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

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On the Horizon

The Investment Horizon:

I began writing this piece a week after the stock market saw a correction which began as a reaction to over leverage in the US mortgage market and will move into the dollar and the US debt markets. It will not be pleasant. The mortgage market was "reorganized" in the last recession. The S&Ls, remember them, collapsed and were replaced by Wall Street using mortgage brokers to generate loans, itself to securitize loans, third parties to service loans, the general public to buy mortgage backed securities and, hedge funds to buy derivatives and to generally royal the markets. My bottom line: lighten up on mortgage backed securities in fiduciary holding accounts and lengthen US Treasury bond durations as US interest rates fall. Quality matters. Underwriting matters. Integrity of the bankers matters. If we are lucky, we may get stagflation (slowdown, maybe recession, plus inflation).

The Competitive Horizon:

We have talked a lot about data in the Tribune over the years. You know that I believe that *"data matters"*. We have talked about how you should use data to run your service bureau soundly. We have talked about what data to measure and where to find it.

I continue to think that the payroll industry is a doorway to financial services. As such, it will cause more players to be drawn to it. If these players are regulated institutions, like banks, brokerage houses, and insurance companies, the industry will come under more regulation and public review. Those players manage their operating margins, and so should you.

Data that you have at your fingertips, you can use to better manage your operating margins. In this edition of the Payroll Tribune, I want to look at three things that you can do with your data: to improve customer acquisition strategies, to manage customer attrition, and to cross sell key services to your customers.

Using data on your current customer base will help you attract and provide a better service to new and current customers (and current customers). Collect data from your Customer Service Representatives. They know a great deal about your customers, just ask them. Ask them to keep a log: customer ID, topic discussed, and time it took to service each customer for two weeks. You will see what you are good at, and what you are less good at. You will see which service processes work, and which are causing problems (and costing money). You will see how well you are training your CSR's, and what training they might find helpful. You will see what are the attributes of a good customer, and a bad customer. By collecting the data you will see which customers, services, and CSR's are building margin and which are reducing margin because they hinder the free flow of work throughout your organization, adding to costs and reducing margin.

In general, you can control customer attrition two ways: attract a targeted customer base, and provide the best possible service you can while maintaining your planned operating margin. For most small bureaus, attrition is like a death in the family. Few customers leave and when they do they are mourned throughout the company. But is that right? A customer who leaves because they were too complex for either the bureau's operating system or the training or experience level of the company's employees, should not be mourned. A customer who demands more CSR time then they should because they want the company to be their HR department, should not be mourned. A company that refuses to educate their employees on the company's payroll system or that hires untrained workers to interface with the payroll bureau, should not be mourned. Better, of course is a process of targeting potential customers based on their needs and the capabilities of your bureau's operating system. Equally good is looking at the data on customers that leave to go elsewhere. The data is not just the 'exit interview' questions that some bureaus ask, that data is not always reliable. The data should come from a review of the services provided to the customer over time. CSR logs on servicing issues, NSF history, turnover in bureau and customer staff and review of the type of company the customer was—industry, size, location. This data can help spot trends which can help you determine which customers could use remedial action by the bureau to reduce the probability that the customer will attrite. Poorly defined customers targets increase the cost of acquisition and servicing; and result in smaller operating margins.

Horizon (cont.)

Better data on customer account usage and from understanding customer trends will enhance cross sales revenues and help maintain or increase operating margins. A simple case in point in payroll is the move from providing a service of check and some reports, to providing tax service payment options, reports, and HR services. A more complex example is the change in the options for payment of employees from a check to direct deposit, to split deposits, to credit and debit cards. Data on the customer and the customer's employee base give a bureau a head start in creating payment alternatives for customer employees which build a stronger and deeper customer relationship between the bureau and its customers. The banks, of course, control the payment system. They are collecting data on payment options and they see both incremental income and control over the payment process as a competitive advantage in building their operating margins. For now, most banks are not in the payroll business. In fact, years after they abandoned payroll in the 1970s and 80s they are only just beginning to get interested in it again. When some of those banks come back into payroll, they will want partners. The partners they will seek will have a strong, scalable, and controlled operation.

Marketability vs. Liquidity

These are two old time bond market terms which apply to most assets. They apply to the ownership of your service bureau. In the 1970's the best example of 'marketability' (an asset which has the attributes of assets which can be traded in an open market) and 'liquidity' (the strength and depth of an actual market for an asset) was New York City bonds. New York City was a big bond issuer. It was "too big to fail" but a lack of fiscal responsibility by its spendthrift mayors, raised questions about the City's ability to pay the interest and principle on the bonds when due. Overnight, liquidity disappeared, and the City became technically bankrupt. A couple of present day examples of marketable assets are sub-prime loans and a huge variety of derivative instruments. Clearly, they were designed to be marketable. But in the case of sub-prime loans, they became illiquid overnight when credit quality became an issue. Major sub-prime lenders went out of business within days. The banks shut down their credit lines. No one would buy their loans, or their stock. The jury is still out on derivatives, but the trial is in session.

Payroll service bureaus exist in a unique segment of the market because they provide their owners with an annuity style of income, they are marketable assets. Currently there are at least seven major buyers of service bureaus and numerous smaller regional buyers in the market. So currently, well run companies are also liquid.

The question for an owner is "Is my bureau liquid?" Am I doing the right things to maximize value and liquidity?

I hope that our readers know what they should be doing to ensure that their bureau is not only marketable, but also liquid. They should have a defined market that they serve. They should generate consistent growth in customers, operating margins, and cash flow. They should have trained staff who use documented and reviewed processes and procedures. Bureaus with these attributes make good working environments, strong companies, and should be marketable as well as liquid assets for their owners.

Henshaw/Vierra Management Counsel, LLC

Henshaw/Vierra was founded to help the owners of family held companies and their managers build value.

We work with owners and their key staff to: develop a business plan; evaluate operating systems; organize system conversions; and define the control environment within the service bureau.

We work with owners to: develop plans for succession, and represent owners in growing and/or selling their company.

We can help owners build better bureaus.

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