GERALD EDELMAN

INDUSTRY UPDATE
QUARTER 1
YEAR 2023

Recruitment

After significant growth across 2021 and 2022 in the UK, the recruitment industry is entering into a period of uncertainty, with forecasts of a recession looming, although changing employee habits mean that more people than ever are changing jobs.

Recruitment Overview

The global and, more specifically, UK workforce is undergoing significant change following the Covid-19 pandemic. The Great Resignation, a term coined in May 2021, describes the record number of people leaving their jobs since the beginning of the pandemic. The max exodus is thought to be driven by people placing increasing value on work-life balance and the flexibility of being able to work from home with no commute. There is no sign of this trend slowing, with research indicating that one in five workers were expected to have quit their job in 2022.

In addition, the increasing representation of Gen-Z (those born between 1997 and early 2000s) in today's workforce has brought a generational shift, with evidence suggesting that Gen-Z workers don't tend to stay in a role for too long and are more likely to take career breaks. A report produced by ThoughtExchange on Gen-Z workers stated that only 34% plan to stay at their company for at least five years, meaning that recruitment companies will be able to capitalise on expected increase in frequency that Gen-Z workers will be looking to change jobs or resume job searching post career break.

According to the Recruitment & Employment Confederation ("REC"), the UK recruitment industry's Gross Value Added ("GVA") reached £42.9 billion in 2021, a 21.7% increase from 2020. This increase was driven by economic conditions significantly improving after Covid-19 when the majority of companies cut jobs and a near standstill in hiring occurred.

This trend has continued into 2022, with the REC stating that there was a 14.3% growth in the volume of clients despite fees having increased by 7.4%, showing that demand continued to rise even after price increases.

Looking ahead, the REC predicts year on year growth of 6% after 2022. The reduced growth prospects have been primarily attributed to the uncertainty around the current UK economic climate and forecasts released by the ONS suggesting unemployment levels are likely to increase by c.1% this time next year.

Market Structure

Recruitment agencies are broadly split into two forms:

1. Permanent placements; and
2. Temporary/contract placements.

Permanent Placements

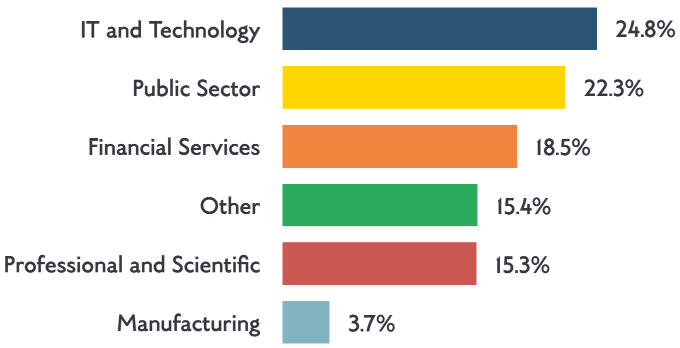
Following on from a disruptive period in 2021 due to the economic slowdown following the Covid-19 outbreak, 2022 saw growth in revenue of 5%, reaching £16.9 billion. This growth is expected to continue over the next five years through to 2026-27, with industry revenue expected to expand at a compound rate of 5.2% to reach £21.7 billion.

However, it should be noted that the strong growth is artificially heightened in the first half of the period as the industry rebounds from its decline caused by Covid-19.

Despite the forecasted growth, there are some economic uncertainties the market is currently facing. Potential job losses in the financial sector following the UK's exit from the European Union are likely to reduce demand from this sector, which is one of the industry's largest markets. In addition, online job-search websites remain a threat to the industry; however, the personalised nature of the industry's services ensures that the threat will remain low.

Below is a breakdown of key sectors within permanent placement recruitment:

Major Market Segmentation



2022 Industry Revenue £16.9bn

Source: IBISWorld

As shown above, the primary sector is IT and technology accounting for 24.8% of revenue. Demand for IT professionals has significantly grown over the past five years as technology firms expand and the adoption of more sophisticated technology by businesses in general. This trend is expected to continue in the coming years.

The next largest segment is the public sector, specifically: administrators, healthcare workers and education professionals.

As the public sector requires a large number of staff, this market accounts for a significant portion of industry revenue each year. Jobs in these industries require an easily quantifiable set of qualifications and skills that can be matched accurately with the appropriate prospective employee by industry operators making it a strong sector for the recruitment industry.

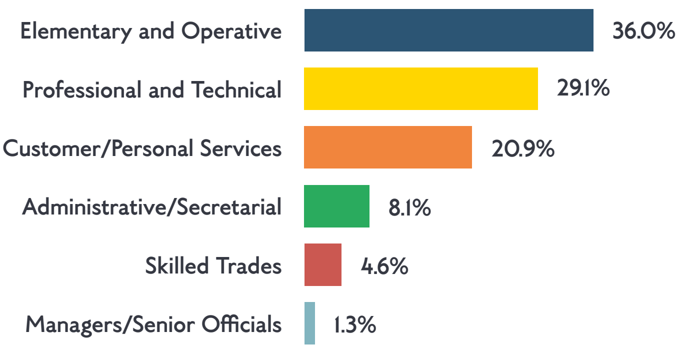
Temporary/Contract Placements

Temporary/contract placement agencies provide clients with workers to temporarily replace or supplement their existing labour force. Over the previous five years, industry revenue has declined at a compound annual rate of 3% to £39.5 billion. This was due to the economic uncertainty surrounding the EU referendum in June 2016 which had limited industry demand. In the current year, industry revenue is expected to rebound from the significant decline recorded in 2020-21 amid the gradual reopening of the economy with 2022 revenue anticipated to rise by 3.4%.

The industry is expected to continue to grow over the five years to 2026-27, with industry revenue expected to expand at a compound rate of 3.5% to just under £47 billion. However, setbacks, such as legislation relating to wage rates are expected to adversely affect the industry, with a rising National Minimum Wage likely to dampen demand for low-wage temporary employees.

Conversely, the rise in the number of people working in the gig economy and the expected continued high number of non-EU workers offsetting the decline in EU citizens working in the United Kingdom is expected to support the industry's performance over the next five years.

Major Market Segmentation



2022 Industry Revenue £39.5bn

Source: IBISWorld

The largest market for temporary employees is elementary and operative occupations. Professions in this segment are often low-wage and low-skill positions, including assemblers, machine operatives, transport drivers, cleaners, porters, and shelf fillers. Demand from this market has increased over the past five years and reached 36% of revenue in 2022. This subsector of the industry was supported by the strong performance of supermarkets during the Covid-19 pandemic.

Competitive Landscape

The recruitment industry generally exhibits a low level of market share concentration, with the top four companies accounting for just 7.2% of industry revenue in 2021-2022. This is due to a high number of niche companies targeting specific sectors. In addition, there are a large number of small operators that serve local regions, with companies spread across the country in line with population distribution. This has come about due to most workers seeking help from local recruitment firms.

Market share concentration can vary significantly between market segments. The larger firms operating in the industry provide recruitment services to clients in a broad range of industries. In contrast, smaller operators tend to specialise in hiring people for a specific sector. Below is a breakdown of enterprises by employment size in 2022 from the Office of National Statistics.

Employees	Share of Total
0-4	73.5%
5-9	10.5%
10-19	7.0%
20-49	4.6%
50-99	2.4%
100-249	1.4%
250+	0.6%

Source: Office of National Statistics

In 2022, 84% of employment placement agencies employed fewer than 10 staff members and only 2% employed 100 people or more. A marginal increase from 2020, with 87.1% employing fewer than 10 staff and 1.4% of firms employing 100 or more people.

Smaller firms have struggled to stay profitable over the last two years due to the economic effects of Covid-19. As a result, distress acquisitions have become more prevalent, increasing consolidation within the market to a slight extent. However, several smaller companies entered the industry towards the beginning of the period, mainly because industry employees decided to start their own firms.

The rapid digitisation of online job listings and other services has enabled new companies to enter the industry and quickly capture market demand. However, the overall market share concentration has remained low over the past five years and is expected to stay the same over the next five years.

Current Climate

The industry is significantly influenced by business confidence, the unemployment rate and level of demand in specific sectors.

Business Confidence

When businesses become more confident about their financial outlook, they are more likely to increase capacity and look for expansion opportunities. These growth initiatives require extra staff which in turn drives demand for the services of permanent placement agencies. The business confidence index table below shows how confidence has changed in recent years.

As expected, business confidence fell sharply during the Covid-19 pandemic. Although business confidence saw a steady improvement in 2021, in December 2022 it was 100.7, a significant reduction from a score of c.104.9 in July 2021. Other indicators, such as high inflation and a cost of living crisis suggest an economic recession is looming.

If a downturn does hit the UK economy, the recruitment industry will also likely be impacted as companies look to reduce recruitment in an attempt to cut costs. This will, in turn, reduce the number of contracts recruitment firms will receive.

Unemployment

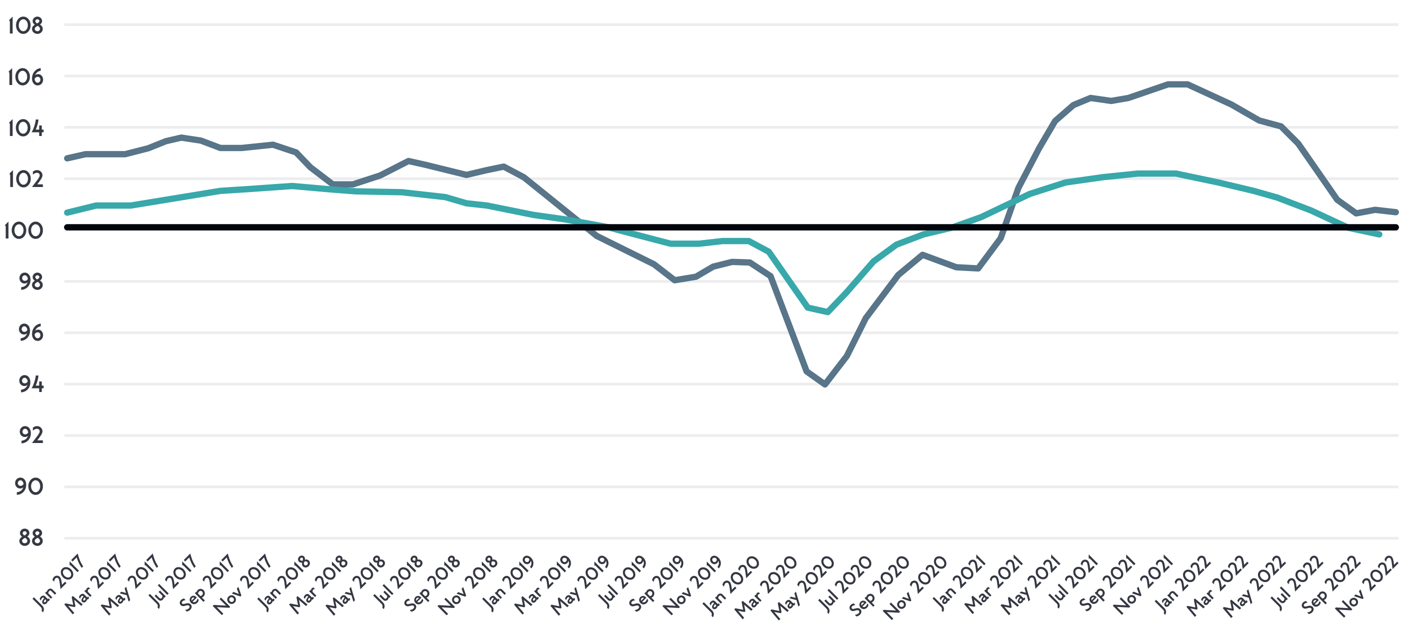
The unemployment rate indicates the strength of the employment market and demand for industry recruitment and placement services. The UK unemployment rate, seasonally adjusted, is currently 3.7% according to the ONS. Statista predicts unemployment to rise to c.4.9% by 2024 before falling gradually to 4.2% by 2027. A rising unemployment rate reflects a lower hiring rate among businesses, which can also negatively affect this industry.

Sector Demand

The UK is currently in the grips of a skills gap which is expected to widen in the coming years. One of the key drivers of the increasing void is the evolving jobs market. The technology sector is growing at a rate which outstrips the number of skilled potential employees.

A similar trend has been seen in private equity ("PE"). According to a new study commissioned by Intertrust Group, three-quarters of interviewed private capital funds struggle to recruit and retain new talent. The most significant shortages were noted in automation and cyber security. The main drivers of these shortages were changing demands and Diversity, Equity, Inclusion and Belonging ("BEIB") related challenges. These skill gaps have pushed employers to think of alternative and creative ways to draw in new talent and resulting in driving up demand for services provided by recruitment companies.

UK and OECD Business Confidence Index



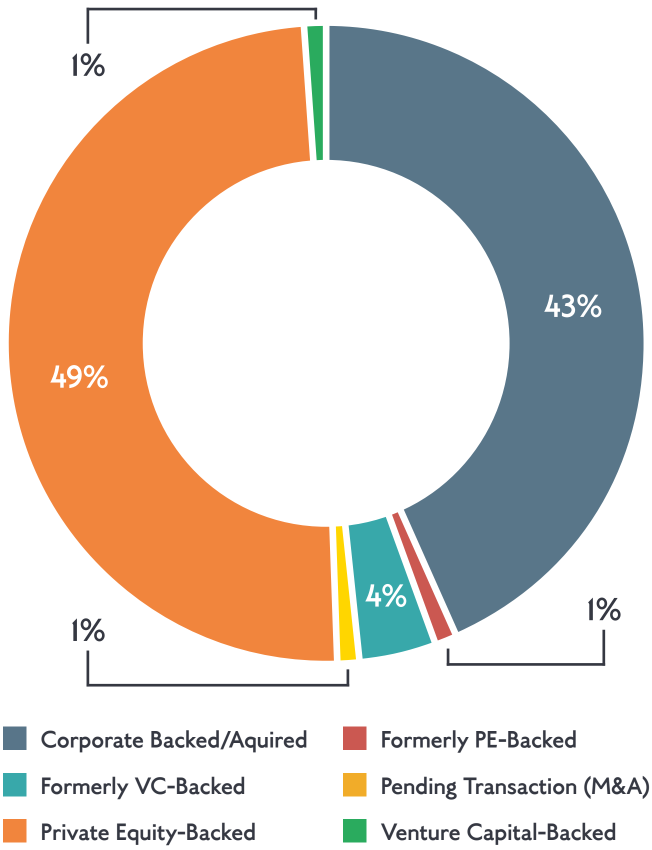
Source: Organisation for Economic Co-operation and Development

Deal Activity

Summary of recent M&A and investment activity

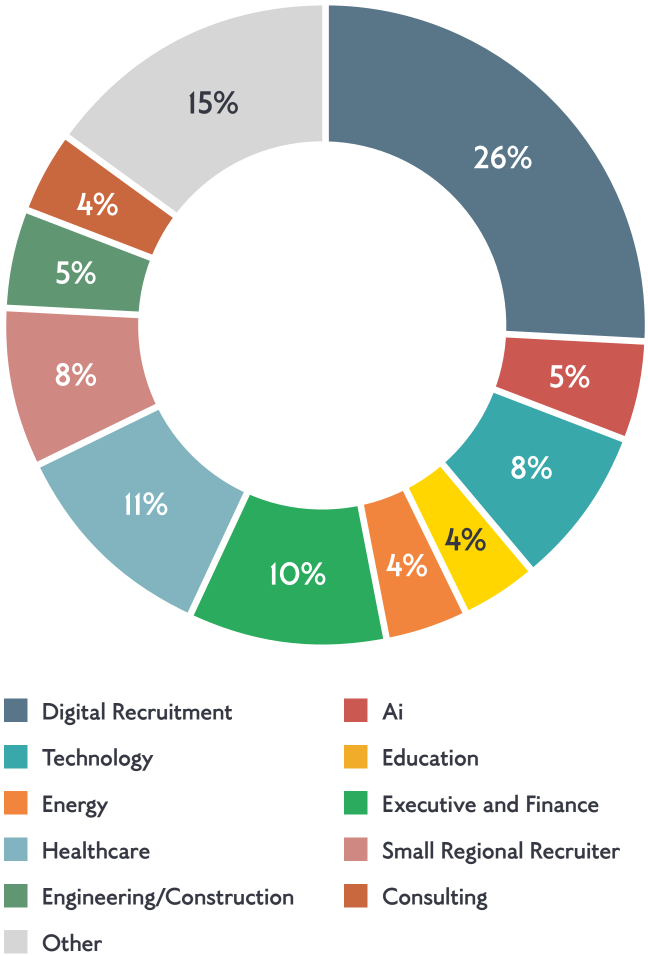
PE backed investments in 2022 financed the majority of deals within the recruitment industry, as shown below. PE firms are looking for opportunities to assimilate small firms, capitalising on the fragmented market structure previously highlighted through bolt-on and roll-up acquisition strategies. Elsewhere, corporate acquisitions made up around 43% of total deals in 2022.

2022 UK Financing Status of M&A Activity in the Recruitment Industry



Source: Pitchbook

2022 Recruitment Deals by Industry



Source: Pitchbook

Digital recruitment software providers accounted for a quarter of the deals observed. Outside of digital recruitment, firms that provided for technology, Artificial Intelligence ("AI"), education, energy and healthcare industries saw several acquisitions.

M&A appetite is expected to remain high within these subsectors of recruitment even if economic conditions worsen. Below is a table showing some of the significant deals completed in 2022:

Corporate Backed or Acquired

Deal Date	Company	Acquirer	Deal Size (£m)	Revenue (£m)
12 Jan 22	Osmii	Hitchenor Wakeford (Spencer Jinks)	Unknown	6.75
7 Jun 22	Business HR Solutions	Marlowe (UK)	5.8	Unknown
21 Jun 22	Brownlee Dean	Tech Search Associates	Unknown	7.74
1 Jul 22	On Track Recruitment	Sammons Group	Unknown	13.48

Source: Pitchbook

Private Equity-Backed

Deal Date	Company	Acquirer	Deal Size (£m)	Revenue (£m)
7 Feb 22	Apprentify	BGF	5.0	Unknown
8 Jun 22	Just IT Training	Back2Work (Palatine Private Equity)	Unknown	8.8
5 Aug 22	MYNT Recruitment	Next Recruitment (Recruitment Investments)	Unknown	Unknown
29 Nov 22	Job.com	SOJA Ventures, Serengeti and Ghost Tree Partners	Unknown	119.4

Source: Pitchbook

Outlook

Historically, the recruitment industry performs poorly during recessions and with indicators of an economic downturn increasing, investors are being more cautious. While this will most likely reduce the number of deals in 2023, recruitment firms within the technology, education, energy, and other sectors highlighted are still likely to experience growth.

Therefore, investors will continue to pursue these opportunities in 2023 and beyond, especially with the Gen-Z worker boom meaning changing jobs is becoming more of a regular trend.

CONTACT US

Nick Wallis
PARTNER
+44 (0)20 7299 1420
nwallis@geraldedelman.com

MEET NICK

Joanna Loizidou
PARTNER
+44 (0)20 7299 1460
jloizidou@geraldedelman.com

MEET JOANNA