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Payroll is the Key to Single Source Success

Three years ago I wrote in the Payroll Tribune that an investment bank had released a report that ADP and Paychex were expanding their service offering to their customers to include **payroll services, human resource services, and benefit administration services.** As a result, they forecasted that these industry leaders could double their annual revenues off their current customer base.

Today both ADP and Paychex have indeed expanded their services into these three lines of business and are half way to the banker's forecasted goals. And, the industry and the competitive environment have changed, perhaps forever.

At least three things have happened which will affect service bureaus directly: the broader service offering has been well received by customers; customers are reacting well to having their payroll provider bring them an expanded service offering directly, or acting as a 'quarterback' who offers multiple services through a variety of service providers; the former separate service providers are now beginning to lose business to ADP and Paychex, and are looking for ways to respond.

We have seen payroll service bureaus respond to this opportunity/challenge in several ways. Some have or are pushing to have their payroll system provider expand their systems to provide broader data bases and information links. Furthermore, they are asking their system provider to expand their delivery capabilities to web based (SAAS), thin client, and current updated in-house software. Some bureaus are writing their own links and designing expanded service offerings. Some bureaus are partnering with HR service providers and benefit administrators. These bureaus are now getting a much better reception from these 'partners' now than they were a couple of years ago when the 'partners' had not yet begun to lose business to payroll companies selling single source employee compensation services.

We have seen some things tried that have generally not worked so well.

Marketing agreements which paid bureaus a small fee for customer referrals are often a ticket for the 'partner' to shop the bureau's customer base, and provide few if any new customers and little income to the bureau.

Recently we have seen software experts, who understand the complexity of the construction of the information systems and data bases, entering the market and selling what I would term 'switching' services to payroll bureaus, HR service providers, benefits administrators, insurance brokers, retirement plan administrators and others. Some of these 'switches' have numerous providers and combinations of providers. They may/will not necessarily put your bureau on the top of their list. They may or may not know or understand the complexity of each service, the fiduciary responsibility and liability that you have with each of your payroll customers.

Finally, we know that each of the services– payroll, HR and compliance, and benefits administration– require a high level of expertise and skill. A bureau can be like ADP and Paychex and hire departments of people to fill in the skills required beyond payroll. If you are not in a position to do that, then you will need to carefully select your 'partners' and your operating systems to best be able to compete. A good 'partner' should commit to the same high level of service that you provide for your payroll customers, commit to cross sell their customer base, and commit to fund systems and data base integration at the time you close the deal.

Single Source Success (Continued)

Here are some things that we ask our clients to think about as part of the planning process in considering this line of business:

Key questions about the Bureau: What is your target market? What role do you want to play in the sales and customer service support? What do you want to own and how will it be valued?

Key questions about the Software: Does the software support the services that you want to provide for your target market? Is the software well designed, well documented and in service? What do you know about the capabilities, the commitment, and the integrity of the software providers.

Key questions about the Partners: Do they seek the same target market that you do? What business structure is best for your relationship with them? Have you decided in advance what should happen when you want to terminate the partnership?

Payroll, we know, is the key to providing the data for a complete employee compensation service. The demand for a fuller product offering is real, as ADP, Paychex, and many service bureaus are seeing. The time to put your plan together to significantly increase your customers 'share of wallet' is now, and you can do it independently of how the economy is doing in your market!

Beware of the Bond Markets

When the markets crashed the problems were: trust, liquidity, and credit.

The Government acted quickly on the trust issue: FDIC raised insured deposit limits, money market funds were included with no limit.

The Fed through its 'open window operations' and as lender of last resort, bought trillions of dollars of Government paper and loans from banks at above market values and forced interest rates to abnormally low levels. Those actions provided banks with liquidity. With very large spreads between their asset prices (Prime Rates were locked at above market rates) and what they paid for their deposits, the banks earned profits to improve their capital accounts and restore their credit standings. In addition, TARP funds were generated to supply banks with more capital until they could figure out if their assets were worth anything.

Some results to date:

Trust was restored domestically. After the failure of the EU to protect Ireland and Greece, globally the dollar retained its roll as the world's sole reserve currency. Although over 250 US banks have failed in the last few years, and more than 100 suffered 'shot-gun weddings', the banking system did not fail.

The FDIC took steps to further increase trust in the banking system by increasing insurance coverage on deposits to stop individuals from causing runs on banks. In addition, the FDIC Provided money market funds insurance coverage after The Reserve Fund failed and stopped the run on money market funds.

Businesses, which had been locked out of the bond markets and lost their commercial paper lines from Wall Street firms stopped trying to borrow. Instead, they opted to help themselves. They cut costs by reducing inventories, slowed or stopped new purchases of technology/ capital goods/ research and development and laid off millions of workers. Their free cash flow grew to historic levels as they looked to self-fund their operations. These actions have helped them survive, but not necessarily to grow or provide for more jobs in the economy.

Beware of Bond markets (continued)

It's still not time to come out of your foxhole yet: Keep your tax money short amd in top quality paper

In my opinion, the economy in the US and the developed world is still on the brink of deflation. Unemployment remains high and capacity utilization low. The Fed is still putting its efforts into keeping interest rates low to encourage lending and economic growth. Interest rates could remain at their current levels for the forseeable future. The US economy, while thankfully growing at about 2.5% to 3%, is still not growing at a rate which will reduce unemployment significantly. Businesses do not see a need to borrow to grow. Consumers generally cannot borrow because their real estate assets are continuing to lose value.

If businesses and consumers do not borrow, the velocity of money will remain too low to ignite the economy or inflation. Japan, until last quarter the second largest economy in the world, has seen 22 years of deflation. They have not been able to restart their economy. Their interest rates have been at rock bottom for years. The US is not Japan. We will recover more quickly, but the recovery will take longer than any recovery we have seen since the 1930s.

If this is true, or even mostly true, interest rates will be zero to very, very low for the next several quarters. Keep your maturities short, like 90 days. Keep your focus on credit quality. Do your homework when you invest in money market funds because some are at the point of closing or consolidating. Keep an eye on your bank.

Beware the bond markets. One thing worse than earning next to nothing on your deposits is to lose money your bond portfolio. Do not chase yields. Demand the highest grade credit. If I am wrong and you do this, you may miss a quarter of higher rates, but you will still be in business. If I am right and you chase yield and lower your credit standards, your cost could be more than you might like.