Small business retirement plans

The importance of employer perceptions of benefits and costs

Prepared for Bank of America

Research conducted by

CENTER *for* RETIREMENT RESEARCH *at* BOSTON COLLEGE

BANK OF AMERICA

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

Executive summary

At any given time, only about half of U.S. private sector workers are covered by an employer-sponsored retirement plan, and few workers save without one. The coverage gap, which undermines the retirement income security of the nation's workers, is driven by a lack of coverage among small employers. But, in fact, about half of firms with fewer than 100 employees do offer a plan for their employees.

This study presents results from our *2023 Small Employer Retirement Survey*, which provides an up-to-date and comprehensive understanding of why some small firms offer retirement plans and the barriers preventing other small firms from offering one. A unique aspect of this survey is the inclusion of 100 firms with 0 to 4 employees, a group typically ignored in most small business retirement surveys.

Key insights from the survey:

- Firms' perceptions of the value of retirement plans for hiring and retaining workers and of the costs involved are important determinants of whether they offer, or will likely offer, a plan.
- As in previous surveys, firms report that the two main barriers to offering a plan are:
  - Revenue stability/size of the firm
  - Perceived costs or administrative burden of having a plan
- However, concerns about costs or administrative burdens are driven by misperceptions; many firms are unaware of lower-cost options for employers and tax credits.
- Finally, the recent growth of state-sponsored retirement programs may encourage firms without a plan to offer one.

These results suggest that many firms overestimate the financial and time costs required to offer a plan, and that better awareness of lower-cost plan options for employers and tax credits could help move the needle on the coverage gap.

Introduction

At any given time, only about half of U.S. private sector workers 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 are 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 for future growth in coverage. However, a meaningful share of small businesses does offer a retirement plan.

The purpose of this study, which is based on a new survey, is to provide an up-to-date and comprehensive understanding of why some small firms offer retirement plans and the barriers preventing other small firms from offering one.

The discussion proceeds as follows:

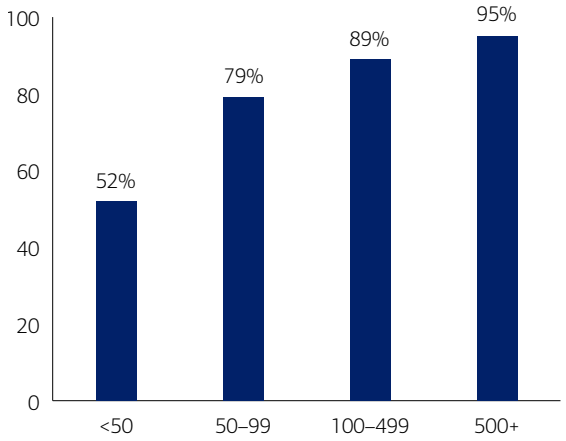
- The first section provides an overview of what we know about small business retirement plans so far.
- Turning to the new survey data, the second section examines what factors make a firm likely to provide coverage.
- The third section examines the perceived barriers firms face to offering a plan and dives into some of the misperceptions.
- The fourth section explores what characteristics make a firm without a plan more inclined to adopt one in the near future.
- The fifth section examines whether the presence of state-sponsored retirement programs — which generally require firms without a plan to enroll their workers in the state program — shifts firm perceptions.

The final section concludes that important drivers to offering a plan — in addition to standard characteristics like industry, firm size and employee salary — are beliefs about the value of retirement plans for employee retention and a firm's future revenue growth. But employers that don't offer a plan hold many misperceptions about the financial and time costs of offering one. Therefore, better awareness of the many available options for small firms may help close the coverage gap.

What we know about small business retirement plans

The coverage gap is a pressing concern for the nation's retirement income security, and the gap is driven by small employers. Small employers (firms with fewer than 100 employees) account for the vast majority of businesses and 35% of private sector workers.[2] But only about half of small employers offer a retirement plan for their employees (see Figure 1).

Figure 1: Percentage of private sector firms offering a retirement plan, by firm size, 2021

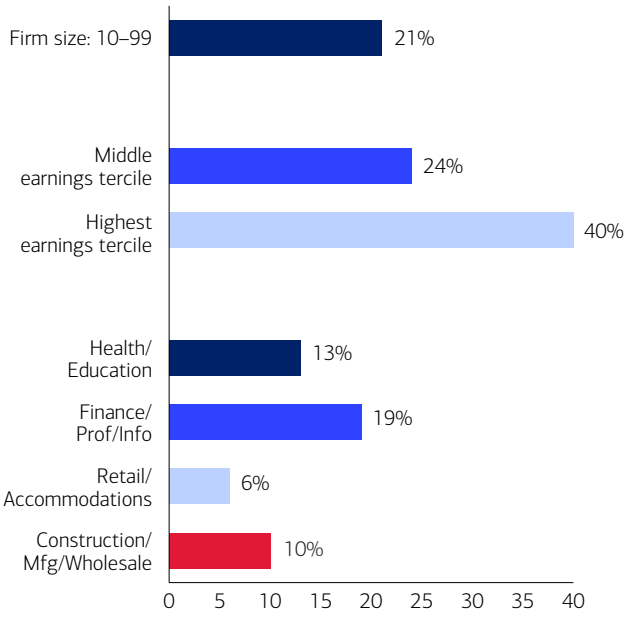


Source: National Compensation Survey (NCS), U.S. Bureau of Labor Statistics, 2021.

In order to encourage growth in coverage, we did an initial analysis of the characteristics of firms that do and do not offer a plan in an earlier study (see Figure 2). The results showed that the biggest drivers among small firms are:

- Larger firm size
- Higher-earning employees
- Being in finance or other professional services and scientific industries[3]

Figure 2: Employee characteristics on likelihood of small firm offering retirement plan



Notes: Base case variables are firm size fewer than 10 employees, bottom earnings tercile and "other" industries. Other controls include education, hourly vs. salary employee, tenure, age, marital status, gender and race/ethnicity.

Sources: Chen and Munnell (2021) using the University of Michigan's Panel Study of Income Dynamics (PSID), 2019.

The question is, what's preventing other small firms from offering retirement benefits? Historically, small firms have consistently cited the same three major barriers:

- Uncertain revenues that make it hard to commit to a plan
- Employee preferences for wages and other benefits
- The costs associated with establishing and administering a plan[4]

It makes sense if small firms don't offer a plan because other business concerns take precedence or their employees would prefer higher cash wages. The less compelling reason is the concern that establishing and maintaining a plan would be too costly or burdensome. Surveys have indicated a substantial lack of knowledge about the various retirement plan options, the costs of the options, and even the need to provide a match in a 401(k) plan.[5] This area seems like fertile ground to make inroads into expanding coverage.

But several important questions remain unanswered, such as: Do revenue growth, percentage of full-time employees, or perceptions of the value of retirement plans matter for offering a plan? Most of the information available on small firms is from employee-level data, which lacks key details on firm characteristics. And while recent surveys have touched on the issue of small businesses and retirement plans, the last comprehensive survey was done more than two decades ago.[6]

The economy and options for small businesses are quite different today. This study updates the survey conducted by the Employee Benefit Research Institute (EBRI) and Greenwald Research in 1998 to answer four main questions:

- What characteristics — other than firm size, salary and industry — make a small firm more likely to offer a retirement plan?
- Have the major barriers to offering a plan changed in the last two decades?
- What characteristics make a firm without a plan likely to adopt one in the near future?
- Have state-sponsored retirement programs changed firm perceptions about offering their own plan?

Here's a brief description of the survey methodology:

Methodology

The *2023 Small Employer Retirement Survey* is produced in collaboration with EBRI and Greenwald Research. The survey, which addresses why firms do or do not offer a retirement plan, was conducted between February and April 2023 and includes 703 firms with 100 or fewer employees.

Roughly 46% of the firms surveyed offered a retirement plan, while the other 54% did not offer a plan, which is nationally representative of small U.S. firms. What's unique about the 2023 survey is that it includes a sample of 100 firms with 0 to 4 employees. This group of micro-firms is typically ignored in most small business retirement surveys.

Characteristics of firms offering a plan

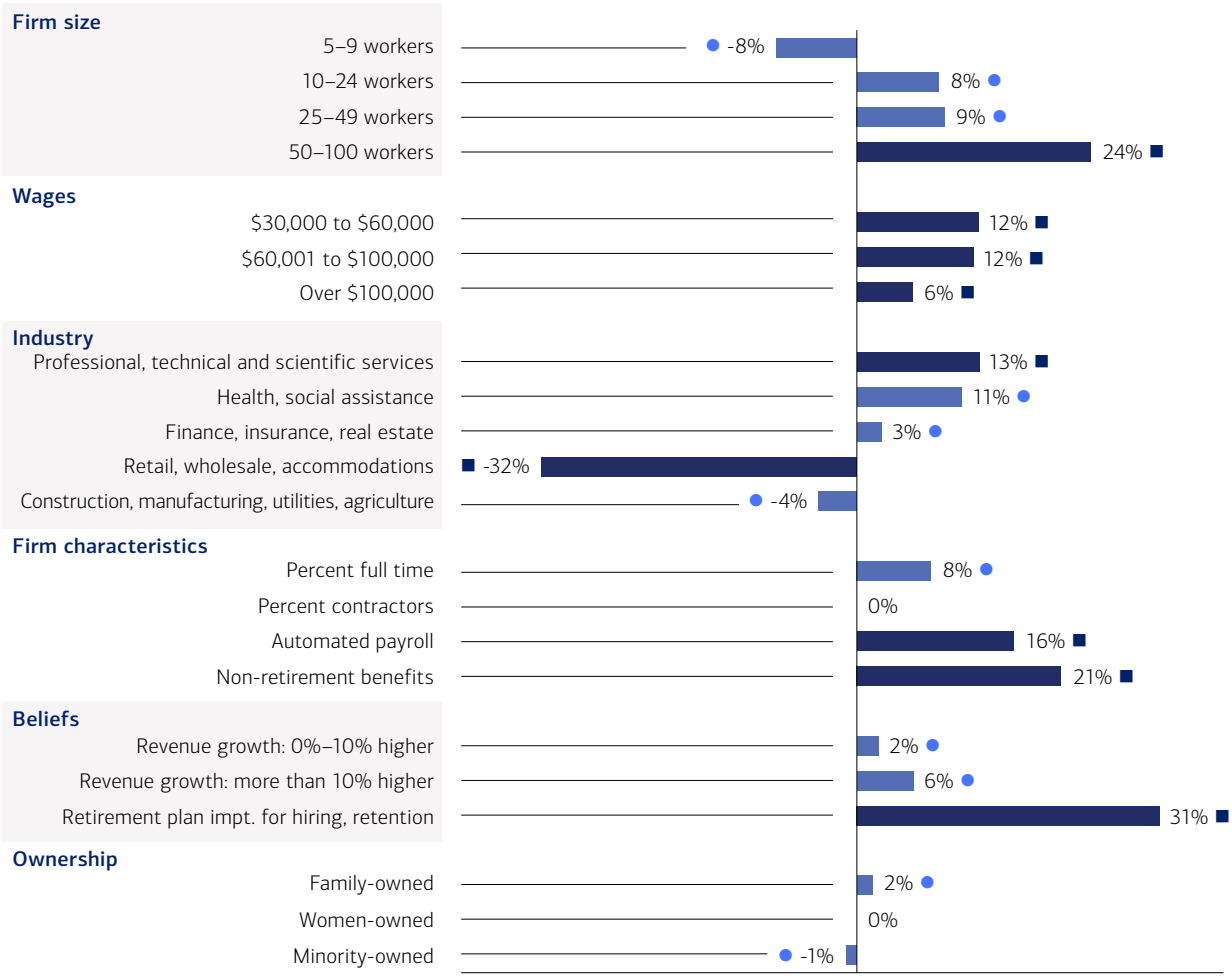
To begin, we examine the characteristics of small firms that do provide coverage. Our prior analysis, using worker-level data, found that salary, industry and firm size were the biggest drivers for whether a small business offered a retirement plan. However, the prior analysis didn't include data on other key firm characteristics. With the latest survey results in hand, we can examine whether salary, industry and firm size are still the biggest drivers or if other factors also influence whether a small employer offers a plan.

The additional characteristics we explore are:

- **Percentage of employees who are full-time.** Small firms that hire mostly part-time workers or contractors are unlikely to offer a retirement plan.
- **Revenue expectations.** Firms with booming business are more likely to offer a retirement plan than those that are unsure whether they'll stay open next year.
- **Employee retention.** Beliefs about whether offering a retirement plan is important for hiring, retention and employee performance could impact whether firms offer a plan.
- **Automated payroll systems.** Retirement plans require payroll deductions, so setting up a plan may be easier for firms with automated payroll.
- **Health or other benefits.** Firms that offer health insurance or other benefits may be more likely to also offer a retirement plan.
- **Ownership.** Perhaps family-, women- or minority-owned businesses are more likely to offer a plan.

Many of these characteristics are highly correlated. In order to disentangle their relative importance, we estimate a simple linear regression relating various factors to the likelihood of a firm offering a plan (see Figure 3).

Figure 3: Effect of firm characteristics on likelihood of offering a plan, 2023



■ Statistically significant
● Not statistically significant

Note: Dark blue bars are statistically different from zero at least at the 10% level.
Source: Authors' calculations from the *2023 Small Employer Retirement Survey.*

After controlling for all these characteristics, firm size, employee wages and industry are still important predictors of whether a small firm offers a retirement plan. As expected, firms with 50 to 100 employees, those with higher average salaries, and firms in professional, technical and scientific services industries are much more likely to offer a retirement plan. Meanwhile, firms in retail or wholesale sales, and in accommodations (hospitality and food services), are much less likely to offer a plan.

But other factors also mattered. Beliefs about whether having a retirement plan is important for hiring and retaining good employees is an important driver as well. In fact, it's the strongest indicator of whether small firms offer a plan; firms that believe having a retirement plan is important for hiring, retention and performance are 31% more likely to have a plan than those that don't consider it important. Notably, a firm's beliefs about revenue growth had little to no effect on having a retirement plan.

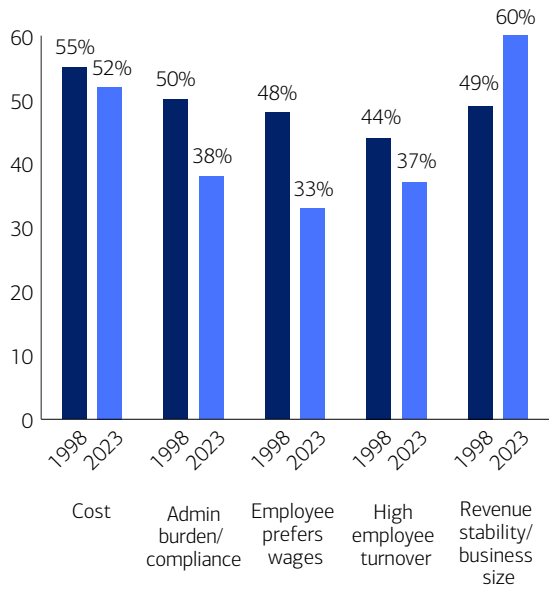
Other characteristics that are important predictors of offering a plan are having an automated payroll system and providing other fringe benefits. Interestingly, though, the percentage of full-time employees didn't matter, nor did the type of people who owned the business.

Have the barriers to offering a plan changed between 1998 and 2023?

Historically, as noted, small firms that don't offer a plan have cited uncertain revenues, employee preferences for wages, and administrative costs. Have the barriers to plan adoption changed since 1998?

Figure 4 compares the responses of small businesses in 1998 and 2023. The top two barriers that prevent small firms from offering a retirement plan — revenue concerns/business size and costs or administrative burden — have remained the same. Today, however, employers are far less likely to cite "employee prefers wages" as a major reason for not offering a plan. But revenue/size has grown to become the biggest barrier.[7] This finding suggests that many small businesses don't feel firmly enough established to introduce a workplace retirement plan.[8]

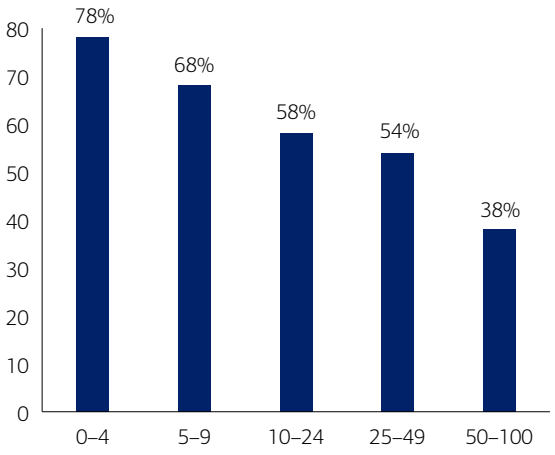
Figure 4: Major reasons for not planning to offer a plan, 1998 and 2023



Sources: Yakoboski and Ostuw (1998), and authors' calculations from the *2023 Small Employer Retirement Survey.*

Indeed, close to 80% of firms with 0 to 4 employees cited revenue and size as a major barrier to offering a plan. This share decreases to 54% for firms with 25 to 49 employees and to 38% for firms with 50 to 100 employees (see Figure 5).

Figure 5: Percentage of firms that cited revenue/size as a major reason for not offering a retirement plan, by firm size, 2023



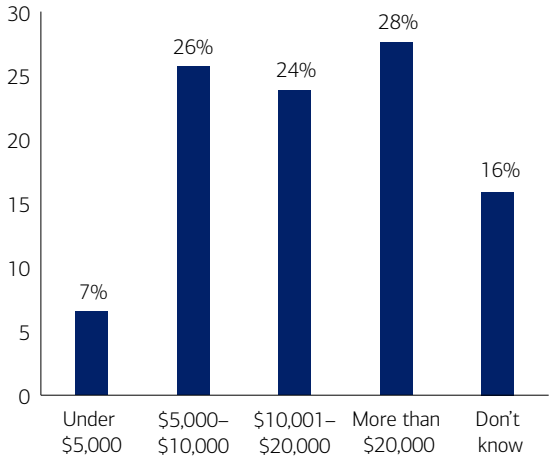
Source: Authors' calculations from the *2023 Small Employer Retirement Survey.*

The smallest of these small firms may simply have too much on their plate to add an additional benefit.[9] For more established firms, costs and administrative burden/compliance become more important drivers for not offering a plan.

Financial and time costs of offering a plan

Interestingly, most small firms that cite costs and administrative burden/compliance as a barrier don't have a good sense of how much money or time is actually required for setting up a plan. A quick Google search yielded several 401(k) options where annual employer costs would be only about $2,500 for a firm with 10 employees and $5,000 for a firm with 50 employees.[10] But over half of small firms believe providing a retirement plan would cost more than $10,000 per year, and nearly 30% think it would cost more than $20,000 per year (see Figure 6).

Figure 6: Perceived annual costs of offering a retirement plan, 2023



Source: Authors' calculations from the *2023 Small Employer Retirement Survey.*

Not only do small firms overestimate the cost of offering a plan, the vast majority—particularly those with fewer than 50 workers—aren't aware that they can claim a tax credit of up to $5,000, for three years, to help offset the costs of starting a plan (see Table 1). And, interestingly, about 80% of employers say that such a credit would make offering a plan more attractive.

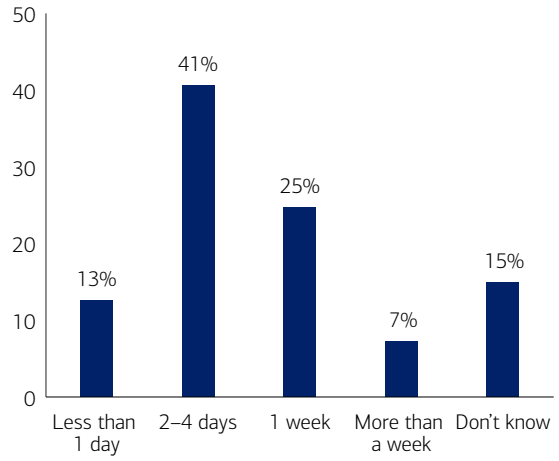
Table 1: Awareness of retirement plan tax credit and impact on attractiveness of offering a plan, by firm size

	0–4	5–9	10–24	25–29	50–100	Total
Aware of tax credit	16%	15%	20%	23%	50%	24%
Existence of credit makes offering plan more attractive	76%	80%	82%	74%	77%	78%

Source: Authors' calculations from the *2023 Small Employer Retirement Survey.*

Additionally, small firms don't have a good sense of how much time it would take to administer a retirement plan (see Figure 7). Most firms believe that it would require several days to a whole week every month. But in reality, after the initial setup is complete, operating a retirement plan should take only a few hours a year.[11]

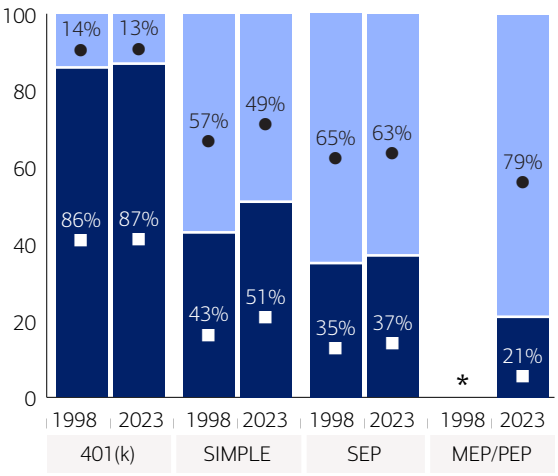
Figure 7: Perceived monthly time required to administer a retirement plan, 2023



Source: Authors' calculations from the *2023 Small Employer Retirement Survey.*

Many small firms are also unfamiliar with the various retirement plan options that are designed to help ease the costs and administrative burden on the employer of offering a plan. While most small firms are at least somewhat familiar with 401(k) plans, the vast majority aren't familiar with SIMPLE and SEP plans (see Figure 8). And this percentage has barely budged since 1998.

Figure 8: Familiarity with different retirement plans, 1998 and 2023



* Firms were not asked about their familiarity with MEP/PEP plans in 1998.

Sources: Yakoboski and Ostuw (1998) and authors' calculations from the *2023 Small Employer Retirement Survey.*

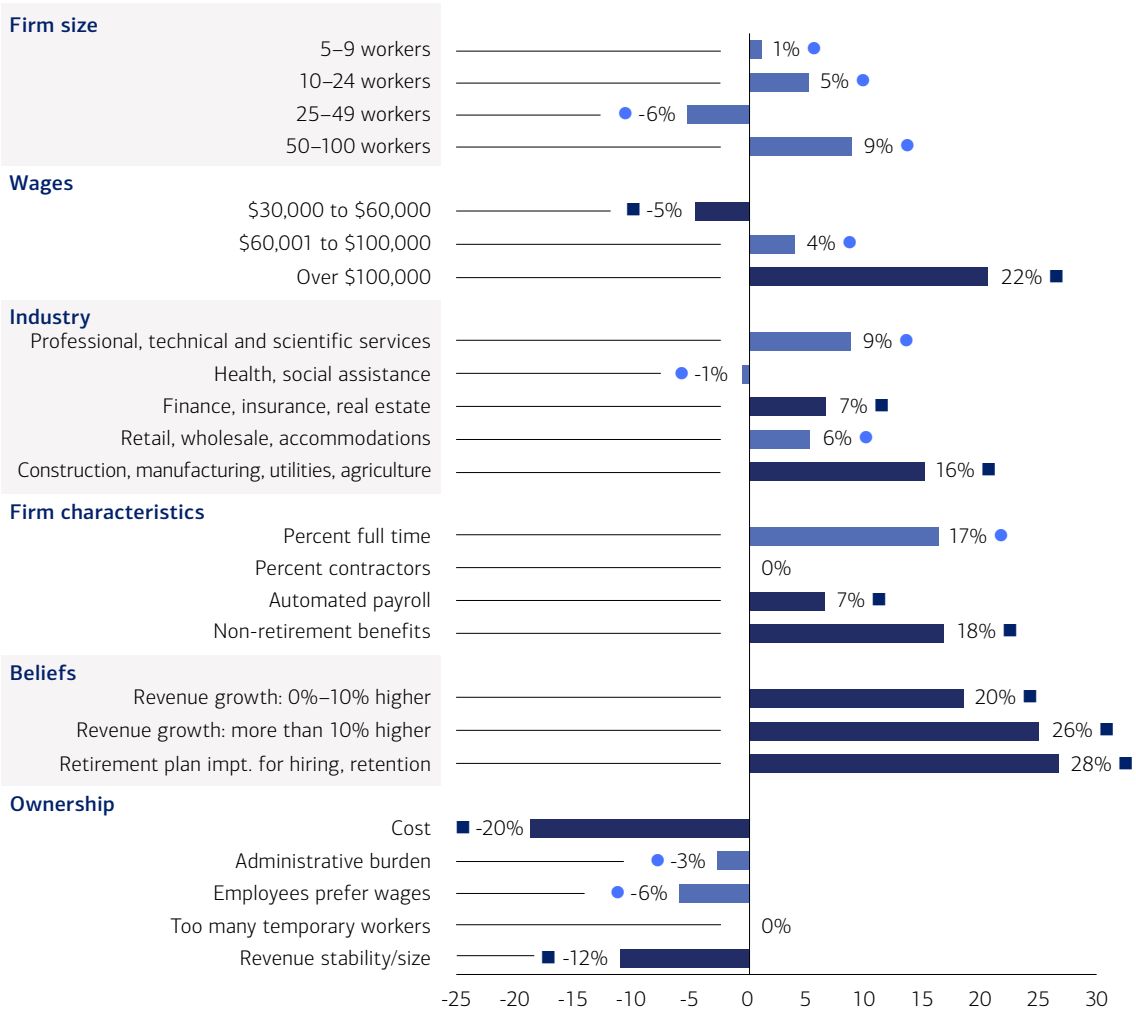
These results suggest that many firms overestimate the financial and time costs required to offer a plan, so better awareness of actual costs, as well as available options, could help reduce the barriers that small firms perceive.

Which firms are likely to start offering a plan in the next two years?

New small firms may need a few years to get their business off the ground before they can entertain offering a retirement plan. So an important question is: Which firms may just need time to become more stable before adopting a plan, and which firms have no interest in offering one?

We once again estimate a simple linear regression to disentangle the relative importance of various factors on whether a firm is planning to offer a retirement plan in the next two years. Interestingly, perceptions matter a lot more, and firm characteristics matter a lot less (see Figure 9).

Figure 9: Effect of firm characteristics and perceptions on likelihood of offering a retirement plan in the next two years, 2023



■ Statistically significant
● Not statistically significant

Note: Dark blue bars are statistically different from zero at least at the 10% level.

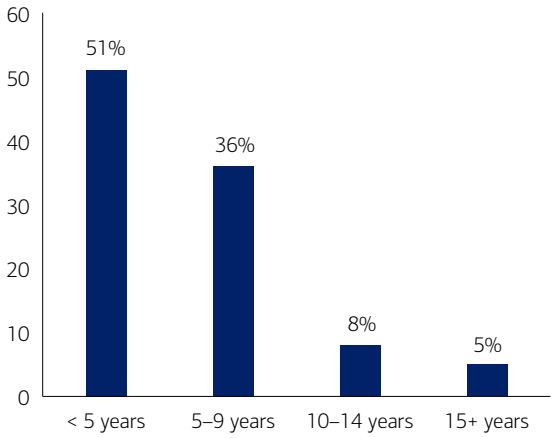
Source: Authors' calculations from the *2023 Small Employer Retirement Survey.*

Not surprisingly, firms where the average salary is more than $100,000 and those that offer other benefits say they're likely to start offering a retirement plan in the next two years. Firms in the construction, manufacturing, utilities and agriculture industries are also more likely to say they'll offer a plan in the near future. This result is driven mainly by firms in construction—perhaps due to labor shortages associated with the booming housing market and high building demands in recent years.[12] This finding is particularly striking because, as noted earlier, firms in this industry are less likely to currently offer a plan.

The biggest drivers of the likelihood of adopting a plan in the near future are whether firms believe their revenue growth will be higher next year and whether they believe offering a retirement plan is important for hiring, retention or performance. Pushing in the other direction, firms that cite the costs of adopting a retirement plan or revenue stability/size as major concerns are much less likely to offer a plan in the near future.

The vast majority of firms that do offer a plan began offering one within 10 years of being in business (see Figure 10). About half begin offering a plan within the first five years, and another third begin offering a plan in years 5 to 10.[13] This pattern suggests that firms that have been established for more than 10 years and still don't offer a retirement plan may be unlikely to offer one in the future.

Figure 10: Years since establishment for firms to begin offering a retirement plan, 2023



Source: Authors' calculations from the *2023 Small Employer Retirement Survey.*

Will state-sponsored retirement programs impact firm behavior?

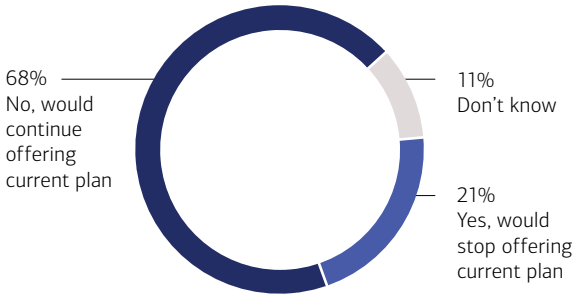
In recent years, a number of states have moved to offer retirement programs in an effort to move the needle on the coverage gap. Currently, 14 states have launched or are preparing to launch programs requiring employers without a plan to automatically enroll their employees in an individual retirement account ("auto-IRAs"). This move could shift small firms' perspectives on offering retirement plans, though the direction of the shift isn't clear. So the survey asked whether employers would be less or more likely to have their own plan.[14]

The results show that the presence of state-sponsored programs doesn't seem to make firms less likely to offer their own retirement plan (see Figure 11). Among firms that already offer a plan, about 70% say they'd continue to offer their own if their state introduced a mandate. Among firms that didn't offer a plan, almost 60% said a mandate would actually make offering their own retirement plan more attractive. Perhaps, then, in addition to ensuring all employees have access to some retirement savings vehicle, these state programs may also encourage firms to offer their own plan.[15]

Figure 11: Firm response to mandates in state-sponsored retirement programs

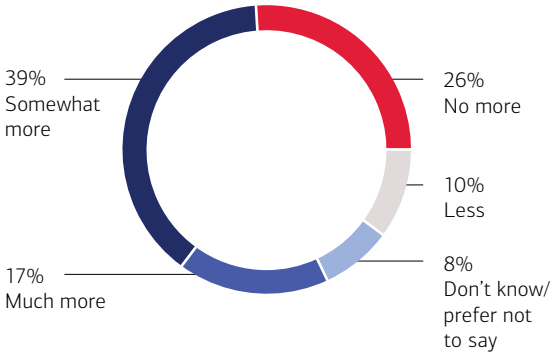
Does offer a plan

Would you stop offering your current plan?



Does not offer a plan

Would offering your own plan be more attractive?



Source: Authors' calculations from the *2023 Small Employer Retirement Survey.*

Conclusion

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's important to understand the characteristics of small firms that do and do not offer a plan.

For firms that offer or are considering offering a retirement plan in the near future, their beliefs are important — such as whether they think retirement plans matter for employee hiring and retention and what their expectations are about revenue growth.

For firms that don't offer a plan, two major barriers — revenue stability/size and costs or administrative burden of having a plan — remain top concerns among small firms today.

Revenue concerns are highly associated with firm size, particularly firms with fewer than 10 employees. It's understandable that firms may need to become established before they see that setting up a workplace retirement plan is a viable option.

The second barrier — costs or administrative burden — however, seems to be driven by misperceptions about the financial costs and the time it would take to operate a plan. Many small firms also aren't aware of the many options designed to help ease the burden on the employer of offering a retirement plan, such as tax credits or SEP, SIMPLE and MEP plans. These results suggest that many firms overestimate the financial and time costs required to offer a plan, and better awareness of the actual costs, as well as plan options, could help reduce the barriers that small firms perceive.

Finally, the growth of state-sponsored retirement programs doesn't seem to deter firms without a plan from offering one, and it may actually encourage them to do so.

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

[2] U.S. Bureau of Labor Statistics, *Business Employment Dynamics* (2022).

[3] Chen and Munnell (2021).

[4] Yakoboski and Ostuw (1998), Collinson (2016), and Collinson, Rowey, and Cho (2021).

[5] For a summary, see Chen and Munnell (2021).

[6] For summaries of the survey results, see Yakoboski and Ostuw (1998) and Employee Benefit Research Institute (EBRI) (1998). EBRI also surveyed small employers in 1999, 2000 and 2002, but the 1998 survey is our reference point because it asked a more comprehensive set of questions.

[7] The 1998 survey did not include firms with fewer than five employees. If we compared the share of firms with 5 to 100 employees, the main takeaway remains the same: a rise in the share of firms — from 49% to 56% — that cite revenue stability or being too small as a major barrier for offering a retirement plan.

[8] It's important to note that revenue predictions aren't the same as citing a concern for revenue stability. Figure 3 shows that revenue expectations don't influence the likelihood of offering a retirement plan, all else equal. But firms can expect higher revenue growth next year and still feel uneasy about revenue stability. For example, over half of the firms that believe revenue growth will be more than 10% higher next year still cite revenue stability as a major barrier to offering a plan.

[9] Some respondents provided explanations of why they didn't offer a retirement plan. Many firms with 0 to 4 employees were self-employed or worked with part-time employees or contractors on an as-needed basis. They may not be aware of options such as solo 401(k)s and SEP IRAs, or they may not consider having a retirement plan for themselves as "offering" a retirement plan.

[10] The mid-tier plan offered by Guideline costs $79 a month and $8 a month per participant. The mid-tier plans from Betterment and Human Interest cost $150 a month and $6 a month per participant. Fidelity offers a small business retirement plan that charges a $500 startup fee and a $300 per-quarter administration fee. However, it also requires employers to match employee contributions, which can increase costs.

[11] Drobleyn (2023).

[12] Data from the National Compensation Survey show that the share of firms with fewer than 50 employees offering retirement plans grew from 48% in 2019 to 52% in 2021. This 4-percentage-point growth is the largest increase in coverage in over a decade, likely driven by labor shortages and increased competition for workers.

[13] The average salary of employees is the best predictor of whether a small firm will offer a plan in the first five years of establishment. Firms where the average salary is above $30,000 are much more likely to begin offering a plan in the first five years. Not much difference exists across salary bands at higher salary ranges.

[14] Theoretically, it's unclear how firms might respond to mandates for state-sponsored retirement programs. Firms could stop offering their own plan and treat state-sponsored plans as an alternative to offering a retirement plan. Alternatively, a state mandate could be the catalyst needed to encourage firms to offer their own plans and change business or industry norms.

[15] A recent study, linking Form 5500 data and individual-level Census data, found that auto-IRA mandates increase the probability of firms offering a retirement plan by 3% and the probability that a worker participates in an employer plan by 33% (Bloomfield, et al., 2023). A similar study by Guzoto, et al. (2022), also found that state auto-IRAs complement the private market for retirement plans.

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