

# Payroll Tribune

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## The New Normal for 2010

Looking back through old additions of the Payroll Tribune (you can see them at [www.henshawvierra.com](http://www.henshawvierra.com)) I see my Feb 2009 headline was “2008 was a Game Changer” and in May the headline turned to “Business Conditions Get More Difficult, But Opportunities Abound”.

My 2010 headline is taken from the wise bond managers at PIMCO, *“The New Normal”*.

In Q1 09 the economy was in a free fall after the failure of Lehman Brothers in Q4 08, and the very near collapse of the global financial system. In the United States, the S&P 500 was down 47% from where it had been in Q1 08. The financial service sector had collapsed 75% over the 12 month period. Key economic sectors were down significantly: finance – 75%, materials - 57%, and industrials -59%. The “best” performers were the consumer staples sector – 28%, healthcare and energy -31%. We were in a recession and had no idea if the economy would stop there.

**The reason that we care is that this is where payroll customers come from, and these are the forces that drive business formations, employment, and interest rates. These are all key factors in growing your business in 2010.**

Beginning on March 9, 2009, the markets began to turn for the better. Fed actions to open the Fed window to more banks and take their collateral of mortgage backed securities at face value poured trillions of liquidity back into the frozen credit markets. Treasury actions to put up to \$600 billion in new capital into the banks saved them from collapsing. The Fed also drove interest rates to zero to help the banks earn their way back to profitability. That did not help payroll companies by taking away their interest income. Federal stimulus programs were begun which were aimed at small businesses, the core of many payroll company’s customer base.

The result of these government actions was that the stock markets began to recover around the world. The S&P 500 recovered to end the year up 32%, the FTSE 300 Eur index was up 36%, the Shanghai was up 56%, and the emerging markets were up lead by Brazil +75%. In the U S most sectors were up year to year: Materials (commodities) +100%, Consumer Cyclical + 77%, and IT + 75 on the high side, and Utilities +20% and Telecom +26% filling out the rear of the advance. As the share prices of larger companies began to recover, business activity grew 4.25% in Q3 and 5.6% in Q4.

The recovery’s good for payroll company customers. It reduces overdraft and bankruptcy issues. But, so far, it is a “jobless” recovery, with unemployment still over 10%, meaning no increases in check counts, yet.

## What about 2010? The road will be bumpy, but we should not fall off a cliff.

The economists think there will be from 2 to 2.5% GDP growth in 2010. That will be good enough to keep firms in business, but too weak to drop unemployment below 9%. The economy has huge amounts of capacity that still needs to be wound down, as well as large operating deficits and government debt. The household sector is over borrowed and under saved, and it is our engine for growth. We will not have strong growth until it recovers, reduces its debt load, and increases its savings. So this means that the small business sector should begin to grow again and your payroll client base should grow. Raising prices more than 3 to 4% will be difficult. Getting back to higher interest rates is a harder call. Interest rates will rise, but not a lot. The Fed is far more concerned about deflation (dealing with vast overcapacity, slack demand, and low levels of funds velocity) than it is with inflation. It fears the kind of economic catastrophe Japan has failed to deal with for 20 years, and it should. So interest rates should rise 100 to 150 BPs, but not to pre 2007 levels. Do not chase yields by investing for longer terms and/or in weaker credits!

In “The New Normal” we will see **bumpy markets**, government **re-regulation** of the financial markets, lots of bad fiscal and monetary policy ideas, slowly increasing interest rates, bank failures and consolidations (the regulators have 1,500 banks on their watch list because if they were to mark their loan portfolios to market they would have no Tier One capital), and high unemployment. But, believe it or not, that’s an improvement over 2009!

## How Do You Plan for 2010?

First and foremost is that the best assets to own in this environment are companies which provide a key service business, with little need for capital expenditures, and a recurring cash revenue stream. **Sounds like payroll is a good place to be in this economy** as long as you work to provide your customers with an accurate and reliable service; and you pay attention to the key risks in this market: credit risks, security risks, and political risk.

**Credit risks** include your bank, your customers’ business success, and their banks. We have talked about how you can monitor your bank using Bankrate.com, fdic.gov, and edgar-online.com. The regulators are serious about dealing with bank risks. You will see their fine hand if your bank decides to cut working capital lines to you or your customers. You may see it through a call from your bank regarding your ACH volumes and activities. **Put back ups in place now.** You will see it in your NSF volumes. **Have a policy on overdrafts** (zero is good since you are not a bank), and monitor them daily. Order credit checks on your customers from time to time and use pre-notes for all ACH relationships (helps to keep them current by reviewing them yearly).

**Security risks** grow daily, just ask Google. We all use cell phones, websites, and electronic transfers 24/7. Passwords, encryption, secured sites, and reviews for embedded security problems need your focus. Storage of data and access to it need policies and review to prevent loss or compromise of customer data.

**Political risks** will come through regulation of the banking / funds transfer system. Generally payroll has been viewed as a good thing by the government. It helps get taxes collected faster. But the regulators were skinned alive by “unregulated” (and regulated) financial institutions, and the populists in government are pounding the drum to regulate as much as possible. Payroll is on the list. Be ready with sound practices and a solid control environment. I was in the banking business for 22 years. I know what a regulated environment is all about!

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