



# Andersch

an FTI Consulting Group Company

SECTOR UPDATE:

**Temporary employment – a sector with many challenges. Macroeconomic downturn is only one of them.**



## 2019: THE NUMBER OF TEMPORARY WORKERS WENT DOWN BY ONE SEVENTH...

...compared to 2017. At 748,400<sup>(2)</sup>, the number of temporary workers is around 10% lower than in 2018 and even 14% lower than in 2017, when the sector reached its peak level so far. As early as in 2018, 10 out of the 25 largest temporary employment providers already saw first declines in revenue. The fact that sector revenue as a whole was still in a sideways movement was mainly due to price effects (higher collective wages (*Mindestlohn*)). However: the growth in revenue did not lead to a significant increase in margins, as wage payments also rose. In the course of 2019, the “loss” of temporary workers to the customer companies became so pronounced that price effects were not enough to compensate: at a national level, the number of temporary workers went down about 10% in 2019 (Q1-3). Even federal states with strong industries such as Bavaria (-14%), Baden-Württemberg (-13%) and NRW (-11%), where 51% of all temporary workers are hired, all experienced substantial declines.

## MACROECONOMIC TRENDS ARE NOT THE ONLY REASON FOR THE CRISIS

The outlook for 2020 is cautious – times are difficult for the temporary employment sector, and this is only partially due to macroeconomic developments. While temporary employment and the macroeconomic development (GDP) show a strong correlation overall, temporary employment agencies are among the first to feel changes in the economic development – when orders go down, temporary workers are the first to be released. The second half of 2019 in particular was marked by a decline in industrial production and a considerable dent in economic growth (GDP growth: 0.6%). However: the demand for temporary employment workers, for example in the logistics, construction, wholesale and retail sectors as well as in healthcare, continued to be high. Hence, the macroeconomic situation is not the only reason for the strong decline in the employment of temporary staff since 2018.

## STRUCTURAL CHANGES IN THE CUSTOMER BASE

At the moment, more than 40% of temporary workers are used in production; industrial companies are the most important customers of temporary employment agencies with a share of around 68%. The manufacturing industry has entered a process of profound change that also has an effect on the demand for additional workers: automotive production, a sector increasingly characterized by digitalization and e-mobility, will require fewer employees in the future. According to the assessment of the outgoing president of the VDA (Association of the German Automotive Industry), Bernhard Mattes, about 70,000 jobs<sup>(3)</sup> will become redundant by 2030. Furthermore, the requirements with regard to skill profiles are also changing: there is a shift away from the traditional core business of the temporary employment industry and towards jobs requiring higher qualifications, – around two thirds of temporary workers are currently used as unskilled workers who have not completed a vocational training and have little work experience. Their jobs face the highest risk of substitution, also in the automotive supplier industry, and especially in the machine and metal engineering sector, the second largest customer sector for the temporary employment industry.

## CUSTOMERS OFFERING PERMANENT POSITIONS

However, the industry is mainly facing another challenge at the moment: the labor market is experiencing a shortage of skilled workers and demographic change, companies are competing for well-trained workers and tend to offer permanent positions – albeit in most cases only fixed-term contracts. With 45.3 million employees, including many former temporary workers who were taken over by the respective companies (placement), an all-time high was reached on the German labor market in 2019. The historically low unemployment rate has an especially strong effect on the temporary employment industry, as it works as a bridge employer between unemployment and permanent employment – about 60% of temporary workers were looking for permanent work before they joined a temporary employment agency. While this led to a decline in the pool of available job seekers, temporary employment was more successful than ever with respect to placing its workers in the primary labor market: according to Lünendonk, the share of temporary employees who took on permanent contracts with customer companies recently climbed to 25% (the long-term average is much lower at around 20% 2013-17). This made growth in the temporary employment sector much more difficult.

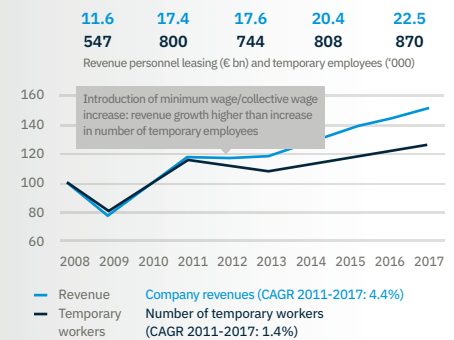
## LEGISLATOR CHANGED THE RULES OF THE GAME

The industry is affected by the German Temporary Employment Act (AÜG), which was reformed by two amendments on April 1, 2017: the equal pay principle determines that after nine months of employment, temporary employees must be paid the same wages as permanent employees. The limitation of the temporary employment period to a maximum of 18 months leads to loss of know-how. Both changes render hiring temporary personnel less attractive. The actual burden resulting from the amendments remained manageable – after all, every third customer assignment in temporary employment (31%) ends in the first 3 months, 50% of assignments in the first half year. However, the reform led to some major uncertainty among customers, for example with regard to the question which components of remuneration must be taken into account under equal pay aspects in terms of a legally compliant quantification. Moreover, it cannot be ruled out that it will come to a further deliberalization in the future.

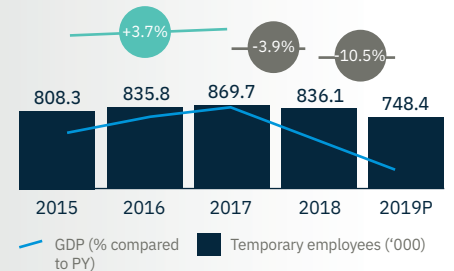
## CONSOLIDATION AND EROSION OF MARGINS

Because of the introduction of the minimum wage and the increase in collective wages, which temporary employment companies were largely able to pass on to their customers, revenue growth in the temporary employment industry outperformed the increase in the number of temporary employees from 2013 onwards. However, the fact that revenue growth is mainly price-driven and not so much volume-driven weighs increasingly on the profitability of many temporary employment providers: the high demand for personnel can only be answered by offering wages that are above the collectively agreed wages. Even in the lowest wage group (unskilled workers), temporary workers are paid on average 5-10% above the standard wage; in the highest wage group, some of the premiums paid amount to more than 30%. In addition, many temporary employment agencies also offer additional benefits in kind. However, the temporary employment industry mainly targets a price-sensitive customer segment, and costs related to switching to another provider are low, as unskilled workers (around 60% market share) are relatively easy to replace. As a result, temporary employment providers often compete based on rates – which burdens the margin.

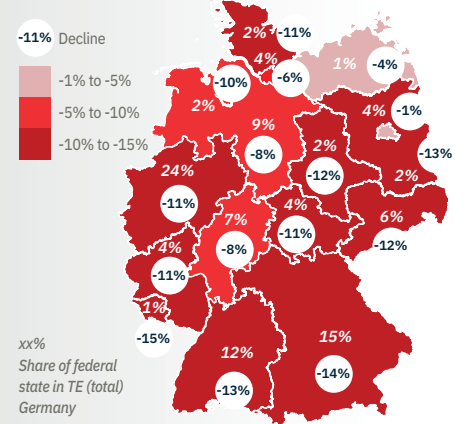
## REVENUE DEVELOPMENT AND TEMPORARY EMPLOYEES<sup>(1)</sup> (INDEX, BASE 2007=100)



## GDP DEVELOPMENT AND DEVELOPMENT TEMPORARY EMPLOYEES<sup>(2)</sup>



## DECLINE IN THE NUMBER OF TEMPORARY WORKERS<sup>(4)</sup> JAN.-SEPT. 2019 VS. PREVIOUS YEAR (%)



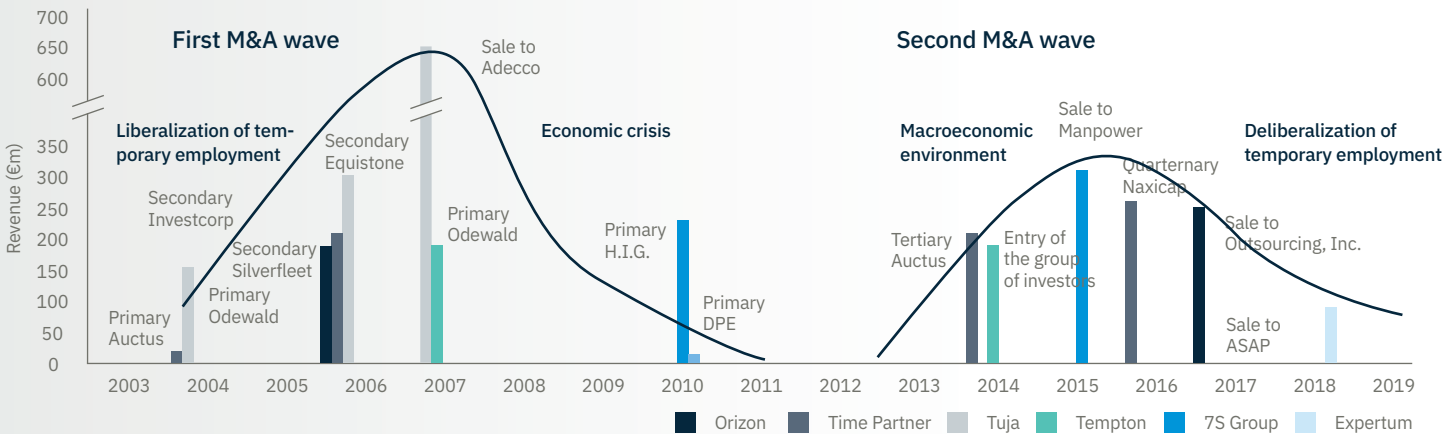
„The temporary employment industry is currently facing two main issues. The industrial sector is seeing a decline in incoming orders, and this is also affecting our industry. At the same time, we are often unable to meet the demand of our customers, as we cannot find any skilled workers.“

Sebastian Lazay, President of the Federal Employers' Association for Temporary Agency Work (BAP) in an interview with the German newspaper FAZ. Available online at <https://bit.ly/37UW7DM>

Note: (1) Employees subject to social insurance contributions in the economic group “temporary employment” and “other personnel leasing”; (2) annual average; (3) total employment, netted – emergence of new jobs, e.g. in the production of electric engines, has already been included

Sources: Andersch analysis; German Federal Labor Office; Federal Statistical Office; Lünendonk & Hossenfelder; German Federal Employer's Association for Temporary Agency Work (BAP); Association of German Engineers (VDI); German Association of the Automotive Industry (VDA); Manpower

PRIVATE EQUITY BACKED M&AS OCCURRED IN WAVES – RISING FREQUENCY OF TRANSACTIONS  
OVERVIEW OF SELECTED TRANSACTIONS



THIS IS A TIME FOR CONSOLIDATION

With more than 11,000 companies, the German temporary employment market is highly fragmented. Apart from the international market leaders Randstad, Adecco, Manpower and other listed companies such as Amadeus FiRe, most companies in the industry are owner-led, among them many small enterprises with under 50 temporary employees.

COMPANIES FAIL TO REACH CRITICAL SIZE

Customers of temporary employment agencies expect increasing professionalization, but at the same time the pressure on margins is also rising. The capital expenditure needed for a comprehensive and qualified portfolio of services, employees, contacts and infrastructure requires adequate internal financial strength and the ability to access the capital markets, which many of the smaller companies are unable to achieve. Challenging market trends increase the pressure to consolidate and trigger market adjustments due to company closures and insolvencies. In the past 15 years, we have already seen many acquisitions carried out by either established temporary employment agencies or private equity companies. Their strategies differ greatly.

DRIVERS OF PRIVATE EQUITY INVESTMENTS

M&A activities of financial investors come in waves that are determined by macroeconomic trends and regulatory conditions: in times of strong economic growth, we see an increase in activities, higher revenues at the target companies and more transactions. During times of recession, these are scaled down accordingly. During the liberalization of the temporary employment sector between 2003 and 2007, investments aimed at creating larger corporate structures. After the announcement of a stricter regulatory framework on April 1, 2017, the main focus shifted to add-on acquisitions for existing platforms. Primary targets were insolvent companies or those at risk.

BUY-AND-BUILD STRATEGY

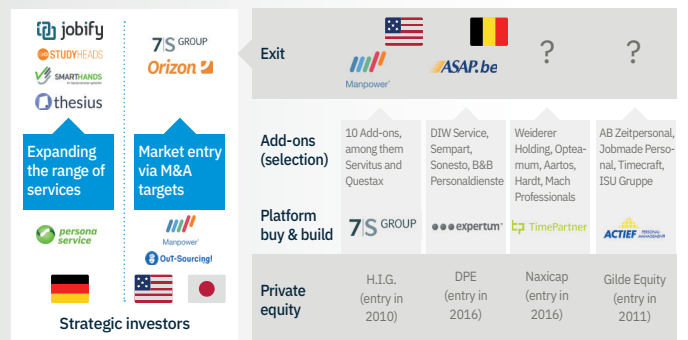
Private equity companies acquired temporary employment agencies in order to use them as a platform for taking over (and usually integrating) additional smaller companies and niche agencies. Examples include Tempton, which added and integrated LHP, Riedl and Teilzeit Thiele, and TimePartner, adding Weiderer Personaldienste, Mach Professionals, Opteamum and Aartus. At the moment, three PE companies have shares in the 25 temporary employment agencies with the highest revenues in Germany: including Naxicap's share in House of HR/TimePartners and Gilde Equity's share in Actief. The objective is to restructure and then sell the companies with a profit. It turned out that strategic investors (large temporary employment agencies) typically acquire the platforms set up by PE firms starting from € 250 million in revenue. Smaller companies are predominantly bought by other PE investors. TimePartner, for instance, has already been sold four times to PE investors.

APPROACH OF STRATEGIC INVESTORS

Established German temporary employment agencies are using the consolidation in the market to optimize their range of services by taking over niche companies. Between 2016 and 2018, for example, Persona Service expanded its core competencies by acquiring Thesius and GVO (studyheads, jobify, smarthands). Likewise, Randstad expanded its digital service portfolio by adding monster.com and eSolve, while Adecco bought LOGworks. Amadeus FiRe acquired the Dortmund-based retraining specialist Comcave in December 2019 from financial investor Gilde Buy Out Partners. With these acquisitions, Amadeus FiRe expanded its further training business. Some smaller companies are also joining forces: the Aurea Group integrated Andrea Gabriel GmbH in August 2019, for example, a company with over 70 skilled employees. Foreign competitors, on the other hand, take over leading companies in the temporary employment industry as an entry into the German market -- often from private equity companies. In 2015, for instance, the US Manpower Group, acquired the German 7S Group with 8,000 temporary employees from the PE company H.I.G. Group. The Japanese company Outsourcing, inc. took over Orizon (currently number nine in Germany with 7,500 temporary employees) from Silverfleet in 2016. Also in 2016, Deutsche Private Equity (DPE) sold Expertum to the Belgian service provider ASAP. [In the largest takeover by far, Adecco bought Tuja, a company with annual revenues of € 650 million].

INVESTOR GROUPS AND STRATEGIES

The temporary employment market is currently particularly attractive for strategic investors in Germany and abroad wishing to expand their portfolios in Germany



The result of this trend is a marked increase in the intensity of competition across industries

Sources: Andersch analysis; company information; Federal Gazette; Finance Magazin; interviews with sector experts

Are you interested in the temporary employment industry's market trends? We look forward to hearing from you and would be happy to arrange an informal first discussion.

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