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

Payroll Tribune

Volume 5, Issue 3 September 2011

Competing and Growing in the New Normal Economy

You can COMPETE in the "new normal" economy

I borrowed the term "New Normal" three years ago from a presentation I heard from Mohamed el Erian, the CEO and co-CIO of PIMCO, one of the world's best bond houses. At that time I was totally stumped by the collapse of the financial system and the US economy. It was hard then, as it frankly is now, to see that the less regulated free market system did not lead us to great prosperity but to a market overwhelmed by greed, stupidity, and a loss of respect for our fellow man. I have since regained my perspective. Thomas Hobbes turned out to be more right than St. Augustine, this time around. 2004 to 2007 was not a "new new" time. We have been there before, and survived. So get over it, and let's go make some money.

The "New Normal" calls for lower expectations, lower growth rates, and more volatility.

In 2011 we can see that the **US economy is growing at a 2 to 3%** rate (in spite of the politicians), Europe is growing at 0.2%, and the still small but emerging countries are growing at 6 to 8% (and battling inflation). To stimulate the US economy the Fed is engaged, but the fiscal side of the house is AWOL. The Fed can and has used many of its tools to provide the system with liquidity, with **lower than low interest rates** and a large volume of cash which has provided liquidity to what was a frozen banking system. But, as the great Fed Chairman of days gone by, Alan Burns, once said, the Fed can't "push on a string". The Fed can supply liquidity, but it can't demand that the economy use it. If people/ corporations don't or can't borrow, the Fed's 'stimulus' has little effect. **Businesses and individuals create sustained demand**. Whether governments can and should, how, and for how long is a debate which we can only hope is undertaken by rational people. I see little chance for that in the immediate future.

So we have a "New Normal". If GNP=C+I+G+/-T, let's look at how they are doing now, and how you can compete.

"C" is the consumer sector. In the "New Normal" the consumer is de-leveraging (on their own or because they are being forced to) and is somewhat less employed. They are saving more and spending less. **They are growing in population** however, so net net, they are creating a moderately increasing demand for goods and services. That's good for payroll and good for the economy. And it is far better than their peers in the eurozone are doing.

"I" is the investment sector. The balance sheets for corporate America have rarely been better. It is liquid. The cost of capital for the best credits is historically low. It is ready, willing, and able to invest in plant, equipment, and people as the demand grows. It has the ability to buy business through **aggressive pricing strategies** (you are seeing it daily in your businesses) and **mergers and acquisitions** (good and bad for payroll companies). New businesses are being formed. Existing businesses are looking to outsource more employee related services now than they ever have.

Competing and Growing in the New Normal Economy (cont.)

"G" is of course us, the taxpayers: the government sector. Our government, and I know this will come as a great shock to many, is a republic not a democracy. We, the people, elect representatives to our business (not theirs). Our republic was constructed to give a free people the environment to pursue happiness (the right to peacefully grow commerce for example) by working hard, and having the will to take risks with their time and their capital; and that is exactly what you are doing in your business. **The government can and does provide incentives and disincentives to encourage commerce. The government can and does redistribute wealth through taxation and spending policies.** The government is more hamstrung now than many would like it to be, for various reasons. **It is unlikely to provide much stimulus to the economy in the immediate future. However, for payroll companies, the government is our friend. It will continue to make the simple act of paying employees more difficult and complex, which of course, is an important part of allowing us to thrive in our "New Normal" economy.**

You can GROW in the "New Normal" economy

2 to 3% growth for a $15 trillion economy is a big number. It is not big enough to bring the unemployment rate down or big enough to remove the excess capacity in our economy. **It is big enough to keep our economy moving ahead and buy it time to more fully recover. New employees will be hired in segments of the economy like consumer non-cyclicals** (think: household products, food, drink, personal products, personal services), **export related industries** (heavy industries, aerospace and defense, rails, highways, parts, commercial services), **healthcare** (managed care, equipment, suppliers and distributors, healthcare facilities, bio-tech), and **utilities**. Think about businesses in your market that make, market, move, service, and supply these industries when you are putting your marketing plan together for 2012.

You can and should have a strategy to **increase your prices** again this year 2 to 4%.

You must plan for and effectively manage your marketing and sales strategy. Most independent payroll service bureaus under spend by more than 40%what they should, and under plan to support their growth. It is a chronic shortcoming. ADP and Paychex are some of the best marketing companies in the US. When you underspend and underplan, you make that an unfair fight. They take advantage of it.

If you cannot grow fast enough internally, you should think about mergers and acquisitions. Here is what you need to think about. In many cases, sellers want cash. Most sellers want to know that the buyer will be able to take good care of their customers. Sellers want to know that the deal is done well so that they do not get rude calls from former customers, tax authorities, or former employees a few quarters after they thought that they have sold their company. In short, before you run out to buy a company (actually in most cases you will buy assets, not the company), **do a due diligence inspection of yourself to make sure that you are ready**. Is your team ready to manage twice as many customers as you have today? Is your operating system capable? Do you have the working capital you will need? Do you have the ACH lines with your bank to clear the added volumes? Do you have the systems, controls, and audits in place? If you have to convert customers from one system to another, do you have the IT and conversion resources in place to convert and retain the new customers? Do you have a lawyer who has commercial experience in drafting deal documents and who understands your business well enough to protect your interests? Do you have people skilled at helping you do due diligence on the portfolio of business that you are buying? I have more, but this should make the point that **you need to plan carefully to be in position to grow through acquisition.**

Competing and Growing in the New Normal Economy (cont.)

Did we talk price yet? What really determines price is a willing seller and a willing buyer. How do you know if the seller is shopping, about to be closed by the tax authorities, or is a real and willing seller? Of course, you can **expect competition**. Paychex and ADP call you twice a year or more. News flash: they are calling that seller too. They have made their general deal terms well known: cash, hold backs, conversions, and professional staff. You can compete with them, but you need to match or beat their **net** terms. Your calculus for the deal is different than theirs. You make different pricing and attrition rate assumptions. **You can win these deals, if you plan for them in advance.**

The “New Normal” will be more volatile than the “past normal”. The US economy will grow and will be the giant in the global economy. Its size and its growth rate will let you grow, if you plan and execute well. **You will have lots of competition, but you can grow internally by increasing your investment in sales and marketing and grow externally through mergers and acquisitions.**

HENSHAW / VIERRA MANAGEMENT COUNSEL LLC

We know the payroll business as owners, operators, and consultants. We are on your side in thinking about the future; solving operating, financial, and planning problems.

We help clients plan strategically, and plan for growth internally and externally no matter what the market conditions.

Call us in confidence at 510-749-3225. E-mail us at guy@henshawvierra.com. Visit our website at www.henshawvierra.com.