

By Michael Neidle



Two years ago, we wrote the cover story, "Shifting Gears in a Changing Economy" (January/February 2002), where we talked about some of the ways to navigate the deep recession that we had entered.

Now, as we move into 2004, we are seeing a better landscape and an improving job market.

Although we are starting from a very low threshold and the recovery is fragile, staffing is finally recovering, albeit unevenly. Based on previous staffing cycles, we are forecasting staffing growth through 2010, when we should likely see the next downturn. This one should be milder, though, as the peak this time should be lower than that experienced in 2000.

Here are some facts:

- The third quarter of 2003 grew 8.2%, the best numbers in 20 years, and is expected to grow another 4% next year.
- Temp employment has recovered over a fourth of the 20% plunge it experienced, with our sixth straight monthly gain (as of October 2003).
- We expect perm to show some sign of life in the first half of this year.
- The median staffing company's sales grew 2% in the third quarter on top of a 3.5% gain in the second half. Profits rose some 25% after a 35% gain. And pretax ROS was some 2% after a 0.7%

level last quarter. But the fourth quarter is cyclical and tends to be down on all counts. We are, however, almost assured of a profitable 2004 after two unprofitable years in 2001 and 2002.

The staffing sectors that did well during the recession included the following, but the key is to figure out what role your company should play in these areas, as well as the rest of the economy, in 2004 and beyond:

- Life sciences and healthcare with an aging population, these areas should continue to rise.
- Refinancing and residential construction

 as interest rates should stay low for at least the next year or two.
- Defense contracting and procurement

 as world tensions show no signs
 of fading.
- Surveillance and homeland security, including biometrics – as the country will be on domestic alert for the foreseeable future.
- Plus various specialty areas and niches that are doing very well.

The world is changing as well. Manufacturing employment was down not only in the United States, but also worldwide by an identical 11% during the last seven years, because of productivity gains. Surprisingly, China was off even more, at 15%. Having undergone a major technological transformation, and now setting standards in wireless, digital and DVD areas, China is now third in R&D spending and is the second-largest importer into the United States. India's combination of low wages and an educated workforce has of course attracted many IT jobs, with companies even risking the transfer of their intellectual property to remain competitive.

Given our recent problems, we may lose perspective and think our problems today are unique. The accompanying tables document some of the changes during the last 50 years. The economic landscape has been completely restruc-

tured with manufacturing jobs representing just 8% of the labor force compared with 25% in 1950. Back then, the chairman of IBM didn't think there was a market for even 5 computers. Although change is challenging, well-managed companies anticipate change, innovate and adapt. In a rapidly changing world, the key to survival is having the ability to respond quickly. And it is the smaller companies that can make decisions quickly, move into new areas overnight, restructure and even reinvent themselves better than large companies.

What Should I do Now?

Now that things are brightening, evaluate your options and make your own opportunities by being proactive. Here are some thoughts as the recovery takes hold, presented in successive levels of risk and difficulty.

Level I: Status quo. Not everyone thrives on challenge. If you are not a risk-taker, you might want just to stay put and enjoy the sunshine. So here are a few safety checks you might want to make before you put your company on cruise control:

- Verify that your business is in good shape and that you really are making a profit. Validate your P&Ls, margins and fixed cost. You might be surprised how many companies think they are making money until the well runs dry or they blissfully price themselves out of the market.
- Check your cash flow, receivables, payables, tax liability and covenants.

Look out for unfamiliar obligations such as: a balloon payment, lease expirations and bank ratios.

- Make sure your staff is performing well and is motivated and that you have policies and procedures to protect the company with non-competes and computer security.
- Shop your competition to see what they have been up to. Take your clients' pulse to verify that you still have a good relationship and that your competition does not have them in their crosshairs.

Level II: Grow with your existing clients and business base. Although the recovery is not exactly expected to be a tsunami, things will improve so be ready to meet your client's demands. Determine your shortcomings and address them before things start to heat up. If you downsized during the recession, gear back up to meet your client's demands quickly enough to be responsive. But this time, develop a comp plan that makes sense for both of you. That is one that is motivational and economically sound. Make sure you are close enough to your customers to know what their needs are or your competitors will. Consider getting into value-added services (see Level V). Develop a tactical plan to implement whatever you decide to do. Measure your progress to make sure you stay on track.

Level III: Move to more dynamic markets and job sectors. It is usually easier to make a living in a growing market than a stagnate one. You can do this by geographic expansion or getting into a dynamic specialty. Here are the top dozen projected markets over the next decade: Las Vegas (48%), Orlando (32%), West Palm Beach (29%), Ft. Lauderdale FL (26%), Riverside CA (26%), Phoenix (25%), Jacksonville FL (25%), Tampa FL (24%), Raleigh-Durham NC (24%), Sacramento CA (24%), Austin TX (23%) and Charlotte NC (20%). Half of the top 20 markets are in California or Florida.

Half a Century of Staffing Changes

1950s • Perm industry moves from applicant (APF) to employer-paid (EFP) marketplace 1960s • Personnel industry grows rapidly, partially due to use of franchising concepts 1970s Recession at start of decade sees major downturn in perm, as employment rises The outplacement industry grows as corporations restructure their workforces • Temp becomes growth industry, with 2.5-fold growth during decade 1980s • Due to inflation, manufacturing/LI staffing starts to move out of United States Industry begins to specialize into niche markets, including temp-to-hire (TTH) · Factoring industry created to provide capital to small staffing companies • Front- and back-office software created to help manage growing companies • Temp makes major inroads and penetrates the market, grows 2.5-fold in decade · Personnel companies become staffing services - new buzzword 1990s PEOs become a major market, as company employee benefits get out of control · Wall Street takes notice of staffing, companies go public, and IPOs explode • Major staffing companies provide VOP and VMS to retain control of the market • Temp grows for third decade in a row at 2.5-fold as economy expands • IT becomes major staffing market, but wage rates and margins become excessive • The Internet becomes a major staffing tool, with proliferation of job boards 2000s • Economic bubble bursts, recession takes hold, temp off 25% perm off 50% • Huge increase in workers compensation rates exacerbates recession's impact · Margins shrink, companies cut staff, some companies fail, most others lose money • The number of staffing company acquisitions falls by 80% from 1998 peak · Advent of Internet has unforeseen impact on staffing, as offshore labor skyrockets Staffing firms providing more value-added services in order to justify services • Promise of automation finally delivers, as manufacturing labor falls 11% worldwide · Recovery begins to take hold in mid-2003 with temp gains, as perm staffing lags

IT is once again projected to have eight of the 10 fastest-growing occupations, and two of these cities, Raleigh-Durham and Austin, have high IT concentration. The other two fastest-growing occupations are in healthcare.

Level IV: Consider entering counter-cyclical markets. If the competition is leaving the market faster than the market is declining, then for you it is a growth market. Counter-cyclical markets represent a hidden gem, but they may only be transitory. So know when to get in and when to get out. Many IT staffing companies prospered by providing legacy programmers at the end of the last decade. During the Y2K crisis they put COBOL programmers on assignment at astounding bill rates and margins. The same thing appears to be happening now in radio frequency engineering, due to the retirement of analog professionals and the fact that few are learning these skills.

Level V: Provide value-added services and solutions. Value-added services save your client money and are designed to make you a more essential part of their operations. Those companies that can deliver here can go beyond recruiting, break away from commodity pricing and set themselves apart from the competition. Value-added solutions go further and make the staffing

company responsible for results. Providing these services adds risks beyond pure staffing. Taking on small projects is the best way to learn. An example here would be a light-industrial staffing company providing manufacturing consulting services along with staffing. It might assign a manager with a production management background as part of the team, place higher quality staff on assignment to cut absenteeism, increase production line throughput, reduce scrap and returned goods. The proposal would demonstrate savings to their client, in spite of higher labor cost incurred. This is a classic win-win program for both parties. This result can become the intellectual property of the staffing company and could be branded and used elsewhere. Similar programs can be set up for any staffing discipline.

Level VI: Growth by acquisition. The number of deals has fallen by some 80% from their peak in 1998; prices are down and, therefore, there are bargains out there. For those companies that want to enter a new market or even try new ways of doing business, acquisitions are an option. But doing a deal is risky. Not only are you buying something that you may not be familiar with, but you may be putting your own business at risk with your investment capital, taking attention away from your core competency and changing your image and culture. Acquisitions provide an opportunity now, but do your homework and due diligence. The flip side is if you build the value of your company, you can be acquired.

Case Studies - Moving into a Recovery Mode

Successful companies need not be great across the board, but doing a lot of things well. Over the years we have found common threads of success and failure in a transitioning economy. Successful companies may not be superstars but are steady performers. They evaluate what they are doing before they do it. They recognize opportunity when it happens and capitalize on it before most of their competition. They do their best to retain their key people during the downturn, so they are available for the recovery. They provide flexible incentive plans so that their costs are kept under control during the recession and allow their staff to recover lost compensation during the upturn. They provide value to their customers with a flexible pricing policy; which allows them to increase their market share during the recession even if volume drops. They maximize their market share and margins during the growth cycle as competition has been thinned out and clients are once again able to pay for value. Although it helps to have proprietary and value-added services, they are not essential to being successful.

Here are some examples of how staffing companies have dealt with the transition from recession to recovery. Two did well; unfortunately, one did not survive. But we often learn as much from failure as success.

Company A is a full-service staffing company doing both temp and perm, providing upper-end clerical people to the office services market. It had \$10 million in sales and a 13% return rate (before the owners' compensation and income taxes) prior to the recession. It was recognized as the leader in its field. During the downturn it retained almost all of its core staff, who had an average of 15 years with the company and great chemistry. Its incentive plan was very rich and the company provided great perks. The owners and their staff made a very good living. When the recession hit they shared the pain in terms of reduced incentives and profit, but the company's strong relationship with its customers got it through the downturn. As the recovery is now taking hold it is starting to do well again, as it did during the last cycle ten years ago. It shifted its customer base from high tech, the VC community and upper-end industries into biotech/biometrics, but is getting whatever business that is available from its original client base. The company made good use of Internet marketing and cut its expenses to survive the downturn. During the last recession sales fell 10%, while the industry fell twice that, and the company remained profitable. During this decline its sales fell 20% as the market fell 40%. Its retained earnings enabled the company to absorb modest losses during this recession and have just turned into the black once again.

Company B is a light industrial company doing \$5 million in a second tier city with a 7% ROS. It has been in business 20 years moving from perm to temp. Its key to success has been in having a good team, with its sales rep both retaining existing accounts and securing new business in a very competitive market. While this position had a high burnout factor, needing to be replaced every three to four years, the company has not missed a beat, paying high commissions

and having good office chemistry. It's set standards of production and has monitored the results closely.

It gets early warning signals when production and efficiency is starting to decline, and reacts quickly. During the last two downturns its sales have fallen only 5% while profit has stayed up reasonably well, in spite of workers comp and health cost pressures.

Unsuccessful companies do lots of things poorly and often have fatal flaws. Typical problems among these companies include: high turnover and poor quality staff, poor focus and direction, insufficient marketing and recruiting, lacking a core competency, insufficient financing, poor management and leadership, lack of operating standards and training, poor reputation, highly competitive marketplace, and unfriendly business environment. Interestingly, many of these companies are successful, but for a fatal flaw. All too often we see a lack of business ethics and a streak of dishonesty.

Sooner or later these traits catch up with them and bring down an otherwise successful organization. Think Enron, WorldCom, Tyco and most recently various mutual fund companies, where greed got the best of them. Other companies may be pushed into this behavior by extenuating circumstances. They may falsify workers comp codes, stiff their vendors, not honor contracts or lie about their performance to get a loan.

Company C was a reasonably successful IT staffing company doing \$11 million in business with a 6% ROS. The company went through the 1990 recession fine, although did not emerge from this last one. The owner in fact was burnt out after being in the business for 15 years and in 1999 at the apex of the staffing cycle handed over the reins of the company to a newly hired president and then relocated to one of its small remote offices. The company had a great set of operating and financial controls in place that served it well. But the new president brought in his own CPA firm and told the owner that he did not want anyone, including the owner, looking over his shoulder, which the owner accepted. The company stopped providing monthly financials and the CPA employed "creative accounting" in its annual financial statement. In only 18 months the owner's hard-earned equity was dissipated. The president was at the same time setting up shop with the collusion of the CPA at a new competing enterprise; to which they moved the company's client base, many of its contractors and staff. When the dust settled there was not even enough money left for the owner to pursue a lawsuit. This company provided a combination of everything that could go wrong from a lack of controls to business ethics when one isn't watching the store. SI

Mike Neidle is president of Optimal Management, which acts as mentors to owners and managers of staffing company to maximize their sales, profits and value. www.optimal-mgt.com 650-655-2190

Half a Century of Business and Political Changes 1950s • Manufacturing starts to leave Northeast for the Sunbelt I (Carolinas), union membership peaks • Era of hi tech businesses: use of computers, discovery of DNA and the space age 1960s • Decade of crisis as Vietnam War begins, John and Robert Kennedy assassinated Manufacturing sees flood of inexpensive imports from Japan, due to cheap labor 1970s • Manufacturing leaves Sunbelt I for Sunbelt II (Mississippi, Alabama, Goergia and Arkansas) for lower costs, tax breaks • Manufacturing moves offshore to Puerto Rico for lower wages and taxes • Japan becomes major auto/chip producer due to low cost and high quality • Start of rustbelt exodus: "The last person to leave Michigan, please shut off • Inflation reaches 15%, price controls enacted, political solutions sought • Era of modern health concerns: Love Canal, 3-Mile Island, Legionnaire's Disease 1980s • Era of financial scandals begin: S&L crisis, insider trading, Dow falls 25% · Era of terrorism begins: TWA Flight 847 hijacking, Achille Lauro hijacking, • World Trade Center bombing (1993) • Free-trade legislation passed in attempt to reduce inflationary pressures · Prolonged Japan recession begins due to high labor, real estate, poor fiscal policy 1990s • Era of mid-East war begins. Iraq invades Kuwait, Unites States leads · Gulf War I coalition • Concerns about pandemic from AIDS, Ebola and other diseases rise · Soviet Union collapses, moving from a communist to a capitalist society · Concerns over pollution, global warming and exploitation of resources rise • Maquiladora laws passed, manufacturing relocates to Mexico border, unemployment at 11% • NAFTA laws passed, which opens up all of North America as free trade zone • Hi-tech boom: IT, Internet, dot-com, biotech/healthcare, unemployment less than 4% • Hi-tech bane: Y2K hype, IPO greed, Gen X/Y syndrome, excessive exuberance • Hong Kong returned to China as it moves to capitalism, becomes major exporter 2000s • The cracking of the human genome code begins the biotech revolution · Hi-tech bubble bursts, stock market falls with recession and high unemployment • Further lapses in business ethics (Enron, et al) lead to Sarbanes Oxley Act

• Hi-tech economy vulnerable to computer viruses/worms, aged infrastructure, etc.

• Bi-polar standoff replaced by WMD proliferation, terrorism and asymmetrical wars

Growth of international economies, India an IT player, China starts to dominate
Recession is over and recovery slowly takes hold, and stock prices rise again