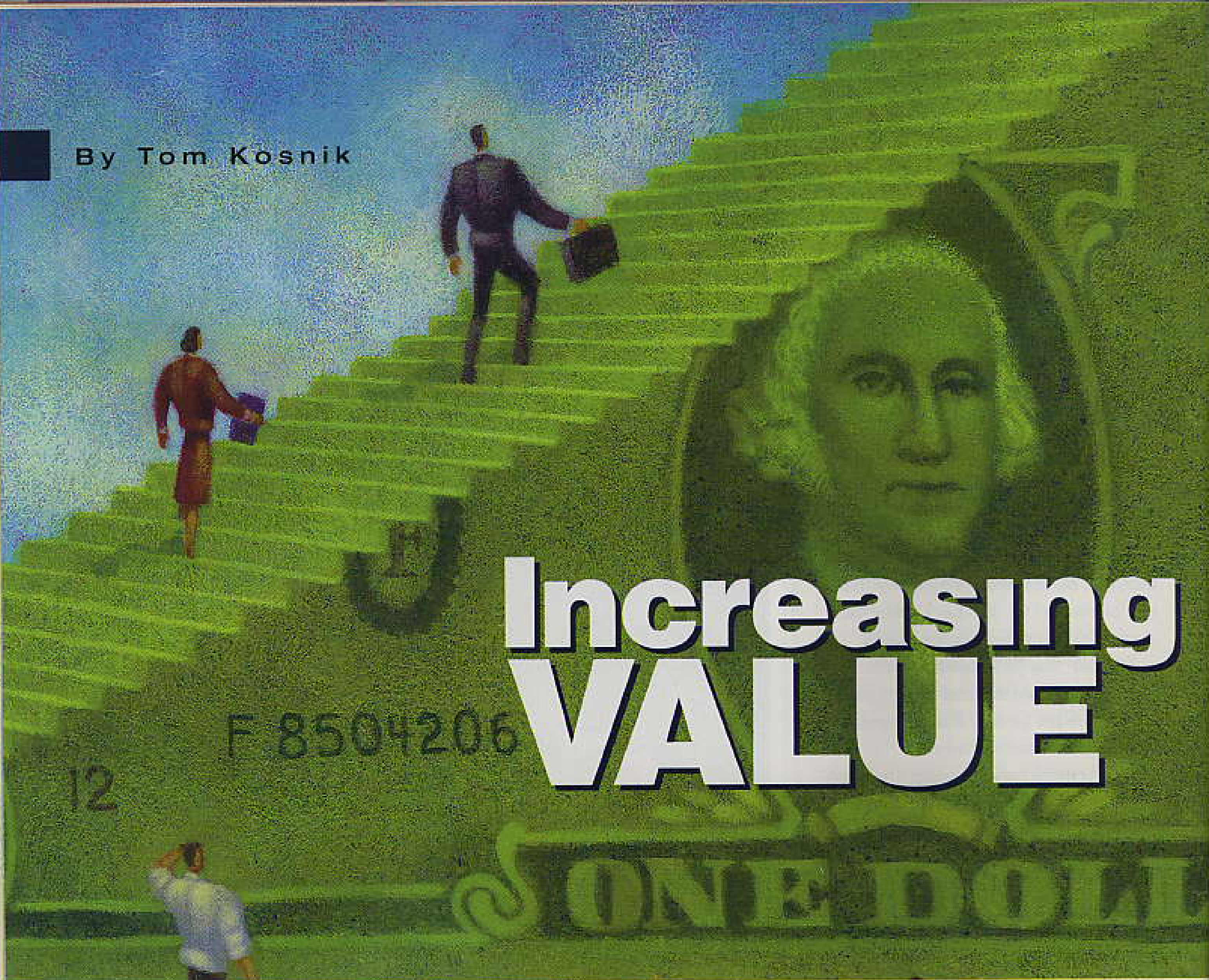

Increasing VALUE

By Tom Kosnik

Critical Steps Every Small Staffing Business Needs to Execute in Order to Raise the Value of the Business

There are hundreds of staffing firms throughout the United States that cannot be acquired. Well, let me rephrase that statement. There are hundreds of staffing firms throughout the United States that could be acquired if the owners wanted to sell their companies under a leveraged buyout structure (meaning that the acquiring company purchases your business with the cash that your business is generating). And why do these staffing firms need to sell under such a structure? Deep down inside of these firms, there's nothing really there.

Wow! That's quite a statement. The "deep down inside there's nothing really there" challenge is particularly acute to staffing firms that generate less than $10 million in annual revenues. Anyone who owns a staffing business that falls into this category (91% of the firms in the staffing industry according to the Staffing Industry Analysts research team) needs to be doing some smart navigational things to insure that something is happening in the business that is worth buying.

There are thousands of things one can do to tweak the performance of one's staffing company. However, there are only a few items that add true value to the business, making it a worthwhile acquisition target.

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Increasing the Value of Your Business

Critical Mass: Build your firm to critical mass as fast as possible. "Critical Mass" can be understood as the top of the mom-and-pop structure. It also can be understood as the point at which the business is generating the revenues and gross margin it needs to hit a certain profitability percentage. In the staffing industry, that revenue number rests somewhere between $10 million and $15 million in annual sales.

It takes a lot of work to acquire a business, whether the business is $2 million in annual revenues or $10 million in annual revenues. So, if I am the acquiring firm, why spend the time acquiring five firms that are $2 million in annual revenues when I can acquire one firm that is $10 million in annual revenues?

Once a firm is acquired, it has to be assimilated into the acquiring firm's culture. Several changes have to be made to the firm that is acquired. Some employees of the firm being acquired will lose their jobs. It is too much work to do five times over with five little firms versus one healthy firm that has reached critical mass. Additionally, it is five times more risk, five times more chance of failures with five little firms versus one healthy firm that has reached critical mass. The point: Grow your firm to north of $10 million in annual revenues as fast as possible.

Gross Margin: Possessing healthy gross margin is another element that will make a staffing firm a desirable acquisition. To get the full range on average gross margin in the various sectors of the staffing industry, refer to the Staffing Industry Analysts Benchmarking Consortium. It is an excellent resource.

For light industrial staffing firms, get the average gross margin of 18% or greater. For clerical staffing firms, get the average gross margin greater than 20%. For special niche staffing firms offering accounting and finance, legal, engineering and the like, get the average gross margin greater than 24%. For IT staffing firms, get the average gross margin greater than 28%.

Obtaining a healthy gross margin is difficult to accomplish. You have to be somewhat selective about the accounts that you pursue and do business with. This is typically done via an educated account profile. You have to have a sales staff that is fully trained and know how to sell the firm's recruiting and fulfillment processes as a differentiator. You have to then ensure that the recruiting function is operating effectively and efficiently.

Obtaining a healthy gross margin means that there are some high maintenance customers who may need to be fired. Regarding your employees, reward sales executives and recruiters that service business that is higher gross margin business. Don't pay any commissions on business that is sold beneath a certain gross margin percentage. The point: Do what needs to be done to ensure a healthy gross margin in your business.

Client Concentration: OK, I get this. When you are a little mom-and-pop staffing business, your top five accounts will make up 80% or more of your revenues. To some extent this is fine, if your firm is growing new accounts and if your firm is growing

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and if you can show that your top five accounts are decreasing as a percentage of your firm's total revenues.

When one or two accounts make up more than 70%, 80% or 90% of your revenue, you are in trouble. There is too much risk involved for an acquiring firm to accept in an acquisition. The only way an acquiring firm will move on this type of acquisition is via a leveraged buyout.

Reducing client concentration is a very difficult thing to accomplish. It requires taking the profits that one is making off the one large account and investing these monies back into the business rather than buying a boat or a second home or a fancy new car. This, for most small business owners, requires a paradigm shift.

You have to first outline what it is you want your business to look like regarding staffing services provided, types of clients, gross margins desired, number of clients, etc. Write out the desired outcome. Then build a bridge describing what needs to be done to get there from your current disposition. Prioritize the key initiatives that need to be accomplished in order for the desired outcome to become realized. Then start investing in the key initiatives that are top priority. The investment in these key initiatives will increase the value of the business.

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Define Your Niche: Focus is critical to success. This is true for every industry in business. Trying to be all things to all people and building line extensions on to your staffing offerings rarely succeeds over a focused strategic approach. If you want to increase the value of your staffing business, then define your niche and figure out how to geographically grow that niche.

One of the benefits of focusing in a staffing niche is that the fulfillment team can build a national database of candidates who work in that niche. Candidate referrals can be leveraged. Candidate networking can be leveraged. As a result, the entire fulfillment team and fulfillment process becomes more efficient and effective (greater production out of each individual recruiter; greater production out of the entire team). A generalist staffing provider simply cannot compete with a skilled group of specialized recruiters. This is of value to buyers.

Another benefit of focusing on a niche is that the sales team can also become highly skilled in the niche in which it is servicing. Instead of selling and working three, four or five service offerings, sales executives can master one specialized service offering. Such a sales team can more easily leverage referrals from hiring managers over a generalist sales team. Sales executives can master production knowledge, giving them the edge with customers and prospects. The result is a more efficient and effective sales team.

From a marketing perspective, your firm can become the "go-to" firm for the talent in the niche in which you are servicing. Your firm can conduct and offer to customers and prospects specialized market research about candidates in the niche space. Your firm actually has a fighting chance to own a brand in the minds of your customers and attain top-of-mind awareness. This is very valuable to an acquiring firm.

Other Key Items: The first item that increases the value of a staffing business is multiple offices. A staffing firm that has three to five offices in a market-

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place is more valuable to an acquiring firm than a firm that has one office location. Multiple offices often equates to greater market penetration. It also means that the business has greater reach in a marketplace from a recruiting perspective. Such an arrangement is attractive to prospective buyers.

The second item that increases the value of a staffing business is the lack of owner dependency. If the business is dependant on the owner, this is not attractive to buyers. In this scenario, the owner is the president, the CFO, the key sales executive, etc. However, if the business has management in place that is running the day-to-day operations of the business, then this becomes a more desirable acquisition. Most acquiring firms do not desire the ongoing involvement of the owner of the business. Unfortunately, the owner typically becomes too great of an obstacle in assisting with transitioning the business into the acquiring firm.

The third item that increases the value of a staffing business is the execution of professional management. Does the firm have formal sales and recruiting processes? Has the firm hired the right kind of employees who are succeeding in the business or are there a number of mediocre performers in the company? Does the firm have established performance metrics? Are employees being held accountable to performance metrics? Are the compensation plans in line with industry standards, or is the firm paying more than the average in commissions to the employees? These are all professional management questions that an acquiring firm will be asking.

Not for the Faint of Heart

The staffing industry has become fiercely competitive. Everyday it is becoming more difficult to differentiate the service offerings. Additionally, customers have put in place mechanisms that have successfully squeezed margins. The result: It has become quite difficult to grow a staffing firm over a short time period.

One way that some owners have grown their firms is by merging with other small privately held staffing firms. This is not a long-term strategy. Rather, it is a three-to-five year strategy. And, there are risks involved.

This strategy begins by seeking out other staffing firms that are in your same niche that are either in your marketplace or in a nearby marketplace, and then meeting with the other owners to determine if an interest exists. The merging firms need to have a certain amount of synergy in their service offerings. The owners themselves of these individual staffing firms need to have synergy as well.

The idea, for example, is that three firms – one from Chicago, one from Cleveland and one from Indianapolis – merge into one business. The back office is integrated and is managed out of one office that becomes the corporate office. This integration of the back office will generate efficiencies that will immediately increase the bottom line.

The next step will be to integrate the sales function and the recruiting function. Certain accounts in all three cities that were off the radar screen now become prospects because the firm is no longer a small one-office operation, but a three-office operation

> *The entire mergers and acquisitions market in the staffing industry has leveraged itself up.*

generating over $10 million in annual sales. In terms of recruiting, a certain number of resources become available that did not exist before via the integration of the databases and the increased network of recruiting power.

So, in a very short time period, by finding a few privately held staffing firms that are willing to merge, you increase the revenues, increase the office locations and increase the bottom-line profit. The minority share that each principal now owns in the new merged entity is more valuable and will bring more dollars in an acquisition than each staffing entity as a stand-alone. In essence, a minority share becomes more valuable than 100% ownership in a small one-office operation.

The risks revolve around how well the owners can work together, make decisions together and resolve challenges together. If they set goals, get good advice from the outside from lawyers, accountants and others, and execute on a business plan that they develop and champion together, success is sure to occur. If the new ownership team cannot work as a team, it will be difficult to succeed.

A Shifting Mergers and Acquisitions Market

The entire mergers and acquisitions market in the staffing industry has leveraged itself up. Back in the late 1990s, a staffing firm less than $10 million in annual sales could sell at a reasonable price. In today's market, a staffing firm less than $10 million in annual sales will be doing well to get 2 1/2 times the firm's EBITDA (earnings before interest, taxes, depreciation and amortization). This is below the average for a service business sold in the United States.

The staffing industry has become a "mature industry." One aspect of a mature industry is that the market is adequately saturated with suppliers from that industry. Some economists who follow the staffing industry would even say that there are too many staffing suppliers in the marketplace. This "adequately saturated" or "over-saturated" dynamic has a dilatory effect on the value of a small staffing business. When there is a staffing office on every corner, it is more difficult to command a high price tag.

Another aspect of a mature industry is that the customers are well-educated on the service offerings. Unfortunately for the staffing industry, not only are the customers educated, but also they have the upper hand in the relationship with staffing suppliers. Customers have, through the use of specific tools, moved to commoditize the industry's service offerings. As a result, margins get squeezed to a breaking point. This dynamic of customers successfully reducing the gross margins in the staffing industry has had a dilatory effect on the value of a small staffing business.

The staffing industry, as a mature industry and having educated customers, has external dynamics that are not favoring high multiples of EBITDA for staffing businesses. Firms can up their value by insuring that something is really there in the business. However, it will take good planning, hard work and smart navigating. **SI**

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