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Clear Path for



Contract Labor

Future Pharmaceuticals speaks with **Gene Zaino**, President and CEO of MBO Partners, about independent contractor risk mitigation and compliance within the industry's changing talent management landscape

Future Pharmaceuticals What are the current trends for the contract talent workforce and are they problematic?

Gene Zaino Throughout the industry there is a change in the landscape of the workforce. More and more organizations are engaging their workers in nontraditional fashions; there is growth in what the industry calls "contingent labor" or contract work. In fact, a recent research report by the Human Capital Institute, which is a think-tank for human capital around the world, found that 85 percent of organizations, even in this climate, are either staying consistent or increasing their use of contract labor. Contract labor today is anywhere from 7 percent to 20 percent of an organization's workforce and it stems from many different places: it could be staffing companies, small consulting companies, or independent contractors. So just from an empirical perspective of what's going on in the world, more and more people are doing work on a contract basis as opposed to a traditional employment basis. There are many drivers for this.

From a corporate perspective, employee bases need to be more flexible, things happen quickly and you need to adjust to the market, so having a larger percentage of your workforce 'turned on and off' through a contract is more valuable and more competitive to an industry. Secondly,

from a demographic and social point of view, there's a large constituency of people — baby boomers — that are approaching retirement and these people are still going to work, but they're going to work differently. This group consists of knowledge workers; they're very well-connected, they have a lot of good experience, and they deliver valuable intellectual capital. As these individuals retire, they're going to become freelancers or consultants and companies will need to maintain use of their talent. Additionally, with the recent economic climate, many people's retirement plans were cut and they are going to have to continue to work for this reason as well. So there's both the social demographic change, of individuals needing and wanting to work more on a contract basis, and there's the company perspective, where it provides more flexibility. Honestly, in an environment like this when companies need to lay off workers, it is much easier for them; it's easier to lay off a contractor from a public relations point of view and moral point of view, so they're inclined to want to use contract talent for this reason among others.

FP How do these trends specifically impact the pharmaceutical industry?

GZ There are both opportunities and minefields to be aware of. From an opportunity »



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perspective, any organization, certainly in the pharmaceutical industry, needs to have best-in-class talent to be competitive. Higher level talent that is able to have a client base and deliver work on a contract basis is most likely confident, talented and in-demand. That's where the higher-level talent migrates to. Organizations that are able to embrace the engagement of this talent, what I would call an independent-contractor magnet (you need to be a magnet to attract these people) will have a competitive advantage in the marketplace. This is especially true in the pharmaceutical industry, where intellectual property is paramount. From the opportunity point of view, there's a chance to ensure the industry is embracing the talent in this segment of the workforce.

From a minefield perspective, we need to be very careful in how we do it. There are a tremendous number of issues regarding engaging individuals as non-employees. Those range from the IRS, to benefits issues, to public relations. There are several areas of concern that you need to manage, but the IRS is probably the most prominent. In a recent report, the IRS discusses the "tax gap," which is the amount of money they received versus what they think they should have received based on tax laws. Of that tax gap, which was about \$350 billion in 2007, approximately \$240 billion is attributable to self-employed individuals. So the IRS has an issue: How do we close this tax gap? The IRS, in turn, is developing tools. One of the biggest is they have put the burden onto the organization that pays the self-employed worker. They audit organizations that use independent contractors. The IRS could come in and reclassify these workers from independent contractors to W-2 employees and charge the organization all of the taxes and penalties going back to the employee's inception — millions of dollars are at risk. It can lead to bad PR and it becomes a cascading negative impact on a company. So it's very important to know and have the right programs in place to attract and engage this talent, but also to manage and mitigate the risks.

FP Where do changes to the models for engaging talent fit in?

GZ There are options to either build an internal program or work with third parties. Generally, this area is handled by the HR Department or Procurement Department, or there are organizations that are actually building a contract engagement group which reports to Procurement and HR. You need a well thought out program that manages the risk as well as makes it easy for

"CONTRACT LABOR TODAY IS ANYWHERE FROM 7 PERCENT TO 20 PERCENT OF AN ORGANIZATION'S WORKFORCE..."

the talent to be engaged for the company. There are staffing companies that can help, or consider independent contractor engagement specialists, such as MBO Partners. We focus on the independent consultant.

The way to begin this is through an assessment program. As the consultant or contractor comes on board you have an automated tool, so they answer some questions online, fill out an enrollment set of data, and based on the business rules the program will assess whether they are compliant as an independent contractor. If they are, all of the data, forms, and proof of compliance are maintained electronically online, so in the event that there is an audit in the future, you have good documentation and proof that this person is legitimately classified as an independent contractor. That's one important best practice: if they are not compliant in the assessment process on the way in, then you need to engage them and make them an employee of someone.

What we do at MBO Partners is we actually give them the ability to become a W-2 employee through us, but they are running their own business unit within MBO. This gives them the mindset and the flexibility of being a freelance, independent worker while at the same time they don't have to worry about compliance in a tax perspective: their estimated tax payments are covered, their Social Security and Medicare taxes are paid, their income tax is withheld. Then, because we have a group of thousands of people, they also get access to things like group medical and life insurance.

There are other ways of solving this problem: you could send them to another vendor in

your supply chain and have that vendor employ them; traditionally this happens a lot. Then these vendors "mark them up" 15 or 20 percent and it tends to drive up the cost structure. Also it generally does not make the individual worker very happy because they feel they are not directly connected to their client and they tend to get angry that someone is taking 20 to 40 percent of their compensation just to engage them. So those are old-fashioned ways of getting around the problem. Today, there are new, best-of-breed programs that are highly automated and manage the risk while making it very easy and cost-effective for these individuals to be engaged with the organization.

FP What are some options available for engaging talented people in new ways?

GZ Companies could engage them as part-time workers, which tends to have another set of issues. For the company, there are part-time rules, such as the threshold for benefits. If a company is engaging a retiree, you really need to look carefully at your benefit plans to make sure you're meeting all rules. So re-engaging them as an employee is not very "clean" for either side.

Another option is for them to create their own company, which requires cost and administration to maintain and does not necessarily make them compliant. The IRS wants to ensure that these people are properly paying their taxes and the fact that someone has created an LLC or S-Corp doesn't necessarily give the organization using them the insight and protection that they need to make sure they are properly



GENE ZAINO, is President and Chief Executive Officer of MBO Partners. After four years with KPMG Peat Marwick as a CPA and management consultant, Gene spent 20 years building, merging and selling various consulting companies, some funded by Kleiner Perkins Caufield & Byers, Austin Ventures and Goldman Sachs. He serves on the advisory board for the Human Capital Institute and has led seminars at the Project Management Institute, the Institute for Supply Management, and the Military Officers Association of America.

complying with the tax laws. Audits for pharmaceutical companies can come not only from an audit on the company, but could also come from one of the independent contractors that the IRS was auditing individually. If it was identified that they were getting paid from a certain pharmaceutical company, then the audit could escalate into a higher level.

FP What about the ever-present issues of benefit plans and pensions? Speak to options in this area?

GZ From the freelance individual perspective, it's very difficult for them to get insurance on their own. Buying an individual medical insurance plan is very difficult and if you do get it it's individually rated, kind of like car insurance, so if you ever have to use it your rates go up. That's the way medical insurance works for an individual if you're not part of an employee group. There are associations that provide medical insurance, but it's the same thing, you're rated

individually and even if the association has a group discount; you're still rated based on your health and your usage of the plan. The only true group health insurance attainable is from an employer. Until this changes, it's very difficult for a freelancer to obtain medical insurance, disability, and all the other commonly obtained group benefit programs. In the program that we offer for these individuals, they become part of an employee group and they receive access to true group health benefits. So from the freelancer's perspective, by joining an organization that provides them with what we call, "portable employment," they receive not only conveniences of being in their own practice area of their own consulting group; they receive access to group employee benefits as if they were plugged into a very large Fortune 500-type company.

We have studied the issues that consultants have today and have spent a lot of time and resources, both on a process and structure point of view as well as from an automation

point of view, and we've negotiated programs with some of the major insurance providers. This alleviates concerns and allows these talented, creative freelance people the ability to do what they do best while we handle their back-office and employment issues.

FP What is one thing you would like our readers to take away from this interview?

GZ Pharmaceutical companies do have people that are misclassified; everyone does. And if they don't realize they have risk and they don't realize that they need to build a program to attract these people, it's a double-edge sword. They need to get together with their legal team, they need to get together with the HR and Procurement team and they need to build a program that provides them competitive advantages to get access to this talent while mitigating and managing their risks. That is the underlying message I'd like for readers to take away because it is a very big, strategic issue to the organization. **FP**

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CHANGE IS COMING. ARE YOU READY?

The new administration is in favor of legislation that would eliminate "industry practice" as a justification for misclassifying workers as independent contractors. But you don't have any contractors, do you?

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