



HUMAN CAPITAL MANAGEMENT

THE BIG QUIT BRINGS
BIG OPPORTUNITY

AT A GLANCE

- The labour market is in a time of flux. It has been disrupted by hybrid working, changing working patterns and growing skills gaps in some industries.
- Human capital management (HCM) solutions are well-placed to support businesses with these challenges.
- Demand is increasing for HCM solutions among small and medium sized businesses, and the market is highly fragmented.
- Investors and businesses in the space must consider how to differentiate their propositions, and create an efficient, targeted sales engine.



TUMULTUOUS TIMES

In March 2020, employers were presented with an unparalleled challenge: move a largely office-based workforce online in just a few weeks.

This watershed moment accelerated the integration of technology into many workforce processes, leading to the rapid adoption of human capital management (HCM) solutions. As such, vendors with well-positioned, tech-enabled solutions fared well.

However, this transition brought with it several issues that continue to drive employee churn and change working practices for the long term. But even though these new challenges and disruptions present risk for some, they present material opportunity for others.

Employees are more dispersed and harder to engage

Employee wellbeing has declined, with many employees finding the transition to homeworking disruptive and challenging. The UK's Office for National Statistics (ONS) found that the public's mental wellbeing reached a record low in January 2021, scoring 6.4 out of 10 for the month (compared to a decade-long average of 7.5). The workforce in the US hasn't fared much better, with 48% of employees in a recent survey reporting to have

experienced 'high' to 'extreme' stress over the past year – a 7% increase over the last two years.

Declining employee engagement is not just worrying from a wellbeing perspective, it is bad for business. A less engaged workforce leads to reduced productivity, absenteeism, and higher churn.

In addition, a move towards a hybrid or largely remote working model has disadvantaged younger workers. Those entering the workforce face new challenges that their more established colleagues did not – whether that is building out a professional network, acquiring new skills or simply overhearing and learning from colleagues in an office environment.

Changing working patterns have driven churn

The step-change in workforce dynamics and declining levels of engagement outlined above has led to increased churn rates across many industries. The US Department of Labor shows a large increase in the number of job openings, while hire rates remain relatively stable.

Similarly, the ONS reported that the number of job vacancies increased to over one million in August 2021 for the first time since official records began in 2001, rising by 35% in just three months.

The move towards an increasingly hybrid working model means that a number of roles in certain industries have seen a significant decline (receptionists, casual dining staff etc), while others have greatly increased (drivers, warehouse staff etc). This, combined with protectionist attitudes towards immigration in the US and the UK, less international travel and some deurbanisation, has led to a significant skills gap in many industries.

The disrupted labour market is affecting nearly every part of the economy, and businesses have become constrained by the need to recruit. As such, businesses are turning to HCM solutions to help them recruit, train, engage and progress employees across the workforce.

SECTOR OVERVIEW

HCM solutions can be split into three broad segments – workforce management, pay and rewards and talent management.

Several areas of HCM have been well-placed to help businesses respond to the challenges listed above, including:

Workforce management tools

Software that supports workforce management has become particularly useful to employers managing a decentralised workforce – and businesses that have supported the digitalisation of these processes throughout the pandemic have done well. More broadly, these businesses support the longer-term shift from manual, paper-based processes to digital, whereby the administrative burden is shifted from the HR function to users. This presents some cost reduction opportunity but can be obstructed by tensions from the HR department tensions: for some, reducing one's own team size can be a hard pill to swallow.

CIL Growth Outlook: Moderate / high growth

Pay and rewards

A 2019 *Work Institute* study found that since 2010 there has been an 107% increase in employees citing poor benefits as the main reason for leaving a company.

Given increasing competition for talent, employers need to work hard to attract and retain their staff while minimising wage inflation. Employers looking to engage

their workforce, retain talent and curate a consistent culture across a dispersed workforce have been investing in employee perks and incentive portals which offer discounts, wellness resources and development opportunities as an alternative to simply paying more. Such initiatives can also help to differentiate employers in a competitive recruiting environment.

CIL Growth Outlook: Low / moderate growth (rewards and benefits in slightly higher growth)

Talent management

Finally, providers that help businesses to address recruitment or staffing shortages, and upskill current employees, are well-positioned for growth. These could be tech-based providers, such as those with e-learning and training solutions, or human-based solutions, such as recruitment agencies and independent training providers.

Online learning solutions, for example, can offer businesses a more economical and practical alternative to purely classroom-based training. They can serve a wide range of training needs in a more efficient way, including training needed for regulatory purposes, "soft skills" and leadership coaching.

CIL Growth Outlook: High



IDENTIFYING OPPORTUNITY

The HCM market has some impressive fundamentals supported by a number of positive macroeconomic factors and changing employee / employer dynamics.

Given the market is highly fragmented, entrepreneurs and investors in the sector have the opportunity to achieve multiple arbitrage through pursuing buy-and-build strategies.

A growing customer base alongside increasing penetration

Many HCM software and content providers have a large proportion of contracted and repeat revenue, as contracts are typically multi-year.

In addition, there is steady growth in the number of businesses across Europe, the UK and the US underpinning the increasing demand for these products. Competition for talent is fierce, with many businesses using HCM solutions to attract, retain and differentiate themselves to employees; employer adoption is increasing rapidly to keep pace, even among smaller firms.

Finally, positive real wage growth has driven demand for more cost-efficient ways of incentivising staff.

A fragmented market

The competitive landscape is fragmented, with a small

number of HCM “suite” vendors (offering the full range of products and services), a larger number of mid-market vendors (typically offering multiple products and services while serving organisations of a certain size across multiple sectors), and many specialist point-solutions (focused on a particular product / service).

The fragmented landscape presents an opportunity for consolidation and many HCM providers are already pursuing buy-and-build strategies. For example, providers offering workforce management solutions may expand into employee engagement and have a healthy, engaged customer base to sell these tools into. There appears to be an increasing customer preference to bundle core HR and payroll solutions, alongside some talent management, with a single provider.

A combination of factors support this, such as ease of use (drives adoption and HR process compliance), the benefits of automating / integrating systems and processes (lowers HR overheads), and the potential to consolidate the number of software vendors (typically simplifies billing and customer service, for instance).



CONSIDERATIONS

Despite positive tailwinds, there are some potential concerns which investors must get comfortable with.

The e-learning content market has relatively low barriers to entry – set-up costs are small and experts in a topic already have the requisite knowledge to write the content for a training course. There can be little differentiation in the content itself, although CIL has observed differences in the method of delivery (e.g., synchronised or in-person), which can affect the level of learner engagement – and hence the overall success of e-learning.

Furthermore, the upper end of the market, in terms of customer size, is well penetrated and most of the largest buyers of HCM software will already have a solution in place. Displacing these incumbents can take significant time and cost. Hence, several providers are actively targeting mid-scale and smaller organisations where penetration is lower.

The challenge here is setting up a sales engine that allows for efficient customer acquisition and management. Once an organisation has been onboarded, it is common to see organic account growth as the ROI and benefits are realised and further roll out occurs across organisations.

The overall resilience in the HCM sector stems from the attractions mentioned earlier: the recurring and repeat nature of spend; the efficiency and workforce benefit that HCM solutions can offer to organisations; and the relatively low cost of HCM products and services in the context of overall IT / HR budgets. Indeed, many aspects of HCM software, such as e-learning, recruitment tools and absence management, can deliver significant cost savings.



OUR EXPERIENCE

At CIL, we have significant experience working with businesses in human capital service provision, including recruitment and staffing, employee benefits and training.

WORKFORCE MANAGEMENT



EMPLOYEE ENGAGEMENT



SKILLS TRAINING



RECRUITMENT & DEVELOPMENT



