OPERATING TOOLS FOR RUNNING YOUR BUSINESS
(By Michael Neidle, President of Optimal Management)

OVERVIEW

If you are like most owners of small staffing companies, you have probably made a sizable investment in your business. You may have put a good portion of your assets into your company, perhaps your own house as collateral to secure funds. You have invested not only your money, but your time and your dreams. Now that we are finally seeing an upturn in the economy, you need to not only secure your investment, but how to grow your operation and make a good return on your investment.

One may ask themselves, why should they grow? Here are a few reasons. Larger companies tend to be more competitive due to economies of scale. Larger operations often attract and retain a higher caliber staff by providing a career path, higher compensation and improved benefits. In addition, the larger the company the greater its market value due to increased profits compounded by a higher price/earning ratio.

As your company grows, it becomes more complex. But you can't run it on the back of an envelope anymore and will need modern business tools to manage it effectively. Think of these tools as the "gages" on our automobile instrument panel that you would use when you are taking a trip.

- Your miles per gallon meter tells you if your engine is burning fuel economically
  - Your key operating ratios tells you if your staff is running their desk efficiently
  - Your P&L tells you if you are running an efficient company and making money
- Your speedometer tells you how fast you are going
  - By tracking your weekly sales, you can calculate your growth rate
- Your gas gauge will tell you if you have enough fuel
  - Your balance sheet tells you if you have enough cash

A staffing company's instrument panel can be divided into 2 categories: external and internal data. External analysis tells us about those things we need to be aware of but can't do much about; the economy, interest rates, our local marketplace, government policies, our competitors, etc. This data can be obtained from both public sources and doing research. This data is then converted into information to help run ones business, such as: determining market size and market share, finding out which markets are most attractive, how to best finance growth, when the next staffing downturn might hit, which competitors are most vulnerable, etc. We will concentrate on internal analysis here.

INTERNAL ANALYSIS TOOLS

Internal analysis focuses on what you're doing in terms of financial and operating measures and you don't have to be an accountant to understand how to use them. Your most important tool is you P&L, which tells you if you are making money and if you construct it right, where to look to either fix things or optimize your performance. It is your business engine and must always be current and in good repair. Think of your P&L as having 3 sections:

- Where your revenue is coming from
- What your costs are, which is broken down into two parts
  - Variable costs which are directly related to revenues and give rise to margin
  - Period costs which are more or less constant
- How much money you are making (difference between revenue and cost)

On the temp side of the business direct costs include temp wages, payroll taxes and workers comp. Revenue less direct costs is margin. Margin divided by revenue is margin rate. The P&L should match up revenues and the direct costs incurred for that same period in order to get a true reading of margins. This is the basis of an accrual P&L (more on this later). Along with margin rate, bill rate is another important parameter. On the perm side, the key variables are: perm margin rate (perm fees less perm commissions and payroll taxes, as a percent of the placement fee), average salary of placed applicants and placement fee % (placement fee as a % of applicant salary).

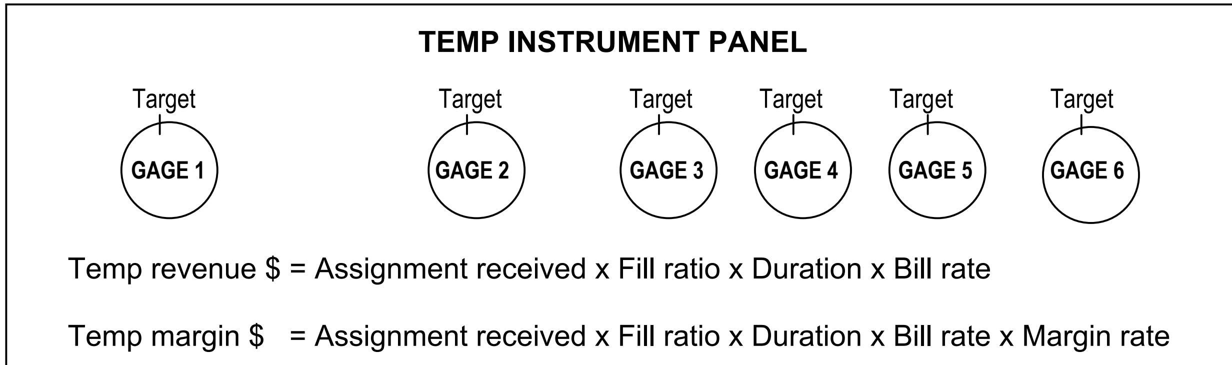
In order to generate revenue there needs to be activity. This is the job of the sales and marketing team who generate assignments and the job of the recruiters and operations group who fill those assignments. One can think of generating assignments or job orders both proactively and reactively. In the proactive area we make field sales and telemarketing calls to clients and prospects in order to solicit business. In the reactive area we receive requests to fill orders initiated by the user of those services. We can measure not only how much of our business comes in via these two channels, but can determine our productivity and efficiency here as well. A productivity measure would be how many telemarketing or field sales calls one makes a week for example, while efficiency might include what fraction of the calls made result in job orders. One can even set performance standards and expectations here based on the industry or similar offices to help motivate the staff.

Another key performance parameter is the portion of assignments received that are filled. This is called the fill ratio. There are many reasons why an order is not filled: prices (hence margins) are too high, too slow in reacting to a request, poor quality of candidate, client is too demanding, competition too entrenched, etc. But whatever the reason, the fill ratio is a critical element of the process. The final element that we would like to consider is duration of assignment, or how long a temp assignment lasts, in general the longer the better. Here too there are many reasons for short-term assignments: nature of the job, poor quality temps who terminated, jobs to temp to hire early, etc.

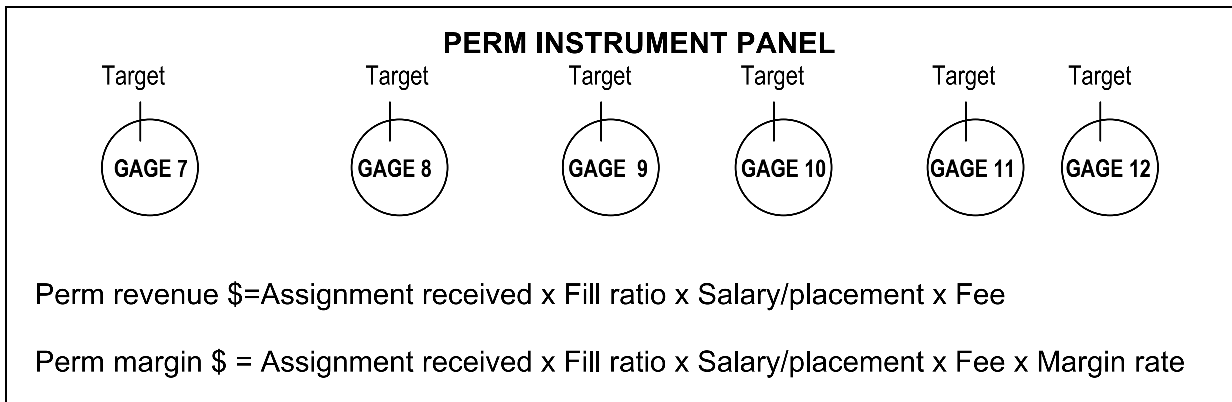
Once profitability is determined, one needs to set standards and expectations of performance to measure results against to determine if results are acceptable. If they are then one needs to reinforce them to keep performance up, or find out what the problem is and correct it. In addition, one should track performance over time to see if things are going in the right direction. If this is done graphically this is not only easy to visualize, but one can get early warning signals and be able to spot trends early and deal with them. This is what is typically done annually, as part of a companies profit plan.

Many companies integrate strengths, weaknesses, opportunities and threats analysis (SWOT) as part of this process to force a review and evaluation of these key elements and your options, at least once a year. In market driven businesses such as staffing, success often hinges on marketing and sales efforts and options, including protecting ones client base and penetrating new accounts. In today’s market with its commoditization and cost pressures due to everything from the after effects of the recession to offshoring and VMS, it is becoming more important for smaller staffing companies to set themselves apart from the competition. This can be done by creating your own intellectual property, value added services, documenting your cost savings and profit improvements to your clients and prospects and even branding your concepts.

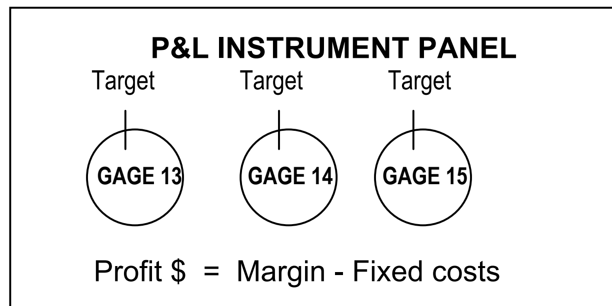
INSTRUMENT PANEL
We have developed a temp algorithm that includes many of these items, so that we have a cause and effect in how we generate temp revenue, which is the product of 4 terms: assignments received, the fill ratio, duration of assignment and bill rate. We can convert this into margin $ by including a fifth term, margin rate, using our concept of instruments or gages. We can even set any of these gages at a desired level of performance or a “target”. This target can either be an industry standard, or a high value that the company has actually achieved during a prior period.



Our perm algorithm replaces a couple of temp terms. The salary level of the placement made (salary/placement) and the fee which has been negotiated for that placement, which is typically a percent of the annual salary of the person placed (fee %).



To arrive at profit: we include fixed cost and make decisions that generate more incremental margin then fixed cost.



One wants to maximize his margin as long as fixed costs don't offset any gain in the former, otherwise although margin may be maximized, but profit will not. But in business most things involve a tradeoff. For example, to fill a high percent of your assignments you may be required to lower your margin rate. If you fill too many of your job orders you may need to hire more recruiters and increase your fixed cost. The key is that the trade off should net out at a greater profit. Thus, lowering margins by 5% would be good if it increased the fill ratio by 12%, even if it resulted in adding recruiting staff and hence fixed cost by another 5%, all other things remaining constant, as our profit would rise by 2%. On the perm side, lowering fees by 10% would make sense only if one were able to increase the number of assignments by 5% and increase their fill ratio by at least another 5%.

It is critical to have data before making decisions. If one thinks that he has good data he will make a decision with confidence and conviction. When one knows that he has poor data he moves more cautiously and slowly. Making the wrong assumptions here can be very costly (just think of this in the current political context of WMD). To increase the odds of getting quality data, make sure to include your staff in the process so that they understand how data will be used, that they are part of the process and have an economic stake in the outcome. This brings us to the subject of compensation and motivation. We find that those of our staffing clients that have instituted a "win-win" compensation plan for them and their staff do the best. That is the higher the margin $ generated the greater the incentive rate. There is of course more then dollars to life and motivating your staff with perks, recognition and contests has proven to be a very effective addendum.

BEYOND THE P&L

But your P&L does not tell the whole story; you need to know not only that you are making a profit, but that you have sufficient cash to primarily cover the time lag between billings and receipt of cash. This is where your balance sheet comes in which allows you to convert from accrual to cash system. You can think of this "as the faster you grow the behinder you get" axiom. That is if you pay your temps weekly, but your clients pay you monthly (or even longer), your cash flow lag becomes rather significant. The way out of this quandary is to either keep your collections under tight control or make sure your profit, retained earnings or an external cash infusion will cover your shortfall. Otherwise, you may have a great looking P&L, but grow yourself into bankruptcy.

If you are obtaining external bank cash you will also need to make sure your key financial ratios are in conformance so that the bank feels that you are a good credit risk. These ratios include at a minimum your current ratio (current assets/current liabilities) and debt ratio (debt/equity).

Beyond the numbers are your reputation and ethical standards. After the Enron's and Worldcom's one can't afford to play fast and lose with the rules. For sure be a hard-nosed businessperson and optimize your performance, but understand where the line is and don't cross it.

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