FEATURE STORY

Staffing: An Industry with Many Facets

BY TERRY KEATING

In May of 2022, when the author became CEO of Access Capital, the Company already had a long history of being a leading non-bank lender to the staffing industry. In this article, written with the help of Raphael Torres, head of business development, and Jessica Sanchez, director of marketing, Terry Keating will share some thoughts about the industry that he has learned through his journey over the past 18 months.

The staffing industry has many dimensions/layers, and I certainly cannot capture every permutation here. These many aspects present opportunities and challenges for lenders. The first challenge is simply understanding the matrix of segments and business models within the staffing ecosystem. And just about when you think you've figured out all the permutations, new ones come on the scene, and others become obsolete. Then there are acronyms and terminology unique to this sector, and we'll try to help with some of that here too.

Next, industry participants must understand the many legal, regulatory and tax considerations. Some on the federal level, but many more on the state and sometimes local level. Again, ever-changing, there are also the dynamics of the labor markets, demand, and supply. Ever-shifting business demand, economic conditions, politics, global events, management philosophies at the customers, and much more contribute to an often-bewildering landscape.

If that isn't enough, the pandemic and post-pandemic conditions and reactions of both employers and employees further blur historical trends that one might look to in an effort to understand this business. So, this isn't easy or for the faint of heart.

Primary Segments

First, let's explore some of the sub-segments commonly identified within staffing.

- *Information Technology (IT):* software development developers, network engineers, IT project managers, data scientists, cybersecurity experts, and more.
- *Healthcare:* nurses, doctors, allied health professionals, medical technicians, and non-clinical staff for hospitals, clinics, long-term care facilities, and other healthcare institutions.
- *Industrial:* production operators, assembly workers, forklift operators, maintenance technicians, and warehouse workers.
- *Office/Clerical:* administrative assistants, office managers, receptionists, data entry clerks, and customer service representatives.
- *Professional/Managerial:* roles that require specialized skills or education, such as financial analysts, project managers, engineers, scientists, attorneys, and accountants.
- *Marketing/Creative:* graphic designers, copywriters, marketing coordinators, digital media specialists, and creative directors.
- *Education:* teachers, teaching assistants, school administrators, and support staff.
- *Hospitality:* chefs, wait staff, hotel managers, and housekeeping staff at hotels, restaurants, event venues, and other hospitality-related businesses.

Business models

Next, we'll explore some of the business models that exist within the broader staffing industry. Keep in mind that they can frequently overlap, and/or companies can employ multiple models.

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- *Temporary Staffing:* providing workers to cover short-term needs such as seasonal spikes in demand, employee absences, or specific projects. The workers remain employees of the staffing firm, which handles their payroll, benefits, and other HR functions.
- *Contract Staffing:* providing workers for a specific contract period like temporary staffing. This is often for project-based work or positions requiring a specialized skill set.
- *Temp-to-Perm (or Contract-to-Hire):* providing temporary or contract workers with the possibility of a permanent position if they perform well and if there's an ongoing need for the role.
- *Permanent Placement (or Direct Hire):* identifying, screening, and selecting candidates for permanent roles.
- *Recruitment Process Outsourcing (RPO):* The client outsources the entire recruitment process or parts of it to the staffing firm. This may include job postings and candidate screenings, interviews, and onboarding.
- *Managed Services (or Managed Service Provider – MSP):* The firm manages all or part of a client's workforce in this model. This can include sourcing and managing staffing vendors and all aspects of the hiring process, from job requisition to payment, but the staff remain employees of the underlying firm.
- *Professional Employer Organization (PEO) or Employer of Record (EOR):* The firm assumes the HR functions for the client, including payroll, benefits administration, and compliance with employment laws, and becomes the legal employer of the client's workforce.
- Solutions-based staffing services, or SOW (Statement of Work), The firm provides not just individual workers, but a complete solution for a specific project or task. Instead of supplying individuals to fill job vacancies, solutions-based staffing involves delivering a complete project. Examples are specific IT projects, marketing campaigns, audits, or similar.

Workers Compensation Insurance

Another critical aspect to understand are the risks associated with workers' compensation, in general, and with individual companies. Risks and challenges associated with worker's compensation come in several areas.

Staffing firms often supply employees to various industries, such as construction or manufacturing, where the risk of workplace accidents and workers' compensation claims are often higher, as are the premiums. If staffing firms inaccurately classify their workers, they might have insufficient coverage and incur penalties and related

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unexpected costs. Or they may be overpaying for the coverage.

Another important aspect is managing payroll tax withholding, reporting and payment. Again, failure to correctly manage these obligations can have severe ramifications. Unpaid payroll taxes can result in tax liens being filed against a company's assets. There can also be Trust Fund Recovery Penalties, and company officers and others can be personally liable if payroll taxes are unpaid.

Size Range

The staffing industry is highly fragmented, with a few large players and many medium and small firms, ranging from small boutique agencies with a few employees and revenues in the hundreds of thousands of dollars to large multinational firms with thousands of employees and billions of dollars in revenues.

According to Staffing Industry Analysts, post-pandemic revenue for the industry is estimated to be $218,800,000,000, which was up 17% in 2022, estimated to be down 3% in 2023 and predicted to grow 2% in 2024. Breaking this down, the American Staffing Association estimates there are 25,000 staffing agencies in the United States. These firms are estimated to employ 16,000,000 workers, 40% of which occupy higher-skilled jobs. In terms of revenue, the largest firm accounts for only 5.2% of that total. There are 251 firms that report revenue exceeding $100,000,000, and these firms account for 77% of the overall industry estimated revenue.

As staffing agencies grow, they often encounter growth barriers or inflection points that require them to adapt and evolve, with specifics varying depending on factors such as industry focus, geographic market, and business model.

The following are some of the most common inflection points for growing staffing firms.

- $1-2 million level, many staffing firms face the challenge of moving beyond the founder-led stage with limited resources and management teams.
- $10 million level, firms are implementing more sophisticated systems and processes, develop a more robust sales and marketing function, and manage a larger workforce.
- At the $50 million level, staffing firms start to face challenges related to scale, multiple office locations, diversifying services or industry focus, dealing with more complex regulatory and compliance issues, and competing with larger firms for clients and candidates.
- At the $100 million level and beyond, staffing firms manage large, complex, and potentially international organizations involving additional complex issues like corporate governance, strategic planning, brand management, and mergers and acquisitions.

Industry Trends

Staffing, like much of the economy, and perhaps more so because of the underlying industry span, is always rapidly evolving and shifting. In this section we'll highlight a few of the current trends.

Key Points

1. Highly complex industry with many segments, sub-segments, and business model permutations.
2. Significant regulatory and tax considerations at the Federal, State, and Local levels
3. Industry for all-seasons
4. Highly fragmented with 25,000+ businesses
5. A significant portion of U.S. employment and GDP:16,000,000 jobs, $218,000,000,000 of revenue.

- *Increasing Use of Technology:* The staffing industry has seen increased use of technology in recent years. This includes the adoption of AI and machine learning to automate the recruitment process and more effectively match candidates with job openings. Digital platforms/mobile apps have also increased, providing a more efficient way for workers and employers to connect.
- *Rise of Remote Work:* The pandemic accelerated the shift towards remote work, with significant implications for the staffing industry. With fewer geographic constraints, there has been a broadening of talent, but it also increased the competition for talent and required staffing firms to adapt their methods for sourcing, vetting, and onboarding candidates.
- *Increased Demand for Flexible Staffing Solutions:* There has been an increasing demand for flexible staffing solutions as companies look to become more agile in response to rapidly changing market conditions.
- *Focus on Diversity, Equity, and Inclusion:* Companies increasingly recognize the importance of DEI and rely on staffing firms to help them build more diverse workforces. This has required staffing firms to reassess their recruitment practices and to develop new strategies for attracting and retaining diverse talent.
- *Expansion of Services:* Many staffing firms are broadening their services to become more broadly based total-talent solutions providers, including offering services like employer branding, talent management, career transition services, and HR consulting.
- *Regulatory Changes:* Employment laws and regulations continue to significantly impact the staffing industry. This includes changes in the classification of employees vs. independent contractors, minimum wage laws, wage transparency, and additional disclosure/reporting. These are primarily at the state level, creating an oft-bewildering maze.

Financing the Industry

The industry is highly reliant on working capital financing due to the need to pay employees on a weekly or bi-weekly cycle. While typically the client is billed monthly and may take 30-60 days (or longer depending on the segment and business model) to pay. This leads to significant working capital liquidity needs.

The industry is served by many bank and non-bank financiers. We have identified more than 30 banks and non-banks which identify staffing as a target segment. Plus, we know there are many other participants who don't identify the industry specifically.

The predominant form of financing to the staffing industry continues to be factoring in various forms, recourse, non-recourse and "full-service". Full-service is especially popular with smaller firms and usually includes additional services like credit checks, collections, and sometimes even more extensive back-office support.

In a PEO arrangement, there's a co-employment relationship where both the staffing company and the PEO share certain employer responsibilities for the employees. If the PEO fails to fulfill its obligations, such as paying wages or managing tax reporting, the staffing company could be held liable.

ABL is also a popular choice, especially for medium-sized and larger staffing companies. ABL allows a staffing company to maintain control over its accounts receivable, which can help the company maintain stronger client relationships as it continues managing its collections process. Additionally, ABL generally is more cost-effective.

Macro Issues

In addition to the dynamics already discussed, the industry is sensitive to the economic cycle, and this can vary significantly by the sector being served.

Staffing businesses experience peak and off-peak periods, closely tracking economic fluctuations. When the economy grows, staffing companies are busy adding temporary or permanent staff. During off-peak times, while business slows, firms may reduce full-time headcount and replace some or all of that with temporary employees to have maximum flexibility in managing their workforce. This second dynamic offsets or softens the effect of an economic slowdown on the staffing industry overall.'

However, it is also critical to pay close attention to the segments within staffing as there can be vast differences in growth or declines. The following data from Staffing Industry Analysts is a stark example of this. In 2020 the Light Industrial segment dipped slightly, grew slightly in 2021, has been flat in 2022/2023, and is expected to grow in 2024. By contrast, the Travel Nurse sector grew 50% in 2020, 190% in 2021, and 45% in 2022, but has fallen 25% in 2023 and is expected to drop another 10% in 2024.

The industry is resilient, often rebounding quickly from economic downturns due to its inherent ability to respond rapidly to market changes. This resilience can translate into consistent returns for lenders.

The industry's fluctuating nature, low entry barriers, and other factors can make it riskier than other sectors. For instance, staffing companies are also susceptible to changes in employment law, labor disputes, and shifts in market demand, adding layers of complexity for lenders.

Other Nuances

In a traditional staffing agency setup, the account debtor is usually straightforward. Typically, the client company has contracted with a staffing agency for temporary or permanent staffing needs. However, the involvement of Managing Service Providers (MSPs) and Vendor Management Systems (VMS) in the process can complicate the identification of the account debtor.

MSPs and VMS are designed to streamline and simplify the staffing process. However, these systems can occasionally reduce transparency. Lack of visibility into the client company's payment practices, creditworthiness, and financial stability can make assessing the risk involved in lending against invoices difficult.

MSPs and *VMS* play critical roles in the staffing industry. These tools provide important benefits such as cost control, standardized processes, and streamlined recruitment. However, they introduce certain challenges regarding financial matters like determining the account debtor.

An MSP is an intermediary between the staffing agencies (or suppliers) and the client companies. So, the account debtor might not be the end-client company but the MSP. This can make it challenging for lenders to ascertain the actual debtor, as the MSP is responsible for payment, but relies on the end client's solvency and payment habits, introducing a pay-when-paid dynamic to the risk equation.

The presence of an MSP also often means working with multiple staffing agencies, which may disperse financial risk across multiple parties, but adds to the complexity of monitoring the solvency and financial reliability of all these involved entities.

Next, MSPs often use a VMS to automate procurement, billing, and other processes, adding a layer of complexity. Using VMS can further obscure the direct relationship between the staffing agency and the client company, making it even more challenging to discern the ultimate account debtor and their payment ability.

Contract terms can vary, sometimes resulting in unique payment structures. Some MSPs might take on the role of an account debtor, while others might pass this responsibility to the client company. These variations necessitate careful examination of contract terms to determine the actual account debtor.

Professional Employer Organizations (PEOs) and Employer of Record (EOR) are a development that has grown out of several key trends and shifts in the business landscape, including the increasing complexity of labor laws and regulations and the need for maximizing cost efficiencies.

In a PEO arrangement, there's a co-employment relationship where both the staffing company and the PEO share certain employer responsibilities for the employees. If the PEO fails to fulfill its obligations, such as paying wages or managing tax reporting, the staffing company could be held liable.

Contracts with PEOs or EORs can often be complex. Some contracts may allow the EOR or PEO to change pricing or service terms with little notice, potentially increasing costs for the staffing firm. Some EOR or PEO agreements might grant the EOR/PEO control over the staffing firm's receivables, which could pose a significant risk for a secured lender that might otherwise use those receivables as collateral for a loan.

Dependence on the EOR/PEO: The staffing company's operations become tied to the EOR or PEO, which means any operational issues or business failure on their part can directly impact the staffing firm.

Sub-contractors have become increasingly prevalent due to labor market shifts and business landscape shifts. This approach allows companies to meet evolving client demands, manage costs, and navigate a rapidly changing employment environment. However, it introduces several risks. If a subcontractor fails to deliver, it can impact the staffing company's ability to service its clients, potentially leading to lost revenue and an inability to service its debt. Subcontractors may be directly interacting with the staffing company's clients. Poor performance by a subcontractor could harm the relationship between the staffing company and its clients, jeopardizing the business.

If the subcontractor invoices the end client directly and the staffing company bills the subcontractor, the lender's collateral is now dependent on the financial stability and reliability of the subcontractor and the end client.

This leads to a broader discussion of continuation of service. It may be critical if the staffing company is facing financial difficulties and can't meet its payroll obligations; the collectability of that AR, and hence the value of the lender's collateral, can come under threat in these situations.

In the staffing industry, the employees (or temps) are the core assets generating the receivables. Employees may cease work if the staffing company can't meet its payroll obligations. This could result in the staffing company being unable to fulfill its contractual obligations to clients, which in turn could lead to the clients refusing to pay their invoices. If a staffing company can't provide staff as promised, it risks an immediate loss of receivables and long-term client relationships.

In addition, failure to meet payroll obligations can result in fines, penalties, lawsuits, and general reputational damage, and if a staffing company fails, the lender's ability to collect on its collateral could be severely impaired. Customer debtors will assert offset claims, and there is always the potential for a messy bankruptcy process.

Conclusion

The staffing industry is a core part of the economy regardless of changes within industries and the ups and downs of the business cycle. The staffing industry is directly responsible for 16,000,000 jobs, and 6,400,000 of those in highly skilled occupations.

But as we have discussed, there are many layers and permutations of risk that are changing. For those who take the time and effort to learn and go on learning, there are great opportunities in this key part of the economy.

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Keating is active in various industry associations. He is also an active member of the Secured Finance Network, including serving as a member of its Industry Data Committee, and its DEI Committee, as well as participating in the Mentoring Program. Additionally, he is active in the New York Institute of Credit, International Factoring Association, Association for Corporate Growth, Alliance of Merger & Acquisition Advisors, and Turnaround Management Association.

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