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## **Automatic enrolment to pension plans in small organisations: A research agenda**

### **ABSTRACT**

**Purpose** – This paper analyses how firm size impacts pension workforce coverage with a particular focus on automatic enrolment (AE) to pension plans in small organisations.

**Design/methodology/approach** – The paper examines the alignment of government AE interests with those of small employers, their employees and pension providers to better understand how firm size impacts pension workforce coverage.

**Findings** – The alignment of interests between stakeholders (government, pension providers, employers and employees) differs between large and small organisations and empirical findings from large organisations cannot be assumed to apply in small organisations.

**Research limitations/implications** – The paper calls attention to the need for future empirical research and identifies a number of research questions for further analysis to examine how AE impacts pension participation in small organisations and advance the field.

**Originality/value** – The policy of automatically enrolling employees into occupational pension plans, recently legislated for all eligible workers in the U.K. and under consideration in the U.S. and Ireland, was developed from research conducted in a small number of large organisations. Pension coverage is particularly inadequate for the large number of employees working in small organisations (1-49 employees). However, little research attention has been focused on pensions in small organisations with pension policy makers assuming that legislated automatic enrolment (AE) will work as effectively in small organisations as it did in large organisations. This paper addresses this gap in the field.

**Keywords:** Pension, automatic enrolment, small organisations, defined contribution

**Article Type:** Conceptual paper

## INTRODUCTION

Research indicates serious shortfalls in both pension coverage (i.e. the proportion of the workforce investing in occupational pension plans) and in the adequacy of retirement savings to meet future income needs during retirement in the U.S. (Munnell and Bleckman, 2014), the U.K. (Sass, 2014) and Ireland (OECD, 2013). A commonly cited reason for insufficient pension coverage is inertia, the behaviour of doing nothing and allowing the current situation to prevail. In the context of pensions, inertia describes organisations that either: (i) offer pensions as a benefit but employees never sign up or delay enrolment for long periods; or (ii) do not provide access to a pension and their employees fail to join a private pension plan.

Legislated automatic enrolment (AE), requiring all employers to automatically enrol their employees into a pension plan, is seen as one solution which harnesses inertia and provides pension access to vulnerable groups who currently rely on a state pension. The research that drew attention to AE, and its promising potential to address inadequate pension coverage, was conducted in three large organisations where employees were automatically enrolled into their occupational pension plan, but allowed to opt out (Choi *et al.*, 2002; 2004a; 2004b; Madrian and Shea, 2001). This research found that many of the individuals in demographic groups (black, Hispanic, young, low income) that traditionally failed to ‘opt in’ under voluntary enrolment conditions, did not ‘opt out’ after they were automatically enrolled into a pension by their employers. This finding excited policy makers because these groups were the most at risk of poverty after retirement because of insufficient pension savings.

The research reported by Madrian & Shea (2001) and Choi *et al.* (2002) influenced the pension policy debate in the U.S. resulting in legislation that allows organisations to use pension plan defaults to automatically enrol employees into pension plans. The U.K.

government recently implemented a more aggressive policy: all employers are required to automatically enrol eligible employees into an occupational pension plan. Similar legislation is being considered in the U.S. (Munnell *et al.*, 2012) and in Ireland (Ireland, Department of Social Protection, 2015).

A policy of legislated AE is based on the assumption that the success experienced by large organisations, voluntarily implementing AE as a feature of their occupational pension plan, can be replicated in all organisations, irrespective of size (Sunstein, 2013; Lunn, 2012; Dolan *et al.*, 2010). This paper argues that this assumption is flawed. Willis (2013) contended that AE in these large organisations was successful because the interests of key stakeholders including pension providers, employers and employees were aligned. Building on the work of Willis (2013), we suggest that the interests of key stakeholders differ depending on the size of the organisation. Pension providers are less interested in small organisations because transaction costs are high and asset accumulation is limited compared to large organisations (Wood *et al.*, 2012). The characteristics of small employers differ from large employers; they have less resources (Hallock, 2012) and a limited capacity to develop and implement a pension plan (Beeferman and Becker, 2010). Employees of small organisations are generally paid less (Ireland. Central Statistics Office, 2014b; U.S. Bureau of Labor Statistics, 2015) and have shorter employment tenure (Hope and Macken, 2007) than the employees of large firms, characteristics associated with un-pensioned members of the workforce. While Willis (2013) explained the success of AE observed in large organisations resulting from aligned interests, we argue that the unaligned interests of stakeholders of small organisations will not increase workforce coverage as policy makers predict.

Therefore, firm size is a critical but, to date, unexplored consideration in pension literature and research. Our paper aims to address this gap by explicitly analysing the role of firm size, its effect on stakeholder alignment and the potential impact on pension workforce coverage. In so doing, this paper makes a number of important contributions to the field. First, to our knowledge, this is the first paper to specifically critique AE in pensions in a small organisation context. Small organisations are a very significant part of the Irish, U.K. and U.S. economies accounting for 49%, 48% and 27% of all private sector workers, respectively. Furthermore, it is these employees in particular who are the key focus of AE policy, yet, empirical research in the field to date has not focused sufficiently on these organisations or employees. Second, alignment of interest among pension stakeholders has been identified as critical for impacting pension behaviour yet this issue has not been examined to date in the context of small organisations. Furthermore, alignment of government interests with other stakeholder interests is largely absent from the debate. This paper specifically examines the alignment of government AE interests with those of small employers, their employees and pension providers. Third, we identify two employment characteristics, wages and labor market attachment that tend to differentiate employment experiences in small versus large organisations; these characteristics need to be considered in AE pension policy. Fourth, we propose a number of important research questions that should be tested through empirical research to better understand how AE in pensions will impact small organisations and employees of small organisations.

The paper commences by discussing the empirical research by Madrian and Shea (2001) and Choi *et al.* (2002; 2004a; 2004b) that reported on the success of AE in a small number of large organisations. The following section considers the objectives of government in legislating for AE. In the context of small business, we examine the alignment of

stakeholders' interests (pension providers, small employers, employees of small business) with government's objectives. We identify key research questions establishing a research agenda that is as important for researchers, managers, HR and industrial relations practitioners in small organisations as it is for pension policy makers.

### **IMPACT OF AE ON PENSION COVERAGE: THE EMPIRICAL EVIDENCE**

A small number of empirical studies in large companies are widely cited as pivotal in concentrating the attention of policy makers on AE as a policy to promote pension participation at firm level which in turn impacts pension coverage at a national level. A summary of these seminal studies is shown in Table 1.

Place Table 1 here

Madrian and Shea (2001) investigated AE's impact in a single large business. Choi *et al.* (2002, 2004a, 2004b) discussed findings from three large organisations implementing AE including the organisation originally discussed by Madrian and Shea (2001). All organisations were U.S.-based and large with 18,000 employees or more. For the studies described in Table 1, the researchers investigated natural experiments, observing the impact of occupational pension policy plan changes on individual behaviour. The policy changes allowed: immediate eligibility to the pension plan without a vesting period; AE (replacing voluntary enrolment) for new hires; and AE for eligible employees who had not yet joined the organisation's pension plan (Company C only). Because employees were automatically enrolled, the companies chose a default contribution rate and investment fund for those employees who did not make an active choice.

Carroll *et al.* (2009: 1640) summarized the research of Madrian and Shea (2001) and Choi *et al.* (2002; 2004a; 2004b) and observed "...a participation default (automatic enrollment) can increase 401(k) [pension plans] participation rates among new hires by more than fifty percentage points..." The results suggested that once enrolled, employees seldom withdrew from the pension plan even in the U.S. where the right to withdraw is protected through legislation. Madrian and Shea (2001:1161) highlighted that AE equalized participation across demographic groups that previously tended not to join their occupational pension plan including "blacks and Hispanics, the young, and employees with low levels of compensation." Many of the individuals in these demographic groups failed to 'opt in' when they were required to voluntarily enrol into the occupational pension plans offered by their employer, but did not 'opt out' when they were automatically enrolled. This was the finding that excited policy makers because these groups were the most at risk of poverty after retirement because of insufficient savings. AE was thus seen as a solution to the pension problem that leveraged employee inertia.

While these findings suggest that AE was very successful at increasing the participation rates in a small number of large firms, researchers and pension policy makers have not engaged in any empirical analysis of the impact of AE on the pension participation rates in small organisations. Employees of small organisations are of particular interest because they are likely to be un-pensioned and are therefore the focus of Government legislated AE. Taking an alignment of pension stakeholders' interests perspective, the next section teases out differences between large and small organisations and proposes important research questions that remain untested in the literature at present.

## **ALIGNMENT OF PENSION STAKEHOLDERS' INTERESTS**

Willis (2013) argued that the success of AE in large U.S. organisations was due to aligned interests stating “With respect to the defaults examined here [including AE], the key is whether the interests of the parties are aligned. In the retirement savings context, the employer, pension-plan provider, and most employees generally benefit from greater participation rates” (Willis 2013:1155). With aligned interests, Willis (2013) argued that defaults such as AE are likely to be ‘sticky’ meaning that employees will maintain their pension contributions following AE rather than opting-out. Though not mentioned by Willis (2013), this paper argues that government is a critical stakeholder legislating for AE with the objective of increasing labor force pension coverage.

#### *Government AE objectives and interest*

Researchers, national governments, the EU and the OECD view inertia as being a major reason why workers do not join pension plans: employees do not engage in the complex decision-making required to voluntarily enrol into a pension plan (see Maloney and McCarthy (2016) for a comprehensive discussion of the complex nature of pension decision-making). In the context of pensions, inertia describes organisations that either: (i) offer pensions as a benefit but employees never sign up or delay enrolment for long periods; or (ii) do not provide access to a pension and their employees fail to join a private pension plan. However, it is also thought that an organisation’s pension participation rate can be improved by leveraging inertia through the use of defaults such as AE, whereby employees, often when they join an organisation or after a short vesting period, become members of their occupational pension plan by default. The underlying assumption is that because of inertia the default is sticky meaning that employees will not take the action required to opt out leading to an increase in the organisation’s pension participation rate.

Governments in the U.S. and the U.K. have taken the view that organisations and government can improve pension coverage and adequacy (level of income required to maintain an individual's pre-retirement lifestyle) while preserving choice by collapsing a complex set of pension choices into the decision to either 'do nothing' or take action to 'opt out' of the pension plan. In the U.K., the *UK NEST Insight 2015 report* noted that although individuals value choice, in relation to pensions, complex choices are an impediment to joining a pension plan. AE harnesses inertia leading to "a sea-change in pension saving" (U.K. National Employment Savings Trust, 2015b: 13).

Governments have taken different actions to promote AE. In the U.S., employers decide whether or not to provide a pension benefit for their employees. Those who offer a defined contribution (DC) type pension plan are encouraged to use AE but employees must be given the choice to remain within the plan or to opt out. In response to organisations' concerns, in 2006, the Pension Protection Act (PPA) protected employers adopting AE, from legal liability of poor investment returns resulting from those plans, as long as the default investment fund complied with regulations specified by the Department of Labor and the Internal Revenue Service (U.S. Department of Labor, no date). However, in the U.S., further changes are being considered to increase participation rates. In 2012, the then-President Obama and Senator Tom Harkin (D-Iowa) proposed different variations of AE for employees who are not members of occupation pension plans in order to improve workforce pension coverage (Munnell *et al.*, 2012). Munnell (2015:6) advised that "The most important policy change would be requiring all 401(k)s [DC pension plans] to be fully automatic, while continuing to allow workers to opt out if they choose." All current legislation and proposed U.S. legislation examined to date allows employees automatically enrolled into pension plans to opt out.

In 2012, the U.K. introduced a new pension policy specifically designed to improve pension coverage through AE. It is being rolled out on a phased basis related to the size of the employer. By 2018, all eligible jobholders (those who are not members of a qualifying plan, who work or usually work in the [U.K.](#), earn more than £10,000 a year and are at least 22 years of age) will be automatically enrolled into either an approved occupational pension plan or the National Employment Savings Trust (NEST) developed by the U.K. government, “...to provide employers with high-quality, low-cost plans” (Sass, 2014, p. 1). Employers are required to auto-enrol all eligible employees; within one month employees can decide to opt out. If an employee chooses to opt out or if they discontinue saving, their contributions, tax relief and their employer’s contribution will cease. If an eligible employee begins a new job, they must be automatically enrolled. Workers who have opted out or ceased contributions must be re-enrolled every three years; they are allowed to opt out each time that they are re-enrolled.

In Ireland, all employers are required to organise access to a pension plan but neither employers nor employees are required to contribute. Employers who offer pension plans as a benefit, can require mandatory employee contributions as part of their terms and conditions of employment. In a press release in 2015, the then Minister for Social Protection, Joan Burton, announced the establishment of the Universal Retirement Savings Group with a remit to develop a roadmap and timeline to implement an AE system. (Ireland: Department of Social Protection 2015). [‘A Roadmap for Pensions Reform 2018-2023’ was published in February 2018 \(Government of Ireland, 2018\) and AE is scheduled to begin in 2022. Many of the design features will be decided following a consultation process. However, it is proposed that workers that are automatically enrolled will be allowed to ‘opt-out’.](#)

Recent research contributes to the policy debate, providing insights into aspects of the current Irish pension system that should be retained or changed. Ireland pays a flat-rate State Contributory Pension and researchers argue that it should be retained as a keystone of public policy because: it raises the replacement rate (pension income/pre-retirement income) for those at the low end of the income distribution (Nivakoski and Barrett, 2017); it is the most important source of income for seven of 10 income deciles and minimises poverty rates for the elderly (Collins and Hughes, 2017), and it provides a buffer for retirees if the value of their pension investments fall shortly before retirement (Gallagher and Ryan, 2017).

Researchers also suggest that the current system of tax relief disproportionately benefits high earners (Nivakoski and Barrett, 2017) and therefore it should be changed (Collins and Hughes, 2017). Pension contributions attract tax relief at a standard and/or a higher rate, depending on income. Collins and Hughes (2017) estimated that a majority of workers, about 58 per cent, paid income tax in 2014 at the standard rate of 20 per cent while about 42 per cent paid tax at the higher rate of 41 per cent. However, it was the top quintile of earners that received 75% of the tax support. Collins and Hughes (2017, p. 510) recommend that “an objective of policy should be to establish a better balance in the distribution of public resources to focus them on low and middle income earners, who need them most, and significantly reduce tax reliefs for the highest earners, who need them least.”

To summarize, there is a clear move by Governments to promote AE through legislation in the U.S., U.K. and Ireland to increase labor force pension coverage. Policy makers appear to believe that legislation alone will be sufficient to make defaults stick. However, we will argue that the success of this legislation depends on the organisational context and the alignment of various pension stakeholders’ interests with AE policy.

### *Alignment of pension providers' interests with government AE objectives*

Pension providers have developed products for employing organisations that feature AE in the U.S. (see Utkus and Young, 2016 for details of Vanguard), U.K. (Standard Life, 2016) and Ireland (Irish Life, 2013). These occupational pension plans typically include a choice of investment funds with a default investment fund/strategy for employees who do not make a choice. The default contribution rate is usually matched by an employer contribution. Employees can opt out or change investment funds and contribution rates, depending on the rules of the plan.

Willis (2013: 1201) argues that pension “Plan service-provider compensation often increases when more employees participate or when more assets are under their management.”

Because management costs for investment funds are generally paid as a percentage of assets, more assets result in higher revenues making large organisations potentially profitable to pension providers. Large employers, like those discussed in Table 1, are also attractive clients to pension providers because many of the costs associated with setting up and running a plan can be spread over more employees.

Experience in the U.K. indicates that the interests of pension providers are not always aligned with government who would like to see all employees automatically enrolled into an occupational pension plan. Medium-sized businesses in the U.K. recently completed the mandatory AE process for their employees. Many of these employers already offered pensions as a benefit to some but not all of their employees (see Terry and White (1998) for a discussion of selective pension provision depending on the employee's classification as either 'core' or 'peripheral'). Research conducted by NEST found that 35% of employers were

unable to enrol their entire workforce with either their current or another pension provider (U.K. National Employment Savings Trust, 2015b). Although the reasons for these actions were not explained, another report based on qualitative research conducted with U.K. pension providers in the lead up to AE provides some insight. Pension providers held different views on the ultimate impact of AE. Most believed that their costs will increase in the short-run. Some thought that the costs would fall as more business was written while others believed that, “Conversely... automatic enrolment would lead to the creation of many very small pension pots, which, combined with high employee turnover, would lead to an increase in administration costs, with large numbers of members needing to be enrolled and de-enrolled on a regular basis, while contributing little to their pension plans. Their funds might, therefore, never reach the level required to generate significant revenue...” (Wood *et al.*, 2012: 84). Pension providers in the U.K. may be refusing to enrol groups of employees that they believe are unprofitable. It is likely that small employers with a few relatively low-paid employees with weak labor market attachments will also fit that classification (discussed further below). Given the current lack of research and analysis in this area, the following research question requires empirical investigation to explore possible misalignment between the AE objectives of government and pension providers:

Research Question 1: Are pension providers’ concerns about transaction costs and revenue growth discouraging their active engagement with small employers to automatically enrol their employees into an occupational pension plan?

#### *Alignment of small employers’ interests with government AE objectives*

This section identifies the large number of employees working for small organisations in the U.S., U.K. and Ireland who are un-pensioned and, therefore, the focus of legislators attempting to increase pension participation rates. Relevant characteristics that differ

between large and small organisations include their ability to pay for pensions and their capacity to design, implement and administrate a pension system. We argue that these differences may result in unaligned interests between governments and small business owners decreasing the impact of AE on pension participation.

The classification of organisational size varies according to national and/or supra-national jurisdiction. The European Union (EU) defines organisational size by staff headcount, turnover and balance sheet total (Centre for Strategy & Evaluation Services, 2012). There is some variation but most Irish and the U.K. researchers use the EU headcount standards of micro (0-9 employees), small (10-49 employees), medium (50-249 employees) and large ( $\geq$  250 employees). (For Ireland, see Maloney and McCarthy, forthcoming; Harney and Dundon, 2006; Hughes and Whelan, 1996. For the U.K., see Storey *et al.*, 2010; Hall, 2010; Sheehan, 2014).

The definition of firm size in the US is not standardised. According to the U.S. Small Business Association (2017), “Small business size standards define the largest that a concern, together with all of its affiliates, may be if it is to be eligible for Federal small business programs.” Size is defined by headcount and turnover for each North American Industry Classification System (NAICS) code (United States Census Bureau 2018) and there are large variations in both headcount and turnover depending on the NAICS code. For example, for small organisations, the upper limit of the number of employees varies between 100 and 1,500 and for turnover, the upper limit is between \$750,000 and \$38,500,000 (U.S. Small Business Association, 2017). Within the same agency, the U.S. Small Business Administration Office of Advocacy (2012, p. 1) “defines small business as an independent business having fewer than 500 employees.” The United States Census Bureau (no date)

conducts a Survey of Business Owners and Self-Employed Persons at five-year intervals categorising firm size by 'sales' and headcount. There are nine numeric categories that vary from less than \$5,000 to \$1,000,000 or more for sales and from no employees to 1000 or more employees. Thus, there is not a standard word or numeric classification system for organisational size among U.S. government agencies.

In relation to studies conducted to investigate HR practices in organisations relating to size, most U.S. researchers use headcount, but the definitions vary. Oi and Idson (1999) consider the wages of employees by firm size using the following numeric categories of headcount, 1-19, 20-99, 100-499, 500+. Only 500+ is identified as 'large'. Recent studies looking specifically at the HR practices of 'small' organisations, define them as having 100 employees or less (Brandon, 2013; Munnell *et al.*, 2012; Kaman *et al.*, 2001; Hornsby and Kuratkol, 1990). Earlier U.S.-based studies are less consistent identifying 'small' as a maximum of 300 employees (Amba-Rao and Pendse, 1985) or between 25-250 employees (McEvoy, 1984).

Thus, U.S. definition of small is complicated. However, the United States Census Bureau (no date) allowed for the aggregation of enterprise size using EU classifications (where small is <50 employees). Table 2 indicates that small organisations are a very significant part of the Irish, U.K. and U.S. economies and they account for (respectively) 49%, 48% and 27% of all private sector workers.

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The un-pensioned component of the workforce is mainly comprised of the employees of many small employers. In 2012, over 98% of Irish firms had less than 50 employees;

approximately 75% of the employees of small organisations were not members of employer-sponsored pension plans in Ireland (Maloney and McCarthy, in press). Although the U.K. is a much larger economy, the proportion of small organisations and the number of employees working within those firms is very similar to Ireland. As indicated by Table 2, in 2014, 99% of U.K. firms employed less than 50 employees and 48% of private sector workers were employees of those firms. In 2003, before the introduction of AE, the U.K Pensions Commission (2004) reported 70% non-participation in any pension plan for firms employing 1-49 employees.

The U.S. economy is much larger than either the Irish or the U.K. economies. Although the proportion of firms with less than 50 employees is similar to Ireland and the U.K., the proportion of employees working in those firms is significantly smaller. The United States Census Bureau (no date) reported that in 2012, 95% of the firms employed fewer than 50 employees and about 27% of private sector employees worked in those businesses. [Using data from the United States Census Bureau, Munnell \*et al.\* \(2012\) calculated that 61 per cent of employees without a pension plan worked for employers with fewer than 100 employees and 39 percent worked for employers with 100 or more employees. A report conducted by the United States Government Accountability Office \(2012\) using Department of Labor and IRS data found that plan sponsorship varied with firm size within the category of 'small'. While 31 percent of employers with 26 to 100 employees sponsored a pension plan, the percentage fell for smaller firms: 12 to 25 employees \(26 per cent\); 5 to 11 employees \(18 per cent\); and 1-4 employees \(5 per cent\).](#)

We suggest that if it is voluntary for organisations to offer occupational pension plans, the ability to pay for the benefit, currently and in the future, is a pre-condition of that choice.

Total labor costs significantly impact on competitiveness. Ultimately, they must be paid for by the customer (Milkovich *et al.*, 2014; McGill *et al.*, 2005). The ability of an organisation to pay more or add benefits to its reward system is related to the higher productivity of its employees which it can return to them in the form of pay or benefits (Hallock, 2012; **Oi and Idson, 1999**). The ability to pay is a key consideration for any small organisation to offer a pension plan as a benefit. Armstrong (2002: 403) argued that a benefit strategy should not only be currently affordable, "...the forces that are likely to shape future benefit design and financing should also be analyzed."

Wu *et al.* (2015) suggested that large firms were more likely than small organisations to have the resources to recruit specialized managers when implementing high performance work systems; this increased the likelihood of better organisational performance. We argue that although the obvious cost for employers is their financial contribution to their employees' retirement fund, the managerial skill required to design, implement and administrate a pension policy is also considerable, requiring resources that are also related to size. Pension policy development and administration is complicated. Caruth and Handlogten (2001) outlined complications including funding methods, legislated requirements and tax consideration for employees and employers. Because benefits are complex and comprise a significant portion of total pay, Caruth and Handlogten (2001: 165) suggest that "...it is necessary to have specialists design, administer and monitor an organization's program." Organisations often seek help from pension providers, independent financial advisors, advisory firms, payroll professionals and accountants (U.K. National Employment Savings Trust 2015b). To overcome this complexity, the large organisations described in Table 1 outsourced pension administration to Hewitt Associates.

Kotey and Slade (2005) suggested that as organisations increased in size, the owner-manager was required to assume a strategic role, hiring managers for operational activities. Large organisations are likely to have several HR managers including one or more compensation and benefits specialists to develop and implement their pension policy. Research conducted in the U.S. (McEvoy, 1984; Little, 1986) and the U.K. (Storey *et al.*, 2010) suggests that most small organisations do not have HR or employment relations (ER) managers. Therefore, responsibility for designing and implementing a pension policy would have to be added to the responsibilities of the business owner or a manager who is likely to have a wide variety of diverse roles and to lack specialist knowledge concerning pensions.

A thorough discussion of the set-up and ongoing costs of AE for employers in the U.K. was commissioned by Creative Auto Enrolment and written by the Centre for Economics and Business Research (Cebr). Cebr suggests that it requires 103 man days to set up the pension plan and 3.5 man days per month for recurring pension tasks (Cebr, 2013) representing very significant resourcing and time investment at organisational level. It is concerning that one of the key objectives of AE policy in the U.K. was to limit, as much as possible, the administrative and regulatory burden on small businesses (Johnson *et al.*, 2010) and yet there is clear evidence that pension administration and management at the organisational level is complex and time-consuming. Small organisations are likely to believe that they will be adversely impacted if they are mandated to offer AE pension plans compared with large organisations who have better resources to fund and manage pension plans. Patricia Callan, the head of the Small Firms Association (SFA) in Ireland, in a statement to the Universal Retirement Savings Group voiced fundamental opposition of the SFA to mandatory pension provision. She stated, “Mandatory pension provision will prove costly to employees, to business and to the Exchequer, without any associated benefits in the long term. As such, the

willingness of both employees and employers to accept compulsory pension savings is seriously questionable” (Small Firms Association, 2015).

Maloney and McCarthy (in press) observed the low pension participation rate of the employees of small businesses, following legislation requiring employers to provide access to a pension plan both in Ireland and the U.K. They suggested employers could either ‘organise’ or ‘sponsor’ a pension arguing that employers who organise, do the minimum required to comply with legislation while those sponsoring a plan are more likely to be committed to its success. Maloney and McCarthy (in press) argued that this could explain the large number of pension plans in Ireland that actually have no members. Further, they suggest that the importance of employer commitment in promoting pension participation is not sufficiently understood and this gap of understanding may hinder subsequent policies to improve workplace pension participation rates.

According to Willis (2013), when a party is against a pension default, it makes it easy and appealing for individuals to opt out. Using an example from the banking industry, Willis (2013: 1174) describes the circumstances that favour ‘slippery’ defaults, “(1) one party opposes the default strongly enough to incur costs trying to make the default slippery, (2) that opposed party has access to the party the default aims to aid (typically a consumer) when the consumer is in a position to opt out, (3) the consumer finds the decision confusing, and (4) the consumer lacks clear pre-existing preferences about the decision.” It is important to apply the conditions described by Willis (2013) to the situation of small business owners. In relation to conditions 1 and 2, small employers have a motive to make defaults ‘slippery’ to reduce administrative and labour costs. In small businesses, with less than 50 employees, owners and senior managers are known to employees and rely on informal communication.

In the U.K., National Employment Savings Trust (2015b: 33) highlights that 91% of small business owners, "...typically communicate face-to-face with workers about HR, staff benefits and pension related issues, and 61 per cent use team meetings." A smaller proportion use written communication in the form of letters (40%) or e-mails (34%). A compliant small business owner could subtly convince employees to opt out of automatic enrolment using informal communication by simply stating, "Remember the financial crisis? People with pensions lost thousands. Of course, this is your decision." An informal communication strategy that undermines pension participation could be adopted at a low cost resulting in substantial savings should employees decide to opt out.

Willis' (2013) third and fourth condition relate to the employee, the potential pension plan member. Most pension stakeholders, including the employers of small organisations (Maloney and McCarthy, forthcoming) and trustees (Sayce *et al.*, 2014) find pension decisions difficult. For the employee, the decision can be overwhelming, resulting in inertia as discussed above. Diamond and Barr (2009) summarise this confusion stating, "People often fail to make choices that maximise their long-term well-being or that of their families, and often make no explicit choice at all—a common result where excessive choice or excessive complexity becomes overwhelming" (Barr and Diamond 2009, p. 8). It is also clear that employees do not have well-established pension preferences. In the research of Madrian and Shea (2001) and Choi *et al* (2002, 2004a, 2004b) discussed above, pension plan members overwhelmingly remained in defaults although those choices were seldom chosen by previous cohorts of employees under conditions of voluntary enrolment. The confusing pension decision combined with weak preferences suggests that employees will be susceptible to the influence of their employer.

The U.K. Pensions Regulator was so concerned about slippery defaults that it enacted regulations to prevent employers from practicing ‘inducement’ described as an employer intentionally influencing eligible employees, job holders and applicants to opt out of their pension plan following AE. The legislation was designed to deter “the minority of unscrupulous employers” from “...trying to gain unfair commercial advantage over other compliant employers” (U.K. The Pensions Regulator, 2012, p. 8). Because small employers are only now automatically enrolling their employees into pensions plans, it is unclear if only a few employers are ‘unscrupulous’ and if the legislation is sufficiently robust to catch employers using subtle, informal communication to persuade their employees to opt out of the pension plan.

To summarise, should the owner of a small business oppose AE pension provision, it may not be difficult to convince employees to opt out. As suggested by Callan (Small Firms Association, 2015), the interests of the employers and employees of small organisations may not be aligned with government resulting in low participation rates for small organisations. Therefore, we suggest that the following research question requires empirical research to anticipate misalignment between the objectives of government and small firm owners, given the very different circumstances that prevail for small compared with large organisations:

Research Question 2: Will small employers’ concerns about the resources required to design, implement and pay for the ongoing costs of AE influence them to either discourage or fail to encourage their employees to remain members of their occupational pension plan making the default slippery?

*Alignment of small employees’ interests with government AE objectives*

This section identifies two key differences between the employees of small and large firms: labor market attachment and wages. We argue the interests of the employees of small organisations may not be aligned with government in relation to pension participation through AE because their employment is less secure and they receive lower wages than the employees of large organisations.

Before AE was enacted, Madrian and Shea (2001) and Choi *et al.* (2004a) reported that pension plan membership increased with employment tenure. Beferman and Becker (2010) suggested that the findings from these large organisations may not be replicated if AE is introduced in smaller organisations because employment in large organisations is relatively stable when compared to employment in small organisations. Hope and Macken (2007: 28) reported that "...we were able to determine that, even after accounting for the effects of union membership, fringe benefits, and earnings differences, employees of large establishments stay in their jobs longer than employees of small establishments." In the U.K., Johnson *et al.* (2010:49) recognised that although 'job churn' impacts all enterprises, the workforce turnover for small organizations was greater, "...with the smallest firms having the highest proportion of workers with less than a year's tenure."

Weak labor force attachment was identified as an impediment to retirement savings in Ireland (O'Connell and Gash, 2003) and in the U.S. (Wu *et al.*, 2014; Wu and Rutledge, 2014; Shuey and O'Rand, 2004). Workers in unstable employment, i.e. employed after periods of extended unemployment or intermittently unemployed, were less likely to become members of pension plans when compared to workers in stable employment. In research that investigated the pension gap observed for older workers, using longitudinal data from the Health and Retirement Study, Wu and Rutledge (2014: 12) found that employees working in

organisations with a pension plan have longer tenure and were more likely to have had pensions in previous employment "... suggesting that some workers seek out jobs at pension-offering firms." They highlight that it is impossible to infer causation. From the data, it cannot be determined if workers join pension plans because of stable employment or if workers seek jobs in organisations with pensions. Weak labor market attachment may impact on the willingness of workers to participate in a pension plans, even if they are automatically enrolled. Therefore, we suggest that the following research question requires empirical research to see if the objectives of government and the interests of employees of small organisations are aligned.

Research Question 3a: What is the impact of weak labor market attachment on the continuing participation of the employees of small organisations who are automatically enrolled into their organisation's occupational pension plan?

Differences in wages for workers of different sizes of organisations may also impact on pension plan participation. The significant differences in average weekly wages for the employees of different sized enterprises operating in Ireland and the U.S. are shown in Table 3.

Place Table 3 here

In Ireland, for example, the average weekly wages for the employee of a small firm is approximately two-thirds of the income of employees of large firms (Ireland. Central Statistics Office, 2014b). The lower wages paid to the employees of small business may impact on their willingness to participate in a pension plan even if they are automatically

enrolled. To test if the interests of governments are aligned with the interests of employees of small organisations, we propose empirical research on the following research question:

Research Question 3b: What is the impact of low wages on the continuing participation of the employees of small organisations who are automatically enrolled into their organisation's occupational pension plan?

There is a limited amount of research that links wages to labor market attachment and while this research considers the combined impact on pension savings for older workers in particular, it is relevant to the discussion here. Duvvury *et al.* (2012: 2) conducted qualitative research in Ireland and summarized the situation of older working women stating, "Many women in the sample were involved in seasonal work, piecework and short-term contracts and this (especially combined with low pay) made it extremely difficult for them to commit to contributing regularly to pensions." Wu *et al.* (2014) report on U.S.-based research having compared pension coverage for lower- and higher-income individuals aged between 50 and 58. They suggest that for the older cohort of workers, low income impacts on occupational pension membership in two ways stating "We find the substantial pension gap between higher- and lower-income individuals is driven primarily by lower-income individuals' weaker labor force attachment and by their lower pension offer rates among those who do work" (Wu and Rutledge, 2014: 2). Thus, the combination of low wages and job insecurity are organisational size contingencies that may adversely affect the ability of the employees of small organisations to contribute to pensions regardless of the fact that they are automatically enrolled into them. Therefore, we propose the following research question:

Research Question 3c: Does the combined impact of weak labor market attachment and low wages have greater impact on the continuing participation of the employees

of small organisations who are automatically enrolled into their organisation's occupational pension plan than each characteristic separately?

## **CONCLUSION**

Policy makers and researchers argue that pension plan complexity leads to inertia, creating a pension problem in terms of inadequate participation and contribution rates. With inertia identified as the problem, AE is considered to be the solution. Employees of small organisations (1-49 employees), who rely primarily on state-sponsored pensions at retirement and who are un-pensioned are seen by policy makers as key targets of legislated AE. However, this assumes that an AE policy will work the same way for small organisations as it did in the small number of large firms studied by Madrian and Shea (2001) and Choi *et al.* (2002; 2004a) from which AE policy has been largely derived. This assumption remains untested at either a conceptual or empirical level in the literature.

Building on the work of Willis (2013), we agree that the success in increasing the participation rate in the three large companies discussed by Madrian and Shea (2001) and Choi *et al.* (2002; 2004a; 2004b) was a result of the aligned interests of four key stakeholders: government, pension providers, employers and employees. We argue that for small organisations, the interests of pension providers, employers and employees may not be aligned with the government objective to increase pension participation in the same manner as found in large organisations. Pension providers may not be interested in offering pension products to small organisations and their employees because transaction costs are high and pension plan revenue may be slow to accumulate for small numbers of employees, with relatively short tenure and low wages. We demonstrate that it is potentially easy for small employers, lacking the financial resources and capacity to develop, implement and

administrate a pension plan, to subtly influence their employees to opt out of the pension plan using informal communication. Employers have motive and opportunity; their employees are likely to have weak preferences and face a very complex pension decision. Further, employees working in small organisations may be willing to opt out because many struggle with insecure employment and low income. Those who are the main targets of a legislated policy of AE are arguably the least likely to remain in a pension plan.

Therefore, government legislation requiring AE may not prove as powerful and the ‘sticky’ defaults observed in large organisations may be ‘slippery’ in small organisations. However, further research is needed to expressly examine AE alignment of stakeholder interests across all organisational sizes as the empirical evidence to date focuses only on large settings.

It is clear that AE changed employee behaviour in the large organisations reviewed in this paper but there is little explanation of why this happened. Case study research in small and large organisations would help to identify the attitudes of employers toward AE pension plans and the impact, if any, on employee decisions. Such research will help to identify how pension policy makers, employers and employees can benefit from AE pension plans and provide evidence-based recommendations for ensuring effective AE policy design and implementation across all organisational sizes. Enhancing the AE and small organisations’ empirical research base is also important for small business owners and managers who have various industrial relations and HR responsibilities including rewards and pensions.

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