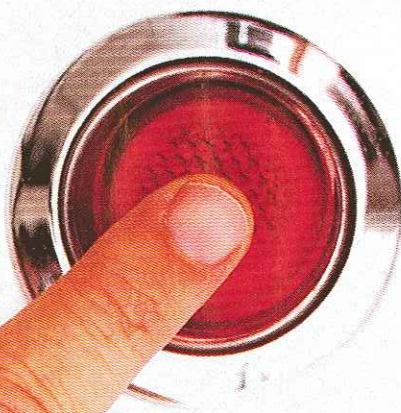


RESET



RESETTING THE STAFFING BUTTON



Step 1.

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Start over with a clean slate.

Overview

Staffing is tied to the new economic realities. This article outlines the economic prognosis then correlates that with the new staffing landscape, following through with specific advice and examples for both commercial and professional staffing firms.

The economic situation we find ourselves in has been coined the resetting of the economy by the CEOs of Microsoft (Steve Ballmer) and GE (Jeff Immelt). Others are calling it the "new normal," while Time magazine's recent cover story was "Reset, the End of Excess" about why this crisis is good

for America, describing a recalibration of expectations that is taking place at a lower starting point that should result in a more sustainable level of goods and services over the long haul. This process is taking place worldwide with a fundamental economic restructuring, which will hopefully avoid the historical 8-to-10-year boom-bust cycle we have seen over the last half century that climaxed a year ago in the financial and housing collapse and quickly spread to most other sectors. This downturn will be twice as long and three times deeper than the last two recessions.



Resetting the Staffing Button

This economy has had a dramatic impact on the staffing industry. But, interestingly, this has the potential of providing substantial opportunities for those companies that can adapt in this new economy.

We are now seeing a greater government role in the private sector but hopefully more sustainable growth. A year ago we were on the brink of depression due to the financial debacle, (see our January 2009 *SI Review* cover story) and passed a poorly thought out trillion-dollar stimulus plan. Although we are not out of the woods yet and any recovery will be a jobless one, it seems that we avoided Armageddon, but there are other problems to come, including defaults on commercial and consumer credit cards.

This economy has had a dramatic impact on the staffing industry. But, interestingly, this has the potential of providing substantial opportunities for those companies that can adapt in this new economy. It may provide a favorable landscape for those temp companies that can restructure themselves, which we will be describing here. The trick is to be able to navigate through the short- to medium-term challenges to take advantage of longer-term opportunities. Although you have to get your costs under control now to compete, drastically cutting costs and going into a shell is not the answer.

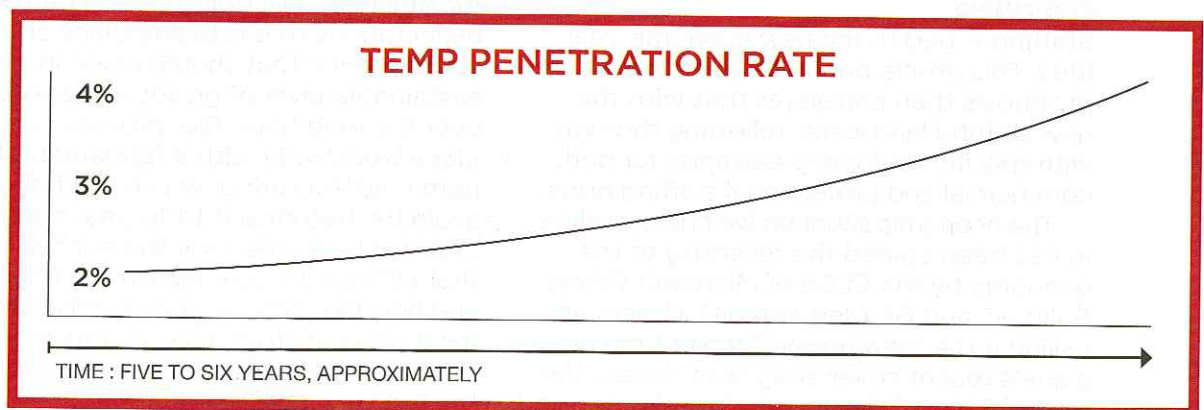
We will see a maturation of the economy, but the boom times of the last 25 years are over, with their conspicuous consumption, excessive

speculation, overly compensated senior executives and ever-increasing corporate profits. If you run your company efficiently you will not only survive through the downturn but also will be positioned for the next stage in the economy, where temp staffing should prosper.

Temp currently represents some 2% of overall employment. Due to the resetting of the economy, a need for a more flexible workforce, lower operating costs, etc., we may well be moving to the European model where 10% of their labor is contingent and 4% comes through staffing agencies (one third of Spain's workers are now contingent). If this materializes, the temp market would double over time (see below).

Precursor to the Economic Mess

Here are the unpleasant facts. Although some Cassandras sounded the alarm, we did little to stop the evisceration of financial regulations, unbridled Congressional earmarks, the revolving door of special interest lobbyists funneling billions to campaign contributions and were not all that concerned about our system of checks and balances. The recession may technically end in the second half of 2009, but unemployment will not likely be below double





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digits for two more years. Profits are down for almost all corporations and although terminations are easing, it was impossible to keep up with the initial cuts, while compensation freezes are the norm, even for profitable firms.

Only one in five new graduates are getting jobs, and those who have jobs are receiving lower salaries, the impact of which typically lasts 15 years into the career-reducing future buying power, which bakes lower consumer demand into the system. Congress is unlikely to fund any more stimulus programs, and financing for both consumers and businesses is still slow. The default rate was inevitable and ongoing as home prices quadrupled in 30 years, while inflation-adjusted compensation was unchanged. The Dow Jones rose 17-fold over the last 25 years (for a 12% compounded growth rate) before it finally peaked and then fell by 50%-plus before partially recovering.

For perspective, it took the stock market a quarter century to recover from the 1929 crash. Our savings rate, once at 11%, fell to 1% before the reset, and now is at 7% and rising as people have realized that they can only count on themselves for survival. The mindless credit card-induced spending spree is over. The concept of frugality is really catching on now and is likely to stay for quite a while, eating into our ability to spend our way back to prosperity. Eight years of overspending, narrowly avoiding a depression and recognizing that job growth will be slow has really sobered people.

The Internet and offshore production brought down costs, but at the sacrifice of a great many U.S. jobs and our tax base. The proliferation of easy credit exacerbated the situation. Buying things we couldn't pay for and over-leveraging became a way of life. No one wanted the party to end, and we ignored the danger signals of an unsustainable level of increasing home values, while investors capitalized on the situation.

The Current Reality

We have finally learned that lowering taxes while increasing spending is unsustainable. We are seeing the initial signs of a turnabout in individual states where the relative decline has bottomed out. Yet, it may well take three-and-a-half years before state tax revenues return to pre-recession levels, with 11 states having negative GDP growth (Michigan, Indiana, Ohio, Kentucky, Alabama, Florida, Georgia, Nevada, Connecticut, Rhode Island and Delaware). Modest inflation, which is a good thing, has now dipped into negative territory, which is not so good, and creates a whole new set of problems we are not prepared to deal with.

Although there are some positive signs, we have hit bottom and are slowly improving in a shallow L-shaped recovery. We are going through the equivalent of financial detoxification. The effects will be seen in everything from our culture of consumerism to politics and foreign policy. Exactly how things will unfold is unclear but a long-awaited maturation process is underway, and a good many people will see their way of life changed forever. Those who planned to retire now recognize that is an illusion. They have to go back to work and even help out their grown children to make ends meet. People have downsized and have had to prioritize their necessities. There are a lot of angry and frustrated folks out there who don't have much hope.

Some 61% of people in a recent Time magazine survey said they will spend less even when good times return, 40% felt anxious, 31% in the lower middle class have been unemployed during the downturn, 40% of those earning \$100K-plus are economizing, and 25% raided their retirement or college savings plan to make ends meet. There has been a sharp decline in luxury and convenience goods once, but no longer, deemed to be necessities.

Although universal health coverage in some form will likely pass, along with green energy programs,

there will be no free lunch, and businesses and the consumer will have to pay for these services. Yet, new initiatives will generate staffing opportunities in a variety of services and manufacturing sectors. Those firms that can capitalize on opportunities quickly will be winners, just as those that are wedded to old industries, where supply exceeds demand, will see the greatest pricing pressures and should either restructure to meet these changes or may fail, as those staffing firms dependent on GM or their suppliers can attest to.

We have now clearly entered a paradigm shift in the economy. We can't go on printing money forever or running up debt that exceeds the GDP. Taxes will have to be raised to soak up the excess cash that has flooded the system. There are not enough millionaires to foot the bill, and higher taxes will be needed to avoid either bankruptcy or runaway inflation (which will lead to a host of problems with unforeseen consequences). The current budget deficit is twice as high as the next-closest period 65 years ago.

While the "official" unemployment rate may max out at 11%, the true number is in the upper teens. We now have \$100 trillion of unfunded liabilities (i.e., Social Security, Medicare), and the money supply is 10 times normal. In the mid 1970s, when the prime rate peaked at 21.5% in 1980, mortgage rates hit 17%, inflation was 12% and the dollar collapsed.

We certainly don't want to see the effects of these conditions again. The

idea is to stimulate the economy just enough to generate jobs without causing inflation. But in a politically divided nation this will be a neat trick – too little stimulus and it's 1929; too much and it's 1980. The best hope for a soft landing is confidence, modest industrial growth and renewed consumption, with no wild cards such as international incidents or natural disasters.

The Challenge

We will be going through a period of adjustment from the boom-bust cycle to marginal, albeit steady, growth. Savings and investments will rise, as will exports, at the expense of speculation. Some states are more difficult to manage due to political gridlock and antiquated legislation, such as California, which, as the largest state, has a disproportionate impact on employment and the overall U.S. economy.

Our trade and budget deficit will have to be brought under control as economic reality sets in. People who have been burned in the market will hopefully have a more realistic investment strategy. The government may mandate that financial institutions cannot take advantage of those who are too gullible or irresponsible to fend for themselves.

The real question is: As we replaced the British as the dominant world player after World War II and fended off the Japanese a quarter century ago, will we be able to keep China at bay, given its low-cost labor? Even though our manufacturing employment is down 31% over the last two decades we are still number



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one by a factor of 2:1. Will our superior technology, educated workforce, innovation, quality control, automation, value-added services and sophisticated management be enough? Our edge, moreover, has been eroding over the last 30 years. We are now sixth in per capita patents and 18th in educational standings. We are 25% in the critical area of math.

That is the big picture, but on a more granular level, what can a staffing firm do to grow? To be successful several strategies need to be implemented: identify and cut fat, not muscle, quickly; pay attention to your metrics; retain your customers and penetrate new accounts; motivate and retain your staff; and make opportunistic acquisitions at attractive prices.

The New Staffing Landscape

During the last 20 years total IT employment was up 260%, management and technical consulting rose 235%, and healthcare and social services increased 58%. And while overall employment rose only 22%, temp staffing increased 65%. On the industrial side, waste management and recycling was up 60% and 64%, with security guards rising 53%. During the last five years, biotech and environmental engineering just started to heat up, rising 18% and 12%. Dramatic percent growth is expected in business and financial analysis, corporate planning and management consulting, renewable energy, digital devices, networking systems, biotech, genomics and nanotechnology, although the number of people hired in most of these fields will be small.

Over the next 10 years the BLS estimates the areas with the greatest absolute employment growth are in healthcare (up 1,624,000), sales and marketing (up 1,102,000), maintenance (up 345,000), food services (up 452,000), office support, (up 404,000) and post-secondary teaching (up 382,000). As noted above, temp currently represents a 2% penetration within the overall employment market, but this varies significantly by occupation, so this cannot directly translate into temp potentials.

The highest penetration rates are in: information technology at 8%, manufacturing at 6%, engineering at 4%, office and administrative support at 3%, healthcare and social services at 2.3%, accounting and finance at 2.2%, and legal at 1.8%. Those expected to grow at least 40% over the next decade, that also represent a reasonable number of employees include: network systems and communications analysts (up 53%), homecare aides (up 51%), home health aides (up 49%), computer software engineers (up 45%) and personal financial advisors (up 41%). The top five states expected to add jobs during the next 10 years are in the Southeast and Sunbelt: Texas, followed by New Mexico, Florida, Nevada and Georgia. The most anemic prospects are in the upper Midwest: Michigan, followed by Ohio, Vermont, Connecticut and Wisconsin. California is in the middle of the pack.

The ancillary cost of having full-time employees is higher than temps/contract due to payroll taxes, workers comp, health insurance (averaging \$14K/year), a 20% cost associated with office facilities, retirement/401(k) plus the inefficiencies and intangibles associated with full-time staff. In addition, telecommuting opens up occupations to temp/contract workers.

On the flip side, temps are becoming more of a commodity with inevitable pricing pressures. This then leads us to the European model noted above with their 4% temp penetration rate. Due to the reset of the economy, this ramp-up should happen sooner rather than later, even in our L-shaped recovery, but it will take a different type of mentality to be successful in this world.

We have divided temp/contracting firms into two basic categories: commercial staffing companies, which need to have low cost and economies of scale to compete from now on, especially if they service larger clients; and professional staffing companies, where quality is critical to being successful and supporting



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a premium price. Although there will always be room for the small niche or boutique firms, by and large those firms caught in the middle with neither low cost or high quality will have high attrition rates.

Being Profitable in Commercial Staffing

Commercial staffing includes primarily industrial, clerical and hospitality, which are classified as commodities as most clients unfortunately do not perceive that much of a difference between one vendor and another, with competitive (low) pricing tending to be the key to success. Client loyalty is severely tested during this period. This is particularly true when servicing larger accounts where one has to deal indirectly with the client using a VMS or VOP model, and predatory pricing has become a reality. Commercial staffing areas are characterized by high volume and fill ratios, quick reaction time, low margins, high cyclical-ity, low-price earning ratios and high working capital requirements. And in today's conservative lending environment the latter area can be a problem.

The procurement department often makes decisions through its VMS system, and will try to minimize the importance of everything but price, squeezing out every cent through the competitive bidding pricing. The problem is in perception, which is difficult to overcome in a down economy. And profits for both the vendor and the customer may well suffer, for temp production line quality and reliability is just as important a factor as it is for the contractor working in the laboratory or doing programming. Nevertheless, a staffing company must either find a way to meet low-ball competitive prices with economies of scales and efficiencies across the board or be able to demonstrate that low price considered in a vacuum may lead to disaster.

In better times it was far easier to do this by working with managers with P&L responsibility, demonstrating the economic value of quality, reliability, value-added services and therefore explaining

how much money they will lose by pennywise and dollar foolish decisions. The procurement area looks at price alone and often overrules the manager. The consequences may not be seen until it is too late, and you must get your prices and cost down to survive, like it or not. If that is not bad enough, they often go beyond setting bill rate, which at least gave the staffing company flexibility on pay rate, and are dictating mark-ups. Some companies are telling staffing companies how much profit they will "allow" them to earn, dictating not only their bill and pay rates but also their fixed costs.

Well-managed commercial staffing companies can become more professional. But this means developing customized value-added services and demonstrating their bottom line impact to differentiate themselves from their competitors and counter the "pricing only" argument. Typical value-added services include testing and training for candidates and existing employees, performance guarantees, creative billing methods, proprietary screening and matching services, a 24/7 hotline, special certifications, strategic staffing assessments, customized reports, employee retention programs, etc.

Too low of a labor rate sacrifices quality and reduces profits as a result of high absenteeism, scrap, returned goods, etc. For example, saving 5¢/hour on temp labor on a product where labor may account for 10% of cost translates to a 0.5% theoretical savings that is much more than counterbalanced by 1% higher scrap and 2% higher returned goods. The key is financial documentation and getting through to someone with P&L responsibility. When this is not possible you need to lower the cost (and hopefully offset this with higher volume) or walk away and try to use temps on more lucrative jobs.

Another approach is to work on a project solution basis where temp labor is not provided, but a deliverable product; i.e., being responsible for running a department and sharing in the profit improvement that it can bring to the process. But this should obviously only be done by those with sufficient expertise, as it exposed them to contingent liability.

Resetting the Staffing Button

Proforma P&L		Reset Economy	Survival Mode	Restructure	No Low Mgn	Reinvent Co
	Before	Case 1	Case 2	Case 3	Case 4	Case 5
Temp sales	8,000	6,000	7,000	6,000	6,000	10,000
% Reduction		(25)	(13)	(25)	(25)	25
Payroll	5,333	4,000	5,000	4,000	3,872	7,275
Burden	720	540	565	540	523	873
Direct cost	6,053	4,540	5,565	4,540	4,394	8,148
Mark-up	1,500	1,500	1,400	1,500	1,550	1,375
Burden % of payroll	13.50	13.50	11.30	13.50	13.50	12.00
Margin \$	1,947	1,460	1,435	1,460	1,606	1,852
Margin %	24.3	24.3	20.5	24.3	26.8	18.5
Staff cost	775	775	700	700	700	730
Overhead	775	775	700	700	700	725
Fixed cost	1550	1550	1400	1400	1400	1455
% Reduction		0	(10)	(10)	(10)	(6)
Profit bef own Comp	397	(90)	35	60	206	397
ROS %	5.0	-1.5	0.5	1.0	3.4	4.0

Proforma Models

Being Profitable in Professional Staffing

Professional staffing includes healthcare, accounting and finance, IT and engineering, legal and various niche specialties, typically characterized by higher bill rates and margins, higher quality in the recruitment, certification and testing process, longer duration of assignment (except for per diem healthcare), better P/E multiple, higher barriers to entry, etc. The resetting of the economy, however, has degraded many of these upper-end areas into commodities where they are dealing with large accounts under VMS agreements. This applies to highly profitable clients and has even trickled down to mid-sized accounts as everyone is looking to save money, and we see no sign of this abating any time soon. The safe price havens are with smaller staffing users, but this savings is counterbalanced by a higher cost, placing one or two employees at a time.

In professional staffing the quality and value added are usually easier to sell, but again we are operating in a profit-conscious environment today, and getting this message through is a challenge. The key is in demonstrating financial savings, providing value-added services and considering project solutions; i.e., a high quality contract programmer may cost 10% more, but they may out-produce others by 50% for a 40% net savings by writing code with fewer glitches. The task is one of salesmanship, in getting through to someone who understands the process, has a stake in the financial outcome and demonstrates the savings you can affect.

When working through a VMS, whittle down your costs so you can make a profit, or walk away and have a low enough cost structure so that you can operate successfully in any environment. Professional staffing has a greater component of direct hire that can add to the bottom line, but in today's economy perm is unfortunately down 50%. Lastly, professional staffing requires a greater degree of care and attention for the human capital including internal staff and candidates. In today's blogosphere having a reputation for maintaining high ethical standards in the professional arena is critical.

Proformas

We developed sample proforma models to show the impact on staffing in a reset economy, and various ways of dealing with this situation to impact profit. These are purely illustrative cases as there are an unlimited number of scenarios that could be generated. The Before Case shows a hypothetical staffing company prior to the downturn, with \$8 million in sales, a 1.5% mark-up and a 5.0% return on sales (ROS). It would likely suffer a 25% sales loss in a Reset Economy-Case 1. With no proactive actions, we would be in a loss position. In a Survival Mode-Case 2, we discounted some prices, brought on 1099 temps to reduce burden and cut fixed costs to get to just above breakeven. In an effort to retain our mark-up in a Restructure Mode-Case 3, we lost 25% of our low margin sales and cut fixed costs with somewhat better results.

In Case 4, we replaced our low-margin accounts with value-added business while still cutting fixed costs, and got back about half of our original profit. In Case 5 we reinvented ourselves to meet competitive prices retaining our clients while penetrating new accounts with a combination of new management thinking and structure, value services, low prices to increase sales and market share. We negotiated lower prices and effected economies of scale for direct and fixed cost. We joined a buying consortium, bid national accounts and are doing VMS bids. We not only recovered our original profits but also positioned ourselves for the anticipated growth in temp down the road.

Summary

So here is our recipe for success in our reset economy, regardless of being in the commercial or professional staffing sectors, particularly if you are not one of the mega staffing firms.

1. Recognize that the reset economy is the new normal and not a temporary aberration. Develop a short- and long-term game plan strategy around this reality.
2. Do a 360-degree survey of your company. Start with a zero-base budget, and rebuild your organizational structure where everything has to be economically justified.
3. Diversify your client base and avoid being dependent on large clients with VMS systems and predatory pricing competitors.
4. If you have to compete on price get all of your costs under control and implement economies of scale.
5. Defend your client base where that makes economic sense, and develop an offensive game plan to penetrate new profitable accounts.
6. Develop a strategy to get you through at least the next two lean years, while positioning yourself for the future regardless which way the economy unfolds.
7. Differentiate yourself with value-added services, and develop project solutions.
8. Track, manage and motivate your staff using metrics. Set standards and determine which areas must be improved to meet your goals.
9. Hire, motivate and retain your key staff to help you achieve your goals.
10. Reassess your game plan frequently, verify your assumptions, consider your alternatives, make changes quickly and have no sacred cows.

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