

## Buy or Sell?

### What Are the Motivations Behind PEO Mergers and Acquisitions?

Carrie Aaron

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When Angie Strunk brought on a strategic investor, her internal staff walked out. Even though motivations are clear and seemingly workable on each side of the transaction, many other factors often come into play during PEO mergers and acquisitions, such as what happened in Strunk's case.

"I took on an investor to provide additional working capital to grow the company, as well as to form a strategic partnership to service its holdings," Strunk said. "I transferred my ownership to an entrepreneur/CPA in exchange for the payment of some long-term debts. The agreement was that I would be paid a salary and would continue to run the business in the same capacity," she added. "When my key employees learned I had sold the company, they left. The new owner brought in his own people to run the company and wanted me to just handle sales. This would have been fine, except the people in charge of running the business had no PEO experience and would not use my knowledge to assist in running the business. The customer service slowly began deteriorating and clients were leaving in droves."

Fortunately, Strunk notes, "When I could no longer sell the service offering because I wasn't sure the service staff could actually provide customer service, I asked the owner to let me out of my non-compete." Strunk was able to start a new PEO, TriServ, and got some of her old clients back when the new owner decided to close the doors.

#### A Walk Down Memory Lane

During the Golden Era of PEO (mid- to late 1990s), the main motivators for selling

a PEO were the high valuations and IPO opportunities. PEOs were selling for a low of \$2,000 to an all time high of \$16,500 per worksite employee. Some of the most memorable transactions were:

- The Administaff IPO;
- The Vincam IPO, which later merged with ADP TotalSource; and
- The TeamStaff sale to DSI, which recently sold to GevityHR.

Not all PEO owners sold for "only" money during that time. Bob Clancy, former CEO of Modern Employers Inc. (MEI), in Bradenton, Florida, recalls that he and the PEO's other two owners sold their PEO for a number of reasons:

- The all-cash offer was very attractive. It allowed Clancy and the other two owners to be financially secure for the remainder of their lives and pursue individual interests. They shared this good fortune with the employees who were with them at the time.
- Knowing the workers' compensation market was so cyclical, Clancy wanted to secure WC coverage for the PEO indefinitely. Selective Insurance Group (SIG) was and is a very strong regional property casualty company. That objective was certainly obtained.
- The purchaser was clearly interested in the distribution the PEO had through independent insurance agents. They desired to keep the organization intact and help it grow profitably over the long term. That achieved the goal of providing opportunity for all remaining employees.
- The buyer had the financial resources to invest for the long term. The PEO had a significant need to update the technology it was using. The buyer had the IS and finan-

cial resources to accomplish that upgrade.

IPOs and dream deals like MEI and SIG were abruptly halted during the recession of 2000 and further exacerbated by the terrorist acts of 9/11/2001. The resulting hard P&C market caused a 35 percent drop in the number of PEOs from the heyday of 1999 through the end of 2002. Many PEOs went out of business or were merged with those that were able to secure workers' compensation coverage.

#### Tides Have Turned

As the economy in general has recovered, so has the PEO industry. Publicly traded PEO stocks are up. Deals are back in the \$2,000/WSE-plus range. Private equity and venture money is back in the industry.

Martin Babinec, founder and CEO of TriNet, has a different perspective about outside investors: "I've been a minority shareholder in my company for more than 10 years now, and I've received much more than simply growth capital from our institutional investors. For years our largest shareholder was a public company, which helped teach us how to operate as a public company would — with the same rules of transparency and the same degree of managerial professionalism.

"More recently, our transition to General Atlantic, a large private equity fund, brought us a more in-depth knowledge of HR outsourcing and a greater span

# Special Report

of relationships. These attributes, along with our newfound access to a large pool of growth capital, will enable us to achieve several key goals: realize our growth potential, develop additional technology-enabled solutions for our clients, and position TriNet as an attractive partner for like-minded PEOs interested in teaming up with us.”

### Motivations Galore

AsmaraHR, a Charlotte, North Carolina-based HRO/PEO, purchased RossarHR, a Pittsburgh-based HRO/PEO, in January 2005. “I looked for a company where I could increase our footprint and add additional expertise to our staff,” said Gary Musselman, president of AsmaraHR. “RossarHR was a well respected company whose philosophy matched ours. Combined, we created a stronger company.”

“It was important to me to find a company whose industry outlook mirrored my view for the future of HRO,” said Marcia Sartori, president of RossarHR and now chief operating officer for AsmaraHR. “In selling RossarHR, I needed to be sure our clients would receive the same caliber of service after the sale. The advice I have for others considering a sale or acquisition is that both the seller and buyer spend real time visiting each other’s office(s). A cultural fit is as important as financial due diligence.”

One PEO owner has had experience both as a seller and a buyer within the last two years. In October 2003, Harlan Schafir, president of Professional Staff Management in Richmond, Indiana, sold to Fortune Diversified Industries (FDVI). Schafir’s motivations were clear: “Things were running smoothly at PSM and I was looking for my next adventure — run something bigger. I thought a public plat-

form was the best vehicle to purchase other PEOs.”

FDVI recently made another PEO acquisition, Century II Staffing in Brentwood, Tennessee. When asked what he was looking for in an acquisition, Shafir said, “We are looking for a PEO with ‘good bone structure,’ room to expand in its market, but a need to get to the next level. We’re not looking to consolidate operations because that model doesn’t work. The internal staff is what drives the customer service and that is what drives the client retention.”

When pressed for a definition of “good bone structure,” Shafir replied, “Good bone structure is the perception in the potential acquisition’s marketplace, client retention, caliber of clients, vendor relationships, staff to service ratios, and tenure/quality of internal staff.” Stay tuned, because FDVI has several more PEO acquisitions in the hopper.

### Different Strokes for Different Folks

Not all PEOs are on the hunt, Jay Starkman, CEO of AlphaStaff, Boca Raton, Florida, claims: “AlphaStaff is not in the market to buy, and of course not to sell, PEOs. There are many different reasons that PEOs look for acquisitions, including adding lives, entering new territories, finding people, gaining technology or other infrastructure, etc. For AlphaStaff, it is all about organic growth, and we have proven that PEOs can grow, and grow explosively, organically. Specifically, in the last two-and-a-half years, AlphaStaff has grown from 6,000 worksite employees to just under 25,000 worksite employees, without a single acquisition. Maintaining a high level of customer satisfaction, a 90 percent retention rate, and strong value propositions are all key.”

But Starkman warns, “Buying a PEO is like buying a handful of sand and trying to hold onto all of the grains as time moves on — it is impossible.”

### Hindsight is 20/20

It’s always easier to look back and see what you would have done differently. Building a PEO from the ground up does not leave an owner with an over-abundant amount of free time to think about what he would have done differently. An entrepreneur growing any business must process the ability to assess market conditions and make split-second decisions. The PEO business is no different.

Jerry Muszynski sold his PEO outright in 2001. “In hindsight,” he said, “I wish I would have merged with a friendly competitor and stayed in the business. I really miss selling PEO services, but not the operational headaches!”

In hindsight, Bob Clancy wouldn’t change a thing: “I never really left the industry, just took a sabbatical. Following our sale of Selective HR Solutions, I had to work out an employment agreement, which expired in November 2001. I then honored a three-year non-compete agreement that ran out late last year. I then joined Merit Resources, Inc. and serve as a director on their board to this day.”

Conversely, Angie Strunk would have consulted with her key personnel and resolved their issues with the strategic investor. With her new PEO, TriServe, Strunk and her two partners are contemplating an ESOP down the road as a long-term exit strategy.■

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