

# Working Without a (Working Capital) Net:

Cash Flow Constraints in the Staffing Industry

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A special report by: THE RECEIVABLES EXCHANGE Working Capital Research Group

# Working Without a (Working Capital) Net:

## Cash Flow Constraints in the Staffing Industry

Securing reliable working capital in sufficient quantities is the number one business challenge today for companies with revenues of \$2–200 million, edging out fears of escalating costs and maintaining margins, according to a landmark study conducted by The Receivables Exchange Working Capital Research Group. The Receivables Exchange studied 670 companies across 15 industries to understand their top business challenges and how working capital and cash flow issues are being viewed by decision-makers.

The study found an overwhelming majority of respondents feel they are performing a “high-wire act” when it comes to working capital management.

Viewed from a macro level, working capital constriction for this group of companies is a significant problem for the economy as a whole. Businesses of \$2–200 million in revenue account for roughly two-thirds of private sector workers and 45% of business revenues in the U.S., yet less than 5% of capital markets activity is devoted to funding them, leaving a substantial financing gap.<sup>1</sup> And that gap has only increased during the global financial crisis, which has further restricted access to capital – unsustainably for some businesses.

The Staffing industry faces specific challenges when it comes to working capital, not the least of which is its susceptibility to seasonality and disruption. To provide insight into the key working capital challenges facing Staffing companies, The Receivables Exchange Working Capital Research Group extracted industry-specific intelligence from the study data to aid Staffing company leaders and financial decision-makers.

Nearly 70% of respondents wish they had a more significant “cash cushion” to fall back on in times of need.

### A “Perpetual Challenge”

According to the study, working capital is the number one business challenge for companies in this revenue range, edging out escalating costs and margin maintenance for the top spot. And it's not a new problem. Forty percent of companies in this range state that procuring working capital has been a “perpetual challenge” over time. This number is even higher in Staffing, where 56% of companies say securing sufficient cash flow for ongoing operations is a serial issue.

Cash flow is a concern for Staffing firms, as the workers they place are typically paid weekly or biweekly, while their customers are only billed monthly. This creates a liquidity gap when it comes to funding payroll, workers compensation collateral and capital expenditures. Indeed, Staffing companies were more likely to be worried about liquidity than nearly all of the 15 industries surveyed (Fig. 1).

Exacerbating these issues is a trend toward large companies demanding extended payment terms. Extending payment terms has a direct negative impact on a company's cash conversion

### What Is The Receivables Exchange?

The Receivables Exchange is a competitive online marketplace where small and midsize businesses sell their outstanding invoices for cash to institutional investors, like banks and hedge funds. Businesses that sell their invoices typically get 98-99 cents on the dollar, and get paid immediately instead of having to wait until their customer sends payment.

Companies that want to sell their receivables go through a one-time approval and verification process, after which they can get funds electronically deposited in their accounts in as little as 2 business days after issuing an invoice to a customer. The competitive online auction process is an effective way to diversify funding sources and to drive down the cost of capital. Sellers can use the Exchange as much or as little as they need, without obligation.

Sellers rave about the results they get from The Receivables Exchange. The owner of a health care staffing company said The Receivables Exchange helped her meet payroll obligations when bank financing provided inadequate. “The Receivables Exchange has helped us tremendously,” she said.

Minimum qualifications apply, including trailing 12-month annual revenue of at least \$2 million, 2 years of operating history and being registered to do business in the U.S.

[www.receivablesXchange.com/seller](http://www.receivablesXchange.com/seller)  
or call 877-392-4952

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<sup>1</sup> Morgan Stanley BtoB Finance Report for Small and Medium Business, March 2010 via U.S. Census Bureau 2002 County Business Patterns and 2002 Economic Census

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Fig 1: Top Business Challenges for Staffing

Working capital	62%
Escalating costs	62%
Liquidity	44%*
Margin maintenance	35%
Maintaining morale/productivity	32%
Managing growth	32%
Ability to forecast results	32%

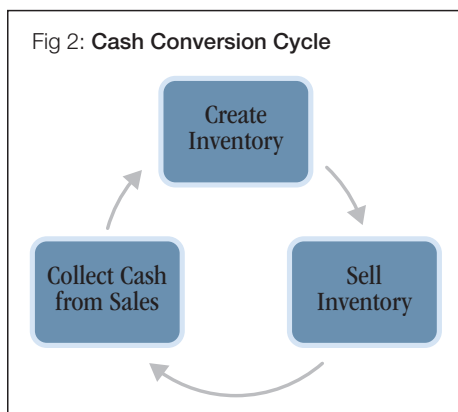
\* Second-highest rating among the 15 industries studied

Source: The Receivables Exchange Working Capital Research Group, 2010

strong economic growth. When a business needs to lay off staff, temporary personnel are the first to go. As the economy begins to recover and corporate profits return, companies will begin hiring temporary workers again, which will contribute to industry revenue.”<sup>2</sup> As the Staffing industry recovers from the downturn, a continuing challenge will be having enough capital on hand to cover operations and keep up with demand.

## The Value of a Cash Cushion

Fig 2: Cash Conversion Cycle



Restricted access to capital can stand in the way of growth or force an adjustment to day-to-day operations. Perhaps that is why a full 69% of the companies surveyed ranked having a strategic “cash cushion” as very important to their business. Top uses for that cash cushion included coping with disruptive events, being in a position to take advantage of business opportunities, dealing with seasonality and slow-paying customers or customers extending terms. Staffing is particularly hard hit in this area: Of the 15 industries surveyed, Staffing had the highest desire for significant strategic cash reserves and yet had the lowest overall cash satisfaction, with only 15% of respondents satisfied with their current cash position.

Seasonality is a significant driver of working capital issues in Staffing, and a chief reason for a cash cushion. Uneven business puts great strain on cash conversion cycles, and Staffing companies, which are service-based and tend to have customers larger than themselves, are especially vulnerable. The

study also showed that Staffing is particularly susceptible to business disruption, which can be sudden and extreme, and can be further exacerbated by customer concentration issues.

Of course, disruption is not necessarily negative, provided a company is prepared. “A sudden shift in the marketplace due to unforeseen events can be a boon to businesses,” said Bill Siegel, SVP and head of the Liquidity Desk at The Receivables Exchange, “but only if they have the working capital on hand to take advantage.” New technology, regulatory changes and even competitors’ business issues can create opportunity. But Staffing companies must have resources on hand to seize that opportunity. This is easier said than done.

cycle and dramatically increases the need for additional working capital. Fortunately, Staffing is in an enviable position versus other industries when it comes to customers extending terms. Only 24% of Staffing companies are having issues with customers extending terms versus nearly half of companies in industries like Manufacturing and Transportation. But 24% is still a significant number, and with such a tight cash conversion cycle to begin with, those companies experiencing extended payment terms can suffer dire consequences.

While extended terms are not as common as in other industries, Staffing industry performance is more susceptible to the ebbs and flows of economic cycles. As a U.S. Staffing industry report by IBIS World explains, “This industry is among the first to suffer during economic downturns and one of the first to benefit during

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<sup>2</sup> Ibis World, U.S. Industry Report, Office Staffing & Temp Agencies, August 2010: <http://www.ibisworld.com/industry/default.aspx?indid=1464&partnerid=ValuationResources>

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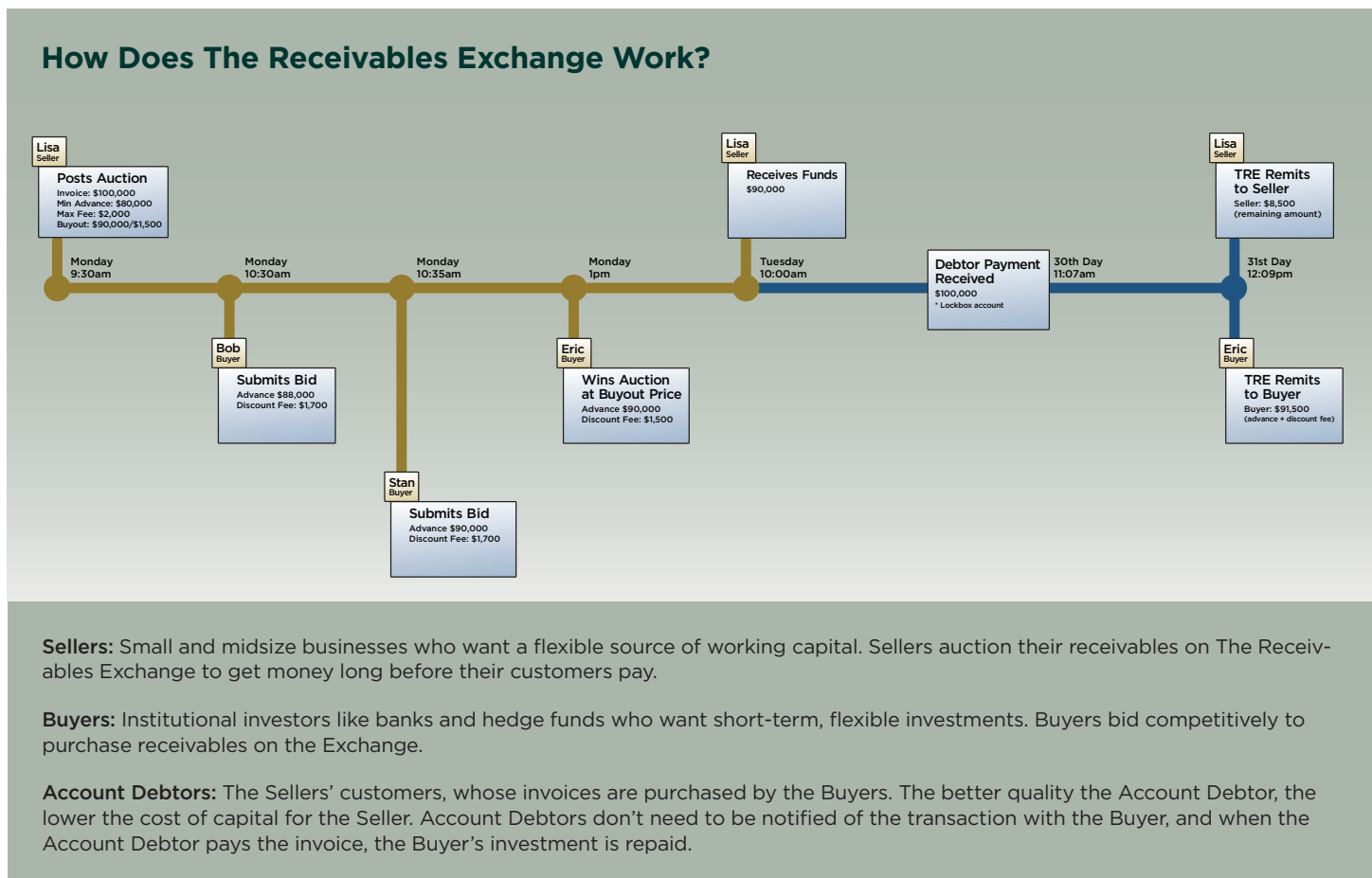
Cash Flow Constraints in the Staffing Industry

## Working Capital is a Distraction

All of these working capital pressures add up to a major distraction for a large proportion of companies in this revenue range. One in four respondents said working capital challenges create excessive anxiety at their companies and 68% indicate they do not feel a sense of control when it comes to their company's finances. Only 1 in 4 are happy with their company's current strategic cash reserves. Even making payroll is a frequent concern for 15% of companies. In Staffing, these sentiments were magnified, with 24% of respondents citing making payroll as a frequent concern. While some of this is reflective of structural issues unique to Staffing, this number is startlingly high compared to industries like Transportation and Media that cited this concern at single-digit levels.

Considering the level of angst over working capital issues, it is not surprising that 57% of respondents consider cash flow a key driver of their business success and 35% of respondents spend "a lot of time" researching and educating themselves about how to best manage working capital issues. What may come as a surprise is that 40% of respondents state they do not proactively manage cash flow "in good times" and that 26% "only deal with cash flow issues when they become a problem."

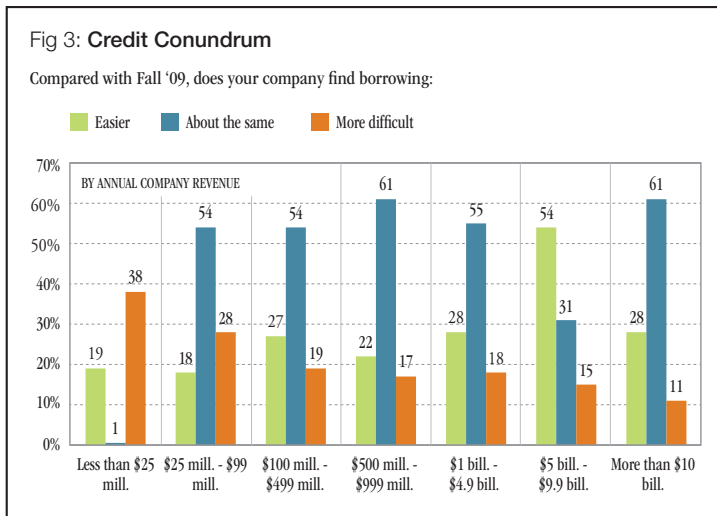
Staffing respondents were particularly concerned with optimizing their working capital management. Nearly 80% were proactive in managing cash flow, the highest of any industry examined. There was also evidence of a real hunger for improvement among staffing respondents, with 38% wishing they had a trusted source to help them evaluate the best ways to manage their cash flow.



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### Seeking Financial Alternatives



Source: CFO Magazine, July/August 2010

This proactive stance and desire to manage cash flow more effectively may be warranted. Until recently, most companies comfortably relied on traditional financing sources such as bank lines, asset-based lending or factoring to source working capital. But small and midsize companies are losing confidence in traditional financing as access to capital has become more restricted (Fig. 3). In fact, 1 in 3 companies studied believe small and midsize companies are increasingly blocked out of traditional financing sources that are now open only to very large companies. One in three also state that they themselves have been forced by the current economic situation to consider alternative forms of financing they had not previously considered.

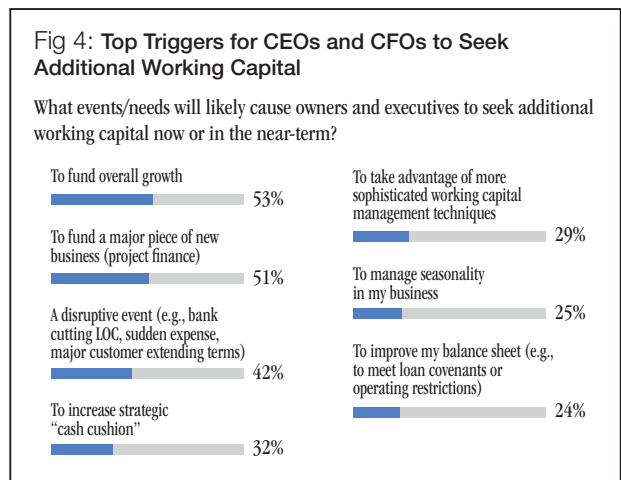
When asked specifically what events would be most likely to trigger their company to seek new financing, project finance (i.e., funding a major piece of new business) and disruptive events (examples cited included bank cutting line of credit, sudden expense and major customer extend-

ing terms) were at the top of the list (Fig. 4). However, funding overall growth was cited by a full 52% of companies, which would seem to indicate a deeper, more systemic issue with working capital access for companies in this revenue range. This is in line with a recent survey by the Pepperdine Private Capital Markets Project, in which 71% of private companies said they believed they could grow their revenues, if only they had access to additional growth capital.<sup>3</sup>

Staffing in particular has been driven to find alternative forms of financing, with nearly half indicating traditional sources had proved inadequate. They cited a host of issues that might trigger them to seek financing. Among the strongest were funding new pieces of business, but there was also a strong desire for reserve funds, and a desire to take advantage of more sophisticated working capital techniques.

The trend towards alternative financing may be driven by more than just availability of traditional financing. Diversification of funding sources has traditionally not been a major issue for companies in this size range, and yet about 40% of respondents indicate they are now concerned about “putting all their eggs in one basket” with a single financing source, and a similar percentage stated that diversification of funding sources was of strategic importance to their companies. This is particularly important in Staffing, where 47% share this concern.

However, despite tightened credit and the newfound desire for diversification, banks are still very much part of the picture. In fact, 70% of the companies surveyed had access to a bank line of credit. This number was highest in industries like Transportation and Logistics (81%), Manufacturing (78%) and Energy (76%) and lowest in Health Care and Education (both 61%). Banks were reported as fast, efficient and reputable sources of working capital, and industries that had a high affinity for lines of credit cited strong ongoing personal relationships with their banks.



Source: The Receivables Exchange Working Capital Research Group, 2010

<sup>3</sup> Pepperdine Capital Markets Project, July 2010: <http://bschool.pepperdine.edu/newsroom/index.php/2010/07/private-business-owners-have-solid-growth-strategy/>

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“Banks are a key source of working capital for a large number of companies, but tightening in credit markets has led many companies to augment their lines with complimentary sources of liquidity.”

Siegel puts it, “Banks are a key source of working capital for a large number of companies, but tightening in credit markets has led many companies to augment their lines with complimentary sources of liquidity.”

Staffing had lower-than-average affinity for banks, with 65% of companies believing a bank line of credit was not the best way to get working capital. This may have something to do with the fairly high incidence of customer concentration issues cited by Staffing companies. Nearly 20% of Staffing companies said it was difficult to get financing because they had a small number of large customers.

“The more concentrated the debtor is, the more stringent the underwriting requirements become,” said Jason Cole, division manager for the Staffing Services group of Wells Fargo Capital Finance, in an article in *Staffing Industry Review*. “While there’s still credit available to Staffing companies, the emphasis placed on the quality of [a Staffing company’s receivables] and the quality of the cash flow is greater than it has been in the past.”<sup>4</sup>

Because of these challenges, nearly half of Staffing companies were willing to try forms of financing they’d never used before. Alternatives that are commonly considered include:

- Widespread use of credit card float (e.g., for T&E or other business expenses)
- Directly incenting earlier payment using techniques like invoice discounting
- Taking advantage of Supply Chain Finance opportunities offered by large customers
- Sale or auction of receivables to a third party

Each of these alternatives has pros and cons based on the unique business situation of an individual company. For companies in the Staffing industry, the key factors in selecting new forms of financing were the company’s reputation (56%) and flexibility of terms (47%). Cost of capital and simplicity were of less importance. Staffing put the highest premium of any of the 15 industries studied on turnover time – i.e., how quickly the cash would be received (Fig. 5).

## Looking to the Future

After losing 1.14 million jobs – or 37% of its work force – during the 2007–2009 recession, the U.S. staffing industry is growing again. The ASA Staffing Index, measuring the percentage change in the number of temporary and contract workers reported by Staffing firms, has shown

Even though 70% of companies surveyed had lines of credit, less than half of those companies indicated that their bank lines of credit were sufficient to cover their working capital needs, and 1 in 3 stated that they needed a financing option in addition to their line of credit. As

### How Has The Receivables Exchange Helped Staffing Companies?

Do you have the cash on hand to handle disruptions, manage extended payment terms, and fuel growth? The Receivables Exchange offers a flexible, affordable and fast way for Staffing businesses to secure financing almost instantly, and on their terms. It is a financial solution perfectly suited to the varied working capital challenges Staffing companies face.

One Atlanta-based IT Staffing provider, Mason-Grey Corporation, approached The Receivables Exchange when it was looking for additional growth capital. The company was unable to collateralize a bank loan of sufficient size to raise the cash they needed. Mason-Grey’s bank was only willing to extend a line of credit for a small percentage of the company’s outstanding accounts receivable, and at disproportionately restrictive terms. On the Exchange, Mason-Grey was able to turn those receivables into a flexible, affordable source of capital. “Last year could have been a tough year,” said Mason-Grey CEO and President Joe Reini. “Instead, my company grew 37%, and I’m paying 40% less for capital.”

Another company, Healthworks, a leading Staffing provider for the health care industry, turned to the Exchange when traditional financing could no longer keep up with the company’s capital requirements. With payroll averaging 80–85% of its ongoing cash requirements, managing cash flow to meet those needs was a big challenge. The Exchange lets Healthworks increase liquidity on its own terms, so the company can easily manage payroll obligations.

Whatever your company’s challenges, The Receivables Exchange can help you secure the working capital you need to cover day-to-day operations and fuel growth.

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<sup>4</sup> Trends in Finance and Funding, Staffing Industry Review, Feb 2010: <http://staffingindustry.com/ME2/dirmod.asp?sid=D657A977717E4533A248A3E41F0FC33A&nm=Corpra+te+Member+Topics&type=MultiPublishing&mod=PublishingTitles&mid=6EECC0FE471F4CA995CE2A3E9A8E4207&tier=4&id=3F8ED5B5625E41488F04A73FB44418CE>

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### What They're Saying About The Receivables Exchange

"The Smartest Financing Opportunity You've Never Heard of" – *Bizmore*

"Turn unpaid invoices into cash – quickly." – *Crain's New York*

"The Receivables Exchange is an online workaround for slow-paying customers." – *Forbes*

"The Internet...has enabled the creation of a digital receivables auction in which borrowers set their terms and lenders compete to meet them." – *Crain's Chicago*

"The Receivables Exchange enables small- and medium-size companies to finance accounts receivable at...21st-century velocity." – *Institutional Investor*

"For sellers, The Receivables Exchange offers faster access to working capital, which is often critical for small businesses that have much of their cash tied up in receivables." – *American Banker*

"Suppliers Find Fast Relief in Auctions on The Receivables Exchange." – *Treasury & Risk*

"A winning online business-to-business idea." – *Institutional Investor*

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steady incremental growth since the end of June, 2009.<sup>5</sup>

As the industry recovers from the financial collapse, ensuring sufficient access to capital at a reasonable cost will remain a significant challenge. The prospect for these broader working capital issues resolving themselves is low. In the study, 65% of Staffing companies anticipate their working capital

needs will actually increase in 2011 versus 2010. As the Staffing industry continues to recover from economic crisis, these companies will need to manage risk more effectively.

While businesses will continue to feel the impact of the crisis, they will press forward with cautious optimism and a renewed focus on risk mitigation. This means optimizing working capital efficiencies, improving cash conversion and diversifying funding sources. Managing these risks is vital, not only to short-term profitability, but also to overall financial health and long-term sustainability for Staffing firms. Financing alternatives abound, including many exciting new options, and smart companies have more opportunities than ever to create competitive advantage using an optimal working capital structure. ■

Fig 5: What Staffing Companies are Looking for in New Forms of Financing

Reputation	56%
Flexibility of terms	47%
Recommended by peers	44%
Turnover time	44%
Low cost	41%
Ease of use/simplicity	35%

Source: The Receivables Exchange Working Capital Research Group, 2010

### About The Receivables Exchange

The Receivables Exchange is a flexible, fast and affordable solution that helps companies overcome working capital challenges and take control of cash flow. Named the most innovative e-commerce company in the world for 2010 by *The Wall Street Journal*, The Exchange lets businesses sell their B2B receivables online to institutional investors in a real-time auction, and competition among Buyers lowers their cost of capital.

The Receivables Exchange is a tailor-made solution for many of the working capital challenges Staffing companies face. With the Exchange, businesses can shorten their days sales outstanding (DSO), helping them cope with extended payment terms from their customers. The Exchange lets businesses leverage the value of their receivables, where 60% of a company's annual working capital usually lies, so companies without many tangible assets can still get financing. The speed and flexibility of the Exchange can also help businesses stay nimble when disruptions occur. They can access capital in a matter of days, not weeks or months, and can use the Exchange when they want, selling as many or as few receivables as they choose.

Make an appointment today for a free cash flow consultation with an Exchange Associate and find out how The Receivables Exchange can help your business. Learn more at [www.receivablesXchange.com/seller](http://www.receivablesXchange.com/seller) or call 877-392-4952.

<sup>5</sup> American Staffing Association, July 2010: <http://www.americanstaffing.net/statistics/economic2010.cfm>