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It Isn't Over 'Til It's Over

I attribute this wisdom to Yogi Berra. I will write about something other than the credit crisis in this edition of the Payroll Tribune, but I want to continue to give you my thoughts on the macro economic environment that you and your customers will need to deal with the rest of the year.

Money Market Funds, At Least Part of the Problem

By August of 2007 money market funds went from "no brainer" instruments as, liquid as cash, which paid interest rates in excess of term bank deposits, to high risk deposits with liquidity issues and the threat that they might not return principle. Today many are still a threat.

What happened? It appears that fund managers were buying assets without doing their homework, or worse. It was not uncommon to find that "better yielding" funds had 60% of their funds in commercial paper, 30% of their assets in asset-backed securities, and 10% of their assets in mortgage backed government agency securities. All these securities were rated AAA, of course. Some fund managers labeled their funds as 100% government secured, when in fact they were a 100% repo fund which was lending money to the likes of Bear Stearns and UBS on mortgage backed agency paper of what turned out to be dubious quality. In August of 2007 the money fund managers stopped buying commercial paper. Without that source of short term funding, mortgage bankers, investment bankers, et al could not finance their longer term loans. They pulled credit lines from originators, and the originators began to fail, weakest credits first (sub-prime), then weaker market securities like auction rate municipal securities. Dozens of mortgage banks failed, others went to the brink. Huge banks wrote off billions in loan losses, some real, some because of complex accounting rules, some because they needed to sell any asset they could to keep their bank/insurance company/ pension fund alive.

Is it over? No. Is it better? Maybe. The Fed has put over $450 billion in cash (by accepting loans and securities from commercial banks, and for the first time, investment banks) into the system. The Europeans have put over $200 billion into their markets. The auction rate market still has $370 billion locked up. Money market funds have let much of their commercial paper portfolio run off, without renewing it. The issuers of that paper have stopped lending, so 60% of a $3.7 trillion market has been diverted in part in treasuries and overseas. The credit freeze may well end when these "enablers" of poorly written securities and commercial paper, can trust the banks and financial institutions to actually underwrite financially sound investment grade commercial paper and asset backed securities again. That has not happened yet.

It is eleven o'clock at night; do you know what your sweep account is actually invested in?

Most banks have several money market and CD funds you can choose. Choose with care. A 100% government guaranteed fund may well not be a fund of short duration treasury and agency securities, but a 100% repo fund with loans out to organizations of dubious management and/or credit practices which, when they get in trouble, may cause your mutual fund to have to freeze or discount part of their portfolio. If this happens when you need to use these funds to meet various financial obligations on behalf of your customers, you have an immediate and large problem. The good news is that the money fund managers seem to know that they pushed their portfolios to the brink. They have seen that a liquidity crisis is not a casual "risk re-pricing" or temporary inconvenience. It is about trust, underwriting, skillful management, and "old time religion" of checking a borrower's character, collateral, and cash flow. The good news is that the return to sanity will give you some alternatives for short term investments, that whether you knew it or not, you did not have for the last nine months!

When It's Time To Sell

I get calls all the time from buyers and sellers of payroll companies. They tell me about business brokers who call payroll company owners with big multiples and quick deals. Most of them don't know much about the payroll business, so lots of time is wasted chasing deals that never happen or worse end up with terms the seller really can not live with.

Here are some thoughts that might help you know when it's time to sell: Before you sell, understand how your company makes money. Before you sell, take a look at your company from the view of the buyer. Before you sell, understand the risks inherent in your operation, and how you are managing those risks.

Conversations between payroll executives and between brokers and payroll executives are often about multiples. Sometimes they include the difference between gross and net margins. Rarely do they talk about what is helpful to an owner which is how they can make a difference in the actual terms of their deal by looking at the questions above well before you "go to market".

Deals are hard to do. They are emotional for many owner/operators. They are often a once in a life time event, so it helps to have advice from people who have been through it before. They require give and take between the parties, and active management of their lawyers! But, they are even harder when "surprises" come up because you have not dealt with the questions above.

You make money because you sell a good product that companies need and want to customers. You hire people to sell it, convert customers, and provide reliable services through trained customer service personnel. You think about market-clearing pricing strategies that will attract and retain customers without giving up the store. You put a budget together to guide you and to show yourself that you can make a predicted profit. Don't you?

When you think about selling through a buyer's eyes, you gage the complexity of your operation to see if it can be understood and followed by others who may not have your processes documented and available. You consider how your revenue is generated, the number of pricing tables you use, you even check to see if you are charging customers for all the services you offer. Buyers want to see what the customer base they are buying will generate going forward.

Risk management does affect your readiness to sell. Old risks like process risk, security risks, privacy risks, operating risks, the risk from the accuracy and reliability of your operating system; and new risks like the treasury management risks discussed above can be defined and planned for.

I often hear from sellers that this planning, these controls, these practices are not important because most buyers are buying assets (customer accounts) only and that the seller can take care of these other issues later. Not true!

Buyers will discount the lack of predictability of cash flows from your customer base. They will reserve against uncertainties based on your lack of controls.

You need to plan ahead to get the best valuation when it really is the time to sell.