

Is a Staffing Company Viable?



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Is a Staffing Company Viable?

It should be no surprise that the performance of the staffing industry is integrally tied to the state of the economy and rates of unemployment. And just like most other industries, staffing also has its own unique set of nuances that must be perfected in order to achieve success.

High demand for staffing services offers growth possibilities for such firms, as well as the ability to earn increased margins in markets where the demand for qualified candidates exceeds the supply of individuals with such qualifications. Conversely, low demand for staffing services, often synonymous with periods of high unemployment, requires staffing firms to strategically contract services and overhead to right-size costs and enable their survival.

This article will outline the challenges staffing firms face in the current economy and the warning signs lenders should look for regarding staffing agency portfolio clients.

The Staffing Firm Business Model

Staffing firms may be thought of as brokers or “assignors” of manpower. Their purpose is to fix supply and demand imbalances in employment needs.

In a healthy or expanding economy, staffing services are frequently highly sought after. Companies in need of additional or replacement employees may not have the time or resources to locate, interview and vet candidates for open positions. Staffing firms manage these and other responsibilities in return for a fee.

The fee for a permanent placement position is generally calculated as a percentage of the employee’s initial year base salary. The fee for a temporary employee, called the staffing markup, is billed to the hiring company in addition to the employee’s direct wage, associated taxes and other benefits—collectively referred to as the employee’s direct cost.

Depending on the assigned employee’s skill set and the temporary position being filled, the staffing markup may range from 30% to 100% of the base employee wage. This sum of the employee’s direct costs and the staffing markup is called the client bill rate.





Working Capital Needs

Regardless of the state of the economy, staffing firms, by their nature, can require surprisingly large amounts of working capital. Whereas a typical manufacturing firm may be able to negotiate payable terms with vendors of 30 to 60 days, the “vendors” used by staffing companies are its contract employees, each of whom requires his/her checks weekly or even daily depending upon the type of work performed.

The client firms to which these contract employees are assigned generally demand credit terms of 30 days or longer, requiring the staffing firms to have sufficient liquidity to cover the gap between the cash outflow to the contract employee and the cash inflow from the client firm. During economic downturns, client firms frequently seek to stretch their payables as far as possible—however the staffing company is unable in turn to stretch its payment terms to its contract employees. The consequence for the staffing firm is a growing need for working capital.

As a rule of thumb, a staffing firm will generally need working capital of up to one month’s billings for each contract employee it brokers. For example, assuming all receivable collections are net 30 days, a staffing firm would require permanent working capital support of approximately \$3,466 for a contract employee with a bill rate of \$20/hour, working 40 hours per week.

$$\frac{\$20/\text{hr} \times 40 \text{ hrs/week} \times 52 \text{ weeks/year} = \$3,466}{12 \text{ months/year}}$$

Based on this example, a firm with 500 brokered employees could potentially have a liquidity requirement of over \$1.7 million. If collections become stretched, this amount would only increase. In today’s economy, many staffing firms are now seeing client collections pushed out to 60 or even 90 days—this has the result of doubling or tripling such firms’ liquidity requirements per contract employee.

Table 1: Monthly Liquidity Needs

		Average Hourly Bill Rate			
		\$ 12.50	\$ 15.00	\$ 20.00	\$ 30.00
Employees	100	\$ 216,667	\$ 260,000	\$ 346,667	\$ 520,000
	250	\$ 541,667	\$ 650,000	\$ 866,667	\$ 1,300,000
	500	\$ 1,083,333	\$ 1,300,000	\$ 1,733,333	\$ 2,600,000
	1000	\$ 2,166,667	\$ 2,600,000	\$ 3,466,667	\$ 5,200,000



Risks In the Staffing Industry

Staffing firms must carefully manage the risk of customer default. Economic downturns increase this risk substantially. Businesses with cash flow issues, or companies which are on the verge of collapse, may attempt to outsource labor needs and payroll liability to unsuspecting staffing firms. These distressed businesses could gain 30 to 90 days of labor before ultimately defaulting on payables due to the staffing agency.

Given current economic conditions, it is critical for the management of a staffing firm to have a clear understanding of the firm's liquidity needs via the maintenance of weekly cash flow projections. Additionally, such firms must scrutinize their overhead and fixed cost structures including their brick and mortar components—as the needs of the various employment sectors change, so must the business model of the staffing firms. The inability or failure of management of the staffing firm to respond to the changing conditions around them can quickly lead to financial distress, which places stakeholders at risk.

What Lenders Should Look For

The typical method by which lenders provide credit to staffing firms is through asset based lending lines. Available credit is generally calculated using an advance rate formula of approximately 80% of eligible receivables under 90 days outstanding. The first and most obvious warning to any lender would be a material increase in the overall

aging of a staffing firm's accounts receivables as this would indicate potential collection problems and likely cash shortfalls ahead. However, the tracking of other metrics may give lenders advanced warning signs before significant collateral amounts become at risk, including:

Weekly trends in:

- Revenue and margin per assigned contract employee.
- Total number of assigned (active) contract employees.
- Total number of billable hours.
- Average hours worked per assigned contract employee.
- Average hourly bill rate per assigned contract employee.
- Average hourly pay rate per assigned employee.
- Average length of assignment.
- Customer concentration.
- Revenue and margin per internal employee.
- Internal employee turnover.

If not already in place, lenders should implement a staffing firm scorecard which includes the applicable metrics above. Persistent negative trends in any of these categories often precede cash flow problems by weeks or months, providing lenders with the opportunity to address collateral risk before it is too late.



A Staffing Company Turnaround

Focus was engaged to determine the current health of a staffing enterprise and provide recommendations to the stakeholders regarding exit strategies and continuing operations scenarios.

Focus developed a detailed business model, tracking all aspects of revenue, direct costs of revenue, field and corporate selling expenses, and general and administrative expenses.

Using this model, Focus prepared a 13-week cash flow forecast for the Company's 18 locations and implemented a comprehensive cash management system. The weekly operational key metric system Focus developed allowed management and the stakeholders to monitor financial and operating performance.

Based on this information, Focus was able to determine that the company was a viable business and recommended to the stakeholders that an increase in their investment to fund

operations until the sale of the business could be completed would result in a higher return to the stakeholders.

Focus led the Company through a bankruptcy filing and a 363 sale process. The company was successfully sold at a significantly higher value than the stakeholders expected, in part due to the detailed financial performance model and the resulting clearly established financial performance.

How Focus Can Help

Focus Professionals have extensive experience dealing with these and other intricacies within the staffing industry. We have provided operational and financial management assistance for a variety of troubled staffing firms.

To adequately protect collateral value, a lender needs to reach out to skilled professionals experienced in staffing, operations support and real estate management to successfully address a staffing firm work out situation.

About the Authors



Peter Dominici is a seasoned Certified Public Accountant with over 25 years of experience in the finance and accounting industries. Pete previously served staffing firm Kforce, Inc. (formerly Romac International, Inc.) in various executive roles including Operational Vice President, Chief Financial Officer, Secretary, and Treasurer and as a member of the Company's Board of Directors. As CFO, Pete was responsible for Kforce, Inc.'s Initial Public Offering and Secondary Offerings.

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Lassiter Mason is an accomplished professional with nearly 20 years of financial experience across a diverse group of industries including real estate, staffing, manufacturing, utilities, transportation and agriculture. With a strong expertise in strategic planning and cash flow analysis, Lassiter has distinctive strengths in corporate restructuring as well as turnaround management for firms in financial distress.

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Contact Information

Focus Management Group is a leading business restructuring firm headquartered in Tampa, with offices in Atlanta, Chicago, Cleveland, Dallas, Los Angeles and Philadelphia. For more information regarding our experience in the staffing arena, contact one of our experienced Managing Directors listed below:

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