# WHY DO SOME SMALL BUSINESSES OFFER RETIREMENT PLANS?

*Center for Retirement Research at Boston College*

**SPECIAL REPORT**
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The mission of the Center for Retirement Research at Boston College is to produce first-class research and educational tools and forge a strong link between the academic community and decision-makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center conducts a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception in 1998, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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## Introduction

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 saving 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 less 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 for future growth in coverage. In fact, though, a meaningful share of small businesses do offer a retirement plan. 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 datasets that focus on the firm. 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 do not provide coverage. The fourth section compares the quality of the coverage provided by small firms to that by large firms.

The final section concludes that while many small firms offer a retirement plan, existing datasets 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 do not offer a plan, suggesting that financial uncertainty and lack of employee interest are real hurdles. Respondents also suggest that plans are too costly, but they 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 Datasets

Before discussing the data challenges, it is useful to provide the lay of the land by size in terms of firms and workers. As shown in Table 1, firms with less than 100 workers account for the vast majority of businesses and 35 percent 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*

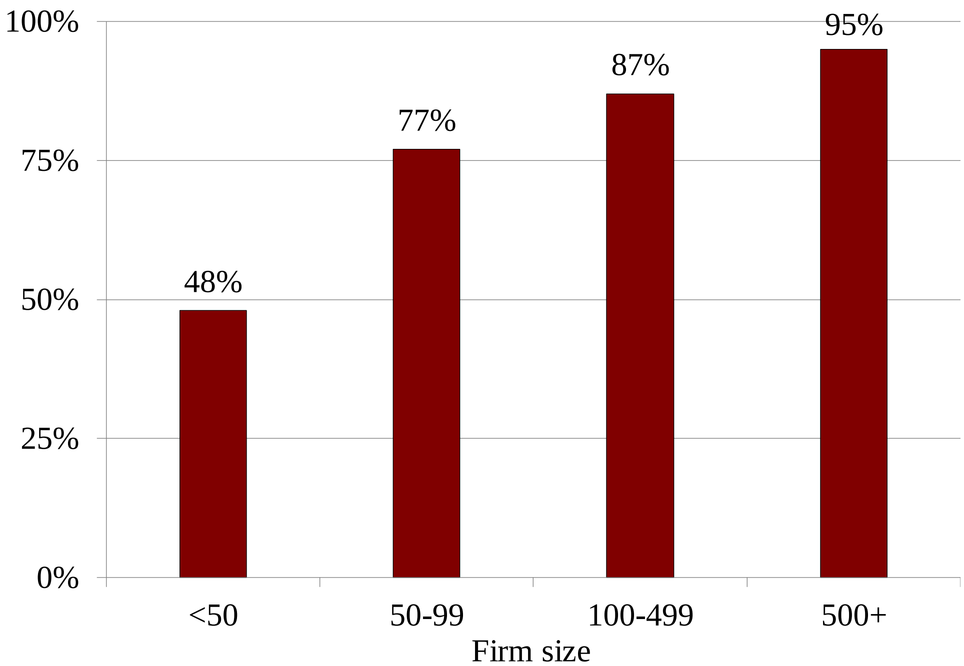
| | Firm size | | | |
|---|---|---|---|---|
| Item | 1-99 | 100-499 | 500-999 | 1,000+ |
| Firms | 97.5% | 2.1% | 0.3% | 0.2% |
| Workers | 35.1 | 17.3 | 7.0 | 40.6 |

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

[1] Biggs, Munnell, and Chen (2019).

And the smaller the firm, the less likely it is to offer a workplace retirement plan.  The percentage of firms with a plan is 95 percent at the largest firms and 48 percent at the smallest firms (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).

The task of identifying the characteristics of small firms that do provide coverage should be straightforward: identify the small firms with and without a plan and explore the extent to which various factors are related to coverage.

Several factors could affect the decision of a firm 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 and 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 size in combination with firm characteristics, such as industry, age, average wage, the provision of health insurance, etc. The box below explains the limitations of a number of datasets explored for this project.

**Alternative Data Sources Explored**

The following data sources were explored as sources for the analysis, but each contain several key shortcomings that limit 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, franchised industries are reported by headquarter location, and, by design, has no information on firms not offering a plan.

The Census' **Statistics of US Businesses (SUSB)** does not 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 NCS, can inform our analysis.

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

*Individual Level*

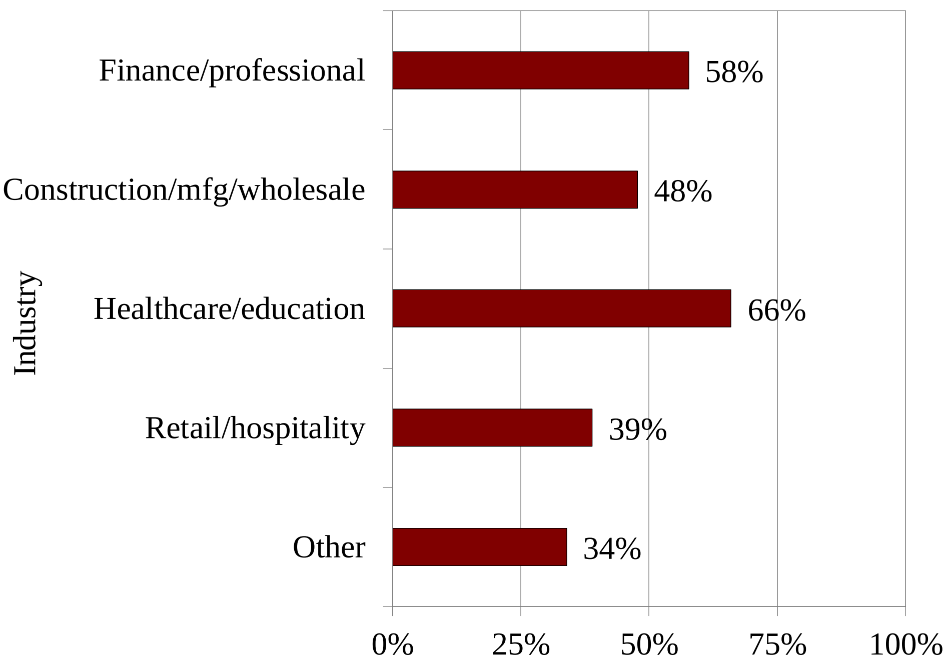
The Census' **Current Population Survey (CPS)** provides information on retirement plan coverage and participation for individuals, in addition to many demographic factors. However, since the survey's re-design in 2014, the CPS has consistently reported significantly lower levels of retirement-plan coverage than all other surveys. Finally, this survey has extremely limited information on the characteristics of an individual'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 dataset, the *National Compensation Survey* (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 percent of private sector employees); healthcare and education (19 percent); construction, manufacturing, transportation, and wholesale (23 percent); retail and hospitality (23 percent); and other, which includes the official "other" category plus agriculture, entertainment, and administrative support and waste services (16 percent). The

NCS, however, does not provide coverage by industry by size, making it impossible to say anything about the importance of industry for small firms.

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 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**

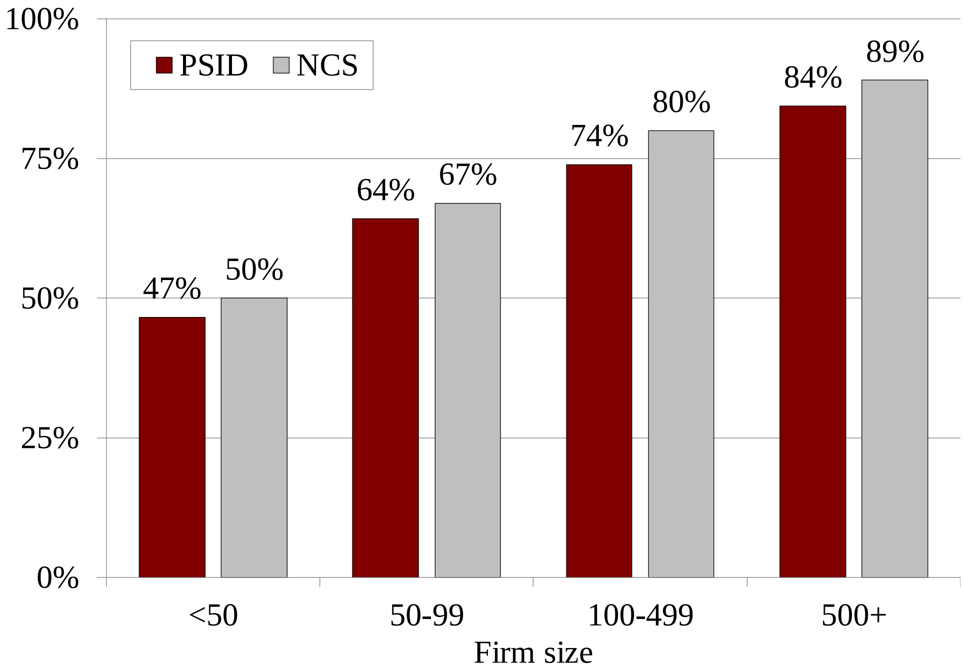
Two household panel surveys – the *Panel Study of Income Dynamics (PSID)* and *the Survey of Income and Program Participation* (SIPP) – provide information to identify some characteristics of small firms that offer retirement plans. The numbers reported below come from the PSID, although the SIPP produced 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 *National Compensation Survey* (see Figure 3), which does ask firms how many of their employees are covered by a plan.

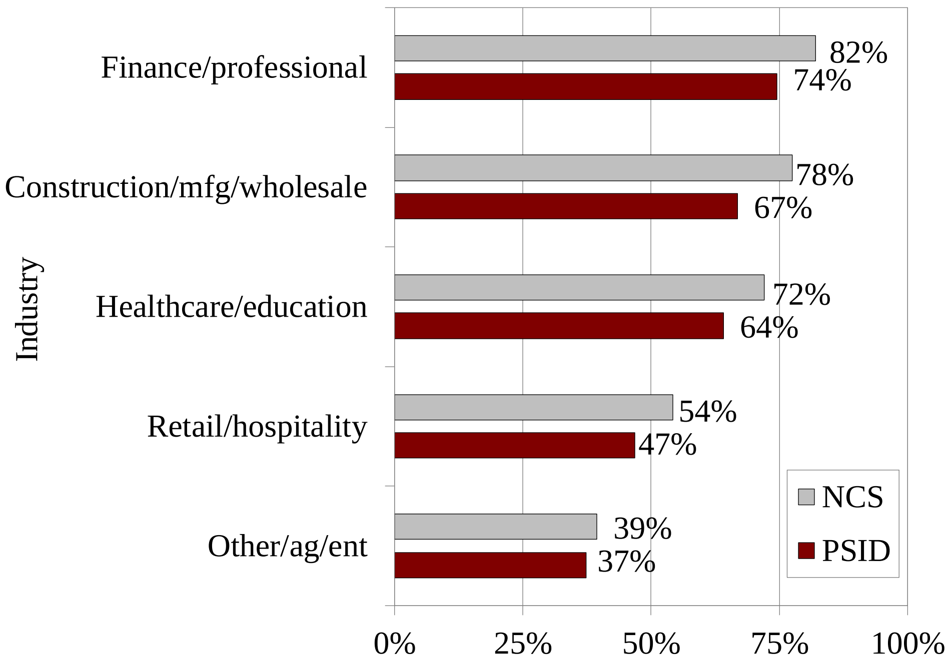
Figure 3. *Percentage of Workers Covered by Workplace Retirement Plan, by Firm Size, PSID and NCS*




*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 *National Compensation Survey*, 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 healthcare/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.

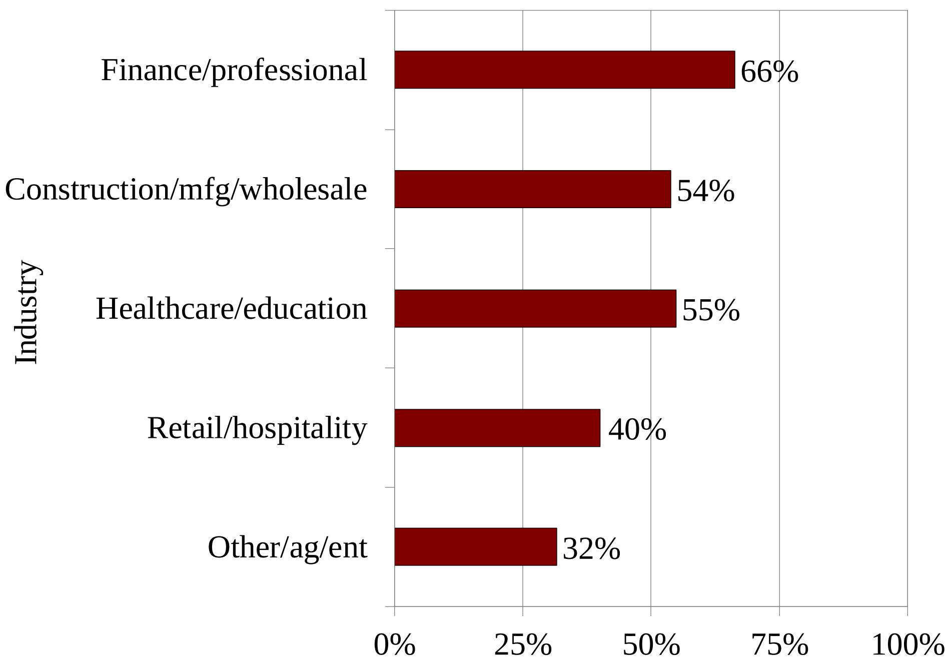
Figure 4. *Retirement Plan Coverage by Industry, All Firms, PSID and NCS*




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

The next step is to focus on individuals working at small firms (<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 be very different, with the firms with coverage having only slightly more employees. Earnings, however, are an important differentiator – with those with coverage averaging $68,000 compared to $37,000 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 | 19 |
| 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 whites constitute a larger share of covered workers than not-covered workers, while Hispanics constitute a substantially smaller share. Interestingly, Black workers have the same representation across coverage groups. Women account for a smaller share of covered than not-covered workers. And, as one expected by the earnings data, college-educated workers account for 43 percent of workers with retirement coverage compared to 27 percent of those without.

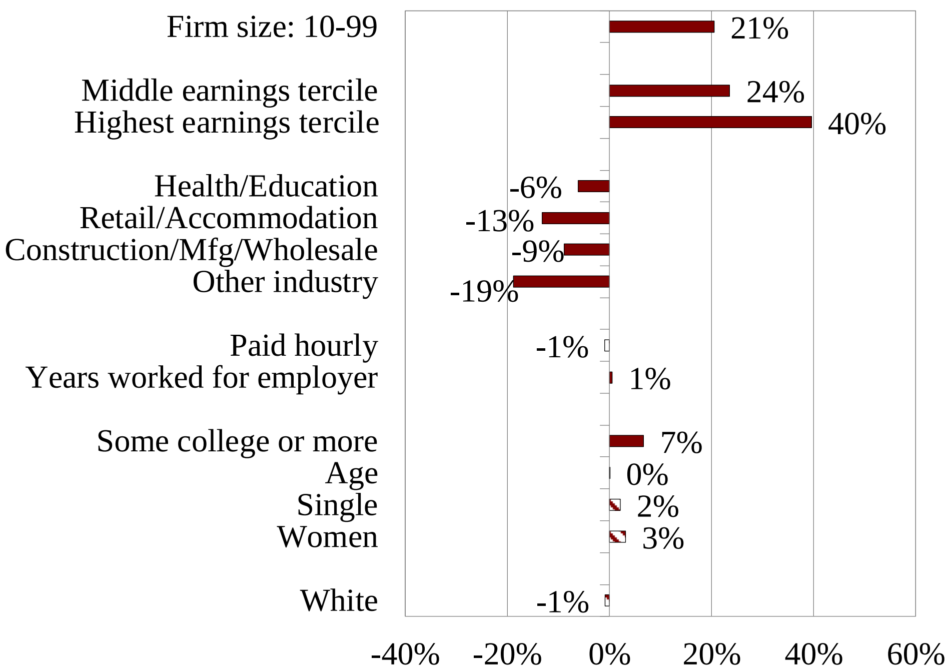
Table 3. *Distribution of Employees at Small Firms, by Retirement Plan Coverage*

| | Covered | Not covered |
|---|---|---|
| Race/ethnicity | 100.0% | 100.0% |
| 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 firms 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 offering a plan.

Figure 6. *Employee Characteristic Impact on Likelihood of Small Firm Offering Retirement Plan*



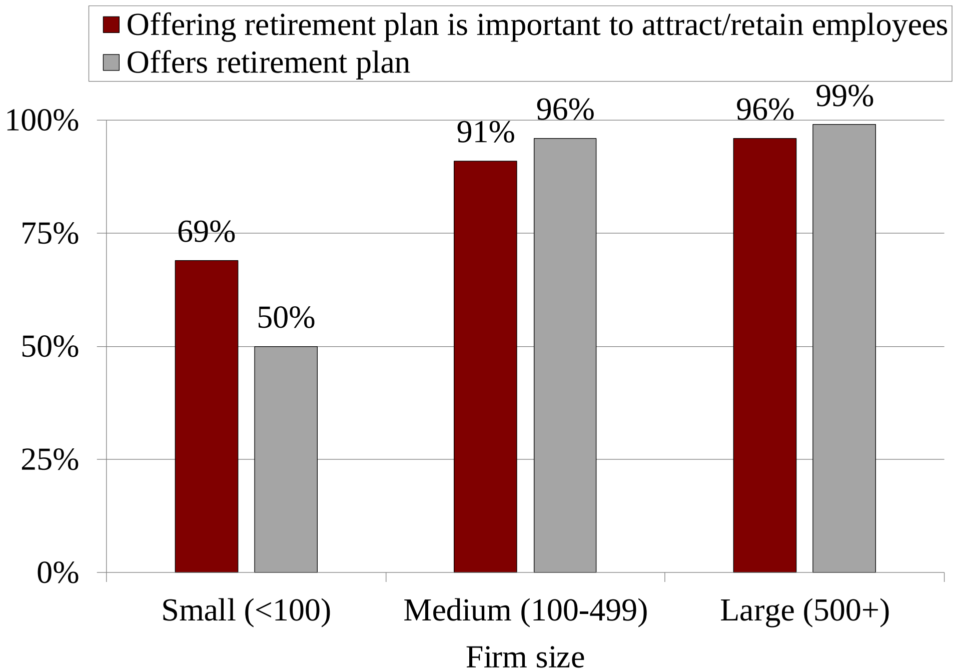

Notes: Base case categorical variables are firm size <10 employees, bottom earnings tercile, finance/professional industry, high school or less education, and nonwhite. Regression looks only at employees at small firms (<100 employees).
*Source:* Authors' calculations using the PSID (2019).

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 firm, the industry, and the educational attainment of workers also have a statistically significant effect.

**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 that Offer a Plan, by Firm Size*

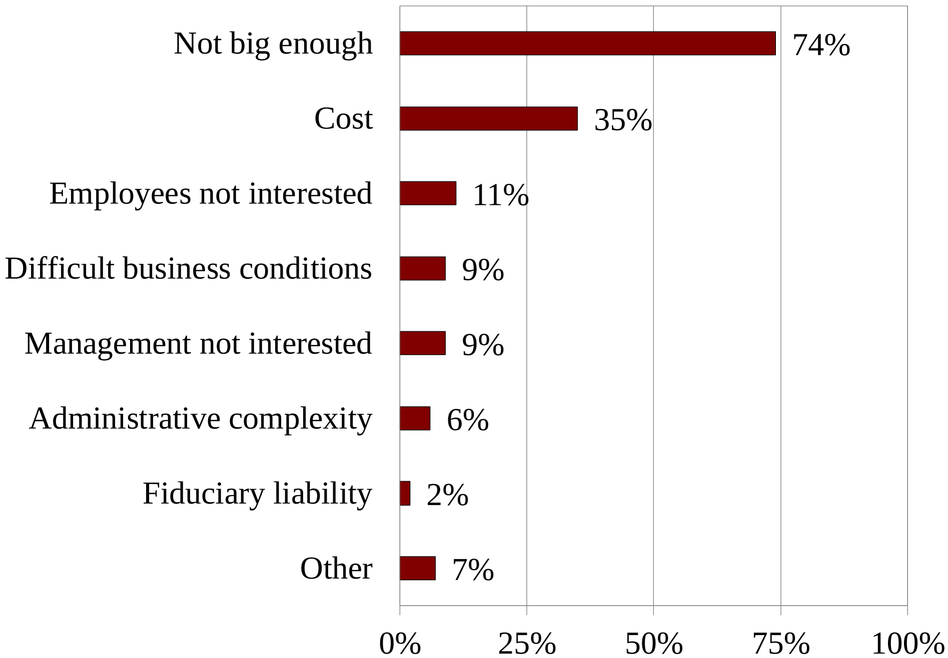



Notes: Employers who responded that offering a retirement plan is "very important" or "somewhat important" are included. The share of employers that offer a retirement plan includes those that offer defined benefit pensions and cash balance pensions.
*Source:* Collinson, Rowey, and Cho (2021).

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 also 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 a 2021 Transamerica survey; employers can offer more than one reason, so the total does not add to 100 percent.

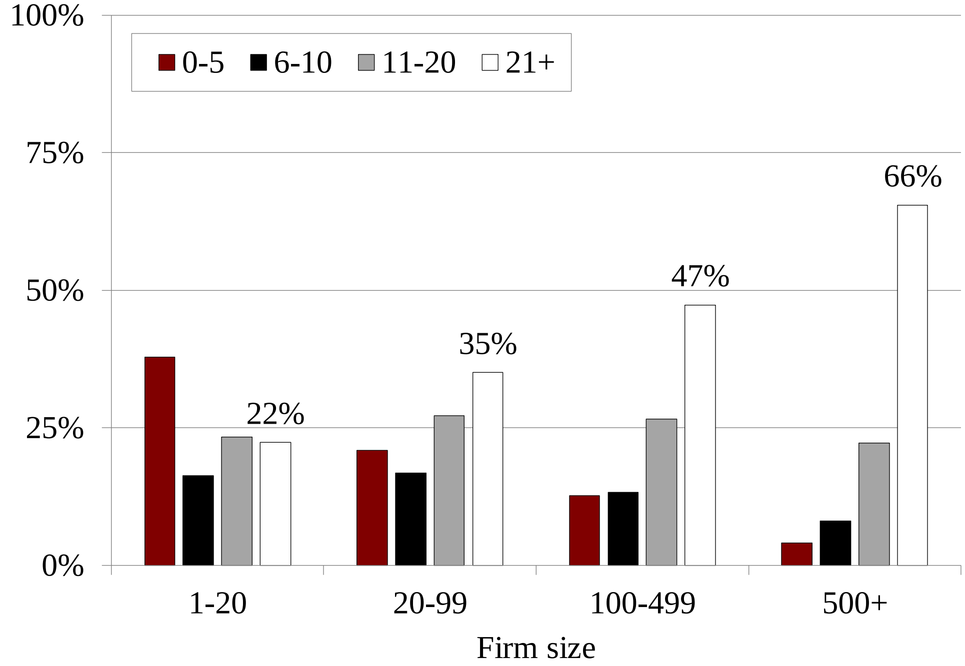
Figure 8. *Most Frequently Cited Reasons for Not Planning to Offer a Plan*




Note: Employers can offer more than one reason, so the total exceeds 100 percent.
*Source:* Collinson, Rowey, and Cho (2021).

Interestingly, the number one 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 firmly enough established to introduce a workplace retirement plan. Indeed, firms that have been in business for less than 5 years constitute the majority of small firms (see Figure 9). These firms may simply have too much on their plate to add an additional benefit.

Figure 9. *Age Distribution of Firms by Firm Size*



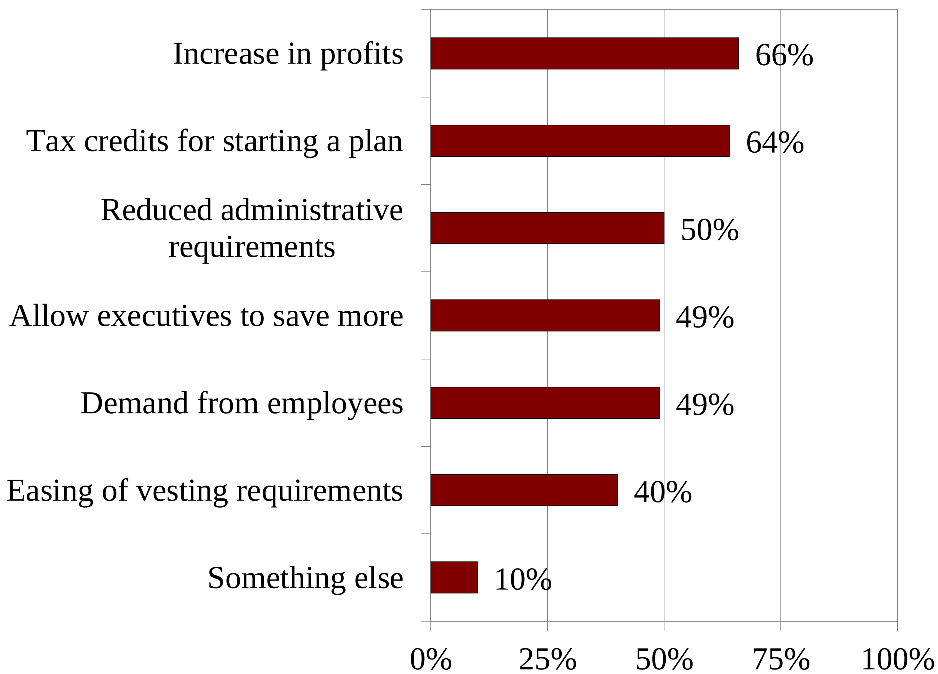

*Source:* U.S. Census Bureau, *Business Dynamics Statistics* (2019).

Cost shows up as the second most cited reason for not 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 business, but Congress has tried repeatedly to minimize paperwork, recordkeeping, reporting, and fiduciary responsibility for small businesses. 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 did not 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 is reasonable to assume that these employees would prefer cash wages over benefits; they have bills to pay and do not see any obvious money left over for retirement saving. Employers have no interest in offering benefits that their employees would not appreciate.

Based on these surveys, several things would have to change for those not offering a plan to become sponsors. According to the EBRI survey, increased 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. 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 do not share a common industry or location to participate in a single retirement plan, 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 that they wanted a retirement plan, only about one-third of them opt 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.

Figure 10. *Changes that Might Lead to Plan Sponsorship among Small Employers*




*Source:* Yakoboski and Ostum (1998).

### What Kind 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).

*Brief Descriptions of Employer Plans*

**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 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 Figure below).

**Traditional Defined Benefit Plan:** The employer makes pre-tax contributions into a trust, directs the investments, and bears the risk. The employee generally does not contribute. Benefits are paid as an annuity at retirement, and are insured by the Pension Benefit Guaranty Corporation (PBGC).

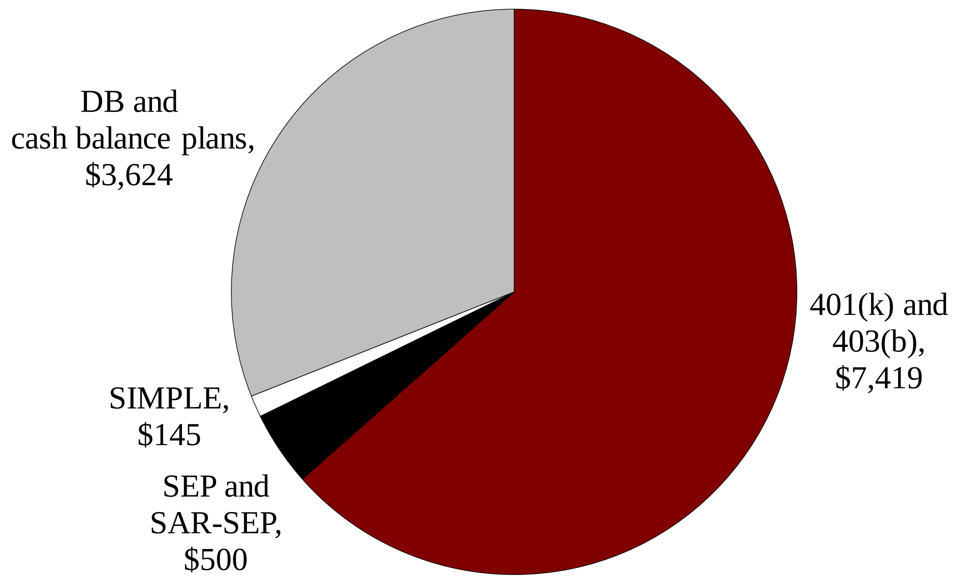
**Cash Balance Plan:** Technically a defined benefit plan, where the employer makes the contributions, owns the assets, and bears the risk, and the plan is insured by the PBGC. To the employee, however, it looks more like a defined contribution plan, since the employer contributes to a notional account 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 percent 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 do not 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 avoids 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.

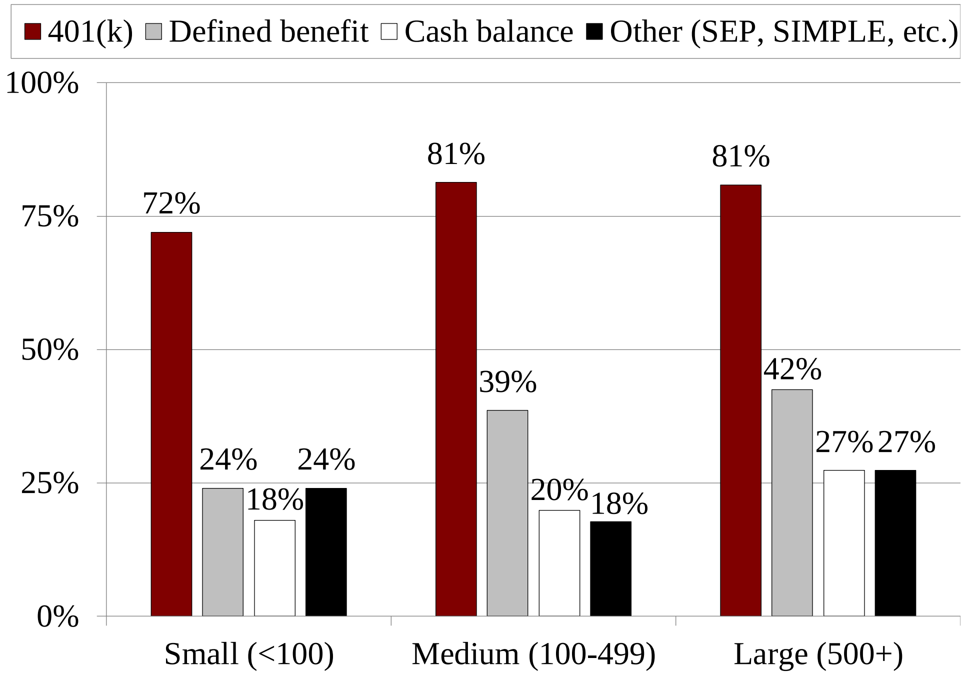
Figure. *Total Private Sector Employer-Sponsored Retirement Assets, Dollars in Billions, 2019*




*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 plan, 401(k) plans are the dominant form of retirement plan across size groups (see Figure 11). The 401(k) plan is slightly less prevalent in the case of small firms, with 72 percent of firms offering one, compared to 81 percent for larger firms.

Figure 11. *Type of Retirement Plan Offered Among Firms that Offer a Plan, by Firm Size*



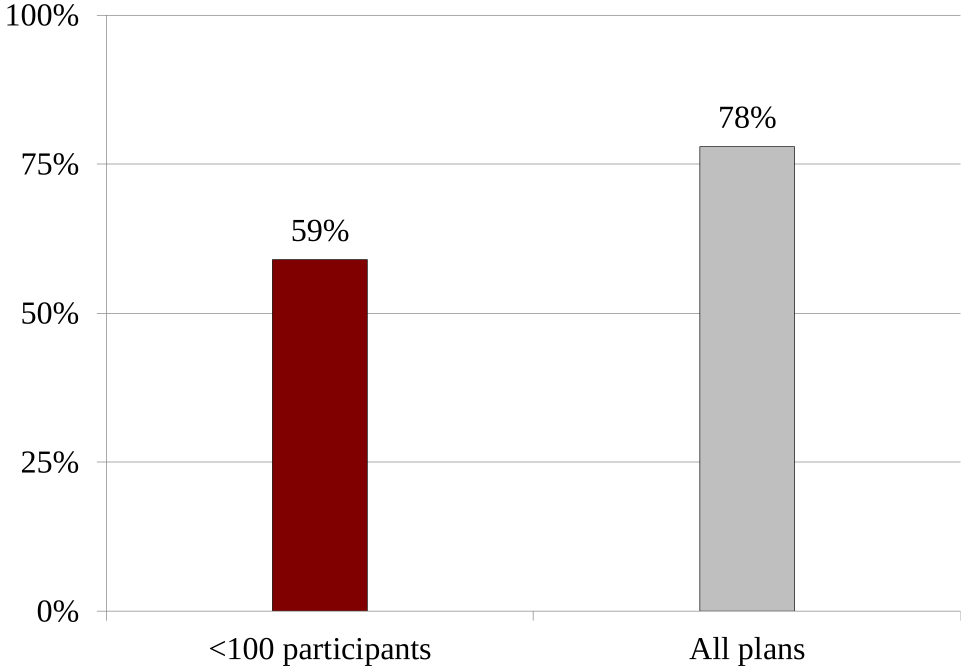

Note: Firms can offer more than one plan, so totals exceed 100 percent. Executive plans are not shown.
*Source:* Collinson, Rowey, and Cho (2021).

Given the dominance of 401(k)s, the question then becomes how successful these plans are in encouraging retirement saving. For that exercise, data 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 less 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 percent compared to 78 percent (see Figure 12).

[2] Vanguard's How American 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.

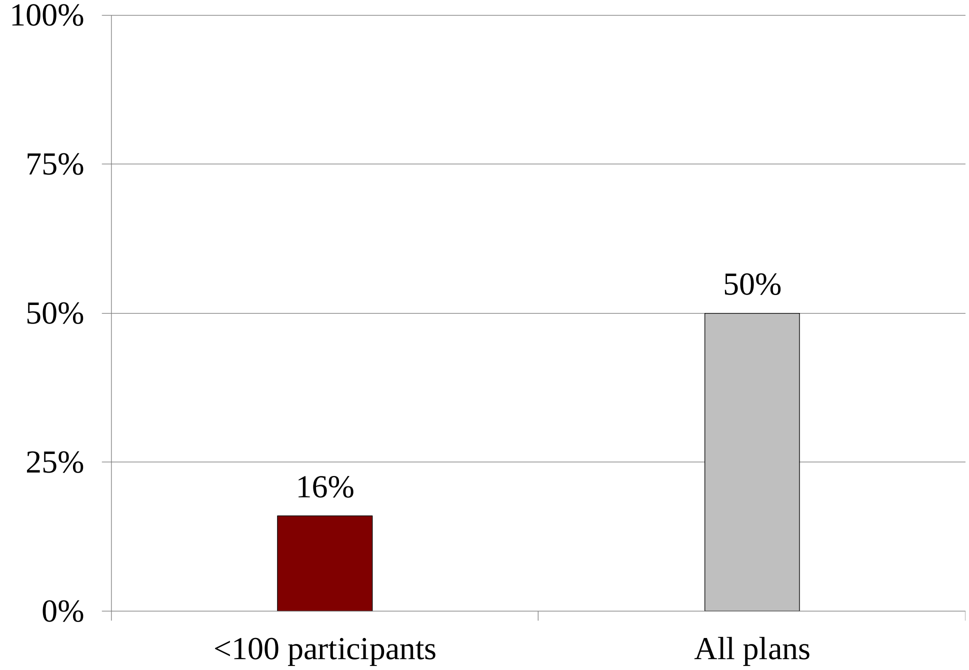
Figure 12. *Percentage of Eligible Individuals Participating in 401(k) Plans, by Plan Size, 2019*




Note: The smallest plans are predominantly comprised of those with less than 100 participants.
*Sources:* The Vanguard Group (2020a, b).

One reason for this large difference is likely due to plan design. 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 percent 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 their concerns about cost: auto-enrollment yields higher participation, which means – for those firms that provide a match – higher costs in terms of matching contributions.

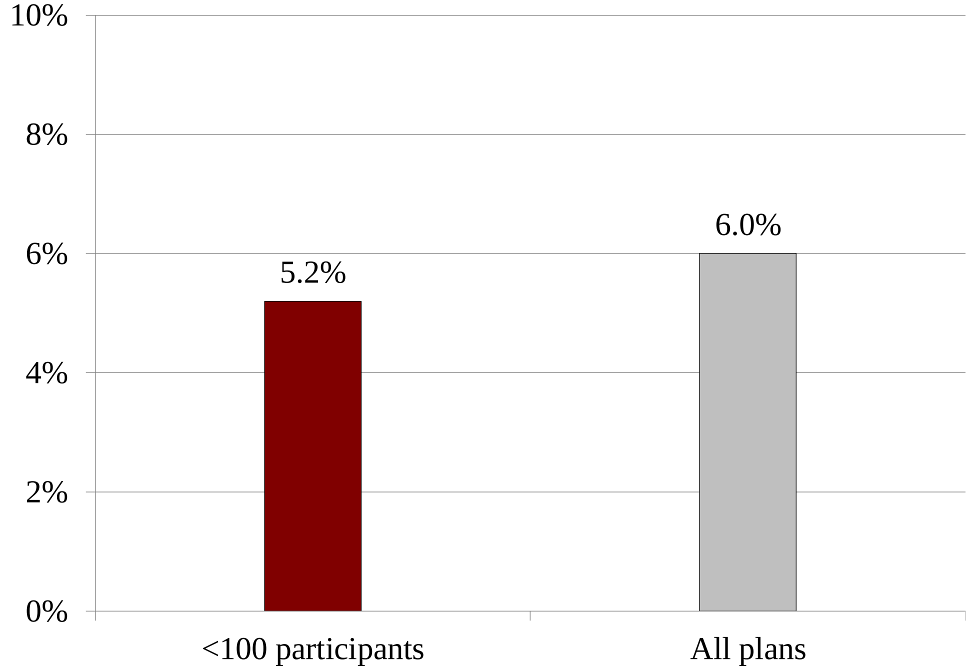
Figure 13. *Percentage of 401(k) Plans with Auto-Enrollment, by Plan Size, 2019*




Note: The smallest plans are predominantly comprised of those with less 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 percent compared to 6.0 percent in all Vanguard plans (see Figure 14).

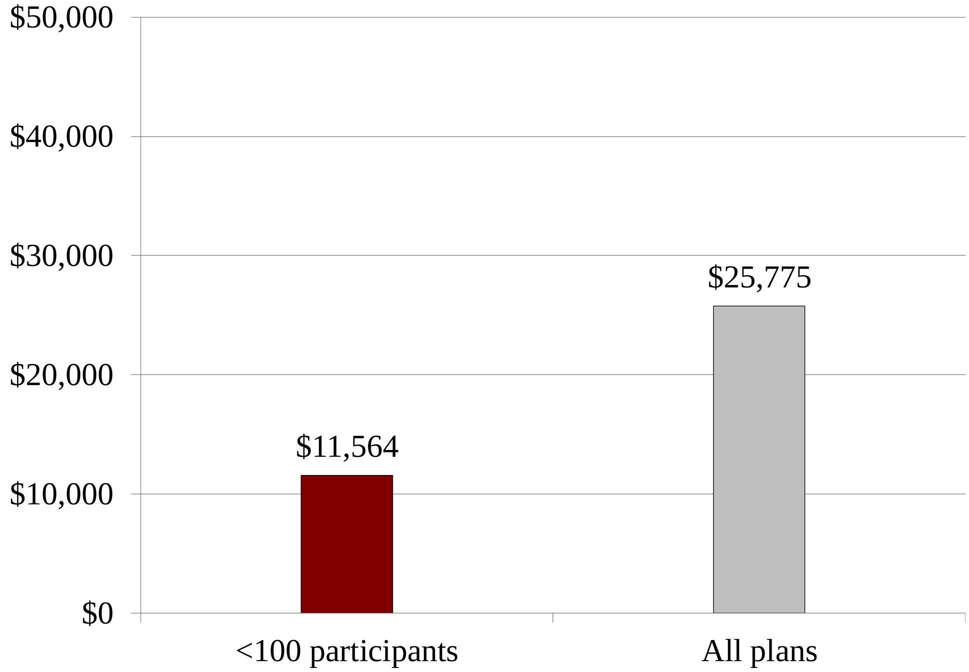
Figure 14. *Median Participant Contribution Rates, by Plan Size, 2019*




Note: The smallest plans are predominantly comprised of those with less 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 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 are predominantly comprised of those with less 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 auto-enrollment. 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 less than 100 employees do offer a plan for their employees. In order to encourage growth in coverage, it is important to understand the characteristics of small firms that do and do not 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 are simply not big enough and do not feel that they are firmly enough established to offer a plan. Indeed, many small firms are new firms, 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 do not 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 of the options, and even the need to provide a match in a 401(k) plan. This area seems like fertile ground to make inroads into expanding coverage – especially with the advent of open MEPs (or PEPs). 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 are not correct, then maybe plans are too costly. In any event, clarification of 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 datasets. 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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