

STARTING A
NEW STAFFING
OR RELATED SERVICE LINE

So you believe you are ready to pursue a new service line? If you answered yes, you are in good company. I would be hard-pressed to identify a firm with less than \$10M in revenue that provides only one service line – even fewer at above the \$100M revenue mark. This is due to the inherent desire of the business owner to take advantage of new and emerging opportunities, spread their business risks and create more shareholder value. Bottom line: Everyone wants to bring his or her business to the next level. The question therefore becomes: How to juggle the time required to successfully start a new service line without jeopardizing your core business? We will explore the pros and cons of the three most popular growth strategies pursued today in addition to asking: Why does starting a new service line make sense? What am I going to create? What strategy is best for my company?

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How to Boldly Go Forward

Let's first consider the definition of a new service line. For the purposes of this article a new service line is the creation of a new service line your organization was not previously directly or significantly involved in. For example: a nurse staffing firm wishes to enter allied health; a light industrial company may wish to pursue professional staffing; or a temporary staffing firm might want to focus more significantly on direct hire or RPO. Let's step gently into this discussion before we say how and when to initiate change. There are a number of external economic and internal organizational factors to consider before boldly going where you have never been before.

The first question to consider is: *Why?* Why do you want to start something new? Over the past two years my associates and I have worked with 11 firms in my consulting practice that thought they wanted to pursue a new "something." During our initial consultation we always ask, "What makes you think this is a good idea?" The answers, beyond the obvious desire to grow a profitable business, were surprising. These include: "our owners want us to" and "to keep this account we need to" or "I just feel like we will miss an opportunity if we don't." It is not my intention to tell you (or them) what a proper response should be since each business is different. However, I am here to urge you to prepare yourself if you are considering taking a journey into uncharted territory. As in any other adventure, you need to buckle up for safety to protect yourself from unforeseen dangers.

Second, we sit down with the company to explore the obvious and sometimes not-so-obvious options available. This is a time for us to ask: *What?* What do you think you want to create? There are many possible options with numerous variations to consider. An example of this occurred when we were working with a large light industrial provider, and we were vigorously debating what growth strategy we should pursue next. Some possibilities included: geographic expansion (more of the same), trades (something new it was familiar with, but with more attractive margins), per piece solutions (an area that the clients were talking about, but they knew little about, and

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also with higher margins) or an entirely new and unrelated service line – i.e. legal or accounting (areas they have only dreamed about) because they have seen the eye-popping multiples. We then help them carefully assess the scenario's likelihood of success. Together we estimate the time and investment required for a successful venture and review shareholder value formulas before encouraging the client to make an informed decision that is best for their company.

The final piece of the puzzle is: *How?* How will we get from point A to point B? This is a difficult question to answer and the discussion almost always leads to heated debates. New opportunities are constantly arising within staffing, recruiting and human capital. The hard part is picking the right path for you and your organization. You should always choose the path that will create the shareholder value you seek as well as one you can successfully execute. The hardest part of the discussion is assessing the overall financial risks and the pros and cons associated with each. My top three strategies for *How* are: Build IT, Buy IT or Blend IT.

Let's now more closely examine the *Why*, *What* and *How* of launching a new service line. To answer the question *Why?* I suggest you look towards the future and visualize how your company will look if

you are successful in creating your end result. This step is important to both the new venture and the company's overall entity. I have seen even the best-intended strategies collide when the future is not carefully considered. I would also suggest you do an assessment of yourself and your organization to see if you are both ready for the journey. Your banker, CPA, board of advisors (if you have one) and other trusted advisors can serve as valuable resources as you wrestle with this question. If you settle into the notion that you are capable and confident, then you are ready to move on to the next step: What should the new venture be?

The *What?* is such a big question that it often seems overwhelming. Therefore, let's break it down, and consider some different possibilities for your company. You want to be very clear when determining if the new venture is totally new or if it is closely related to the core business that you are currently offering? There is a big difference between a light industrial firm starting a medical staffing division and a medical staffing firm attempting to add direct hire. Launching closely related efforts are usually easier since you will be entering somewhat familiar territory. We have found that most people have a very difficult time going from service lines where there are plenty of candidates

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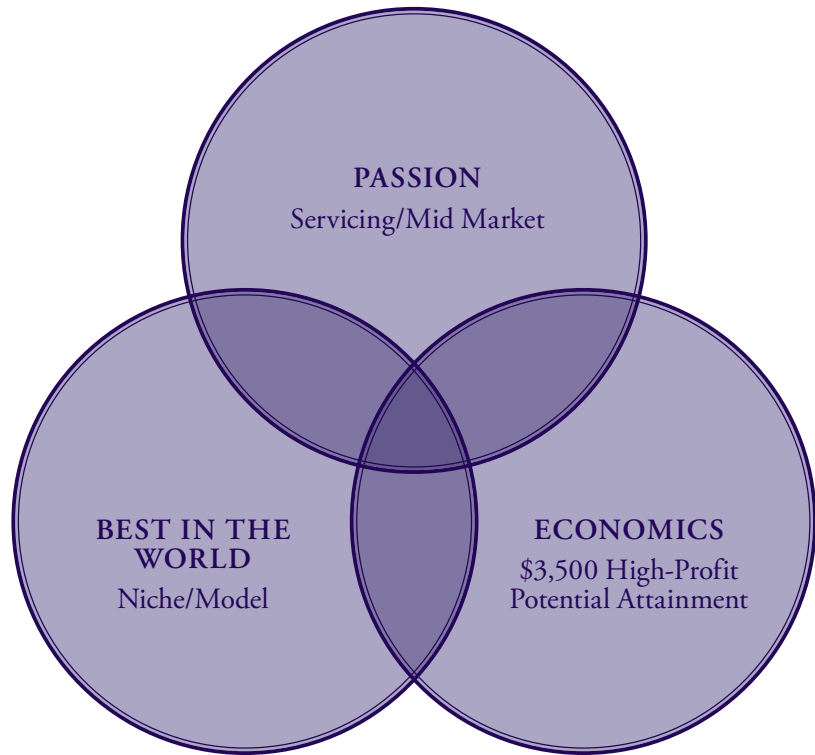
(client centric) – i.e. light industrial and low-level clerical, as opposed to those service lines where recruiting is very tight (candidate centric) – i.e. professional, direct hire, medical, etc. It is also important to be cautious when considering an area that you are not as familiar with, since the new venture will likely have an entirely different focus, feel, pricing model, operations model and operating metrics. These factors need to be first understood and then carefully weighed.

Once we have asked *What?* it is important for the firm to research the growth rates, gross margins and EBITDA (earnings before interest, taxes, depreciation and amortization) margins of the service lines it is considering. In addition it is crucial to know the key competitors and their philosophies, strategies, strengths and weaknesses. If you are going to enter a market, whatever market you choose, we suggest avoiding a “me too” approach. We encourage firms to do something that will make a real difference in the market. Finally, once you have completed these tasks we would not recommend you move forward unless the firm can devise a satisfactory model like the one provided that Jim Collins introduced in his now famous book, *Good to Great*. The model is called the Three Circles of the Hedgehog Effect.

After researching thousands of companies, it was Collins’ opinion that there were three critical components to success (the Three Circles), and only when you create an environment where all three are present would you have an optimal situation. The Three Circles are Passion, Single-Minded Best in the World Practices and What Drives High-Profit Potential Attainment. All of the firms described in his work share these three common traits. In the long run, these firms obtained the highest long-term shareholder appreciation and sustainable growth patterns.

After considering the components of the Three Circles we help companies determine: “What am I passionate about?” and “What can I be the best in the world/my market at?”

Finally, we work with our clients to determine the likelihood of making a desired profit on the new venture. In the example below this particular business is saying,



Example:

What the new service line should have as its three core principles using the Three Circles of the Hedgehog Effect Model.

I'm passionate about small and mid-size clients (they are the ones creating most of today's jobs). I can be the best at (you fill in the blank) and I can have a certain GM\$/ FTE or EBITDA margin if I execute correctly. If you can't adequately fill in the Three Circles you should go back to the drawing board until you have them figured out.

Building the Dream

Who will lead this effort?

Whatever the chosen course, we ask people to determine if they have the talent in house or if they will need to recruit it? We ask them to determine if they will have to hire a new team, bring on advisors or move existing staff around? In 90% of the cases a new team is either recruited or assembled by way of an acquisition. The last gut-checking question is: "Would you bet your future, your company on this leader or this team?" The sobering nature of the question puts into perspective what is at stake.

How do you make the dream a reality? The how is where the rubber meets the road. As previously mentioned

I have seen three strategies work over the years. Some are better than others but I believe they all have a time and a place.

Build IT – Organic growth is considered by most the safest and least risky course to take. There are two primary reasons for this. First, you don't have to deal with the many integration and people issues of an acquisition and second, you don't have to bloat your balance sheet. This practice allows you to create a business or a model that you are comfortable with and one that will not put your company at risk of inheriting bad habits or other people's issues. On the other hand the growth is slower and, depending on your venture, it might take much longer than you ever imagined.

Buy IT – The practice of acquisitions has played a major role within the staffing industry for the last 15 to 20 years. Look at Adecco, the combination of several major billion-dollar organizations (Adia, Ecco, Olsten and others) merging to form the world's largest provider who today stands at over \$20B in worldwide revenue. Adecco is a case study that stands

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apart from the rest as a success since there are many more recorded failures with high aspirations that were never realized. The others failed as a result of firms overpaying for the businesses they bought, not adequately integrating acquisitions or simply because they did not have a clear vision of what the final combined business was going to look like. For these reasons there were a half dozen rollups in the '90s and a few in the past five years that are no longer standalones, since they have been swallowed up. Select Staffing also appears to have cracked the acquisition's code. It bought my old company, RemedyTemp, and has been making a hard charge over the last 10 years, with revenues approaching \$2B. However, I do not recommend this strategy to the faint of heart or pocketbook.

At this time I think it is important to also mention the larger strategic targeted acquisitions that are added to platform companies. Acquisitions such as Jefferson Wells and Right Management have worked well for Manpower. They were large enough to move the needle and make a positive impact to Manpower's bottom line. This was largely made possible by the fact that each of the acquisitions had enough infrastructure established within the acquired businesses that integration wasn't a large problem. This strategy of buying into areas where you have no expertise has proven successful in several cases, provided it is well thought out, a fair price is paid, key staff stays in place and it fits into the long-term overall strategy of the firm.

Blend IT – Blend IT for consistency strategy is a bit of hybrid. This is a growth model where the platform companies' strategy is to buy controlling interests in niche firms. They keep management in place with the promise of a future payout if they execute the growth strategies well. The platform company provides the growth capital and management know-how with the intention that both companies will win down the road. One of the largest drawbacks to many acquisitions is that key management leaves when the deal is done. In the Blend IT model, management stays on (it remains minority shareholders) to hopefully take "another bite of the apple" when it is finally bought out years after the initial acquisition. Vedor was started this way. Today Empresaria, headquartered in Europe and publicly traded, has made this model work in a relatively short time, and now has a firm approaching \$500M in revenues.

Considerations

When to get started? This is a very critical decision and usually very pivotal. Do you start it when things are good and financing is easier? Do you start it at the beginning or the end of an economic cycle? Do you start it when things are down because the multiples are friendlier and the talent is easier to recruit? This is not a simple question since the answer has several dimensions. While at Remedy, we started RemX, a niche accounting and IT company during the depth of the 2001-2002 recession. The reason we chose 2001-2002

is because we believed that we could recruit the talent while the rest of the marketplace was laying off employees. We could have made the argument for an acquisition strategy but at the time it boiled down to what we were comfortable with. We were more comfortable with an organic strategy and brought on Fred Herbert as our president. When we sold to Select, RemX was in the neighborhood of \$100M in revenues with +40% gross margins. We created significant shareholder value with less than \$10M invested.

Another growth option to mention is franchising. I did not highlight this option because I count less than 20 true franchisors in the staffing industry today. When you think about the fact that there are over 9,000 staffing companies in existence in the United States, franchising truly represents a small piece of the pie. However, I believe I'd be remiss if I didn't mention Express Personnel. Express is now doing close to \$2B in worldwide revenue – not too shabby for Bob Funk and Bill Stoller, the founders of this 100% franchise model. Recently, they were both highlighted in the book, *The Breakthrough Company*, by Keith McFarland. Express earned the distinction (along with eight other firms from the 7,000 companies considered) as Breakout company in the book, because it fits the author's definition of growth, profitability and sustainability. If you want to expand a new line I would not totally dismiss franchising. However, I would caution

you to understand that when you are in the franchise business you are more in the world of franchising than you are in the world of staffing. Ultimate Staffing Services, headquartered in California, determined after a brief expansion into the franchise arena that it was not a good fit for them, and they quickly disbanded the effort. Many years ago, Kelly and Manpower discontinued their franchising efforts and have since bought most, if not all, units back. While at Remedy we had over \$200M in franchise revenue, and it greatly helped us expand our footprint nationwide.

Summary

Consider the questions revolving around how to best launch a new service: When, how and what services to consider can be a daunting task. There are many questions to ask, and many roads that can be traveled. From my point of view, it boils down to ability, risk, balance sheet and timing. It's the unique combination of these four items that will lead you to the right answer for you. There is not a one-size-fits-all strategy (Build IT, Buy IT or Blend IT) when it comes to launching a new service line or division. I believe at a given point in time just one or all three strategies might work well, depending on what your ultimate end game is. **si**

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