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BEING PREPARED FOR FINANCIAL UNCERTAINTY

A Staffing Owner's Guide

BEING PREPARED FOR FINANCIAL UNCERTAINTY: A STAFFING OWNER'S GUIDE

In staffing, the one thing you can be certain of is that things will change. For staffing firm owners, volatility and uncertainty is part of the challenge they face every day in running their business. To that end, we have compiled a guide for staffing owners to draw upon when the economic future is hazy. In it we will discuss the economic factors at play, how to manage your finances, what to consider when exploring new revenue streams, how to leverage your taxes, and more.

JUMP TO SECTION

ECONOMIC FACTORS AND TRENDS IN 2019

2019 has a lot of different factors contributing to uncertainty, including rising interest rates, lower unemployment than we've ever seen before, a predicted slow down in GDP, possible trade conflicts, and more.

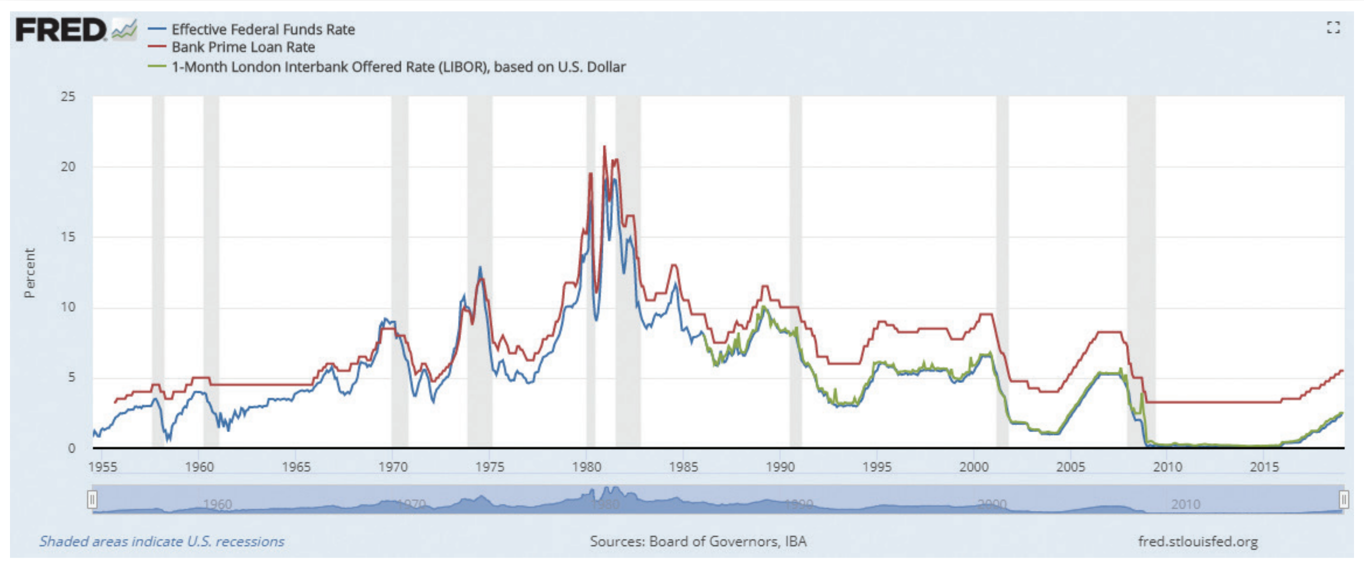
Nearly half – 48 percent – of Americans say they believe economic conditions are worsening, up from 45 percent in December and 36 percent in November, according to a recent Gallup poll.

Let's take a deeper look at some of the contributing factors:

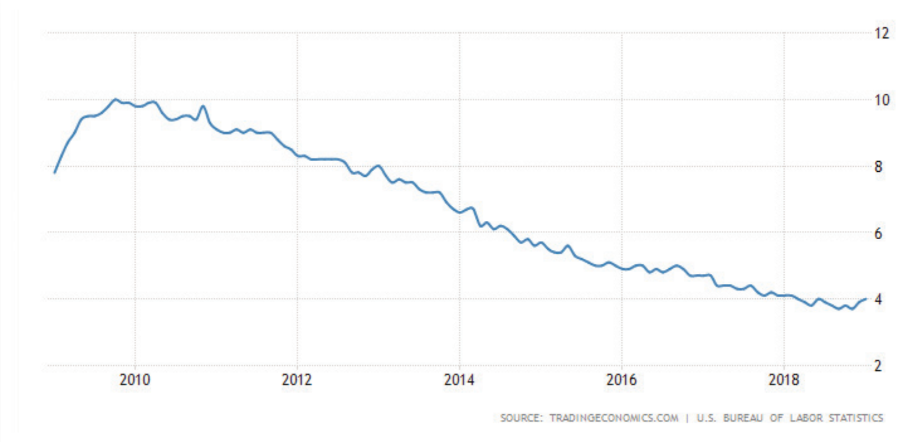
RISING INTEREST RATES

Inflation occurs when an economy grows due to increased spending. When this happens, prices rise and the currency within the economy is worth less than it was before; the currency essentially won't buy as much as it would before. One of the main functions of the Federal Reserve is to manage inflation at a target rate of about 2%, and the way they do this is by raising or lowering interest rates. In a strong economy, the Fed will raise interest rates to make it more expensive to borrow, which should keep spending low and keep prices down. In 2018, the Fed raised short-term interest rates four times, from roughly 1.5 percent to roughly 2.5 percent.

If strong growth continues in 2019, we can expect more rate increases. Most experts are calling for moderate expansion this year, although factors like sluggish inflation, possible trade conflicts, and slow growth abroad may weaken the case for rising rates.



LOW UNEMPLOYMENT



The US unempoyment rate has been on a downward trend for a decade, dropping from 10% in the throes of the Great Recession to a 49 year low of 3.7% in September 2018. Although it has started to tick up slightly in more recent months, there are still more jobs than people to fill them. The number of job openings are still near a nearly two-decade high of almost 7 million, outnumbering the 6.5 million people who are officially classified as unemployed.

The rate is unlikely to fall much farther, however, because the U.S. is unlikely to keep adding more than 200,000 new jobs a month given the already tight labor market and somewhat softer growth home and abroad.

VOLATILE STOCK MARKET

The stock market was looking strong in early 2018, but things went downhill fast in the last few months of the year. In fact, 2018 was the worst year for stocks since 2000, and it was the worst December for stocks since the Great Depression in 1931. Over $1 trillion was lost during the first week of December alone. While a recent comeback has provided some relief, the tumultuous 2018 has prompted Wall Street analysts to dial back their projections for 2019 in the face of a slowing economy, the ongoing trade battles and the uncertainty around the Federal Reserve's monetary policy. At least five banks have recently dimmed their outlook for U.S. stocks.

GROWTH SLOWDOWN

Since the end of the last recession in 2009, the economy has been growing fairly steadily at around 2.2% a year, jumping to a high of 4.2% in the second quarter of 2018 after tax reform went into effect. By the end of 2018, however, annual economic growth fell to 2.6% and economists expect growth to slow even more in 2019 and fall even further in 2020. Real GDP is expected to grow by 2.3% in 2019, as opposed to 2018's 3.1% growth. After this year, annual growth is expected to average 1.7% through 2023 according to the Congressional Budget Office (CBO), curbed in part by a drop in consumer spending power and a fall in U.S. exports.

TRADE CONFLICTS

The US is currently involved in a few trade conflicts, the most notable being with China. Over the past year, America has placed about $200 billion in tariffs on Chinese goods and also placed steep tariffs on all imported steel, angering other major US trade partners like Mexico and Canada. China, Mexico, and Canada have responded to the Trump administration's taxes on imported steel, aluminum, and electronics with taxes on American soybeans, dairy, pork, apples, and potatoes, among other American goods. Many financial analysts and regulators, including the Fed, have warned against these conflicts as they could materially affect US economic growth.

(SLOWLY) RISING WAGES

Slow income growth has been the most persistent problem afflicting the US economy since the recession ended a decade ago. However, recent signs point to rising wages. In October 2018, wages saw their largest year-over-year increase since 2009 – and the bump exceeded the inflation rate. And the strong economy may finally be forcing companies to rethink their pay structures in order to keep employees from leaving.

A lot of these factors contribute to a general feeling of uncertainty as we head into one of the longest economic recoveries in history. When, not if, the other shoe will drop is the question. In the following pages we will talk about strategies to help you deal with the unknown and be prepared.

TIP #1: BE SMART WITH YOUR MONEY

One of the smartest ways to deal with financial uncertainty is to control what you can. You can't control the general economy, but you can determine how you deal with your money and cash flow. Here are a few strategies to follow when dealing with financial uncertainty.

KEEP AN EYE ON COSTS

In the same manner you keep an eye on your personal budget, look closely at all your business expenses to make sure you're being efficient. Are there things you're not using, such as certain licenses or subscriptions? Look at all your expenses so you're using your dollars wisely. Some simple principles to lean on:

- Track every expense closely
- If you can live without it, forego it
- If sales are down, reduce your expenses to maintain your profit margin

REFINANCE OLD DEBT

If you can pay off your debt, great. If you can't afford to pay it off, consider refinancing or consolidating at a lower rate. This gives you an opportunity to put more principle towards your debt and bring the balance down. No different than what you might do with your personal finances, like a credit card. And because we're in a rising rate environment, you might want to consider it sooner rather than later!

REVISE AND UPDATE YOUR BUDGET

When it comes to financial goals, you're not going to know where you're going without a goal or a roadmap. Whether you want to earn $5 million or $50 million in revenue, you need a plan and to know how to execute it. A forward-thinking company also understands the value of analysis. Are you consistently reviewing your business plan to ensure it is current? This is a particularly helpful way to combat changes in consumer demands.

REWORK YOUR TERMS

If you are waiting 45, 60, 90 days for invoices to be paid, it might be time to consider reworking your A/R structure so you reduce the days until you get paid. If your client is unwilling to negotiate terms, you may be able to suggest implementing a late fee if they pay past their scheduled term. This means it is important to monitor all of your unpaid invoices on a regular basis. Don't wait for the deadline to approach before you contact a client. It's better to send gentle reminders a week or so before the due date than to wait until after it's due. Some partners, such as Advance Partners, offer collection services and reporting on average pay terms to help aid in this process.

TIP #2: KNOW YOUR DEBT STRUCTURE

When the future is uncertain, knowledge about your own debt structure is power. Your debt structure provides a historical window into your liabilities, giving you an idea of how soon your business must settle debts and whether you have the working capital to do so. The following are some helpful equations to get a handle on your debt structure.

TIMES INTEREST EARNED

When evaluating your debt structure, you need to know whether you can pay the interest you owe on your debt. To find out, you can use times interest earned, which looks like this:

$$\frac{\text{Earnings before interest and taxes (EBIT)}}{\text{Interest expense}} = \text{Times interest earned}$$

A low times interest earned may mean your company is at risk of defaulting on debt obligations, which is a bad sign. But a very high interest earned may indicate that you are not fully using your available capital and could possibly generate additional sales by acquiring more debt.

FIXED CHARGE COVERAGE

Interest is only one form of fixed charge that a company can default on - Leases are another particularly common form, but there are many others, as well. To determine whether your company will default on any of these charges, you can use the metric called fixed charge coverage:

$$\frac{\text{EBIT} + \text{Fixed charges before tax}}{\text{Interest} + \text{Fixed charges before tax}} = \text{Fixed charge coverage}$$

Fixed charge coverage is particularly important for companies that have a high portion of fixed charges other than interest.

DEBT RATIO

A staffing company with an excessive amount of debt is at very serious risk of default, so it's important to monitor your debt ratio. Lenders like to know your debt ratio because they want to be reassured that they'll get their money back — even if you go out of business. You can determine all this and more with the help of one little equation:

$$\frac{\text{Total liabilities}}{\text{Total assets}} = \text{Debt ratio}$$

A debt ratio of more than 1 means that your company holds more debt than worth. A debt ratio of less than 1 means your company has more assets than the debt it owes. A debt ratio anywhere near 1 can be challenging.

DEBT TO EQUITY RATIO

The debt-to-equity ratio tells you the ratio that liabilities compose of a company's funding compared to equity. Here's what this equation looks like:

$$\frac{\text{Total liabilities}}{\text{Stockholders' equity}} = \text{Debt to equity ratio}$$

A high debt-to-equity ratio is often associated with high risk; it means that a company has been aggressive in financing its growth with debt.

DEBT TO TANGIBLE NET WORTH

If you were to default on your debt or otherwise go out of business, everyone involved would likely want to know the value of your physical assets. Intellectual property and goodwill have little to no value when liquidating a staffing company, so you need to use the ratio called debt to tangible net worth:

$$\frac{\text{Total liabilities}}{\text{Stockholders' equity} - \text{Intangible assets}} = \text{Debt to tangible net worth}$$

If the ratio is greater than 1, you have more debt than it could pay off by liquidating all your assets. If the ratio is less than 1, you could pay off all your debt by liquidating your assets and still have some left over.

OPERATING CASH FLOW TO TOTAL DEBT

If possible, you would probably prefer not to have to sell assets in order to pay your debt, that's typically a bad sign for a company. To measure your ability to pay off debt without actually selling off your assets, you can use the operating cash flows to total debt ratio:

$$\frac{\text{Operating cash flows}}{\text{Total debt}} = \text{Operating cash flows to total debt}$$

A high ratio means you are probably able to pay off your debts by using cash flows. A low ratio means you may end up having to sell some assets to pay your debts.

TIP #3: EXPLORE NEW REVENUE OPPORTUNITIES

In uncertain times, having different sources of revenue can help ease the anxiety and maintain your top line. Here are a few ideas on how to bring more dollars in.

DIVEST IN VERTICALS

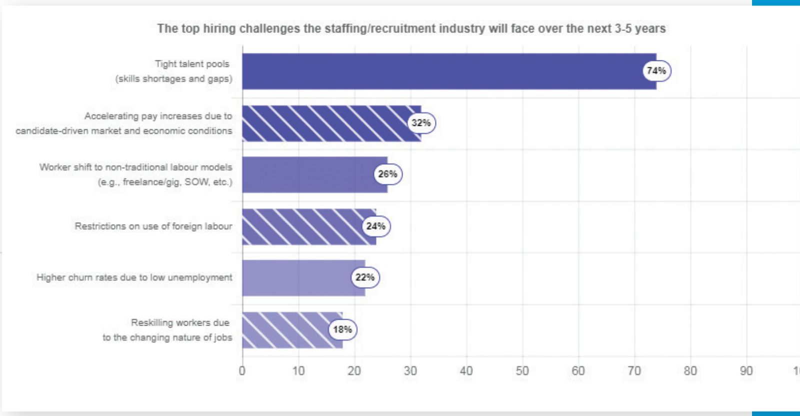
Consider divesting into other verticals. For instance, if you're in light industrial, maybe look into heavy industrial or construction. If you're in finance, add something clerical. It is good to branch out your business so you don't rely on one vertical/industry too heavily.

OUTPLACEMENT

Another thing to consider is using your skills as a staffing firm in other ways. For instance, outplacement is a counter cyclical service. You can help people find jobs while also keeping yourself in with your end client.

UPSKILLING

Upskilling—sometimes referred to as retraining and reskilling—is the process of helping workers turn outdated skills into ones that are highly applicable to the current job landscape. This is a critical service that staffing firms are in a good position to provide, especially considering that skills shortage is the number one hiring challenge:



Source: Bullhorn, Reskilling: A Game Changing Opportunity for Recruitment Agencies

The talent shortage provides a unique opening for staffing agencies to provide even more value. Rather than just placing talent, staffing firms can create talent by training existing talent pools. There are many ways to start upskilling, and it can be hard to know where to start. To get off the ground, here are four steps you can take:

1. **Evaluate what jobs aren't being filled**

   Looking at your data, what trends can you find in terms of the popularity of emerging skills or talents? And what percentage of jobs in those same skill sets do you have?

2. **Translate skills for your candidates**

   Use your recruitment expertise to map the skills keywords that your current candidates have to jobs that may one day be relevant, given proper training. For instance, if your candidate is coming back from military duty, you might say they have leadership ability, logistical insight, or sales acumen – and then you can map those skills to open jobs that require more training.

3. **Consider overlooked talent pools**

   Women returning from maternity leave, returning service members, and candidates with special needs are fantastic sources of talent often overlooked. Pay special attention to these groups Don't ignore these groups when you are initiating your upskilling efforts. Check out our Veteran Recruiting Guide for more information on how to properly recruit this desirable demographic.

4. **Invest in Your Talent**

   Upskilling requires an investment in educating your existing candidates to make sure they have the skills necessary for new roles. As their guide, it's up to you to show them that they have the capacity for change. This kind of investment takes time and energy, but if done properly will be worth it in the end.

TIP #4: FOCUS ON RELATIONSHIPS

In tough times, the people you rely on make a huge difference in weathering the storm.

The same principle applies to business – who are the people and the strategic partners that can help your business long term? The relationships you build with customers, suppliers or others staffing firms are crucially important, particularly during uncertain times. Trust of course plays a large role in building business relationships. Trust takes time to earn, but can be destroyed in minutes. Here are some keys to building business relationships.

START INTERNALLY

Trust starts at home. Focus on creating an environment inside your staffing firm that prioritizes fairness, trust, and honesty. This goes a long way towards building loyalty. If your people are jumping ship, it may be time to analyze your culture and fix what is wrong before your customers start to wonder why.

BUILD YOUR REFERRAL LIST

Some of your best business will come from referrals, so it's important to keep and maintain a good list of your industry contacts. Start by taking a few minutes to identify 25 people who can help you move your business forward. These can be vendors, prospects, customers, former customers, strategic partners, and people that you don't know yet. Then put them on a list and begin the relationship-building process.

SPEND FACE-TO-FACE TIME

To really get to know someone, you must spend time with them face-to-face. This applies to your business networks, your team members, your vendors and, most importantly, your customers. You cannot depend on emails, texts, newsletters, blogs, etc., to build these relationships.

GIVE WITHOUT EXPECTING SOMETHING IN RETURN

Reciprocity is a powerful psychological phenomenon – when you get something, you want to give something in return. Use this to your advantage by passing along good information, resources, or tips to your business contacts even if it doesn't directly relate to your bottom line.

COMMIT TO IT

Building strong relationships require a commitment of time and effort. If it's not blocked out on your calendar, chances are that it's not happening. Commit it to the calendar and then intentionally focus on relationship building.

ALIGN WITH STRATEGIC PARTNERS

Success doesn't happen in a vacuum. What strategic partners does your business need in order to move forward? Chances are there are certain areas of your business that could be improved with outside expertise, so it's worth seeking out paid partners as well as other business relationships.

TIP #5: BE SMART ABOUT YOUR TAXES

Being smart and forward thinking when it comes to taxes can save you money in the long run, which is good – particularly in an economic environment that is up in the air. The following are some tax tips and principles to consider.

REINVEST BACK IN YOUR BUSINESS

The money that you earn by working hard at staffing is yours - don't let the IRS take more than they have to! After the recent tax reform bill passed, many big companies used the windfall of tax cut to reinvest back in the business. Areas to focus include

- Technology – such as a new back office system or ATS
- People – such as a new salesperson in a new region
- Equipment – such as a new computer system
- Places – satellite office or on-site location

Ultimately those expenses flow through your income statement and reduce your taxable income. Plus, with the recent expansion of the Section 179 deduction, you might be able to deduct the cost of some equipment.

TAKE ADVANTAGE OF TAX REFORM

Overall, tax reform was beneficial for the staffing industry. We now have lower tax rates across the board, and recent legislation made it clear that most staffing firms will be eligible for the new 2018 "pass-through entity" tax deduction, under the Tax Cuts and Jobs Act (TCJA). This means that most firms can potentially deduct up to 20% of "Qualified Business Income" – or "QBI" - from federal taxable income.

The effects of the TCJA on other industries have also had an indirect influence on the staffing industry. With the positive business sentiment that came with the passage of the TCJA, many companies have increased their hiring efforts in order to invest more in equipment, plant sites and properties, and they are using staffing firms to increase their labor force.

USE APPLICABLE TAX CREDITS

If applicable, take advantage of the Work Opportunity Tax Credit (WOTC), a federal tax credit rewarding companies for employing individuals who have previously faced significant barriers to employment such as veterans, long term unemployed, and food stamp recipients. Employers can earn up to $9,600 in federal tax credits for each qualified employee, and there is a good chance you may already be hiring individuals from these target groups but not claiming the tax credits.

To apply for these tax credits, employers are required to fill out two forms, IRS Form 8850 and ETA Form 9061, during a new hire onboarding. You must then submit those forms to the Department of Labor within 28 days of the new hire to be eligible for the tax credits. Many companies will outsource the WOTC to a tax credit processing firm for their expertise.

When it comes to the future, the only thing you can count on is that things will change. But the decisions you make now when times are good can have big potential consequences when they are not. We hope this guide was helpful to you. If you have any questions or want to know more about how our services can help you manage financial uncertainty, contact us at www.advancepartners.com/get-in-touch or 866-653-1810.

YOU MIGHT ALSO BE INTERESTED IN:

- The Staffing Firm's Guide to Navigating a Recession
- Understanding Financial Documents Series
- The Staffing Guide to Taxes

ABOUT THE AUTHOR

CRAIG COHEN

After graduating from Ohio State University with a BBA in Finance and then earning his MBA from John Carroll University, Craig built his career in corporate and commercial banking. He gained extensive experience in credit underwriting, risk management and loan workout, both at small community banks and large regional banks.

At Advance Partners, Craig oversees credit and underwriting functions and also supports clients with risk management, acquisitions and business valuation. In 2017, Craig was awarded the Commercial Finance Association's 40 Under 40 Award, which recognizes the high achievers and rising stars in the commercial finance industry.

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