

European employment services market

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Interviewee

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Market Segmentation and Structure

Question: How should the European employment services market be segmented?

Answer:

The market can be segmented by contract type, which is typically the primary lens used by investors. This includes temporary staffing, permanent recruitment and outsourcing. Recruitment process outsourcing, in particular, represents a distinct business model and should be considered separately.

A second lens is the level of specialisation. The proposed segmentation across STEM, healthcare, industrials and other specialist areas is appropriate, given the breadth of the employment services market.

Overall, this is probably as focused as the segmentation can reasonably be, as employment services is inherently a broad market.

Question: Could you explain how the RPO segment works?

Answer:

That's where you want someone to manage your recruitment for you entirely on an outsourced basis. They could be doing both your permanent recruitment, your temporary recruitment, your grads, your senior hires, all of it.

Someone like Alexander Mann (AMS) would offer that type of service. And it's quite different to you partnering with a recruitment firm from your in-house function. It's actually, we're going to give you this whole function and we want you to manage it.

In terms of the commercial model, that's more of a retained subscription model type thing. Attractive to investors, but it's lower margin but more stable.

Fragmentation and Consolidation

Question: How would you describe the industry across Europe in terms of fragmentation and consolidation?

Answer:

Even though there are some consolidators that operate Europe-wide, I'd say overall the market is highly fragmented.

Particularly in Europe, there's a long tail of small agencies, relatively few scaled players. We often get posed the challenge of what differentiates recruitment providers, given that they're glass half empty, just people trying to hire people, everyone's trying to do the same job.

But I think the fact that there are so few scaled players shows that although barriers to entry are typically quite low, the barriers to scale and delivering consistent quality at scale, particularly internationally, are really high.

I would agree with you, fragmented space, there are thousands of small firms in the UK alone. UK, Nordics are more mature and competitive markets. The UK is even more mature than the US staffing market.

More mature means more players, more competitive intensity in terms of tighter margins. It's a tough market to operate in. So if you get to the point where you are a scaled player, you have developed something quite special.

I'd say that characterises the UK and the Nordics. Germany and France are a bit more regulated, less flexible, which means there are actually fewer players there because that compliance hygiene factor creates a more meaningful barrier to entry in those markets.

Question: Are there differences across temporary staffing or specialist segments?

Answer:

I would say it's quite similar. I think the barriers to scale for a temporary staffing or contractor-focused business are probably higher because you are more dependent on a database of candidates, whereas in permanent hiring, it's more of a relatively clean slate every time you start a search process.

Contractors, you can have a database, you can know of those individuals in your contractor database, and when their current contract is coming to an end, you can place them again.

That's a real advantage as an incumbent player, that you have that visibility of when their next placement is coming to an end, so you can start to arrange their next one whilst they're still out on placement.

And that is a really good barrier to those who are trying to disrupt your relationships because you can have all that knowledge in-house. It means that you can have greater visibility of earnings and greater control of your IP in terms of that contractor database.

Candidate Databases and Differentiation

Question: How do recruitment firms build and manage candidate databases?

Answer:

We see that as really critical. If you think about what the threat to this industry is in terms of AI and how that can disrupt things, you've got AI as a potential threat in that you can use AI to source candidates and match them to potential placements in quite an automated way.

That's not necessarily a new threat. People have been saying that there's a threat to recruitment since LinkedIn.

The way you differentiate, and you develop IP as a recruitment business, is the contractor database and the way you engage with that database and enrich the data on it is how you make sure that you are different to just using LinkedIn.

Things that you might want to enrich it with are an awareness of how the candidate likes to work, what cultural fit they would have for an organisation, what their career aspirations are, particular sectors or structure of business they want to work with, dates that they might be available, what their salary expectations might be, what their language skills are, what some of their softer skills are.

Loads of differences wouldn't be captured by LinkedIn, which is really critical that a recruiter captures because that's how they're different to just going on LinkedIn.

And then the other thing is, you've got enrichment, and then you've also got the engagement of those candidates, so are they actually going to pick up the phone? This is particularly relevant within more specialist recruitment. These candidates typically get lots of inbound all the time on LinkedIn with potential roles. Unless you're a really big employer, they're probably not going to respond to it.

Whereas if you've got them on your candidate database, you really understand what role is going to be a right fit for them. You've built up a relationship of trust over time. They are actually going to be responsive.

There are two key selection criteria for working out which recruiter to utilise as a potential client. It's their quality of matching a candidate and their speed of actually identifying that potential candidate and getting them to engage.

If you have an enriched and engaged candidate database, that's number one. And it's one of the meaningful benefits of scale as well. We talked about this massive, fragmented base. How do you differentiate from them? It has that candidate database.

That means it also guards against one of the main risks of a recruitment business, which is dependency on people. People are inherently a flighty asset. You want to make sure that you are codifying the IP that people generate. To the degree that you can make them benefit from that candidate database and share it organisation-wide, that is a really good mitigant against key people leaving.

Question: How do firms initially source candidates into the database?**Answer:**

It's a really difficult thing, which gets a lot easier with scale. You end up as a scale player with a nice virtuous circle, as you attract the best candidates. Well, maybe we say first you attract the best clients and best roles, that attracts the best candidates, and then that attracts the best clients, and then you get this nice flywheel, which means that you continue to grow.

Smaller firms don't necessarily have that. I guess it's through relationships initially when you're a small firm. Lots of people who set up their own recruiting firm have historically done in-house roles or have spun out of one of the larger recruiters.

They have a black book of contacts. From that experience, they'll be getting in touch. And it would be a real scrap at the start, I'm sure, to make sure that you're getting the best candidates and the best roles.

Once you have that, it's building that up over time. And it's one of the big benefits of scale, that becomes more of a self-fulfilling thing because you are typically starting to attract the best candidates because you have the best roles coming to you.

M&A and Growth Strategies**Question: Do larger players use M&A to scale?****Answer:**

Yes, they do. M&A is one of the plays here. It is quite difficult in recruitment, as it is in any other business, like consultancy. Culture is really important to recruitment businesses, and usually it's even more significant in recruitment than it is in consulting, probably, because things like incentives are such a core part of driving the consultants who work in a recruitment environment. You need to make that meaningful for them. And as soon as you dilute ownership structures through merging or anything like that, equity structures, it can change the dynamics there.

I think Randstad acquired a business called Zorgwerk, which is a healthcare marketplace. Adecco has done some deals, and Manpower has done a deal with Attain. These big companies do use M&A as one of their growth levers.

Typically, the strategy they are pursuing focuses either on entering high-growth areas, such as STEM, or on geographic expansion. Many companies that have become international have done so through acquisition. And then diversifying across contract types can also be important because the cyclical nature of the various parts of the recruitment market differs. Contractors and temporary staffing are usually a bit more resilient relative to perm hiring. You also get the benefit of greater visibility of your pipeline within

contractual recruitment. So diversifying across them can also be quite a nice hedge in a cyclical environment.

Question: Why are temporary contracts less cyclical?

Answer:

There is less risk involved in hiring temporary staff, because you can hire them for a fixed period. For example, if you have won a project and need people to deliver it, you can bring them in for the duration of that project and then release them once it is completed.

If a business has uncertainty around its long-term pipeline of work, it makes sense to match resources on a shorter-term basis.

From an investor perspective, you are not starting from zero on day one. You may already have six months of placements in the pipeline. By contrast, on the permanent recruitment side, the revenue model is a percentage of salary, and once the placement is made, the revenue is complete. On the temporary staffing side, the model is based on a percentage of the ongoing contractor salary, creating a more recurring revenue profile.

Revenue Model and Investor Attractiveness

Question: How do the revenue generation models and margins differ by segment?

Answer:

The temporary staffing model is essentially based on a margin linked to the contractor's salary. It has a more recurring revenue profile and is generally more resilient in downturns.

Permanent placement is different. It is typically a one-off fee based on a percentage of salary. It is usually a higher margin, but more volatile.

RPO is closer to a retained or subscription-style revenue model. Again, it is a lower margin, but more stable.

Question: Are investors more attracted to RPO and temporary employment services players?

Answer:

Yes, the revenue model is important, but you also need to think about how differentiated these models are. One lens is the type of recruitment being done. The other is the sector you are operating in and the skill level of the roles you are placing.

If it is more generalist and lower-skill recruitment, it is much more disruptive than specialist recruitment. In the current climate, where everyone is very aware of AI disruption risk, investors are likely to focus more on the seniority of the roles being placed.

That is where the enrichment and engagement of the candidate database become most important, because those are the elements that are currently very hard for AI to replicate.

Profitability and Cost Structure

Question: What are typical EBITDA margins and the main cost components?

Answer:

It's typically a high margin on the permanent side, similar to what you'd get in a consulting business. A 30% EBITDA margin would be pretty good. On the RPO side, it can be as low as 5%, 10%.

Contractors, it depends on the seniority. If it's a relatively senior contractor base, then you can easily get to 25%-ish, but then that would be eroded a bit if it were more of a generalist crowd.

In terms of costs, Bullhorn is the pre-eminent technology platform used by most recruitment businesses, and it offers AI modules that companies can subscribe to. Those can be quite costly. There is also office infrastructure and typical marketing spend.

Sourcing candidates, running events and engaging with clients can also be meaningful expenses. However, the highest cost is usually consultants, with bonuses and incentives often forming a meaningful part of their remuneration.

Market Drivers

Question: What are the positive drivers or tailwinds for the industry?

Answer:

Generally, there is skill shortages in high demand areas, like STEM, healthcare. There's still constraints in terms of capabilities. That means that the balance of power shifts to recruiters and candidates, and it means that as an employer, you really have to rely on your recruitment partners to drive that engagement from the candidate pool, because there's that balance of power dynamic.

The workforce size has been internationally hit by things like COVID, so long-term illness, people being removed from the employee pool, people taking early retirement. Restrictions on labour flexibility, things like Brexit or Trump's anti-immigration policies, means that there's less fluidity in labour pools.

Remote work is possible for some roles. But I think presence and being able to make it into the office is important in lots of industries and to lots of employers. So that's been a challenge.

Employee churn is a big factor for recruitment businesses because any liquidity in the market is helpful in terms of the number of placements that people are making. That's gone up recently as people are demanding roles that they like, and there could potentially be a bit of a shift in that, given the current macro climate and the effects of AI in terms of workforce requirements.

Regulatory trends are generally positive for recruiters because it limits the ability of people to hire in-house because they have to be compliant with labour restrictions. That's particularly pervasive within temporary staffing, where there are rules on employment models, and if you are employing someone on a temporary basis in terms of contract structure, but actually they're more akin to a permanent employee, you can be in a lot of regulatory trouble. Getting a rubber stamp from a recruiter can be useful.

Market Drivers

Question: Is there a broader shift towards outsourcing recruitment to specialist employment services firms?

Answer:

I think in some areas, I don't think you can apply that blanket statement. Some areas of recruitment are really challenging. And people are able to do more stuff in-house.

A really big factor here is AI, which none of what I've mentioned really factors in. That means that there is a real shift in the workforce and the requirements of employers, not just currently but over the medium term and long term. That is a good thing in some ways for recruiters, but it means in some areas there's going to be less demand.

A good example of this is the graduate job market, where there are excess candidates relative to the number of roles. That does create a challenge for trying to do things in-house as well, because graduates can send as many applications as they want now, and actually sifting through those applications and trying to discriminate between those that are AI-generated and not genuinely a good candidate is really difficult.

So that creates an opportunity for some types of business. I came across one earlier in the week, which is called Amplify Me, which is a business which has been invested in by Northcote Equity. What they try to do is really test candidates to make sure that they're not just using AI to apply for jobs.

I think that type of thing, where a recruiter becomes a real partner to an organisation and can help with that type of thing, is going to be a nice adjacency that recruiters can help with.

Question: How could changes in employer organisational structures affect recruiters?**Answer:**

The other thing is that within lots of industries, there's a shift towards more of a diamond structure, or at least there's an intention to shift.

Historically, lots of businesses have had a pyramid structure where they've had lots of junior employees. And there's a lot of rhetoric about shifting to more of a diamond model.

The problem with that is that you don't have the same conveyor belt of talent coming through. So it means that when you try to create the diamond, you're going to need to hire more experienced people, which is good for recruiters. That's where they particularly come into their own, hiring more experienced staff.

That's where the biggest reward is because they have higher salaries. There's going to be lots of demand for that middle layer, which historically would have been developed in-house within the firm.

They're now going to be coming in from lots of different sources, and there's going to be lots of competition for them from companies that haven't developed their own talent. That will shift that balance of power more towards the candidate rather than the client, and you'll need a good recruitment partner to support you with that dynamic.

AI and Disruption**Question: How does AI affect differentiation and the role of recruiters?****Answer:**

To differentiate as a business, especially when you are not developing as much talent in-house, experienced hires need to be of high quality. There is an argument that AI generally lowers the opportunity for differentiation, because everyone is using the same tools, such as ChatGPT and Claude, and businesses are not developing as much of their own talent internally.

As a result, the people you hire need to be high-quality, and businesses need to differentiate by partnering with the best recruiters. There is a real opportunity for recruiters to become more strategic partners to businesses and a more fundamental part of their competitive advantage, whereas historically that has been less the case.

The glass-half-empty view is that businesses may need fewer employees, meaning there would be fewer roles for recruiters to source, although that is not realistic, hopefully.

Recruiters are typically less focused on the areas most exposed to AI, such as more junior roles or specific industries where smart recruiters are likely to be less active. In the AI age, it is important to be discerning in picking the winners: focusing on seniority, more defensible capability sets and more defensible industries.

If recruiters get that right, they should become more strategic partners and, as a consequence, more valuable. Physical work is one example of an area less affected by the theory that AI will replace jobs.

Question: Which stages of the recruitment workflow are most exposed to AI disintermediation?

Answer:

Another thing we have not mentioned is the potential for AI to allow people to disintermediate recruiters. We have been talking about how valuable a candidate database can be as a form of IP, but recruiters need to enrich that database and make sure candidates are engaged within it.

If you are not investing in that differentiation, then you have no real advantage versus an in-house recruiter. They can use LinkedIn in the same way that a specialist recruiter can.

Historically, recruiters have talked a good game about their candidate databases, but many people in the industry still work from their own black book or their own LinkedIn outreach. They do not fully utilise a central candidate database. That needs to change.

Top-tier recruiters will make sure they are putting processes in place so that consultants operate in a consistent way, using a central database that is both enriched and engaged.

If you think about the stages of a recruitment process, it starts with planning what type of person you need, then finding them, engaging them, qualifying whether they are a good fit for the role, managing the selection process and client interview, negotiating salary and then onboarding.

The most disruptive part is probably the “find” stage, but not the engagement stage. Qualification can be supported by AI to some extent, but not effectively without an enriched database. The barriers to AI managing the whole process are planning the right skills requirement, engaging candidates, enriching the data so that candidates can be qualified properly and negotiating with candidates. You cannot really do those parts through AI.

Most clients also want an end-to-end process. So there are still enough separate components in the workflow that are relatively insulated from AI as a whole. The best recruiters will invest in those differentiators to make sure they are protected.

ESG and Social Factors

Question: What are the relevant social ESG considerations for employment services?**Answer:**

There are issues such as bias in hiring and trying to build a diverse workforce, which are important areas where a recruiter can help.

There are also live issues such as pay transparency, so companies should be partnering with recruiters who are professionalised in that way and can help them meet their goals in those areas.

I think this is another positive driver for professionalised recruiters, because they can play into that agenda. I have seen examples where part of a recruiter's IP sits within its candidate database, particularly where it has built a diverse candidate base.

FDM, for example, typically focuses on candidates who are former armed services personnel. Kubrick is another example in tech, using what is called a hire-train-deploy model. They hire people themselves, train them in next-generation skills such as AI, and then deploy them with clients. If everything goes well, the client then hires them permanently.

It is quite a good response to companies not having their own conveyor belt of talent. Kubrick also looks for diverse talent and, for example, over-indexes on the number of women in tech. A good recruitment partner can therefore help clients with the DEI agenda.

Key Headwinds**Question: What are the main headwinds for recruitment businesses?****Answer:**

Cyclicality is definitely a major issue in recruitment, and it means that many investors will not even look at these assets. Hiring freezes and downturns are real risks for the sector.

Another risk is the potential for AI to allow clients to disintermediate recruiters. If recruiters are not investing in differentiation, they have no real advantage over an in-house recruiter using the same tools.

The best recruiters will invest in the areas where they can differentiate from AI, while also using AI to optimise the parts of the process where it is effective.