NACCB Workshop: Financing and Starting the Business

Moderator:
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Table of Contents

CASH REQUIREMENTS 4

DIFFICULTIES IN WORKING WITH BANKS 5

USING OUTSIDE INVESTORS 11

DIFFICULTIES IN WORKING WITH PARTNERS 16

DRAMATIC STORIES ABOUT STARTING COMPANIES 18

ACQUIRING ANOTHER COMPANY 21

MERGING SMALL COMPANIES TO GET BIG ENOUGH TO “GO PUBLIC” 23

SELLING A COMPANY 26

COMPANY ORGANIZATION AND OPERATIONS 27

PHYSICAL SPACE AND OFFICE MANAGEMENT 33

SOME FEATURES TO RETAIN CONTRACTORS 34

NACCB Workshop: Financing and Starting the Business

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Abstract: Representatives from a number of computer contracting companies discussed various aspects of their business models. They talked about how they structured their companies and how they got initial financing. Cash flow was a major issue and they discussed how they worked with banks and outside investors to get the cash they needed to meet their obligations to their contractors. They talked about the control issues involved in joint ownership and the strategy or merging companies so they could get large enough to go public. Finally, they covered how they organized their companies and what they did to retain their contractors.

Participants:

Name	Affiliation
Burton Grad	Moderator
David Cassell	Pro-Access
John Chamberlain	Chamberlain Associates
Jane Cronister-Ross	JM Ross & Associates
Dan Greenburg	TSR Consulting
Phyliss Murphy	P. Murphy & Associates
Bjorn Nordemo	Data Arts & Sciences
Peggy Smith	Data Maters & Noell

Burt Grad: What I would like to do is talk about your businesses, not NACCB [National Association of Computer Consultant Businesses], other than if the NACCB affected some of your operations. Things that you learned there that were applicable. I want to talk about how you ran your operations, how you ran your businesses. Where did the money come from? Did you ever at any point in time get outside investors? Did you sell your company or buy a company? What were your administrative operations?

We talked quite a bit about recruiting and things like that yesterday; but we can explore that further. Where did you hire your recruiters? Where did you hire your salespeople? We spent quite a bit of time on salespeople in the session yesterday, but that is the range of things I would like to go through.

Cash Requirements Error! Bookmark not defined.

Let me start. Each of you explained briefly how you got into the business yesterday. Let us begin with when you decided to start your business. How much money did you need, and where did you get your money from?

Peggy Smith: We did not borrow any money, except from ourselves. There were three partners. We did not take a salary for about six months. We did get a lot of credit later on. The third partner of ours had an established business.

Grad: What are the names of your partners?

Smith: Paula White, Dave Masters and Sterling Sanders. He is no longer in the business. Paula was established and had credit established. So our initial investment was very low. It was just giving up our salaries for six months.

Grad: You had some personal capital that you were able to live off for a while. And the others were in a similar situation?

Smith: They were.

Grad: Ballpark, other than forgiving salaries, how much actual cash did you need for equipment, for offices, for mailing, for any of those things?

Smith: That was the thing about having a partner that was established, we didn't.

Grad: There was no out-of-pocket cash?

Smith: No.

Grad: They have argued that this kind of business had one of the lowest barriers to entry of any business.

Smith: At that time, yes.

Grad: I gather it has changed somewhat.

David Cassell: Yet the biggest failure for most small businesses is that they run out of cash.

Grad: That is why I am exploring this. I think that is an important part. Even the other professional services businesses - the ones that are employee-based - even if they were working on client premises. You had to have an office. You had to have places for the people even though you were using ICs [independent contractors]. Did you come to a point in time, within the first year or two, where you needed additional cash and tried to go to a bank or any other source for money, Peggy?

Smith: We did eventually get a line of credit to help us pay our contractors. We did not get paid by the client until after completion of the project. We had to pay the consultants before we got paid by the clients. So it was a line of credit on receivables to help us pay the contractors.

Difficulties in Working with Banks

Grad: I have heard that, in many cases, banks did not consider those receivables to be very valuable.

Smith: It was an educational experience for us and the bank.

Cassell: This was a bank, as opposed to one of the companies, right?

Smith: It was the bank because this was back in 1984. In our area there were not a lot of companies that financed receivables. Later on, there were.

Grad: There were, but not for us. There had been receivables financing back for 100 years; but not for our industry. So you never had to actually get investment money. - mainly the money was to cover unpaid invoices.

Smith: They would finance up to 80 percent, I think, of our receivables.

Grad: They charged you?

Smith: Yes, I do not remember what the rate was.

Grad: And that was sufficient? You never came to a point in time where you needed to have more cash?

Smith: We had other points in time where we did not get paid, like right after the adoption of 1706 [a provision of the tax code that changed the relationship between companies and the independent contractors they retained] but we never had to use any more capital.

Grad: I am going to stay with that relatively narrow topic for the moment and swing around the room. Dan, how about you?

Dan Greenburg: I knew I had to leave TSR. It was sort of the third company I was leaving that I had built. They asked me to leave - or they made it untenable for me to stay - so I realized that I had to do it on my own. I really had very little money; and, also, my main background was in recruiting and the technical end. So I looked for a partner who had a good sales background and had money.

Money was very important. I teamed up with a gal. I actually put an ad in the Situations Wanted section in the New York Times and met her through that. I also met Gary Zanders through that ad, who is a member of the NACCB. After a long line of meetings between Gary and this gal, Barbara Blair, I went with Barbara. I hate to be crass but it was because she had a lot of money. She lived on Central Park West; and she was a good salesperson, also.

At the end of the day - as some people at the table know - we had a horrible falling out seven years later, a real "War of the Roses"; but that is a whole other story. So we had some money in back of us. At the beginning, I worked out of my house - actually, out of my mother-in-law's basement - in Long Island. Barbara worked out of her apartment on Central Park West in Manhattan.

She would sell; and I would recruit from East Meadow. I would finance our living expenses on credit cards. I had about ten credit cards and hoped for the best. There were days that it was really, really difficult, not because we were not making money. It was because of cash flow. That was the biggest problem.

Grad: We're going to come to that issue about the collections. I had a similar kind of business; and getting the clients to pay in a timely fashion and when you had to pay your ICs was a fairly tricky ballgame.

Greenburg: Yes, it was. At the beginning it was difficult because you figure you are new on the block. If I go to Citibank and say, "I need my money," what are they going to think of me, this little company? "Why should we work with you guys? You guys need money."

Then, as you mature in the business, you realize this happens to the big guys as well as the little guys. My partner was very tough; and she was our collections person. I still remember the day MTV was one of our accounts; they owed us a lot of money, probably around $100,000. That was a lot of money for us at that time, even though we were growing. We had a payroll coming up; and we had almost no money. Everything was wrapped up in receivables.

She called the manager's boss's boss and said, "We need the money". He tried to stall her. She said, "Look, I'm coming over, and I am going to sit in your office until we get paid." I said, "How can you say that to a client?" "I am just coming over." She went over there; and it was like the guy reported us to security. This guy was high level; and she sat in his office. This was before 9/11 and all the security and everything; and you could just walk into places. They kicked her out. At the end of the day, he gave her the check; and he said, "You know, I really respect you for this." She said, "Look, I am a small business. I need to pay these people; and you have been screwing around with us for the last 90 days."

Grad: Did any of you ever try and get advanced payment on your projects?

Bjorn Nordemo: I tried.

Grad: If you tried, my next question was - did you succeed? I will come around and talk to you about that. It is interesting because I tried it, too. Dan, did you come to a later point in time that you needed actual cash for an office, for equipment, for things like that?

Greenburg: Yes, we eventually moved out and got a regular office, a real office. We went to the banks; and the banks were very receptive to us because our receivables were gold receivables. They were from Citibank. They were from Chase Manhattan Bank. They were all from Fortune 500 clients. They would give us a little hard time on the rates.

Grad: John, how about yourself? You obviously had lots of money so it was not a problem.

John Chamberlain: Yes, I had just moved to California and bought this $195,000 house, after selling a $78,000 one in New Jersey.

Grad: You mentioned you had some money left over.

Chamberlain: I had $20,000 left over. I said to my ex-wife, "I am going to give you $10,000. I am going to keep the other $10,000. Make it last as long as you can." So I started. I did not know quite how I was going to get the financing, but I knew what I knew. I have a very strong math background; I'm a graduate engineer, so I had worked on the spreadsheets and I figured it out.

First of all, I worked for a guy who did employee-based consulting and I decided I was going to do consulting using independents consultants. And, number two, he billed every month. I learned from another friend who worked for one of these engineering body shops that they billed every week. That cut the amount of money that I needed way down. I recalculated. I knew at different levels of contractors how much cash I needed for receivables; and I didn't have enough, not with ten grand.

So I called my mom and dad and told them what I was doing. I said, "I would never spend your money. I am only going to use it for receivables. If I go out of business, I will shut down. I will give you back the money." So that got me $15,000 or $20,000. I called my Uncle Francis. He was never married, a single guy. He was retired; and he lent me about $15,000. I called my sister Ruth, who is single and living in Manhattan; and she lent me somewhat less, maybe $5,000 or $10,000. Then I called back; and finally everybody said, "That is all we can do."

At the same time - and I may have done this before I went around, I called Crocker Bank. They said, "You are new in business. The minimum deal we do is $50,000 credit. Come back in six months or a year." I went to Bank of America; and I got the same answer. Their minimum deal is $100,000; and they said, "Come back in a year."

Then I went to Hibernia Bank and went into the branch manager's office. He said, "You are new in business. We are not venture capitalists here. You are going to have to get your own money and get going." But he said, "We will talk to you. Come in every month and show us your P&L, how you are doing, what your plan is. When it makes sense, we will do a deal."

Every month I marched in there and showed him the numbers. About six months in, they agreed to do a deal. It was an if/then thing. It was going to be two points over prime; and the house (the house I was up to my eyeballs in – although real estate was going up nicely in 1978, like 25 percent a year) was put up as collateral.

Grad: This was a personal note you signed, not a company note.

Chamberlain: There was no corporation so it was a personal loan, a second mortgage on the house; but it was a line of credit. It would go up and down.

Grad: So you had about $50,000 to start with. I added up the numbers you had. Including your own $10,000, you had about $50,000 altogether.

Chamberlain: Yes, because I think I collected about $35,000 from my family. So, yes, close to $50,000. Eventually, the first line of credit might have been $30,000 or maybe $50,000; but I think about $30,000.

Grad: Did you incorporate when you started?

Smith: We did, as a C Corporation.

Grad: As a C. How about you, Dan?

Greenburg: An S.

Grad: You incorporated as an S Corporation.

Smith: But we still had to do personal guarantees, as a C corporation.

Grad: Anything you signed, you were the person signing, weren't you?

Smith: Yes.

Greenburg: Yes.

Chamberlain: Yes.

Grad: That was scary. All right, John, so that was where you got the money. Did you come to a later point where you needed significantly more money?

Chamberlain: I always needed more money.

Grad: Not personally. I mean for the business.

Chamberlain: For the business, for years.

Grad: So where did you get it?

Chamberlain: Same bank. I just kept going back; and I just kept pushing to get that line increased.

Grad: Did you ever take any outside investors?

Chamberlain: No, it was all line of credit.

Grad: Dan, did you ever take an outside investor?

Greenburg: No, I did not.

Grad: How about your saleslady, was she an investor in the company?

Greenburg: No, we were partners. We were equal.

Grad: And the other people - were they partners? There were three of you and equal partners? So you shared the stock in that way?

Smith: Right.

Chamberlain: The other thing is, from the get-go I paid myself 25 percent of the gross margin. Basically, I never lost money. I never took out more than that amount of money so the business was profitable almost from day one, maybe by the second or third quarter.

Grad: How about you, Peggy, profitable from the beginning?

Smith: After about four or five months, yes.

Grad: Dan?

Greenburg: On an accrual basis. At the beginning we were not profitable; but, yes, within a year.

Grad: That's one of the wonderful things. As soon as you get any work, there is some money. You are profitable as far as the books are concerned.

Chamberlain: Using the house with no rent.

Grad: You used your house then. Did you come to a point where you got an office, an outside office?

Chamberlain: Three years in, yes.

Grad: Three years in. Dan how soon did you get an office?

Greenburg: I think it was about two and half or three years.

Grad: Peggy.

Smith: We were in one immediately because, again, my partner was a headhunter. She had an agency.

Grad: She had space.

Smith: Right, she was the recruiting end. We thought we needed this marketing for technical recruiting.

<u>Using Outside Investors</u>

David Cassell: The answer you have been looking for regarding outside investors – yes, I did have outside investors. Actually, I started two companies. Both of them were a little bit different. The first one was in 1982. I was with IBM at the time. I spent six months, probably closer to ten months, working spreadsheets; and this was back before Excel. We were doing month-by-month for the first two years and then by quarter for the last three. You would get to the end result; and it wasn't right - so you would go back and do all the spreadsheets all over again.

Grad: Were you using VisiCalc?

Cassell: No. It was paper. I literally had stacks.

Grad: VisiCalc existed at that point in time.

Cassell: Not in Texas.

<laughter>

Cassell: I decided that if I was going to do this, I needed to go out and get some investment capital. We ran all the numbers and decided that we needed a quarter of a million dollars to start the business. We had done the spreadsheets. Every time you start a business, you are very conservative on revenues. You double what you think your real costs are going to be; and, of course, reality turns out to be revenues are still half and costs are double.

So I went out and prepared a prospectus. In fact, you have a copy of it in that stack of stuff that I had for the first company. I went out and found five investors; and one of them was a neighbor. The others were customers at IBM. I went to these people and told them what I wanted to do. These were all customers that were in need of the kind of services that we were going to provide.

Grad: This is not the normal dentist/doctor/lawyer investors.

Cassell: No. In fact, one of them was with Rotan & Mosely and was involved in their investment end; but this investment was a personal thing. I got a commitment from each of them for $50,000 up front and a commitment for another $50,000 with 14 days notice. In other words, if I sent them notice, within 14 days they had to send me another $50,000. Now the price you pay for this: I had to pay them back at eight times their original investment and then they would end up owning 20 percent of the company.

Grad: Clarify that. They were getting stock in the company?

Cassell: They would end up - after we paid back eight times their original investment, they would then also become 20 percent equity partners.

Grad: You gave away relatively little of the business; but you committed to a very large base. Now your interest rate was unbelievable, if you want to think of it that way.

Cassell: What was interesting is that this was in January of 1982. I had gotten the money the last couple of months of 1981. I went out with this prospectus; and I made it - coming from IBM, of course - a flipchart presentation of what we were going to do, how it was going to work, a source and use of funds statement, the whole thing.

The first guy I called on was Steve Wyatt, who was Oscar Wyatt's son, Oscar Wyatt from Coastal Corporation. I presented to Steve and got through with this meeting; and I said, "What do you think?" He said, "I'll give you $50,000." Of course, that was a huge confidence builder. When I went out with the rest of them, it was one call on each of them; and I had the money.

Grad: Wow, having come from IBM.

Cassell: Oh, coming from IBM was a huge help. There was no question about that.

Grad: And these had been his customers. He even looks like an ex-IBMer doesn't he? Look at me! Eighteen years I spent at IBM.

Cassell: The interesting thing about it is that we opened our doors; and six months later, the bottom fell out of the economy. Brown & Root was the largest user of contract resources. They laid off 600 contractors, professional service people, out of their organization. It turned out it worked out well because we were there to pick up the dribs and drabs.

To make a long story short, I never had to go back for the second $250,000 and eventually paid the guys back their original investment, plus another $10,000 or $15,000; and they disappeared. They were so happy to get their original money back because, at that time, a lot of businesses were failing. . So it worked out very well. I paid back slightly over one-to-one and ended up owning the whole company. It is different from the way a lot of people obviously got into the business.

Grad: From a cash flow standpoint, did you have the same concerns with the AR versus paying the contractors?

Cassell: Yes, and, of course, the bank's attitude is, "If you are not making money and you need cash, we cannot help you. When you get cash flow positive and you are profitable, come back and we will help you." It is incredible, the attitude of these banks toward small business.

Grad: Did you use banks then, for yourself?

Cassell: Yes, we finally ended up with a small line of credit. It was always against Receivables. They had no problem with the receivables.

Grad: So you ended up with 100 percent ownership.

Cassell: Well, I had a partner in the business who had 20 percent.

Grad: But these other five people just ended up getting their money back plus. What city were you in?

Cassell: This was in Houston, Texas; and we operated in Houston and Dallas. Business was very good when I got the commitment for the money; and then it immediately turned bad. I think that is why these people were willing just to get their money back, because a lot of their other investments had gone south. I sold the first company in 1990 to RCG Information Technology. I stayed on with them for approximately six years, sold the company right before the peak selling time and so had to continue working. I left them and took six months off.

In 1997 I started the second company, this time with a little different approach. I went out to 15 of my consultants - and we eventually ended up getting six more - and said, "I have got a deal for you. I want to start a new company. It is going to be primarily with you folks. You are all going to be participants as shareholders in this company; and we are going to set up a formula where you immediately vest in the company according to the revenue that you bring in personally from your billings, plus any help you give us in bringing in additional clients.

I would like each of you to put up $10,000; and I will promise to pay that $10,000 back within five years, no interest." They became participants so we were a C corporation. The first time around we were S. The second time we were a C corporation because we were making everybody stockholders; and we thought - delusions of grandeur - "Oh, surely we will be over 75 stockholders."

That is how I funded that operation; and we got everybody paid back in five years. I had promised to give away ten percent of the stock in the company over the first five years to the employees; and it worked very well. This was until the dot com thing came and failed; when all these people had these great stock option programs and it turned out to be worth nothing. But when we did it, it was huge in terms of our ability to attract really good people because we were offering them equity in the company; and it really did help us. We were profitable very quickly in that second company; and that's the company that I still have today.

Grad: A very creative approach there, David.

Cassell: It was; and it worked very well. It provided the funding. We had skin in the game from the people that were involved with it. By the way, out of those 22 people, probably 15 of them are still with us today, ten years later.

Grad: You have got a different relationship involvement. You are committed to them, to some extent.

Cassell: Oh, absolutely.

Grad: Bjorn, how about yourself?

Nordemo: Well, being an independent contractor at the time, I was burning funds to start with. My partner, whose name was John Babers, was also doing the same thing. So we were both contracting when we started. Initially, we did not go to the banks. We self-funded everything. It did not take very long before we had so many people that we had to go to the banks. The initial reaction of the banks was, "Gee, we have not seen you do anything. We would love to lend you the money, but come on back when you can show us what you have done"

John and I struggled for a while and kept on self funding everything until all of the profits we made ourselves went back out to paying contractors. The first few we did was a strain; but then, as it kept rolling, there were more funds coming in. It self perpetuated itself fairly well.

As the growth really took off, we had to go back to the banks. At that point we had been in there probably a little over a year; and they said, "No problem, what do you need?" I already had banking relationships with these people. They said, "Fine, we will give you operating income based on your receivables but with personal guarantees." So both John and I had to guarantee our homes. We kept dealing with them; and I would call up the bank and say, "I need $50,000 in there today." He would say, "Okay, when are you coming over to sign the papers?" I said, "Well, I am going away next week so how about the week after that?" He said, "Fine. Do not worry about it." It was that kind of a relationship from the beginning.

He called me one day and said, "Can you get over here? I have got the auditors coming. I have got a bunch of papers that have not been signed." I dropped everything, went over and took care of the paperwork. It was a wonderful relationship; and this was called Old Colony Bank in Lexington, Massachusetts.

Shortly thereafter they got gobbled up by Bank of Boston - a totally different world, personal relationships, personal guarantees no such thing. Everything was strictly by their crazy books. We continued with them for many, many years. Then we got into the late 1980s; and we had a line of credit with them. I had a mortgage with them for our building; and they came in one day and said, "We are calling in your notes." It became a horror show. I just threw our keys on the desk. I said, "Here, you own the building." "Oh, we don't want to own the building. Pay us $5,000 for us not to call the note. It is called a forbearance." I said, "Here, you own the building".

A note was due in October. It was always a balloon type of thing. John and I at that point were in a position where we just paid off everything, just paid the bank off and told them to go to hell and stayed self funded after that.

Grad: Did you have any outside investors besides the two of you?

Nordemo: No, never did.

Grad: Were you a C corp?

Nordemo: Yes, we were a C corp.

Grad: So you owned the stock 50/50?

Nordemo: That is correct.

<u>Difficulties in Working with Partners</u>

Grad: Did you ever worry about the fact that either one of you could veto anything? No one of you could make anything happen.

Nordemo: Twenty years of dealing with that caused a nervous breakdown at the end. I totally fell apart, had to be hospitalized it was so bad; but that only happened after all the papers on a merger and an IPO were put together. The pressure was off; and that was it.

Grad: Now you had three people, Peggy. Was there a problem with two versus one kind of thing?

Smith: We bought the third one out in 1986. After that, based on the sale, it was 50/50. We had issues.

Grad: It is a very difficult thing to be 50/50. Because the concept of anyone can veto, no one can make anything happen.

Nordemo: Conversely, either one can do something - and the other one cannot stop him.

Grad: You have veto at 50/50. Did you all have buy/sell agreements?

Smith: Yes, we did.

Cassell: With buy/sell, you get tired of somebody, and you make them an offer; and then you have the right to buy it for the same price.

Nordemo: I tried going through the buy/sell issues. We came up with an evaluation. An outside evaluator came in; and I said, “Okay, I will be either the buy or sell. You choose.” John said, “I am not going to sell it to you because you are going to take it and make something out of it.” I said, “Okay, then you buy it.” He said, “What and get stuck with this monster?” We went through this a couple times.

Grad: That concept seems so logical. Set a price; and I will either sell it to you at that price or buy it from you at that price. I ended up doing evaluation studies. I ended up in the court, cases where they were unhappy. They tried to break the agreement in spite of what it said. Any evaluation formula, it never works. It never works, so someone puts a price on the table.

Greenburg: The problem that we ran into - and I think most companies run into - is that when you start the company, it is like a marriage. Nobody thinks about, “Gee, what is going to happen if we do not agree?” You sign these boilerplate shareholder agreements that do not really cover everything; they have a buy/sell but it is not a true buy/sell. It is like someone wants to buy it and they make a price and whatever; but nobody can force a sale.

Grad: Almost invariably there is some kind of a formula in there.

Greenburg: In the boilerplate ones, there are none. The one you are talking about is not a boilerplate where any partner at any time can set a price and then the other partner has the right to either buy it at that price or sell it at that price. That is not a boilerplate.

Grad: But if you do not have that in there, it is meaningless.

Greenburg: Exactly. I think 90 percent of the companies do not have that in there. I almost had a nervous breakdown myself. When we had the thing with my partner, it was terrible. It was worse than a divorce.

Grad: Dave was a hell of a lot of smarter than me - and you, too, John.

Chamberlain: I was determined to do it myself; and it held me back.

Grad: You do have to limit. One of the things that is fascinating is that work can be out there for 20 guys, and you cannot handle it because you cannot handle the AR. You cannot take the gambles because there is a lag in that AR. It is a real limiting factor in the business.

Nordemo: To try to convince a bank that the worst thing that is going to happen is all my customers stop doing business with me. Now what is my biggest problem at that moment in time? What am I going to do with all the money coming in?

Grad: They did not understand the cash flow of a professional services business. You had no locked in cost if the guy said no more. That is the difference. The other guys had locked in costs. You had none.

Chamberlain: Right, it was my business.

Smith: They had no clue about what we did. We had to educate people all the time.

Grad: The point is that all of you had this problem if you had partners. If you have stockholders, there are fundamental issues. I am going to explore a little bit later on the NACCB sessions on this, did they help you in terms of this, how to guide you, how to set it up to deal with those kind of issues.

Nordemo: It was over at the time.

Grad: But there are new companies coming in, new people joining. Did NACCB provide them that kind of leadership and that kind of advice?

Cassell: You had to be in business for a certain period of time before you could join the NACCB, so those problems were often over with.

Grad: That is interesting because we did a lot of that in ITAA [Information Technology Association of America], that kind of financial training, how you manage your business properly, how you set up deals if you have partners, those kinds of things.

<u>Dramatic Stories about Starting Companies</u>

Phyliss Murphy: I guess my business is sort of based on no guts, no glory. I filed for divorce. My husband, Mr. Murphy, said, “I am not moving. If you want to file for divorce, you move.” So I moved to a furnished apartment. The company I worked for had serious cash flow problems, and I resigned. I am now unemployed and living in a furnished apartment. I am 39 years old; and I have custody of my son, no child support, no nothing.

I went around and interviewed other companies, trying to find someplace I wanted to work. I found that they were sort of like tires that were flat. They looked inflated, but all of them had a problem. I finally said, “Okay, I am going to do this.” My grandfather had given me $200 in stock when I was in high school. I had never touched it. It was worth over $25,000. I said, “I am going to take this; and I am going to create a business.” So that is what I did.

I finally borrowed some money - about a year in, I think - because I decided that I really did not like selling. I hated being told “no;” and I hated failing. I hired four salespeople. I borrowed $30,000 on a signature from a bank, where my father happened to be on the Board of Directors, in Illinois. They later called the money back like six months or nine months later and said, “You have to pay it all back because we cannot loan money to a company or a person in California.”

I paid that back; and I said, "If I cannot even trust my father's bank, I don't trust any banks." So we were strictly self-funded; and I was very frugal for eight years. My father said - before he died, he had cancer - - "I want you to get a credit line." On his death bed he said I should get a credit line. So I have a credit line that I have never used. I have gotten two clients to pay me in advance. One of them was for $400,000, from GTE. They gave it to me. I put in a separate account; and I only pulled it out as I invoiced.

Greenburg: Did they discount it?

Murphy: No, they just did it. They had budget money so they said, "Do you need money?" I had said, "Because we are adding so many people, this is really putting a little strain on our cash flow. I need you to pay me promptly." They called me on Monday; and they said, "You have been giving us such great people, and you said something about funding problems. Do you have any suggestions?" I said, "Well, you can give me a chunk of money." They said, "We will do that."

Grad: Sometimes if you are into the end of the year, they want to use up budget money.

Murphy: They said, "We trust you. You have always been honest with us." I said, "Are you doing this with other vendors?" They said, "No." I said, "Fabulous!"

Grad: That is wonderful, Phyliss. That is a great story. You had no partners?

Murphy: I have no partners.

Grad: So you avoided some of those other issues. Are you a C Corporation, an S Corporation? What were you?

Murphy: Because I had cash flow problems to start with, I opened a new personal account and put the money in that account at Security Pacific Bank. For a long time I did not realize that I was really putting corporate money in; but they did not put a hold on any of my checks, so I had immediate cash.

One day they woke up and said, "Wait a minute. These look like company checks, not personal checks. You have got to open a corporate account." I said, "You will put me out of business if you put a ten-day hold on it." They said, "We promise you we will not do that." That was the biggest thing that I had because otherwise I would not have survived.

Grad: So you incorporated?

Murphy: Yes, C, and then an S.

Grad: You are an S now?

Murphy: Yes. We were making too much money. My accountant said, "You are really in danger of this being double taxed so you need to get to an S."

Grad: Really. That is an interesting argument. I have been back and forth on that kind of thing.

Murphy: I now have a $650,000 credit line that I have never even touched.

Grad: They are charging you for having it available?

Murphy: I worked out a deal. They are not charging me; but I have to keep it because I promised my dad.

Grad: Jane?

Jane Ross: When we started out, Jim was unemployed. His contract had finished; and he started selling through the company that had placed him on his last contract. When those two partners got into a fight and split up, we just kind of took over the St. Louis territory. He got a contract for himself; and he placed a couple of people. He came to me in this middle of the night conversation and said, "What are we going to do?" I said, "The kids are grown. It is you and me and the two cats. If it does not work, we will just go live in the car until you get another contract."

I had a job at the time, so we had some cash coming in. But we, too, went to the bank once we decided that this was what we were going to do. We had no partners. My dad had been in business a couple of times and had partners; and it never worked out. I said to Jim, "Do not come to me with a partner. It is you and me but nobody else." So he worked it initially.

We had money in two IRAs, one of his and one of mine. We took his IRA and cashed it in - $13,000 - and paid the penalty on it. That is how we were able to live. We went to the bank, Bank of America in Westport; and they said, "Come back when you're profitable; and we know that you are…"

Grad: When you do not need us.

Ross: They do not understand anything about the receivables business; but the branch manager said, “I have a friend who works in this factoring company across the street. You can go over there; and he will factor your invoices for you.” Since we only did 1099s to begin with, we began making money right away; but the factoring costs a lot of money. It is another usury kind of thing.

As soon as we could quit doing that, we did. We finally found a bank where we could explain what we did. It was Mercantile Bank in St. Louis. We educated the banker.

Grad: You had a little bit of a track record, too.

Ross: Right, we had people working. We had money coming in. We explained to him what we wanted to do. I think we started out with a $25,000 line of credit; and then every year we just bumped it up, bumped it up. We have one where we are now, in Arizona. I think it is a $250,000 line of credit; but we rarely borrow off of it. It is always personally guaranteed; and we are a C corporation.

Grad: Thank you. I think it is a very interesting set of stories. There are some common threads; and there are obviously some differences. We have just about another 35, 40 minutes. There are some other things I would like to explore if we can. Some of them we will do quickly. I am not going to go around the room. We will just do general discussion now.

How many of you bought any other companies? Did any of you buy any other companies? You did, Dan. What did you buy?

Acquiring Another Company

Greenburg: I bought a smaller company like mine. It was actually a gal that I used to work with. She started her own company. In 2000 she was tired of running the business; and I was looking for a new salesperson. My senior salesperson was leaving. I bought the company. She replaced the senior salesperson. It worked out pretty well.

Grad: How did you price it? How did you determine what to pay her?

Greenburg: That is a good question. I do not have an answer. It was all spreadsheets; and… I cannot remember.

Grad: Do you remember what her revenue was at the time that you bought her?

Greenburg: She was probably about a $7 million company.

Grad: Did you pay \$2-\$3 million?

Greenburg: No, I paid a lot less. It was less than \$1 million. I pay her a lot in terms of salary.

Cassell: What was she bringing to the bottom line, five percent, ten percent?

Greenburg: Five percent.

Grad: That's still 300K.

Greenburg: Yes. It was a good deal for all of us because she had a real reason. It was a nice symbiotic kind of deal.

Grad: Did anybody else acquire any companies? Okay. Let me come to the other side now. Did any of you have offers made to you - not that you sold - have offers made to you to sell your company to somebody? Tell me about some of those.

Ross: Well, we had gone to a conference; and we were thinking about possibly selling our company then. There was a company in Illinois that was looking to buy companies, and they wanted to move into the St. Louis market. We had no idea how to price our company at all. We looked at gross sales and decided if we sold it, what we wanted to have come out of that. We gave them a price. He went back to his partners and came back with another price; and we said "Thanks, but no thanks."

Grad: Do you remember what the ratios were to your revenue at that time?

Ross: No, I can remember that what we wanted was \$1.5 million; and they wanted to pay \$1 million. We said no.

Grad: Do you remember what your revenues were, any idea?

Ross: About \$2.5 million at the time.

Grad: One million was a fair price.

Ross: We had never been a big company. It probably was a fair price; but we were still young enough that we did not care. Like Jim said, we treat our company right now as an annuity.

Grad: Let me ask an interesting question. I am looking in terms of the NACCB connection. Didn't you have sessions on how to price your company, how to value your company with the NACCB?

Greenburg: Yes.

Grad: Okay, so you knew what the ballparks were and what was a fair price at that point; and you purposely paid less. Go ahead.

Murphy: One company approached me; and when they found out we did not have any debt, they ran. What they wanted to do was to assume your debt and make it a really good deal…

Grad: Did you get anybody offer to buy you, Bjorn?

<u>Merging Small Companies to Get Big Enough to "Go Public"</u>

Nordemo: No, but we ended up in an unusual scenario. I got a call from Grace Gentry one day about this funny deal that was going around about merging companies, roll-ups. After about three years we got involved in it and did partake in a roll-up, an IPO.

John, you may remember better than I do because some of those things are pretty fuzzy for me right now.

Chamberlain: I do not know what year it began. I know the ultimate end was February 14th of 1996. We were approached by this guy named Jim Lavelle. Grace - I think - was one of the first to sign onto this. She ultimately decided not to do it.

The concept was that we would assemble a group of local companies from around the United States and then, in a simultaneous transaction they would try to go public. In other words, if we could successfully take it public, then the deal would go through. If they could not take it public, then we would just all run our own companies. During the course of the gestation of this deal, business was ramping up nicely. We were lending money to this TSG as it was called until it was changed to Cotelligent. It ended up that we went public on NASDAQ and opened at $9 a share.

Grad: How many companies were involved?

Chamberlain: Four.

Grad: What were the four companies?

Chamberlain: Chamberlain Associates, Incorporated, and a company in Seattle what was that called?

Nordemo: FDSI.

Chamberlain: FDSI, Financial Data Services, Incorporated.

Nordemo: There was a New Jersey company and one more.

Grad: Those were the four companies that went public on NASDAQ. What was the relationship that each of you had to that new company?

Chamberlain: Once it was public, we each had a percentage of the stock, depending on our size. We went through this whole evaluation process to determine what percentage of the stock we owned. It took very little cash - $150,000 a company - so we were all mostly stock. It was a tax-free exchange so we did not have capital gains at that point. A person or two from each company was on the board of directors.

Grad: Was the stock in the company's name or your individual name?

Chamberlain: Our individual names.

Nordemo: Individuals, yes.

Grad: But you had a partner. You split the stock?

Nordemo: We split the stock based on the percentages of ownership in the company.

Grad: Was it primarily based upon the revenues or the profits?

Chamberlain: A combination of revenue, profit, growth. It was quite a sophisticated formula.

Grad: That is a very complex deal.

Chamberlain: I had a friend of mine that sold a business. He is a college friend. He said, "You are never going to do it. You will not be able to agree on how to split it."

Grad: The odds would have been very much against making that work. As they change over time, you sort of get a ratio set in your head; and your business grows faster or grows slower than the other ones and profits change. But you were in a very good period as far as the growth was concerned.

Chamberlain: We were in a good period. Still, it had some flaws in it. One was it did not really adequately account for what you did afterwards. For example, Bjorn's company and my company were growing like gangbusters. We compounded in the mid-1990s. After 1996, we grew 50 percent a year for a while.

Grad: How did you get the extra payoff? You guys were sharing revenues, of course.

Chamberlain: We didn't.

Cassell: Was Jim Lavelle running the company?

Grad: Was he a good manager?

Chamberlain: No. So ultimately my wife, Linda Cassell did. She and I were both on the board of directors. She was the only woman on the board of directors. Anyway, we learned fairly soon how incompetent Lavelle was. Linda was smarter than I was. She quit first. Then we learned - after she quit - that did not absolve her from Rule 144. She could not get out from under because she was married to me. About a year later I quit. Then we unloaded our stock as fast as we could, which was the best thing we ever did.

Grad: What eventually happened to the company?

Chamberlain: Lavelle tried all these different things, like doing consulting and software products. I think Wall Street was blowing in his ear; and he wanted to do higher margin business. All of those failed. Ultimately, the crash came; and he sold all of the contracting business that remained to Comsys.

Grad: So Fred Shulman ended up as the owner of everything.

Chamberlain: Yes. Jim Lavelle got $125 million for that business at that point. But they had done all these acquisitions during the boom, so they were heavily in debt. He sold off the debt. I think they had $100 million in debt. He paid that down; and he had $25 million in cash.

Then some character in San Francisco tried to take it over, which was stupid. I was getting calls from Cotelligent and from this guy about how I would vote. Dan Jackson called me. He said, "I hope you are going to support us in the buy." I said, "Dan, I do not own any stock anymore. The best thing you could do is shut this thing down and pay out that $25 million to the shareholders."

Grad: That is a fascinating story.

Chamberlain: It was a great story. The stock is about 12 cents a share on the pink sheets.

Grad: Let's finish up on this item. Anybody else sell their company? Peggy, did you end up selling?

Smith: I sold my half to my partner in 1989.

Grad: How did you price it?

Smith: Poorly. I was fortunate in that I had contacts at LAMBDA. I called some of my old contacts there. This was in 1988. I had an idea of what the business was worth; but in Greensboro, North Carolina, with a partner who was not really cognizant of what it was worth. I settled with her because, like these guys were saying, that is the worst divorce I ever had. It was just very difficult.

Grad: There was no buy/sell?

Smith: We had a buy/sell. We went through the process. I would buy it. We set a price; but she was unwilling to proceed. Some people just do not deal with things the way it says to deal with things.

Grad: Dan, how about yourself?

<u>Selling a Company</u>

Greenburg: I sold Allegiance in 2002 to a person whom I had known and become friendly with through NACCB. He was a young guy and he sold his company probably in 1998 really at the top. I mean he made a lot of money. Unfortunately, he had some financial setbacks and had to come back to the business.

I was ready to sell. I had been through some tough emotional times. We had lost three people on 9/11. We had three contractors at the World Trade Center. I was ready to sell anyway before that; and then, when that happened, it was definitely time to sell.

I had done all kinds of spreadsheets on what I needed to live on for the rest of my life without working again. So when I presented that to him – I would rather not discuss the numbers - I said, “This is what I need.” So he looked at the numbers and said “That’s a very high multiple; and I just can’t do a multiple that high. I said, “You don’t understand. This is what I need for me to live for the rest of my life. This is the number. I am not negotiating the number. This is the number. You can figure out whatever multiples you want to figure out, but this is what I need.” Finally we agreed on that number. Totally irrational, but it was rational to me.

<u>Company Organization and Operations</u>

Grad: I’m going to cut this because there are two or three things I want to cover while I have you guys. Any one of these we could spend the whole time on. The next one is operations, running your actual business organization, bringing in people. All of you needed salespeople. All of you needed recruiters.

Murphy: Our salespeople do their own recruiting.

Grad: Any others use that model?

Murphy: I’ve used it both ways; but I started with separate. I merged them together. Now they are separate.

Grad: This is the kind of thing I wanted to come out. That’s a new one to me; and I think that is wonderful. My initial model was that you needed salespeople, you needed recruiters and you needed some administrative and financial people. Those are the three. Have I left anything out that was critical as far as employees are concerned?

Murphy: Non-tech employees? Now you also need technical employees. When we started, we did not have a computer. We just sold computer people. Spreadsheets were manual. The accounting system was manual.

Grad: So your general organization, four elements: sales, recruiting, administrative and finance. Then what you call IT, technical. Anything else?

Murphy: Database maintenance type people.

Grad: Anything else? You had databases and so forth, didn’t you? Any other major skills?

Chamberlain: As you get larger, you need somebody - depending upon whether you are doing sales and recruiting separately or jointly - to manage the office manager, recruiting manager, sales manager.

Grad: So you need a manager to be on another level. What was your maximum employment of employees, not people out on assignments but people to run the office? Ten people, 15 people?

Murphy: I have had as many as 25; but that is when we had a huge volume. We had five people managing resume files, getting them to the sales and recruiters and back into the files. Those were low paid people.

Grad: Did you have a CFO or a controller or anything like that?

Ross: We did our own.

Smith: We hired one at the 1706 time.

Greenburg: No, we did not have a CFO.

Grad: Did you do your own financial stuff?

Greenburg: Pretty much. I enjoy doing it. I like numbers. And I had a good accountant.

Grad: How about you, Dave? You haven't been saying much.

Cassell: We had a controller in both companies. The gentleman that was the controller was actually one of the directors of information technology for one of my clients at IBM. He had an accounting background, and he came in as a 20 percent partner in the business. He took care of the books. That was also for the second company. I hired him back in shortly after we started to do the same thing.

Grad: Originally you would just get recruiters and salespeople, or some combination of them. Later, as you got bigger, you would have a manager of sales and a manager of recruiting. Is that common across here?

Nordemo: It depends upon how many people you have as to whether you need that or not.

Grad: What is the ballpark?

Nordemo: My partner was a recruiter. He remained a recruiter throughout the whole process. I became the chief financial officer; and I had a sales manager under me, as well as an office manager. At that point we were probably about 20 people in the office, total.

Grad: You had a real office at this point?

Nordemo: Oh, yes.

Grad: Phyliss, how about yourself?

Murphy: I have a degree in accounting. I worked for a CPA firm before I fell in love with computers, so I have always done it. I now have a controller; but I have always been hands-on, on my books. I have an incredible need to have control of money and books and cash. Until recently I have always had a flat organization and controlled expenses really tight.

Now we are building a real organization; but we started with sales and recruiters. They were always arguing. Finally, one day I had had it; and I said, “You all think you can do each other’s jobs better. You want to do both sides?” They said, “Yes.” And our sales actually went up a third when they combined it.

And I have had two or three people that have had 50 and 60 people billable each, doing both selling and recruiting. It is just incredible. We were just making piles of money when we did that. But it is really hard to hire people that have the skills to do both sides. So in 2000, when I knew the bottom was going to fall out of the market, I switched back to the standard model of sales and recruiting separately.

Grad: It is fascinating because the same kind of skills one would have as a good headhunter, in a sense, are some of the same skills you need as a good salesman. Aren’t they?

Cassell: Some of the best salespeople come out of the recruiting side.

Grad: Is that right? That’s interesting. Peggy, any comments you want to make on this aspect of it?

Smith: We always had separate salespeople and recruiters. Going back to the financial thing, I kept a close control, too, over the expenses and the income. I think - for all of us – we are pretty hands-on.

Grad: Let's swing back to Jane here. You ran the office; and you also did the financial stuff yourself?

Ross: Yes. Jim has a degree in accounting. So initially he set the books up. We have an excellent CPA that does our taxes and helped us set the corporation up to begin with; but I did all the basic bookkeeping, budgeting, and financial kinds of things with him.

Grad: What did you do about the recruiting and sales?

Ross: Jim did it all to begin with. I do not like sales. I hate sales. I do not want to talk to people. I am a nice person; but I am not a salesperson. I can do recruiting; and I did some of that in the very beginning to help him out. The first conference we went to, we talked to Phyliss; and Phyliss said, "My salespeople do the recruiting. Why pay them both? Why have that aggravation?"

So we went home and decided to hire some salespeople because we thought - this is wonderful! We will build this business and make zillions! That is what we told them.

I honestly feel that that is a better way to go because you do not have that internal conflict going on between the recruiters and the salespeople. When a salesperson gets a job order, they have that contact with the client. They know what the client is looking for. So when they go out to recruit, they know the kind of person that is going to work with that client. Why have a third party getting in the mix? So that is how we did it.

Grad: So the salesman cannot complain to the recruiter, "You did not get me who I asked you for." And the recruiter cannot say to someone, "You did not tell me what you needed."

Ross: Right, and the salesman cannot go back to the recruiter and say, "What the heck are you doing there? I need people."

The only conflict that we ever had was if a salesperson had two or three job orders that they may have gotten in a day, which one did they recruit for? Did they stop trying to get job orders to find recruits? We just said, "When you get the job order, you go recruit. Then you go look for another job order because that placement is going to help carry you through to get the next job order."

Murphy: If you build a big database and no one owns the candidates, they really share. They just say, "Oh, so and so is available."

Grad: That would be my concern. Would some of the salesmen hide some of the candidates?

Murphy: The company owned the candidates.

Cassell: We pay our recruiters on a pool concept. This is what the office does. We have got a full-time contracting staff, as well as W-2 hourly, as well as 1099s. We want the best candidate for the job so we wanted to make sure that the recruiters - if we had people sitting on the bench - got paid for pulling that person off the bench the same as they would get paid for going out and finding a new candidate. It has worked very well.

Grad: But you split that function, sales is here and recruiting is there. How about you, John?

Chamberlain: We had separate recruiters and salespeople, basically a pool of recruiters and a pool of salespeople. The orders would get assigned to recruiters based on how heavy a load they have. That never really worked. There were always conflicts. He is working on his order and not mine.

When we got larger - just about the time we were doing the Cotelligent deal - we hired a full-time manager who had worked for two other companies prior, one in Washington State and one in Oregon. He said, "My whole career, we have always had the salespeople and recruiters work as a team. I am familiar with doing this. It is the way I like to operate."

We decided we were going to hire him. We're going to do that. The idea was both the salespeople and the recruiters would know the clients, could talk to them, so if the manager calls and wants an answer on something and the sales guy is somewhere else, they talk to the recruiter. It worked well.

Grad: Dave, did you ever consider that possibility?

Cassell: I have been in this business since 1982. Over that period of time we have probably tried a bit of everything. What we are doing right now, we are much more on the solution side of the business today than on the staff supplement side. That also makes a difference.

Grad: Dan, how about your thoughts?

Greenburg: What we did - and it worked very well for us - was our recruiters were recruiting by skill because we were very consultant oriented. That is the way I wanted to set up the company. We wanted the consultants - especially the ICs - to know that they had one point of contact in the company. We had one recruiter who specialized in AS-400's in the mid-range. We had one recruiter who specialized in CICS. Then we had one who specialized in what we call "purple squirrels", which were unusual requirements, like a left-handed COBOL programmer with Java and a banking background.

It worked well because, once again, the consultant knew when they became available either through us or, if they were working for somebody else, they knew to call Ellen to tell them that they're available. Also, the recruiters really got to know who the players were in those skills. When they did have a requirement, they had a nice pool of people that would do referrals. We had a nice referral plan going on. So they were quick. They were really, really fast. When a requirement came in - if it was a normal requirement, the goal was to get somebody out within two hours.

Murphy: You have to move very fast. That is why we had all those file room people who would convert everything to the computer. The whole business has changed with the Internet.

Grad: I used the term supplemental staff. No one will get mad at me then. Is that okay? Not body shop.

Chamberlain: I don't mind body shop.

Grad: We have got five more minutes. Let me switch. That is very interesting, the different ways you would handle the same kind of thing. One final question: Did you consider - from a business management standpoint - that the selling and recruiting were your core responsibilities as general managers? The financials you sort of handled them various ways, so this was your core business - selling and recruiting. I just want to make sure I have not overlooked something that was different in your case.

Ross: At one point in time, we did have a technical person working for us. But we downsized the business a little bit when we realized that we could use the Adapt database online. They maintain our database of contractors and clients; and we access it through the Internet. We have people right now working from home offices. We do not have an official building that anybody goes to anymore. And ICs, they just go right to that same database. I can access it to see who is doing what. I don't have to do that anymore.

Grad: Can anybody else access it though?

Ross: Supposedly not.

Physical Space and Office Management

Grad: Okay, last topic for our session, before we break up. The physical offices, office management and facilities. Did you buy your own buildings? Did you rent space? What did you all do on that?

Ross: We rented space, and we renovated it once we went into it. It was a big blank room. We put in offices.

Grad: Phyliss?

Murphy: I was pretty clear about the focus of my business; and I said, "If I buy a building, I become a property manager. I need to do sales and recruiting." So we rented.

Nordemo: We rented initially. Then I spent a few years convincing my partner to buy the facility. We bought a building; and it turned out to be a good investment.

Grad: Did you find yourself becoming a facilities manager?

Nordemo: Not really. Your office manager could handle most anything that we had to do anyway. We were the only tenants in the building.

Grad: David, how about you?

Cassell: Class B office space sublet. In other words, as little as possible because in our business, the facility that you are in is not that important.

Grad: Do clients ever come to you?

Cassell: Very rarely. Now that we have moved into the solution business, we do get more of that; but I have always sold the fact that,"Look, we are not spending your money on fancy offices and artwork and that kind of thing". It worked very well.

Grad: John, yourself?

Chamberlain: First class B. We always rented. I hoped the business would grow beyond my wildest dreams; and I did not want to be trapped in a certain amount of space. Every time a lease was up, we would look at our needs for the next three years or five years, whatever the length of the lease was; and then we'd lease, find the best deal we could.

Grad: But you were leasing, you did not buy.

Chamberlain: Never bought, always leased.

Greenburg: We rented. We actually decorated it nicely; and it was important to the people in the office. They spent a lot of time there. It was not a 9:00 to 5:00 job. We had couches; and we had nice wallpaper and nice carpets and a nice big kitchen. That was sort of important for the people there.

Smith: We rented.

Grad: So, with the exception of Bjorn, you stayed in rental space; and you kept growing.

Ross: Around the corner from where our offices were, there was a building. We thought what we might do is kind of branch off and offer space to clients for overflow of their employees. Or if they had a big project, they could put it in this space. So we did buy a building. It turned out to be not a smart thing to do. We ended up selling it. We didn't lose money on it; but we didn't make any money on it either.

Grad: Any other topics—we have tried to talk about your office operations, how you ran your business, organization charts. All very, very simple, it seems like in your businesses. These were not complex.

Some Features to Retain Contractors

Greenburg: There is one function that we had. I brought it up at the meeting yesterday. That was a consulting services person. This is the late 1990s.

Grad: Talk about that.

Greenburg: It worked very well because one of our problems - as every company had - was retention of consultants. Everybody was trying to steal everybody's consultants while they were on billing. As we grew - at our peak - we had two people whose entire job was the care and feeding of the consultants, ICs or employees. They would go out. They were taken to lunch. We would have "Consultant of the Month" awards. We would have clients vote on consultants of the month. We knew their birthdays. We knew - with Indian consultants - we knew…I forget what the holiday is, but whatever the Indian holiday was - we sent them cards and stuff like that. This gal and her assistant were in charge of all that. We had big parties.

Grad: It wasn't the recruiter, just adding on a care and feeding role.

Greenburg: This was their job. They would have a newsletter go out. It was unbelievable, the stuff they did.

Murphy: We developed a process so that our recruiters and salesreps could stay in contact. We developed some standard emails. We sent birthday cards. We did a whole bunch of things; but that is just part of the contractor relations process.

Greenburg: Our retention went way up. It was not just because we were nice people. It was really a good business move.

Grad: Did you invite them to come to the offices? Did you do things at your offices for the ICs, for your other people?

Ross: We used to have a holiday party. It wasn't necessarily just Christmas or New Year's; but it was a holiday party that we would have everybody come and have a catered dinner and do those gift things.

Cassell: We do that once a quarter for our people, too. We will go to a basketball game or a baseball game or the rodeo.

Grad: This is for everybody.

Ross: But this was basically for the contractors because our office staff is small enough that we all had to work to put this deal on. So it was for the contractors.

Grad: Thank you very much.