Volume 10, Issue 1

January 2016

Payroll Tribune

Thinking about Tomorrow

Year End is over, almost. Long hours, missed time at home over the holidays. Changes in regulations and software. Customers gained and lost. Annual fees for W-2's, 1099's, Record Retention collected and, of course, ACA...

But, there is no rest for the wicked. That was last year. What's the Plan for the years to come?...where to take the Company?,...competition, staffing, succession planning, building margin, managing risk, and creating value. Below are some thoughts I have on The Year Ahead, Risk Management, and Value Creation I hope will get you refocused and on track for a strong future.

2016: The Year Ahead

I keep track of headlines from the Financial Times of London to help me see what influences short and longer term trends.

What They Said

1. *Grim Jobs Report (Unemployment 5.1%)*
2. *Emerging Market Turmoil:*
   - i. *Lower growth, Lower Demand*
   - ii. *Currency has fallen 20-33%*
   - iii. *Deflation risk increases*
3. *Flash crashes on the rise*
4. *Unexpected turmoil as Fed raised Repo Rate*

What It Might Mean

1. *More employees, more checks, more H/R*
2. *Emerging Market Risky*
   - i. *U.S. Investors at risk if they loaned money*
   - ii. *U.S. Investors can buy assets at 0.70/$1*
   - iii. *Long term bad news for all*
3. *Market Volatility, increased mistrust*
4. *Higher rates sooner on tax/payment funds*

What it means for you is that the US GDP should increase by 3% in 2016, employment should be equal to or better than last year so more employers will be in the market looking for more employees, and interest rates in the US may actually increase, so plan for growth.. Do you remember when Interest Income was once 5-7% of your gross income? That will not happen in 2016, but it will begin. Remember, however, that with the volatility pointed out above credit ratings, duration and liquidity will matter even more for very short over-night investments, make sure you know what funds are investing in.

If 2015 HCM trends continue into 2016 (with the forecast for rising GDP they should), plan on basic payroll volume growth rates of 5%+, price increases of 3%+, and HCM human resource management services (HR data and consulting services, healthcare and workers comp insurance services, and benefits administration data services) up 18%+. Regulatory reporting services like ACA will add new revenue streams to providers serving companies with 35 employees or more. Expenses for current staff appear to be increasing 4%. But overall staff expense will increase as new staff is added to provide a broader service offering. "Per employee per month" product offerings will expand in the industry, and so will costs from third party providers and in house subject matter experts. The competition is tending to try to buy market share (some even giving services away), so margins are still hard to predict for 2016. At some time in the near future, providers who are left in the market will experience more volume by effectively cross selling more products to their customers. Their expenses will increase, but more slowly because Economies of Scale will matter. Providing services efficiently will matter. So, in this environment, if margins revert to their historical mean, large companies will see 25% margins, and smaller firms 10 to 20% margins. You might want to think about using at least a 10% margin for your planning purposes in 2016.

The year ahead then should mean:

- *More customers and Employees*
- *A broader product set to increase volumes*
- *Somewhat higher interest rates*
- *New pricing and servicing strategies*
- *Added costs with higher salaries, more IT (sad but true. SaaS changes IT costs. It does not reduce them) and customer service costs*

Risk Management

After thinking about your 2016 business plan, take some time by the end of the first quarter of the year, to think about risk management for your business, your business processes and control environment, and the team you have both inside and outside the company to help you think it through. Then consider what will change your risk picture as you implement your business plan in the new world of payroll plus and HCM.

Being in business means being at risk. Staying and succeeding in business calls for being realistic in taking risks, and managing risks effectively. You and your internal team are the first line in controlling risk at your company. Business practices, work flows, documentation, controls, team member expertise and continual training are measures that you can control. Your outside risk advisors may include your accountant, business lawyer, insurance agent, or risk management consultant. They should bring experience, knowledge, and speed of implementation to your organization.

Thinking about risks should not overwhelm you, but neither should you ignore them. Our industry is marked with those who have not thought enough about risk and done so at the peril of their customers and themselves. Think about risk management by looking at risk and solving for the long term, low probability, yet high consequence risks first. These are risks that you can define. Good insurance agents can help you analyze and reduce your risks through well thought out business practices, critical audits, and insurance. Natural disasters and technological accidents happen. General and specific insurance policies cover things like floods, fire, snow damage, business interruption, some employee activities, different levels of product or service liabilities, and you should have that coverage. Fraud gets more difficult, more personal, and you need professional help to determine your level of risk and the control environment you have in place. Onsite IT risks run from software selection, implementation, documentation, to access (onsite, in-house, third party vendor, mobility) and hacking/breach vulnerabilities and controls.

As we continue to go "into the cloud", risk management needs to be cranked up a few notches. Most of the Payroll Tribune readers will use third party cloud vendors and multiple software product vendors. In dealing with third party vendors, trust but verify. You need to manage your relationship with them all. Many vendors have been in business less than five years, and have short track records. Do your homework on their products, their background, their value system, their capital strength, and their reputation. Carefully consider how they will be integrated into your day-to-day operations; what their impact will be on your internal controls; how they will affect your compliance requirements, and how they will support you day-to-day and in a crisis. Set up a real third party assurance program with them and have your accountant, lawyer, and other team members buy off on it. The assurance program should include processes, workflows, and control environment. The risks you run are risks to your reputation, business disruption, data risk, and the vendor's lack of compliance from poor performance, hosting risks, security risks, and others. Understand how contractor relations will be managed, what their management and capital capabilities are, and the back-up they have in place.

Value Creation in a Multi-Sourced World

You have completed Year-End, now you have thought about your 2016 Plan, and worried your way through "what goes bump in the night" with risk management planning. Why do I write about and lecture you about so many uncomfortable things?

It's simple. I want to increase the probability that you will make more money in the short-run and build value for the long run.

The sources of value are revenue streams, free cash flows and EBITA multiples. The streams, flows, and multiples come from building long term profitable relationships with customers. The long term relationships are established by providing good products and services which are accurate, reliable and quickly delivered through well-controlled processes by well-trained and fairly paid staff members.

Well thought out businesses have a higher probability of providing what customers want even in a business like yours which is under-going deep, disruptive, and exciting change. They bring value to their customer, staff, and to current and future owners.

In a multi-source world, planning and defining your environment is more important than ever. It's going to be a team effort for most companies. It will be full of outside vendors and providers. Think of this world as one made up of a few well capitalized vertically integrated companies and many horizontally integrated companies. In the horizontally integrated companies the players are a group of subject matter experts who bring deep targeted knowledge and experience to the group. The horizontally integrated could be made up of big or small companies. Some of you will consider joining/creating horizontally integrated companies in the years ahead. The relationships you will have with vendors, particularly software vendors, will be deep. There will be questions about the origin and ownership of cash flows and customer relationships. There will also be questions about differences between single player contribution value and synergistic values, and about control and additional investments, and exit strategies. I believe that the sooner you begin to think about how the industry is evolving, your role in it, and the better you play the defined role you play with others, the greater the amount of the value you will be in a position to claim.

To repeat: ***the sources of value are revenue streams, free cash flows and EBITA multiples and your role in creating them.*** What part of that value you receive at the end of the day will depend upon how you structure your relationship with the third parties you work with. Think before you sign up.

If you would like to meet and talk with me, I will be attending the IPPA 2016 Sales & Marketing Conference February 22 to 24 at Caesar's Palace in Las Vegas. I would look forward to seeing you there.