Henshaw/Vierra Management Counsel, L.L.C.

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Business Conditions Get More Difficult, But Opportunities Abound

I think that I have confessed to you that in February 2007 I was awoken by a BBC report at 3 AM that banks in Europe were questioning the value of collateral banks were providing each other for over night loans. As an old asset/liability manager from the then world's largest bank, I knew this was a big problem. I wondered why I had not picked it up by reading the Wall Street Journal and the New York Times. So I turned to the Financial Times of London, the most pessimistic but pragmatic news source I knew of. You may remember that in October that I told you, through the Tribune, that the head lines were "Credit Panic Hits Historic Levels", and "America Will Need a Trillion Dollar Bail-Out". The headlines were depressing enough. Of course, the reality was worse. Q4 of 2008 and Q1 of 2009 gave us a taste of what deleveraging means: bank failures, credit market collapses, job losses, huge drops in equity prices, and massive government intervention.

Let's look at the headlines again to see what they tell us. "GE, Alcoa, Bank of America, General Motors, and Citigroup shares becocome meaningless to Dow Jones Industrial Average"; "Geithner reaffirms the dollar's role in the world"; "Markets have seen a 25% rally"; "Russia – a wave of defaults and bankruptcies could come in the autumn"; and "GM debt swap greeted with deep skepticism as US government and unions end up with the company".

These headlines are beginning to show us the effects of deleveraging. Companies and individuals with highly leveraged balance sheets can not refinance their debt and will default, go out of business, or be taken over; even the mightiest of them. However, the Government in the US is not sitting on its hands. It said that it would support the economy, and it has. Charts will show you that as consumer spending has fallen off Government spending has matched that fall by growing. The question at this point is not if Government spending is too much and therefore inflationary, but if it is too little and too late. We will all get to see in the next few quarters!

So now that you are armed with general economic treads, what's it mean to your service bureau?

We are in a Recession. It will be deeper and last longer than any in our life time. It does not mean that the world has come to an end, but it does mean that you need to pay attention and focus.

In a Recession, we know that your customers come under stress, that can put pressure on your operating margins as pricing gets sticky while your operating expenses get stickier. Check counts go down. Interest rates go down. Numbers of new company start-ups go down.

In a Recession, we also know that weak competitors go out of business, customers look for value in critical services, small businesses recover first, and smart investments in good people and technology can contribute outsized returns.

So what does this mean to you? Control what you can control, and use common sense to deal with what you can not control.

You can control your costs. You can control your business risks. You can improve your efficiency. And, you can invest carefully in technology and increased selling efforts to enhance your competitive position. We help our clients do this, and have for over 15 years. If you are not focused on these issues, we encourage you to do it now.

Opportunities Abound

You can not control everything the Recession can throw at you. ***Pricing.*** Big competitors have economies of scale they can use to compete aggressively on price during a Recession, and they will. Stupid and frightened competitors can cut prices, but will go out of business. You are in business to make money. You need to understand your costs and how volume, customer complexity, and your service offerings affect your costs. You need to target a 20% pre-tax operating margin to be a healthy competitor. If you know your costs and how to control them, and you know the margin you need, then you know what you need to do with your prices to compete. If you need help with this, get help from your peers or from us, people you know understand the business well. ***Volumes.*** Your customers are going to control their costs, and cut employees as they think they have to. You can not control that, but you can track it and plan for it. You can do at least two things: read Paychex quarterly reports, they do a good job of tracking this. Or you can track changes in unemployment in your market place. The forecast for US unemployment for 2009 is 8.6%, for 2010 it's north of 10%. ***Interest Rates.*** It is Government policy to keep interest rates down. They should be letting them rise to encourage savings, but that will come later. Now you need to make sure that you do not chase yield by buying questionable credit quality or by extending the duration of your investments. Improve the credit quality in your investments. Your banker or your broker should be helping you do this. If they are not, I would be happy to talk to you, or them on your behalf.

I want to close on a higher note. We are in a Recession. Weak competitors and weak customers will not survive. But, well run bureaus will. Two things to remember: now is the time to *control costs* and be as lean and focused as you must be; second, this is the time for outsourcing to bring greater value to customers looking to manage their payroll, HR, benefits administration, and retirement plans. It is the time to *expand your selling efforts* to maintain and grow your business.

Survey Yourself

Summer is coming and it is a good time to survey your customers' attitudes about your service levels, the competition, and what they want and need to help them manage their way through the Recession. We have found that bureau customers like to help the bureau get better. They also appreciate that the bureau is listening. So, we encourage you to survey your customers. By the way, your competition is, and they are not telling your customers that you listen or that you care about them!

Take a self survey of your company too. If the key to not just surviving, but thriving in a Recession is to manage your costs and maintain your operating margin, how do you do that?

Here are some numbers to gather and watch that might help: % change in total revenue over 12 months; change in the mix of revenue between payroll services and benefit administration and retirement services; new sales growth rate; customer retention rate; average fund balances held for customers and changes in interest revenue. By the way, these numbers for the big guys are -2%, 76/24, 8%, 78%, $15,625, and -40%.

We will be helping several groups take surveys in the next couple of months so that they can give "peer" comparisons to help "peers" plan better in the future. If you get one of these surveys, I encourage you to participate. Your data can help the "peer" group. If you need help with your customer or self surveys, call us.

Henshaw/Vierra Management Counsel LLC

We know the payroll business, as owners, managers, and consultants for over 15 years. We help service bureau managers and owners with strategic planning, such as—Growth plans, mergers, and company sales. We can help select and implement new systems. We assist our clients in looking at their current operations to make them more efficient and less costly. **We can help you** as we have helped dozens of payroll companies around the country.

Call us, in confidence, with your questions at 510-749-3225 or e-mail guy@henshawvierra.com. Visit our website www.henshawvierra.com for IPPA peer group surveys, tools to help right size your firm, and past Payroll Tribunes. We are on your side and are happy to help.