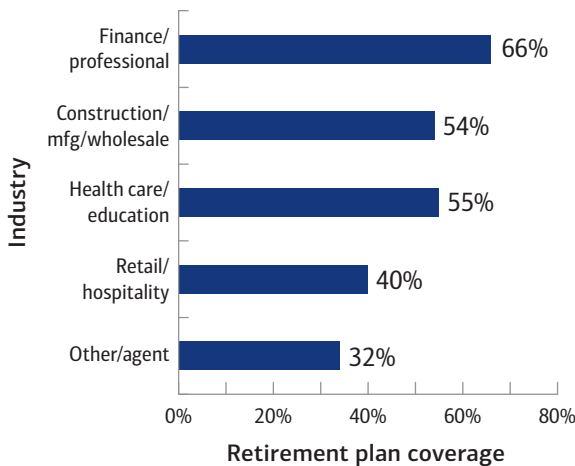
Figure 4. Retirement plan coverage by industry, all firms (PSID and NCS)



Sources: PSID (2019) and NCS (2019).

The next step is to focus on individuals working at small firms (those with fewer than 100 employees) and determine their coverage by industry. Although the coverage rates are lower than for the population as a whole, the pattern is similar (see Figure 5).

Figure 5. Coverage by industry for small firms (PSID)



Note: Small firms are defined as firms with fewer than 100 employees. Source: PSID (2019).

The PSID also, as noted above, provides information on firm size, earnings and tenure, which makes it possible to compare characteristics for covered and not-covered workers (see Table 2). Firm size does not appear to vary much by coverage provision, with the firms with coverage having only slightly more employees. Earnings, however, are an important differentiator — with those with coverage averaging almost \$70,000 compared to \$39,000 for those without coverage. Similarly, hourly workers constitute a much smaller share of covered employees than of those not covered. Finally, those with coverage had noticeably longer tenure than those without.

Table 2. Characteristics of individuals at small firms by coverage status

	Covered	Not covered
Firm size	29 employees	19 employees
Earnings	\$67,500	\$36,800
Paid hourly	58.6%	76.2%
Years of tenure	9.5	6.7

Note: Small firms are defined as firms with fewer than 100 employees. Source: PSID (2019).

In addition to earnings, the PSID provides information on the demographic and educational attainment of employees at small firms by coverage status (see Table 3). The big difference by race is that white employees constitute a larger share of covered workers than not-covered workers, while Hispanic employees constitute a substantially smaller share. Interestingly, Black workers have relatively similar representation across coverage groups. Women account for a smaller share of covered than not-covered workers. And, as one would expect by the earnings data, college-educated workers account for 43% of those with retirement coverage versus 27% of those without.

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Table 3. Distribution of employees at small firms, by retirement plan coverage

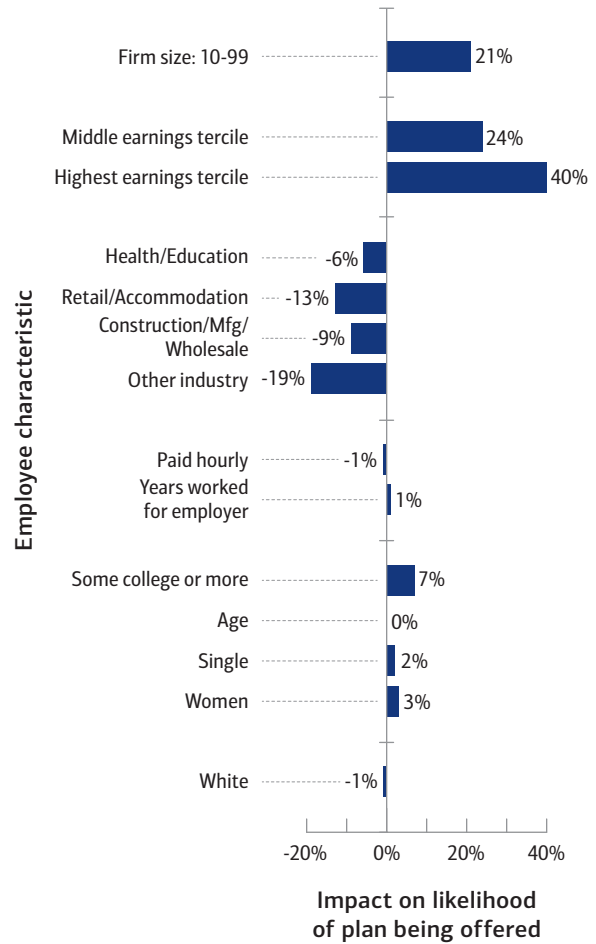
	Covered	Not covered
Race/ethnicity	100%	100%
White	68.4%	61.9%
Black	8.8%	8.8%
Hispanic	15.6%	23.8%
Asian	6.5%	4.1%
Other	0.9%	1.4%
Women	43.0%	48.5%
College-educated	42.6%	27.3%

Notes: Small firms are defined as those with fewer than 100 employees. The results presented in the table are from the PSID, but the SIPP shows similar results.

Source: PSID (2019).

Of course, many of these characteristics associated with being offered a plan are highly correlated. Workers in the professional services and financial sector tend to be college educated and high earners. So it may be that earnings levels are driving all the results. In order to disentangle the relative importance of various factors, Figure 6 presents results from a simple linear regression relating various characteristics to the likelihood of a firm's offering a plan.

Figure 6. Employee characteristic impact on likelihood of small firm offering retirement plan



Notes: Base case categorical variables are firm size <10 employees, bottom earnings tercile, finance/professional industry, high school or less education, and nonwhite. Regression looks only at employees at small firms (<100 employees).

Source: Authors' calculations using the PSID (2019).

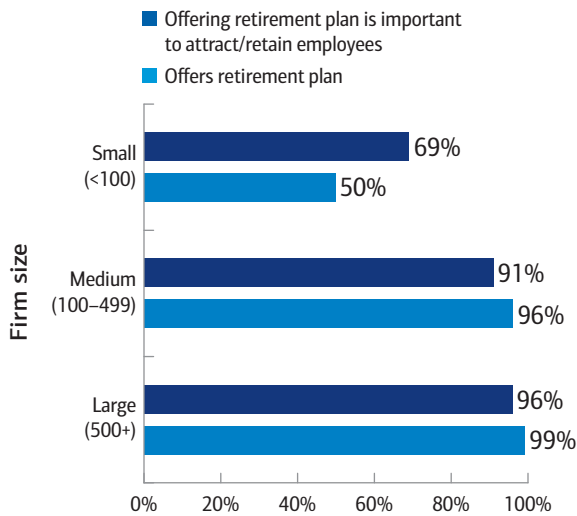
Interestingly, even though many of these factors are correlated, the earnings level of workers is not the only factor that determines whether a small firm offers retirement coverage, although it is by far the biggest factor. The size of the firm, the industry and the educational attainment of workers also have a statistically significant effect.

Why do some small businesses offer retirement plans?

Why are small firms less likely to offer a retirement plan?

While small employers are less likely to offer a retirement plan, most still believe that offering a plan is important for hiring and employee retention (see Figure 7). However, a significant discrepancy exists for small firms between the percentage thinking retirement plans are important and the percentage offering such a plan.

Figure 7. Percentage of employers that believe a retirement plan is important vs. percentage offering a plan, by firm size



Note: Employers who responded that offering a retirement plan is “very important” or “somewhat important” are included. The share of employers that offer a retirement plan includes those that offer defined benefit pensions and cash balance pensions.

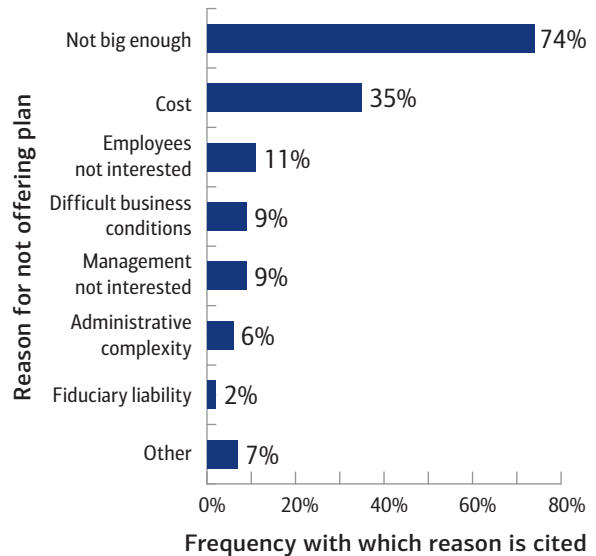
Source: Collinson, Rowey and Cho (2021).

The question is why, despite recognizing the value of a retirement plan, many small firms fail to offer this benefit. Identifying what firms view as impediments can help identify those small firms most likely to offer coverage in the future. Over the last two decades, three institutions have surveyed small firms about their failure to offer a retirement plan—Employee Benefit Research Institute (EBRI) (1998), the Pew Charitable Trusts (2017a, b), and

the Transamerica Institute (2016 and 2021). In these surveys, firms consistently cite three main barriers: the cost associated with establishing and administering a plan, uncertain revenues that make it hard for a firm to commit to a plan, and employee preferences for wages and other benefits.

Figure 8 shows the findings from the 2021 Transamerica survey. Employers can offer more than one reason, so the total exceeds 100%.

Figure 8: Most frequently cited reasons for not planning to offer a plan

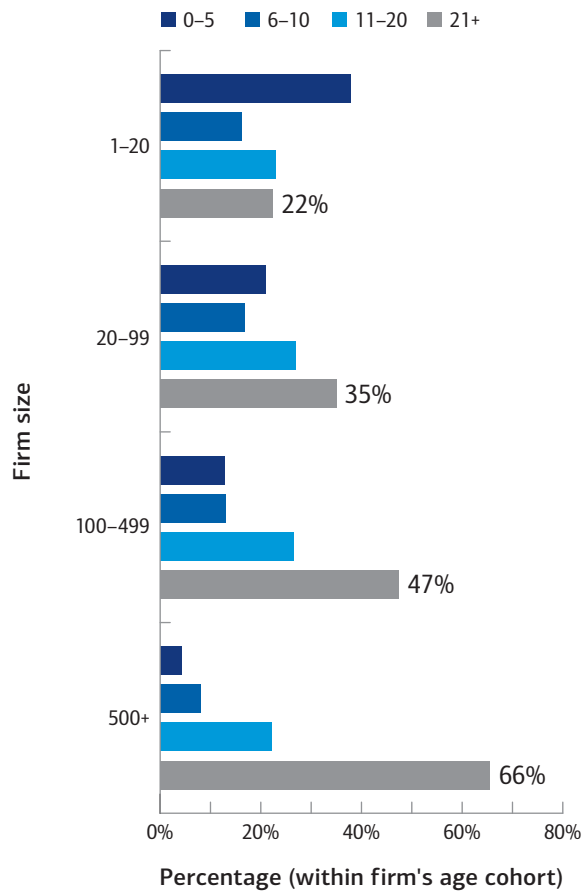


Note: Employers can offer more than one reason, so the total exceeds 100%.

Source: Collinson, Rowey and Cho (2021).

Interestingly, the No. 1 concern in the Transamerica line-up is that the firm is not big enough, which, combined with “difficult business conditions,” suggests that the firm does not feel well enough established to introduce a workplace retirement plan. Indeed, firms that have been in business for less than five years constitute the majority of small firms (see Figure 9). These firms may simply have too much on their plates to add an additional benefit.

Figure 9. Age distribution of firms by firm size



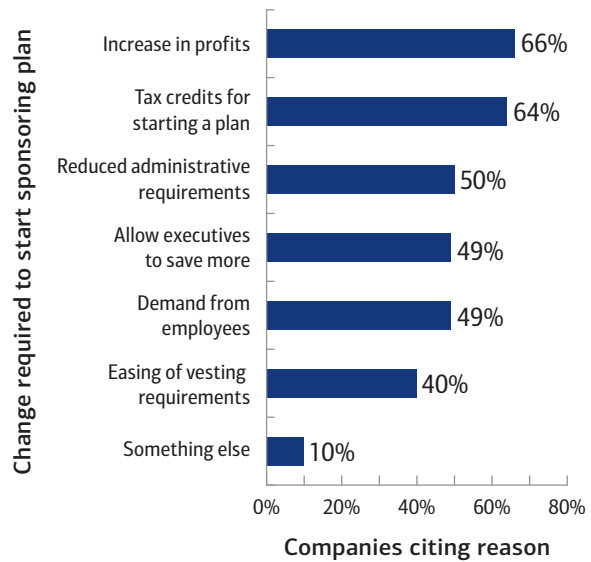
Source: U.S. Census Bureau, Business Dynamics Statistics (2019).

Cost shows up as the second-most-cited reason for offering a plan in the Transamerica survey and always ranks in the top three. The story here, however, is a little complicated. Historically, cost and administrative complexity have always been an issue for small businesses, but Congress has tried repeatedly to minimize paperwork, recordkeeping, reporting and fiduciary responsibility for these companies. The Revenue Act of 1978 established the Simplified Employee Pension (SEP), and 1996 legislation created the Savings Incentive Match Plan for Employees (SIMPLE). The EBRI and Pew surveys, however, both found that many employers were unaware of these low-cost options, and the EBRI survey also found that many didn't realize that an employer match was not mandatory in 401(k) plans. Thus, lack of accurate information may be a significant obstacle.

The final major reason cited by employers for not offering a plan is lack of employee interest. Earlier surveys showed that small employers without a plan had a younger workforce, experienced higher turnover and paid lower wages. It's reasonable to assume that these employees would prefer cash wages over benefits; they have bills to pay and don't see any obvious money left over for retirement saving. Employers have no interest in offering benefits that their employees won't appreciate.

Based on these surveys, several things would have to change in order for those companies not offering plans to become sponsors. According to the EBRI survey, an increase in profits was at the top of the list in 1998 (see Figure 10), and the most recent Transamerica survey, where business conditions were cited as the major impediment, indicates that it probably remains at the top of the list today.

Figure 10. Changes that might lead to plan sponsorship among small employers



Source: Yakoboski and Ostum (1998).

Why do some small businesses offer retirement plans?

The next two items pertain to cost. As noted, employers lack information about plan options and may well have a misguided notion of how much it costs to set up and administer a plan. Educating the small business community with simple numerical examples about the cost of plan options might be helpful. This approach may be particularly salient given the advent of open Multiple Employer Plans (MEPs), which allow unrelated employers that don't share a common industry or location to participate in a single retirement plan, thus reducing costs and

eliminating most fiduciary liability. Also high on the list is the need for employers to believe that their employees would value a retirement plan. Here the evidence from the auto-IRA initiatives in Oregon, California and Illinois may be informative. Even though lower-paid workers may not have thought they wanted a retirement plan, only about one-third of them have opted out, and testimonials suggest that many are grateful to have some money in reserve that they can either accumulate for retirement or withdraw in case of emergency.



What kinds of plans do small businesses offer?

The analysis so far has been based on a binary question: Does the small business offer a plan? In fact, firms have an array of plan types from which to choose. These options include traditional defined benefit plans, cash balance plans, 401(k) plans, and SEPs and SIMPLEs especially designed for small businesses (see box below).

Employer plans in brief

401(k) plan: Under a 401(k) plan, the employee agrees to have a percentage of each paycheck deposited directly into an investment account. The employer may match part or all of that contribution. The employee gets to choose from among a number of investment options, usually mutual funds, and bears the investment risk. The majority of private sector employer-sponsored retirement assets are in 401(k)-type plans (see chart below).

Traditional defined benefit plan: The employer makes pretax contributions into a trust, directs the investments and bears the risk. The employee generally doesn't contribute. Benefits are paid as an annuity at retirement and are insured by the Pension Benefit Guaranty Corporation (PBGC).

Cash balance plan: This is technically a defined benefit plan where the employer makes the contributions, owns the assets and bears the risk, and the plan is insured by the PBGC. To the employee, however, it looks more like a defined contribution plan, since the employer contributes to a notional account and provides an interest credit on the balances. Employees generally withdraw the balance as a lump sum when they leave or retire.

SEP: A SEP (Simplified Employee Pension), enacted in 1978, allows employers to make tax-deductible contributions to an employee IRA (up to the lesser of 25% of salary or \$57,000 per year). Unlike most employer-sponsored plans, employees are not eligible to make their own contributions to SEPs. Employers must make the same percentage contribution for all

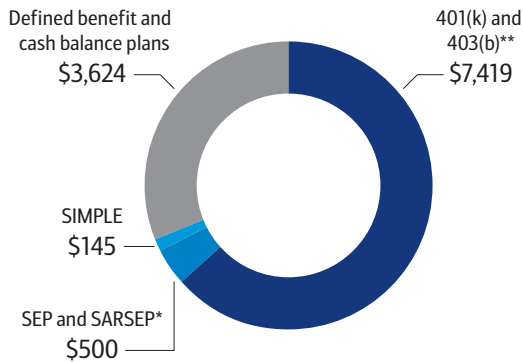
employees in a given year, but don't need to contribute every year. This plan may be attractive for self-employed workers or for small employers looking for a plan that is easy to administer.

SIMPLE IRA: The SIMPLE (Savings Incentive Match Plan for Employees) IRA, enacted in 1996, was designed to be a dramatically simplified 401(k)-type plan, holding assets in an IRA for each employee to spare the employer the responsibility of maintaining the assets in trust and overseeing the investment options. It lets the employer avoid nondiscrimination testing and standards, lengthy plan documents, summary plan descriptions and annual reporting. The SIMPLE is available only to employers with 100 or fewer employees and the self-employed, and firms can either match the employees' contributions or contribute a fixed percentage of payroll regardless of whether employees contribute.

“Open” MEP: A MEP (Multiple Employer Plan), which can be either a defined benefit or defined contribution plan, is administered by a sponsor on behalf of multiple employers. These employers can be related via mission or interest, as in a “closed” MEP; geographically connected, as in an “association plan”; or completely unrelated, as in an “open” MEP. Regular defined contribution or defined benefit plan rules apply, and most open MEPs are expected to be 401(k)s. MEPs offer employers cost savings through economies of scale and reduced fiduciary, investment selection and administrative responsibilities.

Why do some small businesses offer retirement plans?

Total private sector employer-sponsored retirement assets, dollars in billions, 2019



* Salary Reduction Simplified Employee Pension Plan, a retirement plan for employees of small companies, discontinued after 1996.

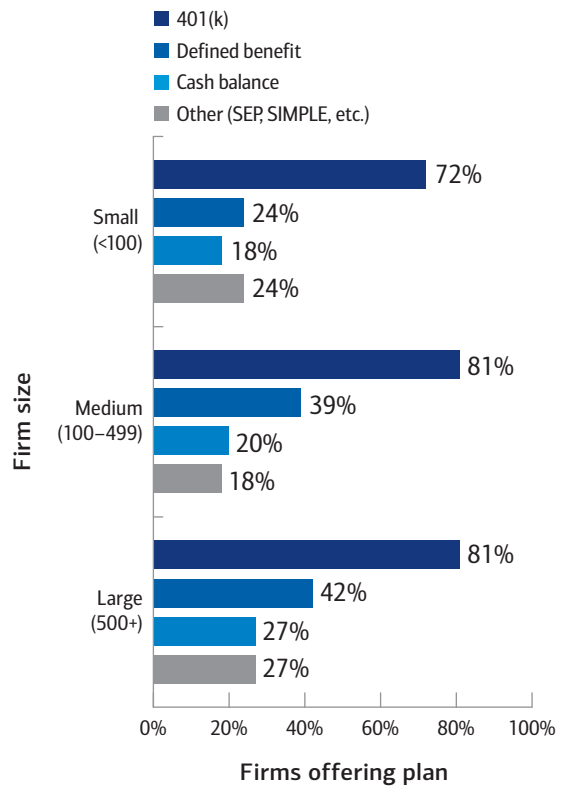
** A tax-advantage retirement plan offered to employees of government agencies and nonprofit organizations.

Sources: U.S. Board of Governors of the Federal Reserve System, Flow of Funds (2021); and Investment Company Institute, *Quarterly Retirement Market Data* (2021).

Plan offerings vary somewhat by size, but the interesting finding is that, for firms offering a retirement benefit, 401(k) plans are the dominant form across size groups (see Figure 11). The 401(k) plan is slightly less prevalent among small firms, with 72% of them offering one, compared to 81% of larger firms.



Figure 11. Type of retirement plan offered among firms that offer a plan, by firm size



Note: Firms can offer more than one plan, so totals exceed 100%. Executive plans are not shown.

Source: Collinson, Rowley and Cho (2021).

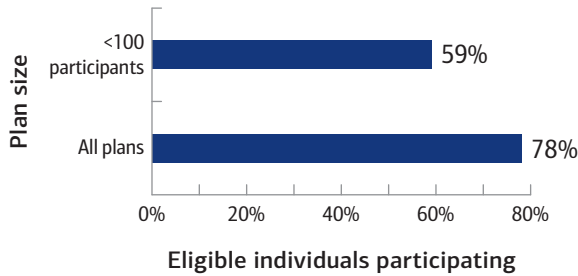
Given the dominance of 401(k)s, the question then becomes how successful these plans are in encouraging retirement saving. To answer that, information from Vanguard is the most useful.

The following charts rely on two different Vanguard reports on groups of plans that it administers: 1) small business plans (primarily fewer than 100 participants); and 2) a separate group that includes plans of all sizes.² In each chart, the first bar comes from the small business report, and the second bar comes from the main Vanguard report. The key plan metrics reported here relate to participation and savings levels.

Participation rates: A basic measure for success in any plan is the participation rate. The gap between the smallest firms administered by Vanguard and all firms is substantial: 59% compared to 78% (see Figure 12).

Why do some small businesses offer retirement plans?

Figure 12. Percentage of eligible individuals participating in 401(k) plans, by plan size, 2019

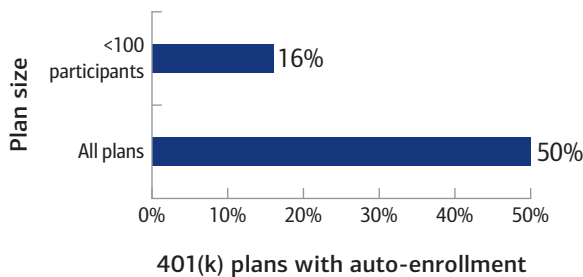


Note: The smallest plans predominantly have fewer than 100 participants.

Sources: The Vanguard Group (2020a, b).

One reason for this large difference is likely the design of the plans. Specifically, auto-enrollment has proven very successful in boosting participation rates. The lower participation rates at the smallest plans likely reflect differences in the use of auto-enrollment: Just 16% of the smallest firms have this feature, compared to half of all plans (see Figure 13). The low adoption rate of auto-enrollment by small plans could potentially be related to concerns about cost. Auto-enrollment yields higher participation, which means — for those firms that provide a match — higher costs in terms of matching contributions.

Figure 13. Percentage of 401(k) plans with auto-enrollment, by plan size, 2019

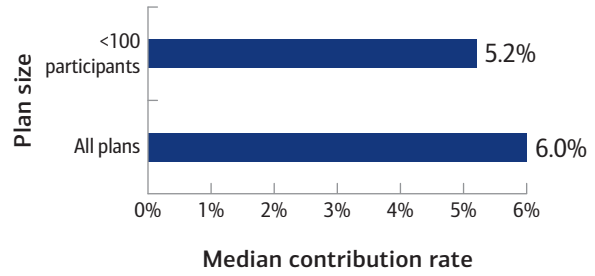


Note: The smallest plans predominantly have fewer than 100 participants.

Sources: The Vanguard Group (2020a, b).

Savings levels: The other key issue is how much employees save in their 401(k)s. The main metrics here are contribution rates and total account balances. Participants in the smallest Vanguard plans have a median employee contribution rate of 5.2% compared to 6.0% in all Vanguard plans (see Figure 14).

Figure 14. Median participant contribution rates, by plan size, 2019

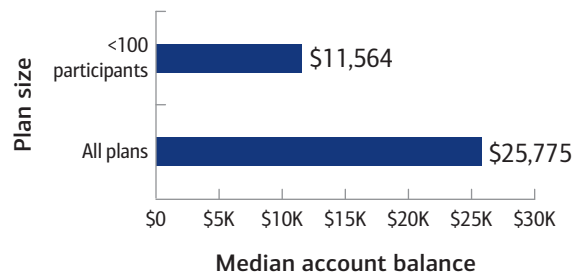


Note: The smallest plans predominantly have fewer than 100 participants.

Sources: The Vanguard Group (2020a, b).

Finally, the median account balances at the smallest firms are also lower than all Vanguard plans — \$12,000 compared to \$26,000 (see Figure 15). The significant difference between the balances in small plans relative to all plans is likely due to plan design, because the average earnings for those covered by a plan is not very different between small firms (\$64,000) and all firms (\$72,000).

Figure 15. Median account balances, by plan size, 2019



Note: The smallest plans predominantly have fewer than 100 participants.

Sources: The Vanguard Group (2020a, b).

In summary, the Vanguard data show that the firms with the smallest plans tend to have substantially lower participation rates, perhaps due in part to a reluctance to offer autoenrollment. The smallest plans also have lower contribution rates and lower account balances than all 401(k) plans. Thus, the challenge is not only to get more small businesses to offer plans, but also to ensure that the plan design is most helpful to the saving needs of small business employees.

Conclusion and next steps

The coverage gap is a pressing concern for the nation's retirement income security, and the gap is driven by small employers. But, in fact, about half of firms with fewer than 100 employees do offer a retirement plan. In order to encourage growth in coverage, it's important to understand the characteristics of small firms that do and don't offer a plan.

Over decades, small firms have cited the same three major factors for not offering a plan. Two seem totally understandable and perhaps insurmountable. Some firms claim that they're simply not big enough and don't feel they're firmly enough established to offer a plan. Indeed, many small firms are new, and it may take a few years before setting up a workplace retirement plan is a real option.

The second factor cited by small employers for not offering a plan is that their employees would prefer to get their compensation in cash wages, or, if they have to choose among benefits, they would much prefer health insurance to retirement benefits. From an employer's perspective, it may never make sense to offer a benefit that their employees don't value. Even though, as noted earlier, many low-wage workers in testimonials about the state auto-IRA programs feel much better having some money in the bank, either to cover retirement needs or to meet short-term emergencies, an employer-sponsored plan may not be the answer.

The less compelling reason for not offering a plan is the concern that establishing and maintaining one would be too costly. Surveys have indicated a

substantial lack of knowledge about the options, the costs, and even the need to provide a match in a 401(k) plan. This area seems like fertile ground for making inroads into expanding coverage — especially with the advent of open MEPs (or Pooled Employer Plans). If it were possible to establish a plan as part of a multiple employer plan for, say, \$10,000 and maintain it for \$5,000 a year (including internal costs for administration), then those numbers should be splashed in headlines in *The Wall Street Journal*. If those numbers aren't correct, then maybe plans are too costly. In any event, clarifying the costs seems like a useful thing to do.

Finally, while recent surveys have touched on the issue of small businesses and retirement plans, the last comprehensive survey was done by EBRI in 1998. Repeating that survey — and perhaps updating it by adding information such as firm age and profitability — would be extraordinarily useful. It is simply not possible to get all the information needed about the nature of small firms, particularly age and profitability, and the characteristics of their employees from the existing data sets. A comprehensive new survey would be an enormous contribution to anyone interested in the activities of small business and to those trying to identify the most likely potential sponsors.



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¹ Biggs, Munnell, and Chen (2019).

² Vanguard's *How America Saves — Small Business Edition* defines small businesses as firms with less than \$20 million in plan assets; the average number of plan participants is 45 and the median is 20.

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