Why Track the Industry and Your Performance?

By Michael Neidle

INDUSTRY OVERVIEW

After 8 years of solid growth in staffing from 1992 to 2000, the last 2 years saw a substantial decline. Business has finally leveled out and like spawning salmon we are poised to make our regular migration upstream as the employment cycle is starting to move up again. Figures 1 and 2 shows the US long-term index for perm* and contract** (temp) respectively, with contract having had a substantially higher growth rate and almost all cities show a similar cycle. The cyclical volatility for perm staffing is much more pronounced, with declines of 40-50% when a recession hits, vs. 5-15% for contract. Staffing cycles occurred every 7-11 years. Because contracting's growth rate has been higher then perm, it may appear that contracting is not effected by cycles, but when magnified these cycles are clearly in phase with perm (see Figure 3). The reason perm is so much more volatile is that when a recession hits the first thing that happens is a hiring freeze, followed by layoffs. The impact of this is to cripple perm revenues whose lifeblood is additions to staff. Contracting is impacted but much less severely, as although many are terminated, those on assignment still generate billings.

Although these graphs make the staffing cycle clear, those who have been in the business less then 10 years have not experienced the ups and downs. But, understanding the nature of staffing is important to ones success. By tracking what is happening in your market, you can anticipate lean times and then be poised to take advantage of the next surge in the market.

Getting a Heads-up

Understanding the market can enable you to evaluate when to curtail spending, identify counter-cyclical market opportunities, restructure your compensation plans and many other options. As it is said, knowledge is power. Tracking data and correlating different items enables one to see trends that are not obvious from just looking at a snapshot of events. For example, in Figure 4, we have correlated the unemployment rate with the perm placement activity and found a very strong inverse correlation and in fact almost a mirror image. That is as unemployment rises perm placements fall in direct proportion. Major cities show a similar picture. One can predict an upturn in perm as unemployment falls, which it is expected to improve later this year.

Our current recession appears to be very similar to that of 1990, as measured by the perm index in Figure 5. Our current cycle peaked in the 2nd quarter of 2000 and was exacerbated by the events of 9/11 and we have now leveled out. By tracking your company data with your market, you can determine how your trends compare to the market and separate out market from management effects.

Creating Your Own Destiny

One can develop strategies regarding these events and make decisions with a certain degree of confidence before the competition is fully aware of what is happening. Success often hinges on nothing more then getting the jump on the competition to win the race for market share, profit and equity. For example, many IT staffing companies realize that their traditional markets were heading down and that they needed to make structural changes in their business. Here are a few examples. Many companies moved from traditional IT staffing to project solutions, which tend to be more resistant to cutbacks due to the high visibility of headcount vs. project outsourcing. Others moved into Biotech (which is now being recognized as the "fifth wave" within hi-tech). Still others recognized the crest was occurring back in 1997 and 1998 and sold out before acquisitions peaked in the latter year (the number of deals are now only 14% of what they were then).

YOUR OPERATING PERFORMANCE

Although most people track their stats, they typically don't get the maximum value out of them. Operating stats can be basically divided into two parts, productivity, which measures how hard your staff works, and efficiency, how smart they work. When combined, this information can be converted into margin and profitability equations for your company. This can in turn be used to create staff compensation plans with a cause and relationship between what one does and what they earn, which is a great motivator. Lastly, with sales, margin and compensation in hand, one can factor in fixed cost to arrive at profit.

Productivity

So what do we mean by productivity? We can define productivity as assignments (job orders) received, which in turn is a function of marketing activity. Marketing can be broken out into proactive activities such as: e-mails, telemarketing and field sales calls and reactive activities. Reactive marketing includes such elements as unsolicited marketing inquiries and response to ads. From the recruiting side we can define productivity as the number of staffing company interviews (interviews), which in turn is a function of proactive and reactive activities.

Efficiency

We can in turn measure their efficiency. For example, the effectiveness of different market channels, such as assignments received/telemarketing call vs. inquiries/ad. We could then compare the cost of getting an assignment by each of these methods to see where to

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put our marketing dollars. From the recruiting side we can define productivity by ratios such as the number of sendouts/interview. But to make any determination we need to accurately track what we are doing, remembering garbage in, garbage out.

The Profitability Model

So how can we apply these concepts? The following formula shows how this can be done for contract, along with some sample values. Although most of these terms are probably familiar, we have strung these elements together so that one can input key operating ratios in one end and get margin $ out the other end. With this model one can make tradeoffs to maximize margins by emphasizing one element at the expense of another, i.e. lowering margin rates with a disproportionate increase in fill ratios (see formula below). A similar formula exists for perm, with duration, value and margin rate being replaced by fee, salary level and contribution after perm compensation. Likewise another algorithm has been developed to maximize margins from the recruiting side. Graphing the information allows one to see critical trends. Our database has industry standards for both contract and perm terms.

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CONTRACT MARGIN FORMULA:

PRODUCTIVITY ------------------------ EFFICIENCY ---------------------------

MARKETING ACTIVITY	CONVERSION	FILL RATIO	DURATION	VALUE	MGN RATE	MARGIN $
100 calls x	0.10 assign./call x	0.20 x	1000 hrs/assign x	$70/hr x	25% =	$350,000

CONTRACT PROFIT AND ROS FORMULAS:

Once we have determined our margin, we can arrive at profit and return on sales (ROS). Here are some sample values.

MARGIN $	=	CONTRACT STAFF COMPENSATION	–	FIXED COST	=	PROFIT
$350,000		$120,000	-	$100,000	=	$130,000

ROS	=	PROFIT/BILLING
9.3%	=	130,000/1,400,00x100

* Derived from the Conference Board's Help Wanted Index.

** Derived from the temps employment data from the ASA