November 2019

Roland Berger Focus

Brexit retrospective

How the UK recruitment industry has developed since the vote to leave the EU

Roland Berger

Management summary

Recruitment firms are often highly cyclical businesses that act as economic bellwethers, something that dissuades some financial investors from considering recruitment firms altogether. In the aftermath of the Brexit referendum, where companies held back investments and hiring decisions, uncertainty existed over the future of freedom of movement of people and immigration policy, and many expected the UK economy to stagnate, recruiters were expected to suffer.

With the UK having missed its deadline for departure from the EU on the 31st October, we at Roland Berger have reviewed how the UK's recruitment industry has performed and whether investors have missed an opportunity.

We have reviewed both the wider macroeconomic indicators for UK jobs against the financial performance of the UK's top 150 recruitment firms, to see which underlying trends have driven some firms forward and held others behind.

Despite Brexit headwinds, we find that the macroeconomic picture remained favorable, and that UK employment value[1] has grown healthily. This is supported by the aggregate performance of the top 150 recruiters who have grown by 11% CAGR over 2016-18, but further assessment highlights how this performance has varied in terms of company size, industry focus and degree of internationalisation.

How the UK's departure from the EU develops is still far from clear, but amidst all the uncertainty, one thing is clear: the reality has certainly exceeded expectations.

[1] Number of jobs x average gross annual pay

Contents

1. The big picture: Macroeconomic indicators

Positive developments suggest opportunities for recruiters

On 23rd June 2016, the people of the United Kingdom voted to leave the European Union. A great deal of uncertainty followed the vote, with predictions of a post-Brexit world ranging from paradise to the apocalypse. For staffing companies, however, the macro-environment since 2016 has been broadly favourable. Job numbers have grown, wages have risen, and average placement turnover is on the rise; factors which, ceteris paribus, should result in increasing demand for recruitment agencies.

POST-BREXIT UK JOBS LANDSCAPE

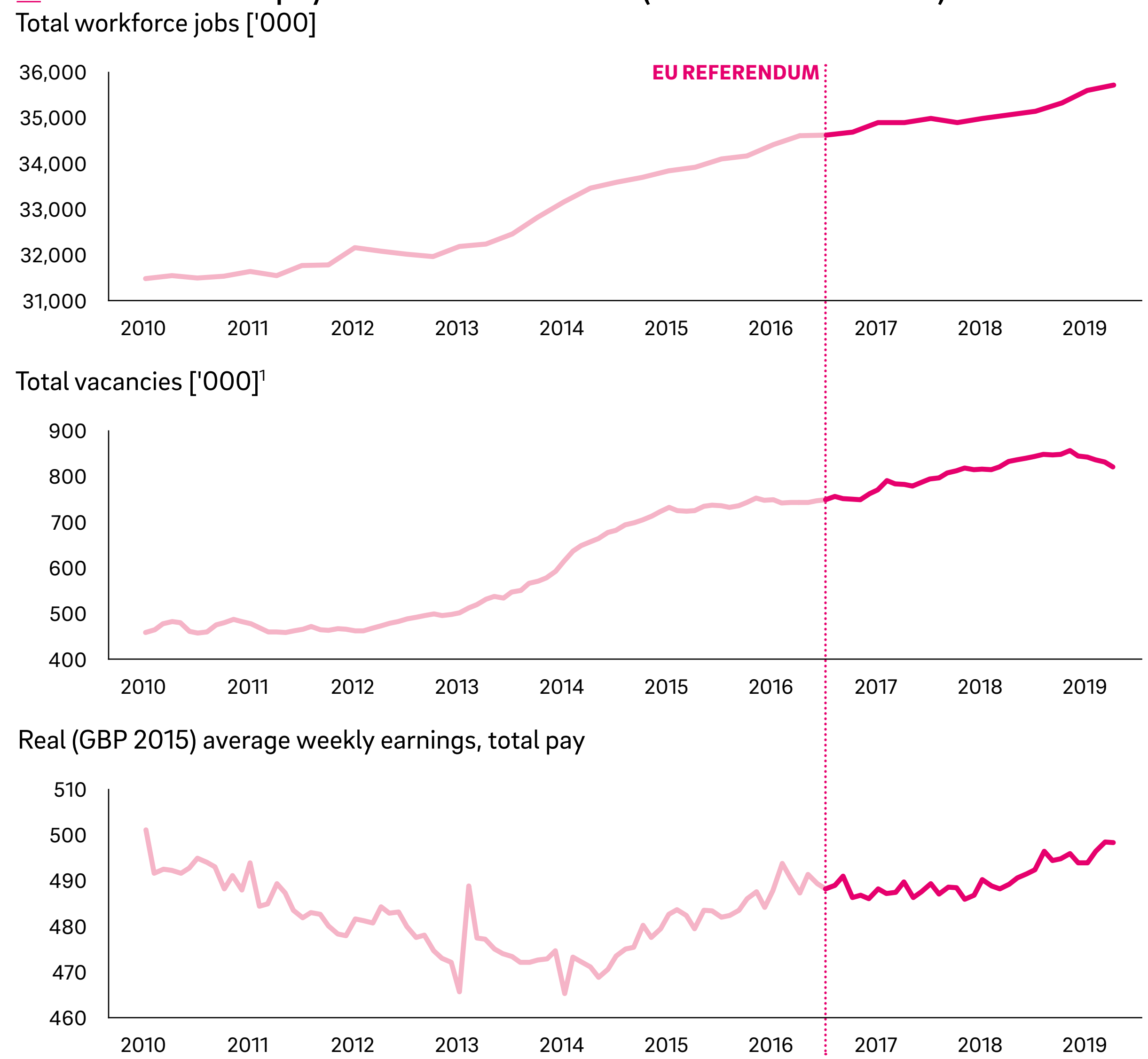
The overall number of jobs in the UK has grown steadily since 2013, with the UK's working population increasing by 3% since June 2016. A number of sectors, such as human health & social work, public admin, and information & communication, have even picked up in growth after the referendum. In fact, UK jobs growth between 2016 and 2018 exceeded that of Germany and France[2], suggesting that the impact of the Brexit vote has been far from disastrous.

In terms of vacancy rates, however, those of the UK have been increasing at a slightly slower rate compared to European peers since 2016 (5% 2016-18 CAGR compared to Germany's ~10%), indicative of hiring caution due to Brexit uncertainty. The most recent data also show a drop in number of vacancies, though figures remain higher than pre-2016 levels.

Average real wages in the UK had fallen significantly over 2010-14, and whilst they stagnated in the year and half post the referendum, have increased strongly since Jan 2018 by 3%. In autumn 2018, the CIPD[3] reported that over half of employers facing recruitment difficulties and who struggled to fill vacancies over the past year decided to raise starting salaries in response. With rising wages one would expect to see greater average turnovers per placement/assignment, which has indeed been the case: the REC reports that 2017-18 saw average value of permanent placement fees increase by 6.4% on the previous year, and average annualised turnover from temporary placements grew by 20%[4]. Rise in temporary turnover value demonstrates the positive drive not only from higher average charge rates, but also from placing workers for a longer duration – surveys indicate the average length of both temporary and contract assignments increased from 2016/17-2017/18[5]. → A

> **"It's inevitable that the current uncertainty surrounding Brexit will continue to affect client and candidate confidence in the UK."**
>
> Robert Walters, Annual Report 2018

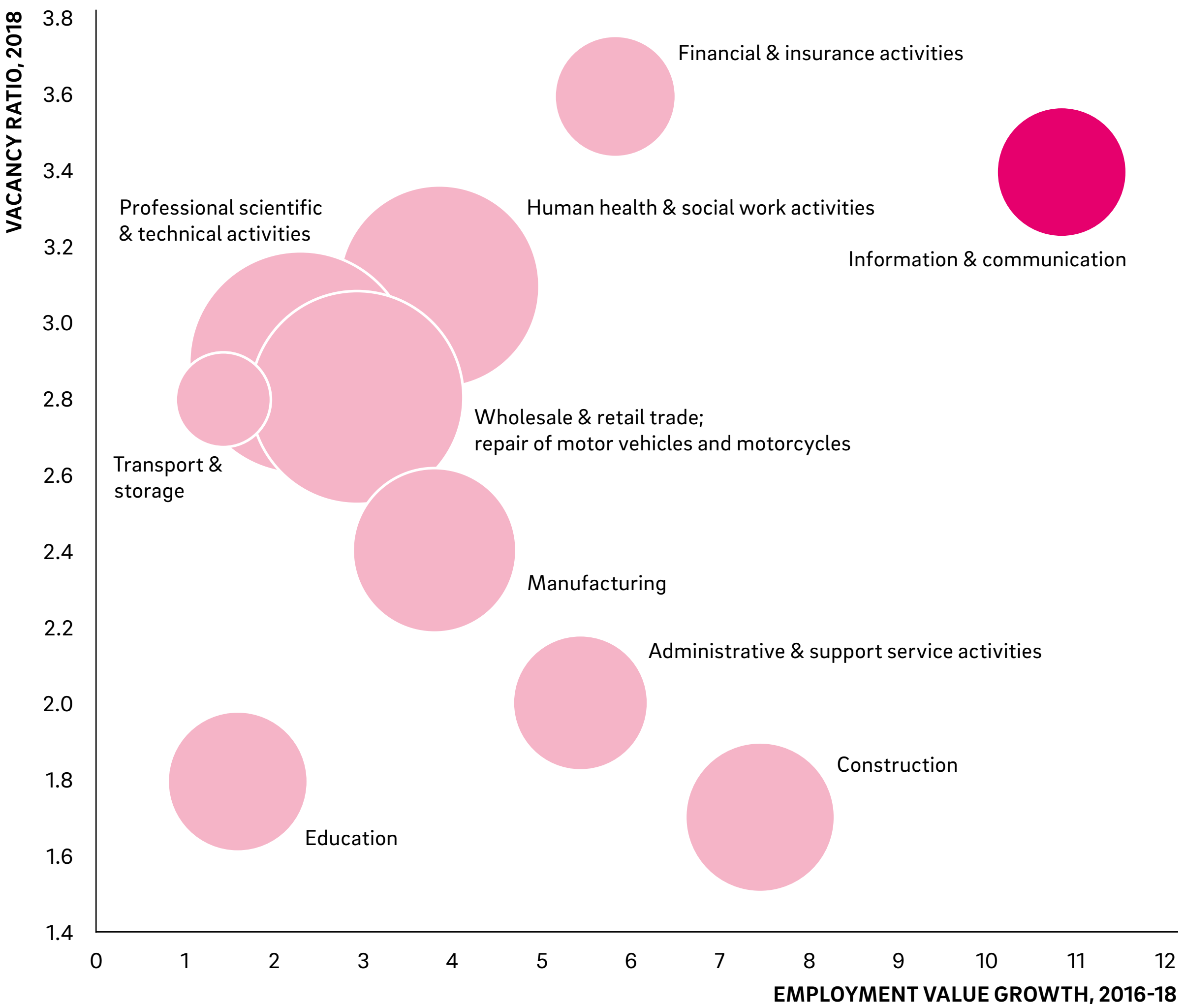
A: Post-Brexit vote employment market in three charts (March 2010 to June 2019)



Notes: Seasonally adjusted; [1] Excluding Agriculture, Forestry and Fishing
Source: ONS, Roland Berger

[2] Metropolitan France; data from Eurostat; [3] Labour Market Outlook, Autumn 2018; [4] REC Recruitment Industry Trends report; [5] Ibid

B: The UK's most 'attractive' industries
Employment value growth and vacancy rates



Notes: Circle size represents employment value, 2018
Source: ONS, Eurostat, Roland Berger

MIND THE (SKILLS) GAP

An underlying driver of increasing vacancies and wages is the UK skills shortage. In 2017, the OECD reported that 40% of workers in the UK are not properly qualified for their job[6]. The shortfall is most acutely felt in digital skills, where it may cost the UK GDP GBP 141 bn in growth over the next 10 years[7]. Many believe Brexit has exacerbated the already chronic skills shortage, with decreased EU candidate confidence further reducing the talent pool – net EU migration in the year ending September 2018 fell to a level last seen in 2009[8]. Impact on staffing companies would likely have been mixed: skills shortages typically increase demand for recruitment companies as firms need more help finding increasingly scarce suitable candidates, however those serving industries or regions with a high dependence on EU workers might themselves struggle to find the right talent.

Owing to a combination of high vacancy rates and employment value growth, the Information & Communication industry, which includes all technology service activities, has presented the most positive macro indicators for recruitment companies. → B

Here, workforce jobs alone have grown at 4% CAGR over June 2016-19 and vacancy rates are higher than most other industries. Furthermore, unlike other industries, leading technology firms have announced major investments in the UK following the Brexit vote. → C

Looking forward, technology is considered to be a key driver of post-Brexit economic growth, with the IT and computer programming sub-sector alone forecast to see GVA growth of 8% CAGR over 2019-24[9].

The potential impact of Brexit on the UK's financial services industry has been much publicised and indeed the future attractiveness remains uncertain. According to

[6] UK skills mismatch in 2030, ISC; [7] Accenture; [8] ONS; [9] BNP Paribas

C: Big-tech doubles down on the UK
Snapshot of major investments announced

- → **SEPTEMBER 2016**
  Apple announced plans to move UK headquarters to Battersea power station
- → **NOVEMBER 2016**
  Google committed to a new headquarters at King's Cross, creating 3,000 new jobs
- → **JANUARY 2017**
  Microsoft confirmed its commitment to the UK was unchanged as it continued to build two new cloud computing services facilities in Britain
- → **JULY 2017**
  Amazon revealed plans to double number of R&D staff in London
- → **DECEMBER 2017**
  Facebook announced addition of 800 more jobs following opening of new London office
- → **OCTOBER 2018**
  Amazon publicised addition of 1,000 more skilled jobs in Manchester, Cambridge and Edinburgh

Source: Roland Berger

latest reports, close to 1,000 jobs in investment banks have been relocated to the continent, and 41% of financial services firms are reporting that they are considering moving or have confirmed that they are moving some of their operations and/or staff[10]. In spite of this, financial and insurance services employment value has grown well ahead of other industries since 2016, though this has principally been driven by increasing wages rather than increasing job growth, implying employers are having to spend more to retain talent in the UK.

Of the industries depicted, vacancy rates have grown or remained stable over 2016-18 in all except wholesale & retail trade reflecting the continued struggles of UK high streets. The highest growth rates in vacancies were seen in Transport & Storage, Financial & Insurance Activities and Manufacturing. Construction saw a low vacancy rate vs. top sectors by employment value in 2018, but there is more than meets the eye – the 2018 value represents a relatively high 7% CAGR growth since 2013. Additionally, the 2017 Employers Skills Survey found that 36% of all vacancies in Construction were 'skill-shortage vacancies', where the places could not be filled due to lack of appropriately qualified or experienced applicants[11]. This skills shortage is reflected in the 4% CAGR in gross pay in the Construction sector since 2016, contributing to the second highest employment value growth after Information & Communication.

STIFF UPPER LIP

Hiring has not ground to a halt, and there is undeniable potential from a macro perspective. On an industry level, some industries have undoubtedly fared better than others, with IT and technology being a star performer – strategic industry positioning will become a more important consideration for staffing companies as Brexit progresses. But overall, the old British stereotype rings true: it appears that many companies have simply kept calm and carried on.

[10] BNP Paribas; [11] Employers Skills Survey

2. A closer inspection: UK's top 150 recruiters

Scale, sector focus and international activities are key

Following the Brexit referendum, the immediate reaction of investors in UK listed recruitment companies was far from positive. Robert Walters and PageGroup saw declines of 27% and 33% respectively, against just a 6% decline across the FTSE 100[12]. Expectations were that recruitment firms were to suffer from Brexit because of uncertainty impacting hiring decisions, potential restrictions on freedom of movement and lower economic growth. Share prices recovered by the end of 2016 and strongly outperformed the FTSE 100 for much of 2017 and 2018, suggesting however, that investors had misinterpreted the way the UK recruitment sector was going to be impacted, at least until the UK's formal departure from the EU is completed.

To review the impact of the Brexit referendum on the wider UK recruitment industry, we studied the financial performance of the top-150 UK recruiters (in terms of 2018 EBITDA), and assessed how this varied in terms of company size, industry focus and UK exposure.

TOP 150 UK RECRUITERS

The UK's 150 largest recruiters were already performing strongly before the Brexit referendum; aggregate growth of gross profit (used as a proxy for NFI) was 10% CAGR over 2014-16, combined with 14% CAGR in EBITDA. Since the referendum, however, performance has actually improved slightly; aggregate gross profit growth over 2016-18 amounted to 11% CAGR, demonstrating the continuing tailwinds of the sector. Performance has naturally been very varied across the top 150, but growth has been experienced by most; more than 75% experienced gross profit growth since 2016. → D

This growth has been achieved by small, medium and large recruiters alike. In keeping with the pre-referendum picture the UK's largest recruiters have continued to experience the highest levels of growth, implying some benefits of their scale. Profit growth, however, has demonstrated no consistent correlation to recruiter size other than the continuing profit margin decline of the smaller recruiters. → E

IT & MANUFACTURING ARE STAR PERFORMERS

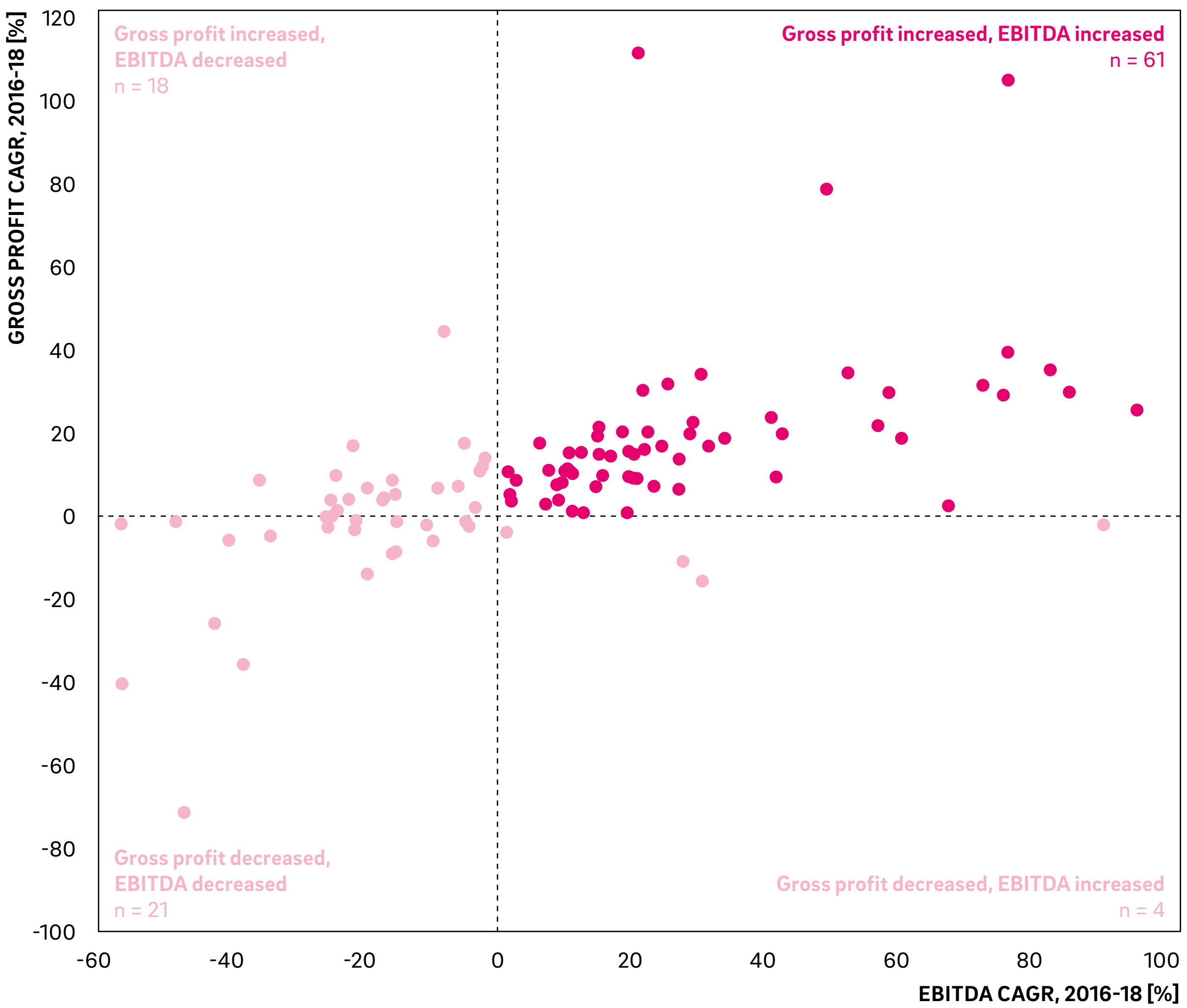
The underlying industry focus of the recruiters has demonstrated some clear winners and losers, although not in all instances has this performance been linked to the Brexit referendum. The analysis shows, nonetheless, that IT & Technology and Manufacturing & Construction have proved to be the star performers with Healthcare focused recruiters showing the worst performance after having been best in class over 2014-16. → E

Among the top-150 recruiters that focus on IT, aggregate gross profit grew at 14% CAGR while EBITDA grew at 17% CAGR over 2016-18, higher than in pre-referendum years. Recruiters within the sector continue to cite the skills shortage for staff as a key driver of demand, alongside ongoing digitalisation across all industries.

There has, however, been some variation amongst performance of the UK's IT and Technology focused recruiters in terms of size. The largest players have sustained the high rates of growth they experienced over 2014-16 since the referendum (at 14% CAGR aggregate gross profit growth) with the acceleration in growth for IT specialist recruiters as a whole being driven by the medium and smaller sized firms. Highest levels of growth amongst the large specialists were achieved by TPG owned Frank Recruitment and La Fosse Associates, whilst best in class levels of growth amongst the smaller specialists were shown by Next Ventures, Square One Resources and Salt Digital.

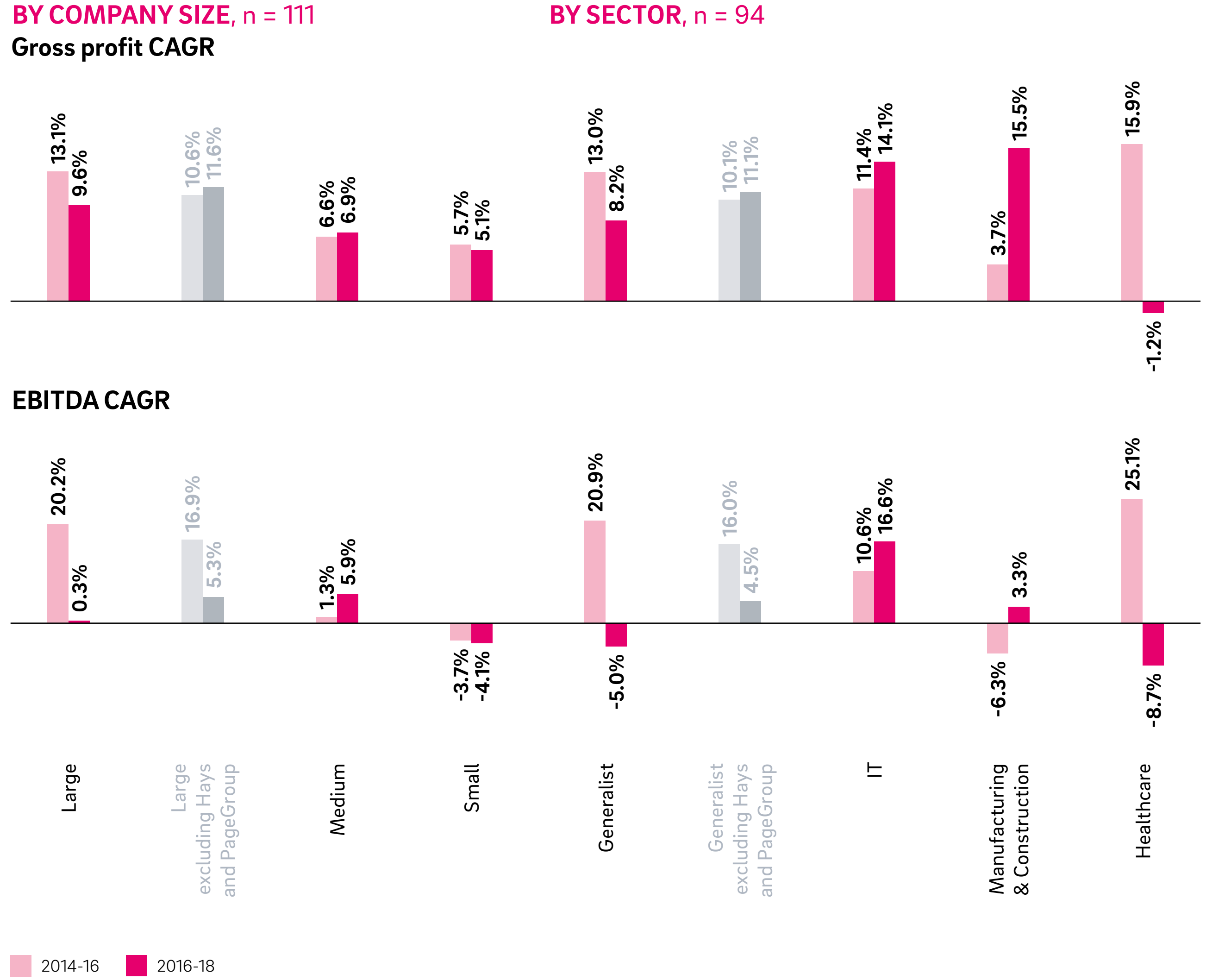
[12] 23-27th June 2016

D: Three quarters of the top 150 recruiters have grown since the Brexit vote
Gross profit annual growth rate vs. EBITDA annual growth rate, 2016-18 [%]



Notes: n = 104 after removing 7 outliers from 111 companies with complete gross margin and EBITDA data from 2014 to 2018
Source: Companies House, Roland Berger

E: Large recruiters have achieved the highest levels of growth since the Brexit vote against widely variable performance from sector specialists
Gross profit and EBITDA growth of top 150 UK recruiters, 2014-18 [% CAGR]



Notes: The number of companies with gross profit and EBITDA data for each year between 2014-18
Source: Companies House, Roland Berger

Manufacturing and Construction focused recruiters have also shown strong growth since 2016, with aggregate gross profit growth of 16% CAGR supported by underlying market dynamics. UK Construction output grew by 3% CAGR over 2016-18[13], largely driven by new housing and infrastructure construction, whilst the value of UK manufacturer sales grew by 3% CAGR over 2016-18[14], buoyed by the devaluation of the pound after the Brexit vote and countering stagnant value output over 2014-16. Part of the greater aggregate growth experienced by Manufacturing and Construction focused recruiters however was due to a reduction in European manufacturing and construction workers within the workforce, making talent harder to source for employers, and also some M&A activity such as the acquisitions by Strategic Workforce Solutions and Russell Taylor.

Healthcare focused recruiters have demonstrated the worst aggregate performance since the referendum, with aggregate gross profit growth of -1% CAGR combined with -9% CAGR in EBITDA. This decline, however, has had little to do with Brexit but has been driven by changes in NHS policy and tax reforms. The combination of the introduction of NHS agency caps in 2015 and changes to IR35 status for public sector contractors in 2017 both restricted use of external staff and made them less affordable. Whilst the impact was significant for most healthcare recruiters, some specialist firms averted this trend and continued to benefit from serving a sector that suffers from a structural undersupply of suitable staff. For example, Newcross Healthcare Solutions and Nurseplus, which both principally place staff into social care and thus have limited exposure to the NHS, recorded gross profit growth since the referendum of 14% and 17%[15] CAGR respectively.

INTERNATIONAL ACTIVITIES ACT AS THE MAIN DRIVER OF GROWTH

International activities have long been critical for the UK's top 150 recruiters; prior to the referendum only c. 40% of aggregate gross profit came from UK activities. But despite the good macroeconomic indicators for UK jobs since 2016, growth has principally been driven from outside of the UK, highlighting the importance of internationalisation as a strategy to recruitment firms.

Whilst internationalisation is more common with scale, overseas activities are still significant for smaller recruiters; for the smallest 50 recruiters in our top 150 list, one-third of 2018 aggregate gross profit came from outside the UK. For three of the UK's largest recruiters (Hays, PageGroup, Robert Walters), they have all developed significant overseas activities (accounting for 76%, 80% and 54% of revenues respectively), evidencing the importance of internationalisation to long-term growth, a strategy that has also been successfully pursued by many comparatively smaller firms. For example, Phaidon International (a multi-brand STEM recruiter) has seen its share of UK revenues fall from 23% to 8% over 2014-18, but has tripled its gross margin (from approximately GBP 20 m to more than GBP 60 m) and doubled its EBITDA (from GBP 4 m to GBP 10 m).

Internationalisation does not of course guarantee growth, but of the 1 in 4 firms that saw gross profits fall since the referendum, three-quarters had less than 20% of revenues being generated from outside the UK, indicating again the importance of the international activities to UK recruitment firms.

[13] ONS; [14] ONS; [15] 2016-17 pro-rata

3. Closing remarks

Internationalisation acts as the perfect Brexit remedy

Since the Brexit vote, the UK has seen growth in number of jobs, real wages and vacancies, something that many did not expect would occur. These developments provided positive tailwinds for the UK's top recruiters, which continued to achieve high levels of growth. This correlation between the UK macroeconomic indicators and recruiter financial performance, however, did not amount to causation.

Certainly, at an industry level, underlying market developments within the UK have driven recruiters with a specialist focus. Widespread digitalisation and the UK's technology skills shortage has continued to drive demand for focused IT and technology recruiters, and specialist healthcare recruiters have had to weather the compounded impact of both significant changes to both NHS policy and tax reforms. Furthermore, the more consistent rate of gross profit growth of generalist multi-sector recruiters before and after the referendum points to impact of diversification across multiple underlying industries.

But for the UK's top 150 recruiters the majority of growth (nearly 90%) since the referendum has actually come from outside of the UK, demonstrating how effectively such firms can be at accessing international markets, mitigating any expected or actual underperformance in home markets and continuing to deliver growth.

For some sectors, however, such as Manufacturing & Construction, Healthcare, Public Sector and Education, sector focused recruiters typically lack any notable international activities increasing their exposure to UK market-specific trends.

As Brexit uncertainty lingers over the UK and government continues to pursue a formal departure from some of its existing international partnerships, the development of the UK's recruitment firms has demonstrated firstly how the sector far outperformed expectations and secondly the importance of internationalisation even when macro indicators present a positive picture at home.

86%

of 2016 to 2018 growth came from outside the UK

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WE WELCOME YOUR QUESTIONS, COMMENTS AND SUGGESTIONS

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