



PLATFORM WARS

Episode I: The Human Capital
Management Universe

An Introduction to the Human Capital Management Space

A battle for supremacy is looming in the Human Capital Management ('HCM') space.

In the same way we have seen battle lines drawn and become blurred by corporates such as Amazon, Apple, Google, Facebook, Alibaba, a handful of titans will emerge following a decade of consolidation and organic growth across the space.

This is the first episode in a series of in-depth guides to the HCM universe and its three core limbs:



In this instalment, we will explore the HCM market and its drivers, while taking a deeper look at the consolidation that's emerging in the space.

In the coming months we'll expand into other areas within the HCM space - take a look at our roadmap below to see what is in store in future episodes:

Episode I - The HCM Universe

Episode II - Talent Management

Episode III - Core HR

Episode IV - Talent Acquisition

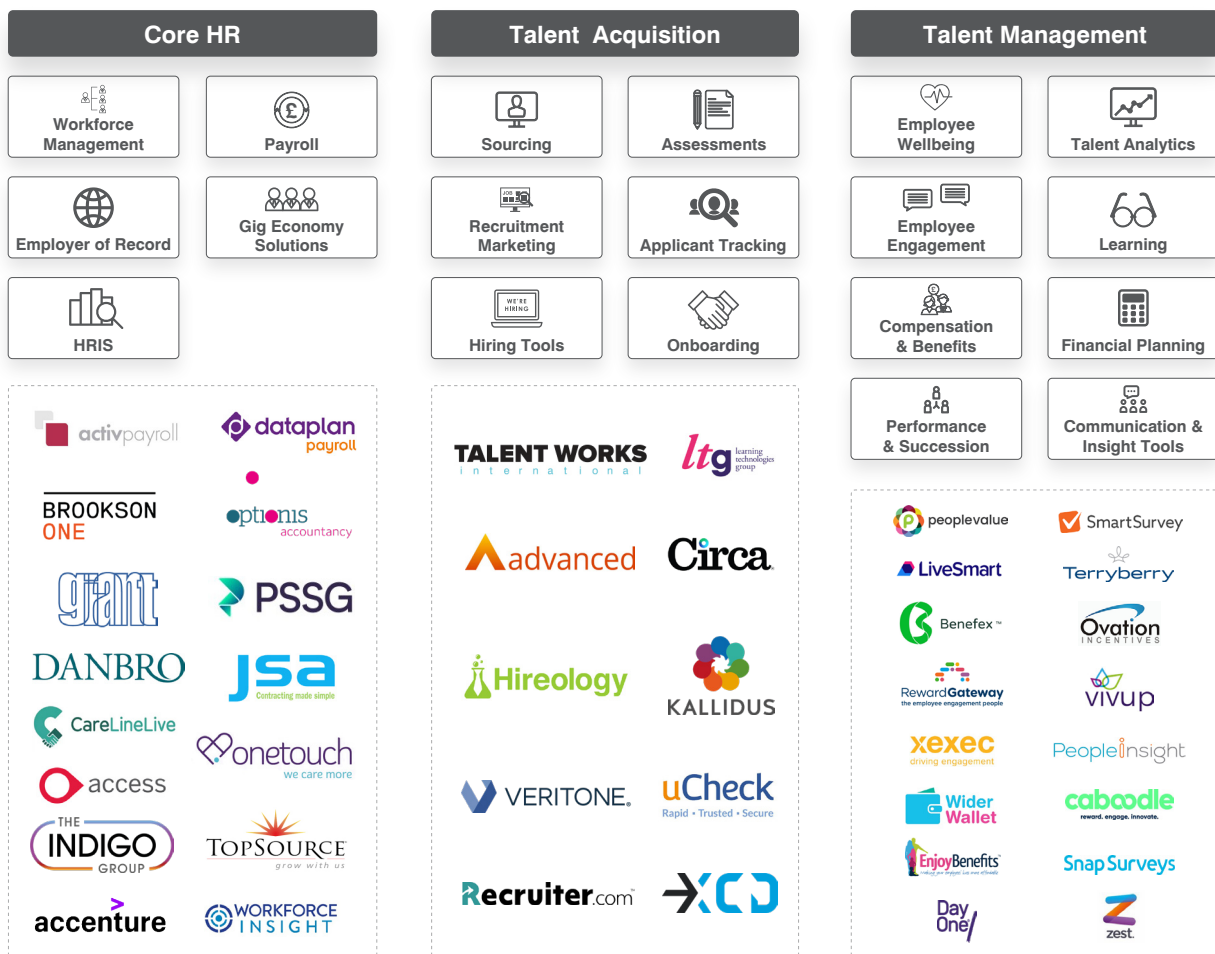
Episode V - M&A Across HCM

1. Market & Key Drivers of Activity

The HCM Landscape

The Human Capital Management ('HCM') market comprises talent acquisition, core HR administration and talent management. Globally this is forecast to grow from \$17.6Bn in 2019 to \$24.3Bn by 2025, a CAGR of c.6.7%^[1].

The graphic below provides an overview of the HCM landscape, together with a selection of some of the principal operators.



[1] <https://www.marketsandmarkets.com/Market-Reports/human-capital-management-market-193746782.html>



Technology-led employee engagement solutions are growing at an attractive rate and becoming more crucial to organisations as distributed workforces and working from home become increasingly accepted; we view this as an interesting sector and are pro-actively looking to invest further

- Pascal Wittet, Ethos Partners



1.1 Structure and Market Dynamics

Structural factors which impact market dynamics include:

- ❖ **Fragmentation** – a plethora of software solutions exist to provide for firms' varied requirements. From core HR services such as payroll, workforce management, HRIS, EOR (employer of record) and contingent labour, through to talent acquisition (recruitment) and the talent management space.
- ❖ **SaaS modular platforms** – solutions were once firmly focused on enterprise-level businesses (>250 employees). However, there has been a proliferation of more flexible/customisable modular solutions which make the platforms more economic for smaller businesses. Instead of higher upfront annual licensing requirements, many now provide modest monthly pricing models.
- ❖ **Scalability/onboarding** – due to their modular and multi-tenanted nature, SaaS (software as a service) solutions are typically scalable with slick onboarding processes that can launch a corporate solution within minutes to a few hours. All these factors serve to increase a market participant's attractiveness to third party investors due to the growth potential of proven, easy-to-use solutions.
- ❖ **Adoption of big data**, cloud-based technology and AI that provide person-centric solutions.

1.2 Regulatory

- ❖ **Compliance requirements** – new legislation (IR35, GDPR and KID for example) has increased the requirement for all HR data to be managed appropriately.
- ❖ **Contracting/self-employed workforce** – increasing numbers of workers are leaving permanent roles and setting up their own companies/contracting. These workers have come under an increasing regulatory burden which is being met by the use of umbrella companies who use software to handle these compliance requirements.
- ❖ **E-learning/LMS** – cloud-based technology can support the ease of administration and documentation of regulatory training requirements, particularly HSE compliance.

1.3 Other Market Drivers

- ❖ **Environmental, Social, and Corporate Governance (ESG)** - staff turnover and environmental credentials are quickly becoming areas of increased corporate focus. ESG credentials serve not only to demonstrate a company's positive culture, but also sustainability goals to all its stakeholders and potential investors or acquirors.

- ❖ **Wellbeing** – Covid has increased focus on the sector, pushing people and their mental health & wellbeing to the top of the agenda. A healthy work force is proven to boost financial performance. Consequently, there has been increasing investment in appropriate wellbeing solutions for their workers (including mental and financial).
- ❖ **Flexible workforce & data** – there is a growing demand from employees/contractors/freelancers for immediate, cloud-based access to secure payroll information. The answer for many is to use new and innovative software solutions to attract, motivate and retain staff, especially due to the recent trend towards virtual working and flexible hours.

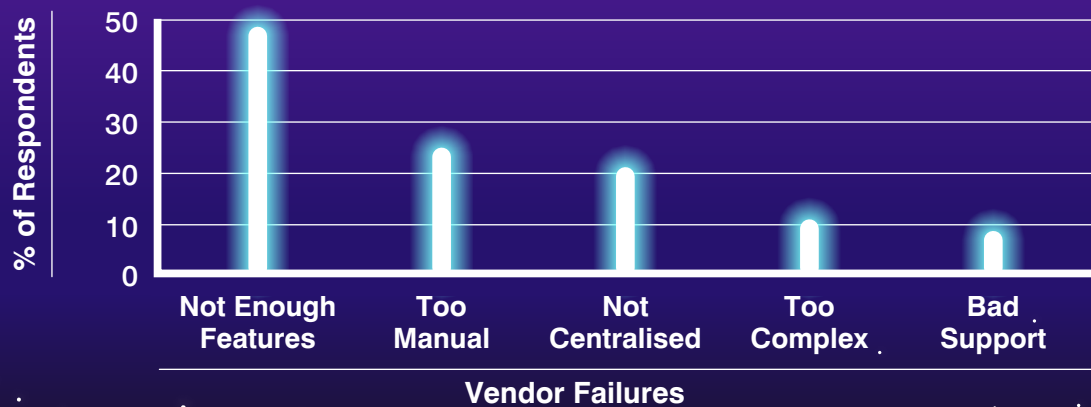
1.4 Consolidation Rationale

HCM is a rapidly developing space and, as such, currently has a plethora of fast-growing firms. A good proportion of these are starting to reach a natural ceiling - in terms of capital and personnel resources - which they need to address in order to jump to the next level.

This is a classic situation for larger competitors or private-equity-backed teams to build substantial businesses through a “buy-and-build strategy”.

Consolidation is happening within specific verticals as a niche targeting, pure-scaling play as well as across verticals. Consolidators such as Access group are hoovering up competitors’ client bases, seeking to extend capability, whilst others are looking at increasing scale within a tighter niche, before expanding the range of their offering.

The Most Common Failures of HR Software Vendors*



*Source: www.selecthub.com/hris/hr-software-buying-trends/

As can be seen from the recent survey results above, a key failure point for buyers of software is lack of features. Accordingly, consolidators are generally seeking to move to become a ‘one-stop-shop’ solution provider that caters for any firm’s HR needs:

- ❖ Broader capability will be more attractive for leadership teams and HR departments, with a reduced risk of competitors accessing your client base through services not offered by you and, hence a positive impact on churn.

- ◆ Increasing the average spend per corporate/SME client (or, in corporate parlance, 'increased share of wallet') – winning a new client is always trickier than extending what an existing client buys from you.
- ◆ Synergies from consolidating sales of multiple products and customer cross-selling.

Opportunities for consolidation are enhanced by the complementary factors of:

- ◆ **Financing:** investors have a substantial wall of money to invest and software represents an attractive and scalable opportunity, even more so given the Covid headwinds still being felt in other sectors.
- ◆ **Market growth:** with HCM increasingly seen as a requirement for employee retention and recruitment and staff shortages evident in the latest UK Government statistics, investors can capitalise on market growth to support their returns.
- ◆ **Market fragmentation:** with few players addressing all the sub-verticals but plenty of smaller businesses in their own niches, the market structure presents strong opportunities to 'hoover up' less-developed businesses to enhance returns.

A Well Trodden Path...

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Over the last 10-15 years, Polestar has seen a similar consolidation play unfold in the telecoms sector. Whilst the core telecoms sector has experienced modest growth (constrained by pricing pressures), individual businesses have done well, often due to increased service offering and the adoption of new technologies.

Alongside this, significant private equity investment has been made into platform businesses. This has enabled both the acquisition and integration of similar and complementary businesses by adding new product/service offerings such as IT support, cybersecurity and data management.

We see a similar scenario developing in the HCM space over the next few years.

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2. Fragmented Landscape

There are numerous firms that specialise in their own niche within HCM who are attractive to larger platform operators and private equity groups who may have capability gaps in their solution offerings. This in turn impacts their ability to pitch to new clients or retain existing clients. Sub-sectors to consider include:

- ❖ **Soft & hard benefits** – flexible benefits/salary sacrifice and voluntary benefit providers.
- ❖ **Reward & recognition ('R&R')** – this helps the alignment of behaviours with a firm's cultural values. Instant recognition is now preferred by 80% of millennials^[2] over more traditional formal reviews. R&R also helps customisation and makes for a 'stickier' customer base.
- ❖ **Wellbeing & health assessment tools** – mental, physical, financial and social wellbeing. Motivate, energise and inspire happy and healthy people. This is now proven to boost profitability.
- ❖ **Physical – virtual classes – gym schemes** – are now a part of a company's tool kit to support 24/7 physical workout programmes in and outside of the home.
- ❖ **Insight, feedback & communication tools** - employee/customer insight is becoming increasingly interlinked with more traditional leadership consultancy. For instance, 360 feedback and instant feedback communication tools can provide leadership with a quick sense check/poll of the workforce regarding new initiatives.
- ❖ **Workforce Management** – the ability to track and record data associated with employee site visits using mobile devices can help increase visibility for customers and employers with real-time information. For example, this can include: timesheet, payroll, journey (mileage data), and a record of observations.
- ❖ **Payroll** – there are those with existing platforms who are keen to acquire other outsourced payroll bureaus, as well as leveraging other (non-core HR) solutions across their existing client base (individual/PSC through to SME). An outsourced payroll business may compliment its service with accountancy, financial planning with a salary sacrifice, e-learning (compliance related) and/or R&R solution.

[2] <https://employeebenefits.co.uk/why-real-time-recognition-is-important/>

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Consolidators are seeking to attack this fragmented landscape to acquire different technologies and provide more holistic solutions. In common with Polestar's recent experience of the software market, cross-border acquisitions are increasingly important, with Access recently acquiring Australian-headquartered Definitiv, and Kallidus acquiring US-based

Sapling

—
Polestar

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3. Battle Grounds

There are several quality UK-based solution providers in the HCM space that are attractive to both Trade and Private Equity. Many of those we speak to have remained Covid-resilient with strong performances across; wellbeing, flexible benefits, learning management solutions, e-learning/LMS content production, feedback/survey communication and insight tools, as well as core HR such as outsourced payroll accounting.

Beyond the HCM space, heavyweights from other industry verticals such as wealth management, insurance or accountancy may also start to see HCM as a way to acquire and protect customer bases.

The reality is that there are only so many UK based firms of sufficient scale and quality in which to invest either as a platform investment or for bolt-on acquisition purposes. This will naturally lead to increased valuation multiples as institutional money chases just a few quality investment opportunities.

Increasingly we are seeing cross-border consolidation plays. International players are active with US-owned, PE-backed businesses such as Terryberry (backed by Tenex), which recently added to its UK operations with the acquisition of Cardiff-based ICOM Reward. European PE fund, APSE Capital, also supported its UK portfolio business Kallidus in acquiring US-based Sapling earlier this year.

Who has the best platform, service offering, technology, management team, and user interface technology? And importantly, who can link it with the best execution and exploitation of that offering? Only time will tell, but the arms race across the HCM space has only just begun.

One thing is for sure - the next five years will be an exciting time for those in the HCM industry. As Yoda would say "Stand still, you cannot"!

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