

Key trends in human capital

A global perspective – 2006

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Foreword

This work is based on data collected from more than 15,000 organisations across Europe and the US, representing industry sectors including banking, financial services, manufacturing, telecommunications, chemicals, IT, utilities and retail. Whilst only a small selection of public service operators was sampled for this report, its relevance to those in the public services arena still stands. The data is organised under a range of categories and provides valuable information on financial performance, added-value, productivity, remuneration and human capital behaviour. It also analyses the structure and role of the HR function.

Increasingly, our clients are using selected measures not only to provide insights into bottom line performance and basic people behaviours, but also to gain a measurable appreciation of critical organisational forces such as motivation, commitment, innovation, talent management and leadership.

This report provides a powerful combination of information on both existing organisational human capital profiles, and those required in future to produce and maintain a sustainable human capital advantage in the marketplace.

This year's report also includes supplementary information on Japan, South Africa and Asia Pacific. Reporting on developments in these economies demonstrates the increasing appetite for human capital data as a tool to help understand economic performance.

Richard Phelps
Partner,
Human Resource Services



Background

PricewaterhouseCoopers Human Resource Services has an established track record in providing global human capital benchmarking studies, and has one of the world's largest HR advisory businesses.

“Trends discussed are highly relevant to all executives attempting to prioritise the allocation of critical resources to key issues.”

In 2003, PricewaterhouseCoopers acquired Saratoga Institute, recognised as the world's leading authority on human capital metrics. Later in 2003, we acquired EP-First, a European-based provider of human capital metrics. What followed was a period of integrating the technologies and experience of each business to create a definitive methodology and data source for human capital measures. The new offering, known as Saratoga, was launched in October 2004.

In January 2005, we produced our first 'Key Trends in Human Capital' report. Based upon human capital measurement and benchmarking work in 2003 and early 2004 in Europe and the US, the document detailed the trends that we considered would dominate the human capital agenda for some years ahead.

Background to key trends 2006

This document tracks those trends through the whole of 2004 and the first half of 2005. Data gathered from organisations on a global basis has confirmed that the vast majority of the human capital trends identified have gained even greater prominence.

The majority of the human capital data continues to emerge from Europe and the US, but this year we are able to produce some interesting case study information from Japan, South Africa and Asia Pacific.

As with last year's study, the trends identified are not always present in every territory; sometimes the economies move at a different pace or even in different directions. In some cases, insufficient time has elapsed for clients to collate the data against the strict definitions and standards we apply.

We believe the trends discussed in this briefing are highly relevant to all executives involved in shaping and managing human capital within their organisation, and who are attempting to prioritise the allocation of critical resources to key issues.



Executive summary

The findings of the 2006 Key Trends in Human Capital report yet again confirm the centrality of human capital to developing and sustaining competitive businesses and economies.

The major findings of the report suggest some very real challenges for any executive involved with human capital if they are to help the organisations they work for adapt and develop to meet the dilemmas posed by the dynamic and highly competitive global marketplace.

The report highlights a number of key challenges that all organisations face, including:

- The new competitive landscape created by emerging economies such as India, China and Central and Eastern Europe
- The implications of increased outsourcing and offshoring
- The likely impacts of demographic trends on the productive capability of working-age populations
- The fact that there is little evidence to suggest that leadership is improving despite a continued focus and investment in this area
- Incorporating corporate social responsibility initiatives into human capital policies
- Addressing the drivers of productivity with effective human capital strategies
- Understanding the drivers of innovation and how to use them to increase competitive advantage
- The factors influencing workforce engagement and commitment
- The impact of work/life balance initiatives and policies on productivity
- The HR function's ability to demonstrate a measurable impact on bottom-line results, using incisive data and analysis

A new competitive landscape

The report shows a stark disparity between the performance of the European and US economies: a trend that over the last 12 months has seen the gap between the two economies grow even wider.

But it is not simply in the development of traditional economies where trends are now having a significant impact on competitiveness. Emerging economies of Eastern and Central Europe, India and China are demonstrating growth substantially above the rates achieved by the established economies of the West.

And emerging economies are no longer providing simply low-cost advantages. The rate and range of skills, knowledge and expertise acquired by many of those economies means that the competitive challenge they represent now transcends pure cost.

One of the features of this report is the analysis of added-value performance provided by the unique methodology of human capital return on investment. Using this method it's possible to provide a clear picture of relative performance across economies. This year's report shows improvement for both Europe and the USA, but the relative performance of each demonstrates a substantial gap in their achievement.

The average remuneration figures for the US show considerable increases compared to those seen in Europe, but US profitability increases more than outweigh more generous remuneration levels. Put simply, the US has managed to increase profits faster than remuneration. Whether this is sustainable remains to be seen.

From a competitive point of view, the productivity gains shown in emerging economies such as Central and Eastern Europe eclipse both the US and Europe; a further indication that the competition map is changing rapidly.

Offshoring and outsourcing

We measured a slight increase in the total spend on outsourcing and offshoring in Western Europe, but it is not simply the scale of outsourcing arrangements that is growing. Businesses are now using third parties to deliver higher value-added activities with offshore suppliers who are increasingly well-equipped to perform them. Though cost alone remains a significant draw, low cost plus expertise is even more attractive. Decisions to offshore and outsource are now seen as major strategic issues. With this trend looking likely to continue, all executives involved in human capital investment need to understand the key benefits and risks underpinning the successful use of third parties and off-shored employees, to enable them to guide their organisations in the strategic decision-making process.

Leadership

The interest in identifying and developing the characteristics of effective leadership continues unabated but, as was the case last year, there is no clear indication that enhanced performance is arising from the considerable investment in leadership development. It is difficult to discover a company that is not operating some form of leadership development programme. The lack of evidence that leadership is measurably improving suggests that some of this investment cannot be producing sound returns for

shareholders and stakeholders. New approaches to leadership development are required.

Corporate transparency and sustainability

Stakeholders want and expect more information from business. HR executives need to understand what human capital information is required, the metrics that they need to use and how to communicate effectively with diverse stakeholder groups. Gender diversity, in particular, is a prominent issue and this year's survey continues to show a wide disparity across all sectors at all levels.

Innovation and talent development

The criticality of innovation to economic success is undisputed. Much of the US's economic strength is founded upon the ability to innovate continuously. One of the key drivers of innovation is the development of employee's skills and talents. The survey shows that relative levels of spending on training are higher in the US than in Europe – where they have in fact declined year-on-year. Though there is no established causal link between training spend and innovation there is a clear and consistent relationship between those companies that invest in learning and development and competitive business results.

Measuring and managing employee engagement and the impact of work-life balance

Instead of looking at employee attitudes, the survey focuses on their actions and behaviour – what people do rather than what they say. The survey shows some signs that organisations are being marginally

more effective at linking performance to pay and encouraging employees to contribute ideas that drive innovation. HR executives need, increasingly, to assess levels of commitment and engagement by whether employees actually 'go the extra mile' towards increasing productivity and competitive advantage, as opposed to simply expressing their contentment. When it comes to work/life balance, the survey highlights a current ambiguity: does commercial success partially result from offering family-friendly policies, or are those policies a by-product of success? Though no conclusive evidence points either way, top performers in the western economies, not surprisingly, tend to operate with positive employment policies. It is a dilemma at the heart of global competitiveness; critically, decisions need to be based upon measured performance results, as opposed to "feel good" factors.

Impact on the HR function

The report makes it clear that human capital issues have a powerful impact upon all businesses' competitive abilities. However, there is little evidence to suggest that the HR role is similarly developing to a higher level of strategic influence within business organisations. The challenge for HR executives is to demonstrate to their colleagues that they have a real business performance contribution to offer. To this end, it is critical that they cease an introspective focus and produce practical human capital policies which have a measurable impact on bottom line results. Using incisive data and analysis, the HR function can begin to develop the tools and policies that should help place them at the centre of corporate strategy.

Key trends in detail

This briefing is based upon an all-industry median. Industrial region, size and sector can have a major influence upon many metrics so, where appropriate, we include tables that detail results by region and sector, and that reveal the strong structural and cultural differences that continue to pervade the European market.

“There are signs that the slower growth seen in the US in 2004 is now making itself felt in the economies of Western Europe.”

The significant differentiation between Central/Eastern Europe and its Western European counterparts in many metric results remains particularly interesting and reflects, in part, the mounting human capital pressures across the continent. The US has less dramatic internal regional differentiation but nonetheless, increasingly, shares pressures of globalised competition.

Financial performance

Last year's report showed that despite rising revenues and profits in Europe throughout the 1990s, revenue and profit per employee went in the opposite direction. Our data indicates that during the economically exuberant years of the late 1990s, organisations lost control of their cost base.

Companies met the following downturn in the US, Europe and elsewhere with extensive cost-cutting, downsizing and other rigorous cost management measures. As a result of their efforts, the cost base for most companies was brought under control. In consequence, though most economies suffered in this period, for the majority, deep recession was avoided.

Economic growth, albeit at a much slower pace than in the late 1990s,

has returned, though there are signs that the slower growth seen in the US in 2004 is now making itself felt in the economies of Western Europe. In 2004, the human capital results show a continued divergence between the respective performances of the US and Europe. Revenue per full-time equivalent (FTE) in the US grew in 2004 by 11.7%. The equivalent in Europe was 8.2% across all regions and 7.9% in Western Europe. In the US, profitability per FTE rose by a significant 54.7%, whilst it has grown by a smaller 13.9% since 2003 in Western Europe, and by 17.5 % in Central and Eastern Europe over the same period. Figure 1 demonstrates the profit per FTE trend over the period 2001-2004 inclusive.

The trend identified in our last report has continued throughout 2004. The US has continued to produce impressive results, demonstrating its ability to move faster and more flexibly than Europe, and putting itself into a stronger position to respond to the new surging economies of the Far East and elsewhere.

Yet both the US and Europe have space for major improvement. Results from a 2004 study commissioned by Convergys Employee Care and conducted by the University of Michigan and Saratoga¹ concluded

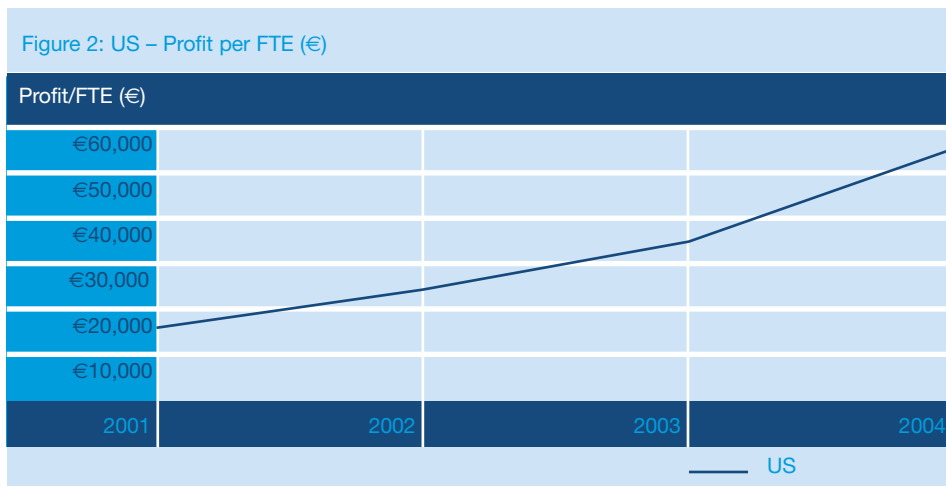
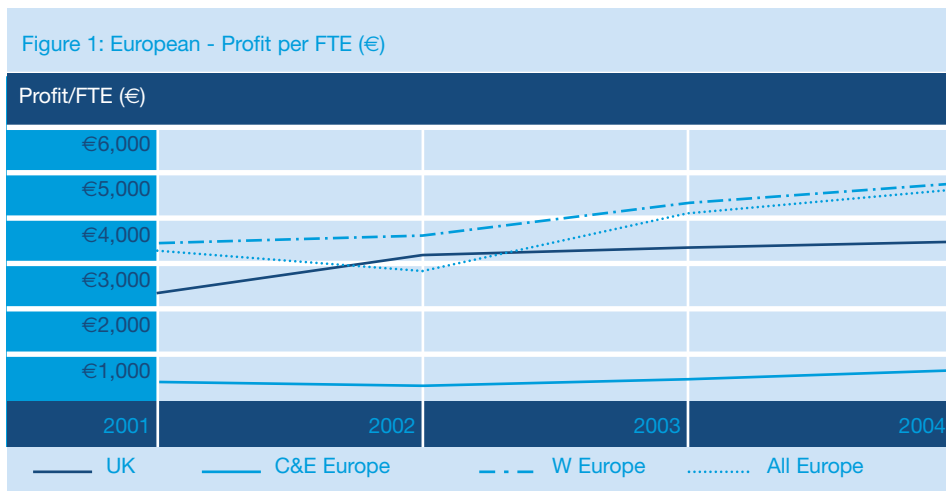
that the best practice companies in both the US and Europe estimate they are overspending by 10% and underperforming by 10% as a result of not having a fully agile and flexible workforce.

European nations report very different levels of economic performance, with the economies of Western Europe now increasingly subject to new competition from Central and Eastern European economies. The rise of Central and Eastern Europe as both a destination for inward capital investment and a provider of well-educated, highly skilled and, above all, comparatively low-cost people is

giving rise to a range of protectionist responses from a number of Western European governments.

More significantly, on a global basis, the rapid emergence of India, China and others as suppliers of low-cost goods and services is increasingly having an impact upon both Europe and the US. It is becoming progressively evident that it is far more than low-skilled services and manufacturing that are being 'exported'. India's growth in particular has been fuelled by an astonishingly rapid development of skills and know-how, notably in information technology and other professional services.

“Best practice companies in both the US and Europe estimate they are overspending by 10% and underperforming by 10% as a result of not having a fully agile and flexible workforce.”



Figures 1 and 2: PricewaterhouseCoopers Saratoga data

Demographic trends

Demographic trends are important in human capital terms for two major reasons. In the first instance, workforce availability provides major opportunities for any country to increase resource available for economic expansion, especially if combined with political, social and logistical support, low-cost infrastructure and a workforce ambitious to improve life standards.

Secondly, longer life expectancies and the growth of the old-age dependency groups reduce both working-age populations and labour forces, placing greater pressure upon smaller numbers to produce the wealth needed to support living standards. Higher life expectancy in existing mature economies is a reward for economic success but, equally, a threat to the future sustainability of that success.

“Higher life expectancy in existing mature economies is a reward for economic success but, equally, a threat to the future sustainability of that success.”

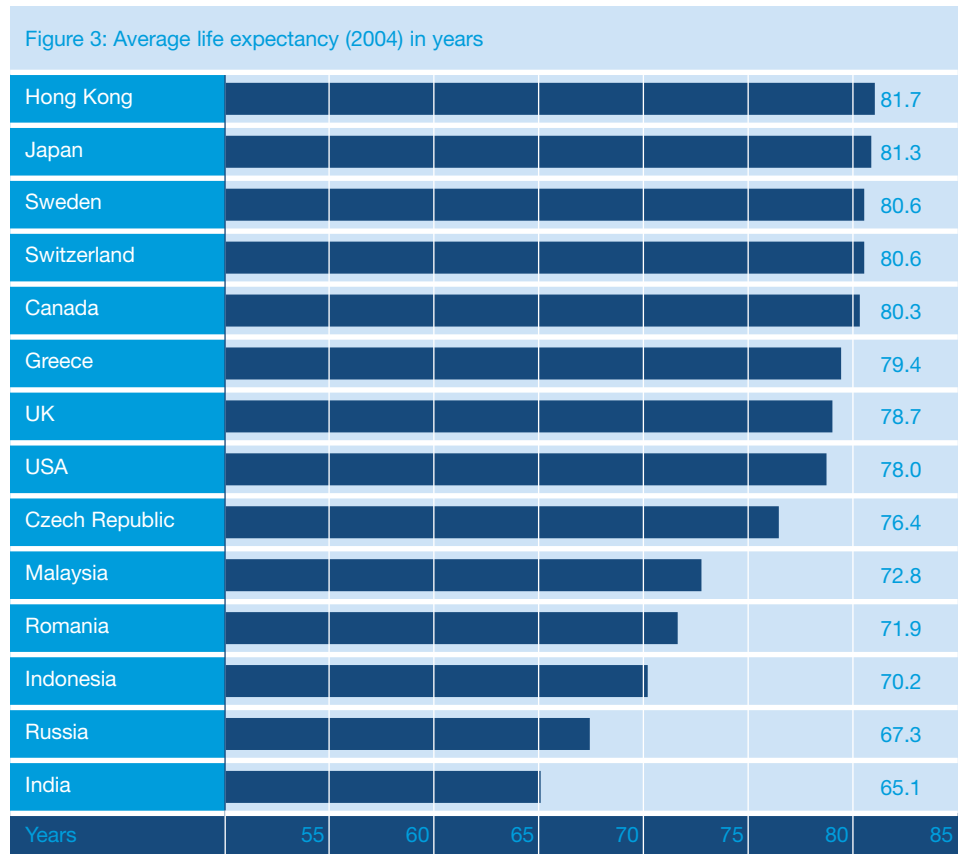


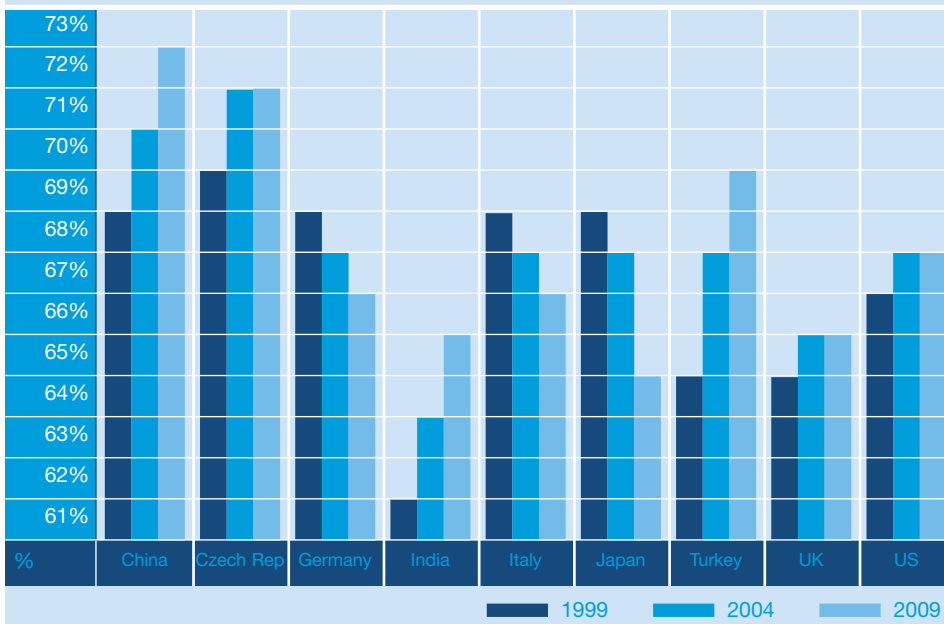
Figure 3: Economic Intelligence Unit, Country-by-Country Analysis, 2005

The US and Western Europe have working-age populations, i.e. populations between the ages of 15-64, which have generally peaked at about 67% of the total population. In the next five years, this is likely to begin to decrease – not dramatically as some commentators have indicated, but by closer to 1% over this period. However, over the same period, the percentage of the

population in Europe aged 65 and over is likely to increase by between 4-12%.

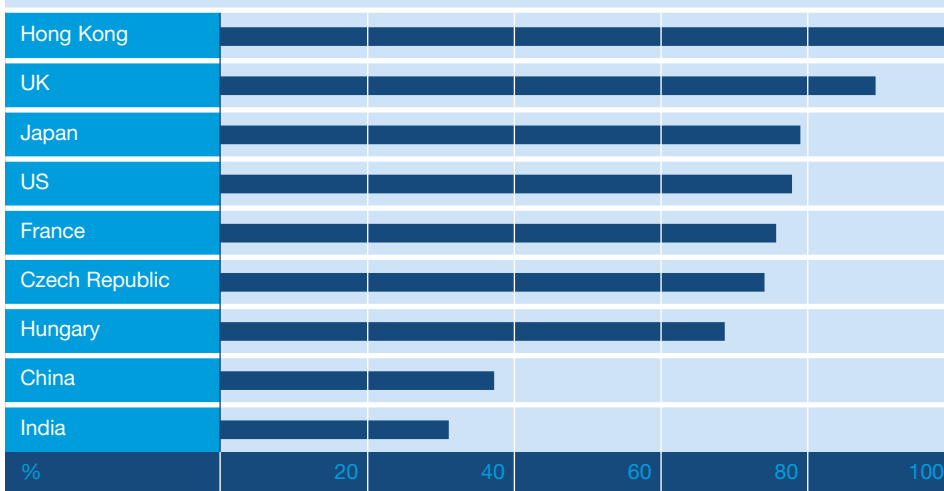
The working populations in Western Europe and the US will encounter increasing competition from Central and Eastern Europe, India and China, with working-age populations in those regions growing by some 2.5% plus over the next five years (see Figure 4).

Figure 4: Working-age population (15-64) as a percentage of total population



“Working populations in Western Europe and the US will encounter increasing competition from Central and Eastern Europe, India and China.”

Figure 5: 2004 Urbanisation as a percentage of total population



Figures 4 and 5: Economic Intelligence Unit, Country-by-Country Analysis, 2005

“Mature economies are increasingly aware that they will be unable to withstand the pressure from emerging economies by competing head on with their human capital potential.”

Many mature economies are also running out of space. The level of urbanisation, which provides some indication of the saturation point for commercial expansion, has reached the 80% level in countries such as Hong Kong, the UK, Japan and the US (see Figure 5).

This demographic overview further illustrates how developed economies of the US and Western Europe will be facing major competitive attacks from nascent economies with high potential both for commercial growth and human capital development. The future prosperity of mature economies with ageing populations and longer life expectancy must be addressed. Many analysts believe that a broad-ranging reassessment of pension and retirement funding/provision is needed if a major future drain on finances – or a level of impoverishment amongst the elderly – is to be avoided. However, much will depend on the growth in wealth creation within individual countries. For example, experts from Tomorrow’s Company, an organisation of business leaders founded by the Royal Society for the Encouragement of Arts, Manufacturers and Commerce (RSA), suggest that a

1.75% annual increase in productivity between now and 2045 would make British workers almost twice as productive as they are today. Meanwhile, the number of people aged 65 and over would be unlikely to rise by more than 50%.² This underlines our conclusion that sustainable and ongoing productivity growth will play a key role in managing the implications of an ageing population.

Mature economies are increasingly aware that they will be unable to withstand the pressure from emerging economies by competing head on with their human capital potential. Instead, the answer may lie in making use of the resources supplied by developing economies, while continuing to develop the innovation and ingenuity within their own boundaries on which the younger economies will rely. Figure 6 demonstrates the imbalances in economic growth between Central and Eastern Europe and Western Europe. The existing gap is significant and the task for Western Europe is to ensure that its demographic profile does not adversely affect its future economic competitive performance.

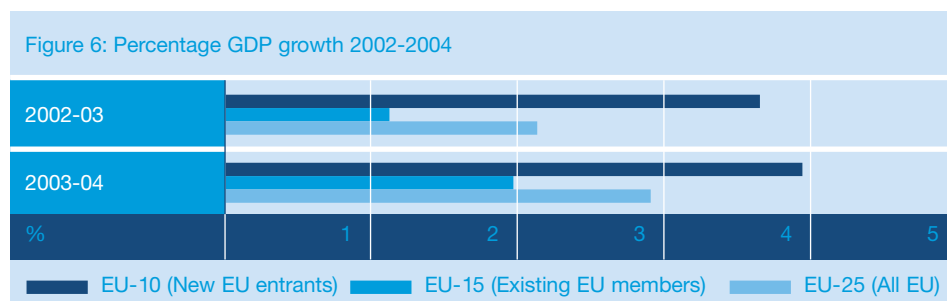


Figure 6: PricewaterhouseCoopers Saratoga data
EU-10: Malta, Slovenia, Cyprus, Hungary, Czech Republic, Slovakia, Poland, Lithuania, Estonia and Latvia
EU-15: Luxembourg, France, Belgium, Ireland, Netherlands, Austria, Germany, Denmark, Finland, UK, Italy, Sweden, Spain, Greece and Portugal EU-25: All the countries listed above

Added-value performance

We use a unique methodology – the human capital return on investment (ROI) – to provide a comparative measure of added value per FTE. Human capital return on investment compares the pre-tax profit generated to the investment in compensation and benefit costs. It is calculated as follows:-

$$\frac{\text{Revenue} - \text{non-wage costs}}{\text{Number of FTEs} \times \text{average remuneration}}$$

This ratio indicates how many units of currency are produced for every unit paid to an employee. The currency itself is therefore irrelevant and allows for cross comparisons between different economies. It is the key ratio for all HR executives, as it covers all the major elements of their potential contribution.

Last year's report saw improvement in ratios for both the US and Europe in 2003, following declines in the previous two years. In 2004, the ratios increased further, but at markedly

different rates, once again showing the speed with which the US economy is able to recover and grow. In the US, the human capital ROI ratio rose from \$1.42 in 2003 to \$1.52 in 2004. Figures for the same period show only very modest growth in Europe overall: from €1.13 to €1.14. The value-added per FTE based upon our formula now demonstrates a difference of some 33% between the US and Europe, to the advantage of the US.

The superior value-added recorded by US performance is not a result of lower levels of remuneration. On the contrary, average remuneration (all compensation and benefits) remains higher in the US by a considerable margin. The average remuneration in the US of €70,090 is almost twice its Western European equivalent of €38,340. Significantly, average remuneration in Central and Eastern Europe is €7,640, 20% of Western European levels (see Figure 7). Remuneration also continued to show a higher average growth in the US when compared to Europe in 2004 (7.9% against 6.6% respectively).

“The average remuneration in the US of €70,090 is almost twice its Western European equivalent.”

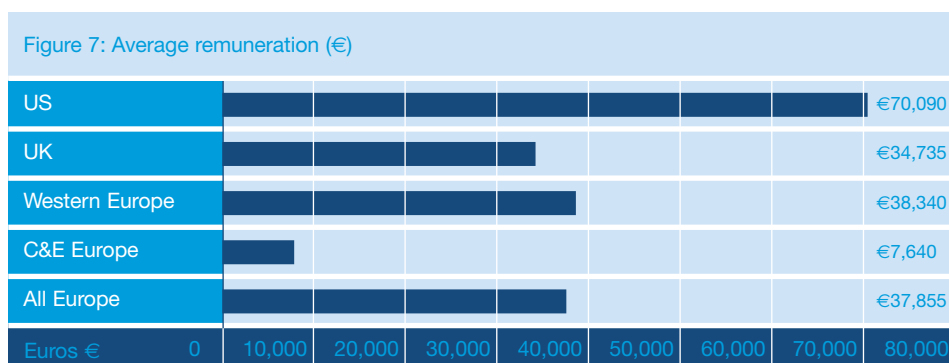


Figure 7: PricewaterhouseCoopers Saratoga data

“European economies have controlled the levels of remuneration/revenue more successfully than the US, but have experienced a growth rate significantly lower than the US.”

We have found a high correlation between successful commercial performance and the level of higher remuneration, on both a national and a sector basis. It is widely accepted that there is a virtuous circle interconnecting comparatively high levels of remuneration with higher consumer demand levels, thereby boosting company revenues and added value per employed person.

Are the higher average – and faster-growing – remuneration levels in the US sustainable? The key to its superior economic performance lies in the ability of the US economy to continue to grow profits faster than the rate at which levels of remuneration rise. To date, it has succeeded in doing so.

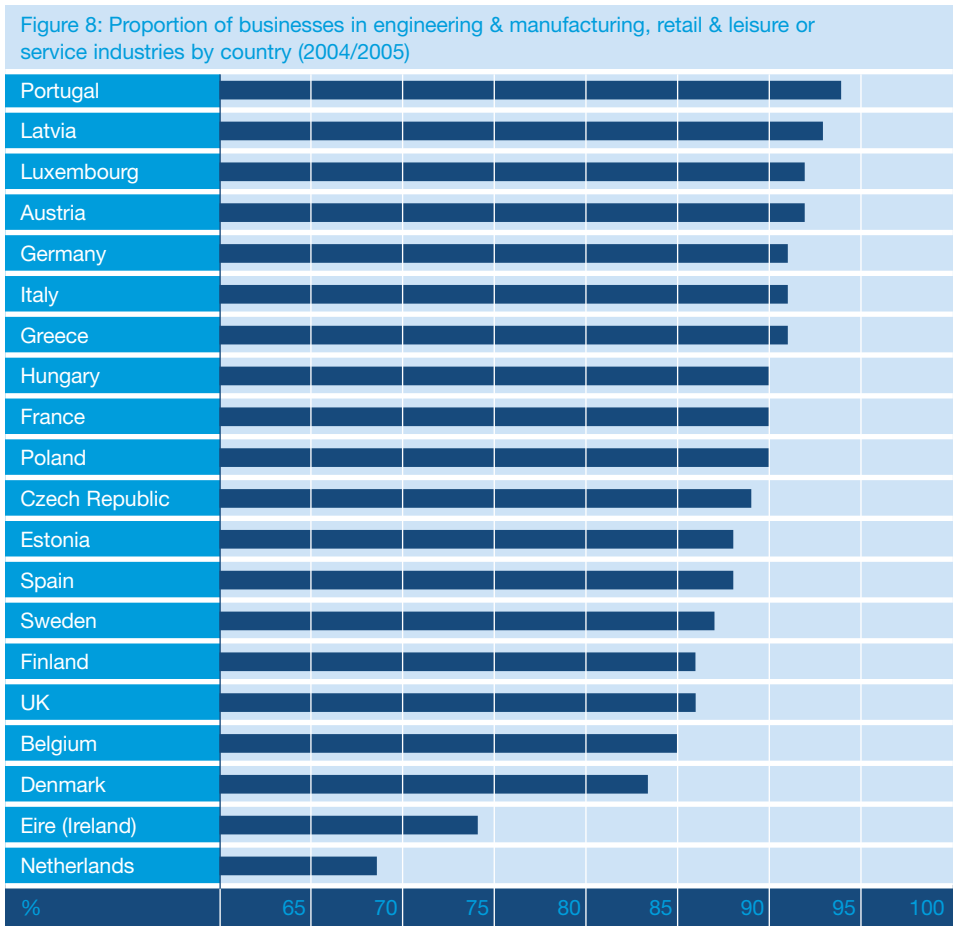
Productivity performance

Whereas added-value metrics demonstrate the ratio of profits to remuneration, productivity metrics look at the relationship of remuneration to total revenues and costs. We look at the added-value metrics to measure the relationship between pre-tax profit in relation to total compensation and benefits – in other words, whether the goods or services are selling at attractive margins. Productivity metrics look at the relationship of compensation and benefits (i.e. inputs) against revenues gained (i.e. outputs) – whether the products or services are sold at a price that the organisation can bear. By using both the metrics of remuneration/revenue and remuneration/total costs, it is possible to establish the movement of the remuneration bill in relation to revenue

growth and total costs, and whether the bill is having a disproportionately negative effect on company competitiveness.

Here again, the figures show that whilst the US has seen a higher growth in remuneration/revenue – up to 28% in 2004 compared with 21.6% in Western Europe and 14.6% in Eastern Europe – other factors come into play that mitigate these steeper rises in the US. Revenue per FTE grew considerably faster in the US in 2004 (11.7%) than it did in Europe (8.2%). These figures show that European economies have controlled the levels of remuneration/revenue more successfully than the US, but have experienced a growth rate significantly lower than the US. The markedly higher productivity in the US shows that controlling remuneration is only one side of the productivity equation. The dynamic growth in revenues seen in the US more than compensates for the steeper rises in remuneration. In consequence, productivity in the US (up 3.1%) rose at almost twice the rate seen in Western Europe (up 1.6%).³

Many business commentators have noted that the superiority of US performance is a result of its prevailing strength in technologically focused companies, resulting in large part from earlier and higher investment in IT across a broader range of sectors. A breakdown of revenue generation by industry sector across Europe, in contrast, highlights a dependency on engineering & manufacturing, retail & leisure, and services.



“Productivity gains in the US and Europe are eclipsed by competitors further East.”

Figure 8: PricewaterhouseCoopers Saratoga data

Figure 8 demonstrates the percentage of businesses, in a number of nations, within engineering & manufacturing, retail & leisure, and services. The nations with the lowest percentage have a lesser dependency on these sectors, and therefore have a greater involvement in the higher technological sectors of, for example, electronics, finance, telecommunications and IT.

Significantly, both the productivity gains in the US and Europe are eclipsed by competitors further East.

Central and Eastern Europe shows a 3.8% increase – equal to India’s performance – whilst China achieved a remarkable 6.3% increase.⁴

The next section, which looks at outsourcing and offshoring trends, amply illustrates the global nature of this competition, as organisations increasingly look to secure competitive advantage by moving elements of their operations offshore, or by engaging third-parties to perform an increasing number of activities on their behalf.

⁴Conference Board “Performance 2005: Productivity, Employment and Income in the World’s Economies”, www.conference-board.org/publications

Commercial metrics summary

Figure 10 summarises the major metrics discussed in the previous sections in relation to the commercial performances across Europe and the US. It provides the background data for the trends from 2001-2004 previously discussed.

The common use of “GDP per employee” and “GDP per hours

worked” (see Figure 9) as indicators of productivity on a national and regional basis correlate closely with our “revenue per FTE” and “costs per FTE” metrics. We measure regional and national financial performance and can also benchmark performance across commercial and industrial sectors to give a more specific view of an organisation relative to its nearest competitors.

Figure 9: Economic productivity metrics and associated growth

	GDP per hour (€)	GDP per person Employed (€)	Growth in GDP per hour	Growth in GDP per Employed
Country	2004	2004	2003-2004	2003-2004
Australia	27.69	48,684	0.8%	0.9%
Austria	33.87	50,760	1.2%	1.2%
Belgium	37.21	59,454	3.5%	2.2%
Canada	26.84	47,834	0.0%	1.1%
Cyprus	17.57	36,989	2.4%	1.8%
Czech Republic	15.89	30,489	4.2%	5.0%
Denmark	32.21	48,222	3.7%	2.3%
Estonia	10.14	20,797	5.2%	6.0%
Finland	30.62	50,581	2.6%	3.7%
France	38.72	55,723	1.6%	2.4%
Germany	33.42	48,211	1.4%	1.4%
Greece	21.76	41,738	1.9%	1.3%
Hungary	17.37	31,364	3.2%	4.8%
Iceland	25.78	46,657	6.0%	6.2%
Ireland	35.77	58,978	2.1%	1.8%
Italy	30.36	48,660	0.1%	-0.3%
Japan	25.32	44,278	3.2%	2.5%
Latvia	8.50	18,243	6.7%	7.4%
Lithuania	10.49	22,735	6.3%	7.0%
Luxembourg	43.95	64,920	5.4%	3.0%
Malta	20.69	40,304	0.2%	0.1%
Mexico	10.41	21,960	0.9%	0.4%
Netherlands	34.40	46,609	0.9%	1.1%
New Zealand	21.23	37,459	0.1%	0.8%
Norway	43.19	58,821	0.7%	2.6%
Poland	13.27	26,313	4.1%	4.0%
Portugal	17.42	29,936	-0.1%	0.9%
Slovakia	13.62	28,683	3.9%	5.4%
Slovenia	19.83	39,290	2.7%	4.4%
South Korea	13.60	32,526	3.1%	2.7%
Spain	25.20	45,299	0.6%	0.5%
Sweden	30.34	47,778	2.8%	4.2%
Switzerland	29.22	44,815	1.7%	1.5%
Turkey	9.94	19,072	9.2%	8.6%
UK	30.37	49,237	2.4%	2.2%
US	34.29	62,369	3.0%	3.1%

Figure 9: PricewaterhouseCoopers Saratoga data

Figure 10: Commercial metrics						
	2001	2002	2003	2004	2001-2004 % change*	2003-2004 % change*
Revenue per FTE (€)						
UK	123,852	129,024	135,888	142,008	14.7	4.5
C&E Europe	34,847	32,408	51,298	58,796	68.7	14.6
Western Europe	144,576	145,766	157,187	169,546	17.3	7.9
All Europe	138,686	134,074	154,315	166,916	20.4	8.2
US	212,297	218,217	233,332	260,543	22.7	11.7
Costs per FTE (€)						
UK	121,995	126,071	134,500	138,999	13.9	3.3
C&E Europe	34,178	31,837	51,512	55,122	61.3	7.0
Western Europe	139,293	142,353	153,838	164,152	17.8	6.7
All Europe	133,539	130,067	150,499	161,989	21.3	7.6
US	185,653	162,941	171,140	181,481	-2.2	6.0
Profit per FTE (€)						
UK	2,538	3,112	3,248	3,495	37.7	7.6
C&E Europe	375	302	612	719	91.7	17.5
Western Europe	3,515	3,696	4,238	4,827	37.3	13.9
All Europe	3,202	2,926	4,045	4,700	46.8	16.2
US	18,961	24,631	35,625	55,128	190.7	54.7
Human capital ROI (€)						
UK	1.10	1.08	1.11	1.11	1.2	0.3
C&E Europe	1.07	1.05	1.10	1.11	3.4	0.6
Western Europe	1.12	1.08	1.13	1.14	1.7	0.8
All Europe	1.12	1.07	1.13	1.14	1.5	0.6
US	1.12	1.31	1.42	1.52	35.7	7.0
Remuneration (compensation and benefits) (€)						
UK	31,453	32,852	33,914	34,735	10.4	2.4
C&E Europe	6,119	5,712	7,588	7,640	24.9	0.7
Western Europe	34,017	34,737	36,000	38,340	12.7	6.5
All Europe	33,227	32,883	35,519	37,855	13.9	6.6
US	57,012	57,666	64,979	70,090	22.9	7.9
Remuneration/revenue (%)						
UK	24.7	24.7	23.9	24.1	-2.6	0.7
C&E Europe	17.6	17.5	15.1	14.6	-17.0	-3.3
Western Europe	23.3	23.0	21.8	22.2	-4.8	1.8
All Europe	23.1	22.6	21.6	21.6	-6.5	0.0
US	20.8	24.1	26.1	28.0	34.6	7.3
Remuneration/costs (%)						
UK	24.9	25.0	24.4	24.5	-1.7	0.3
C&E Europe	17.1	17.7	14.7	14.1	-17.5	-4.1
Western Europe	24.0	23.5	22.4	22.9	-4.6	2.2
All Europe	23.7	23.0	22.1	22.7	-4.2	2.7
US	n/a	34.9	35.8	34.9	n/a	-2.5

Figure 10: PricewaterhouseCoopers Saratoga data

*Rounded to nearest decimal place

“Spending by UK and US-based companies on offshoring contracts worldwide is forecast to rise from €8 billion in 2004 to €48 billion in 2008.”

Outsourcing and offshoring

Although they are clearly different in practice, the concepts of outsourcing and offshoring have much in common, and the differences between them are likely to blur in the years ahead. Both concepts were originally based on a drive to export commoditised transactional activities – either from the organisation or from high-cost operational regions – in order to reduce overheads. In a 2004 survey conducted by PricewaterhouseCoopers entitled “Offshoring in the Financial Services Industry”⁵ 80% of the respondent organisations stated that lower-cost operational considerations were the principal reasons for offshoring investment. However, this narrow focus is now changing. Organisations are increasingly considering shifting higher value-added activities (requiring specific knowledge or where there are skills shortages) to suppliers with the requisite resources and expertise.

Data from participants this year shows that the proportion of total costs attributable to outsourcing and offshoring grew from 2.2% in 2003 to 2.64% in Western Europe. Figure 11 shows a small selection of sectors in Europe, demonstrating that the trend continues to be highly sectorised with industries such as manufacturing & engineering demonstrating far less movement than telecoms and services.

This trend seems set to continue, with an increasing number of jobs in specific sectors both moving offshore and to external suppliers over the next three years. We predict that this trend will increase by 6-10% over the next three years for low value-adding work and by 4-7% for higher value-adding knowledge-based work.

Spending by UK and US-based companies on offshoring contracts

worldwide is forecast to rise from €8 billion in 2004 to €48 billion in 2008, 40% of which is likely to come from the banking and insurance industries. Over the same period, the Organisation for Economic Co-operation and Development (OECD) believes that as many as 20% of all jobs in the US, Australia and Canada, as well as in the 15 pre-accession EU member states, could be affected by the international sourcing of labour by service industries.

There are several areas for concern regarding this trend. They include questions involving management control, quality of service, the depth of labour pools and some of the customer service issues raised by a lack of cultural understanding. However, despite these concerns (and the consequent development of the ‘near-shoring’ concept), the plentiful evidence of strong investment flows into India, China, Brazil, the Philippines, and Central and Eastern Europe suggests that organisations are continuing to pursue the advantages of offshoring enthusiastically. The offshoring market in Russia was forecast to grow by 45% between 2003 and 2006 – and in India by 57%.⁶

Low costs are a powerful draw. India’s continuing attraction is partly because its cost of operations is some 37% lower than China’s and 17% lower than Malaysia’s. But low costs combined with educated talent are particularly attractive. We are seeing this development in places like the Philippines which produces around 300,000 college graduates each year, all of them English speakers. India produces approximately 2 million college graduates a year, 80% of whom speak English.

⁵PricewaterhouseCoopers “Offshoring in the Financial Services Industry”, 2004

People – human capital – are at the heart of the offshoring issue. Access to superior technology or business processes may partially drive the decision by a company to move a functional area offshore, but it is the relative cost of labour and skills availability that are the overwhelmingly dominant factors.

Human resource executives need to understand the skills and competencies that underpin the successful use of third parties and the management of ‘captive’ (i.e. offshoring without outsourcing) operations in remote locations. There are some key risks to which

they need to pay particular attention (see Figure 13). Conversely, there are some key benefits they must build into their agendas (see Figure 12). Our research shows that factors such as the ability to recruit and retain sufficient numbers of suitably-qualified individuals are becoming more difficult in light of greater competition and rising wage levels. Decisions to outsource or offshore motivated purely by reducing costs are providing disappointing results. The success or failure of these decisions has been shown to depend largely on addressing the associated human capital issues. As such, HR executives have a pivotal role to play.

“Human resource executives need to understand the skills and competencies that underpin the successful use of third parties and the management of ‘captive’ operations in remote locations.”

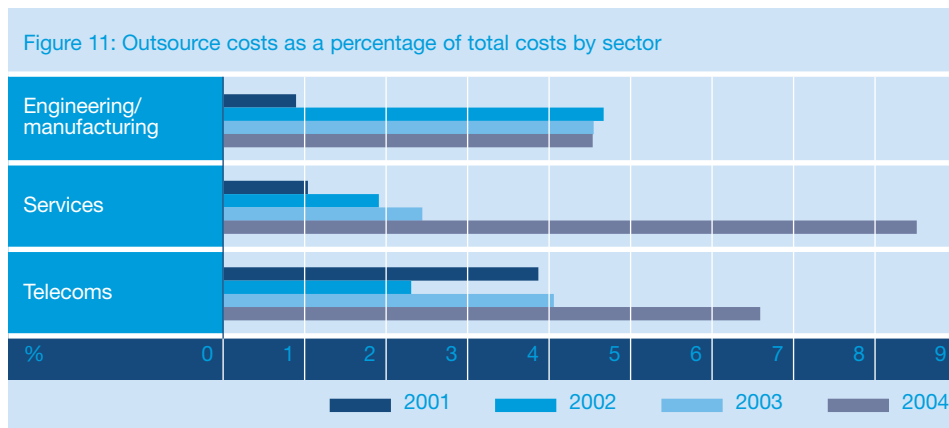


Figure 11: PricewaterhouseCoopers “Offshoring in the Financial services Industry”, 2004

Figure 12: Top five benefits experienced by companies from outsourcing

1. Cost savings	74%
2. Strategic flexibility	33%
3. Greater focus on core competence	28%
4. Business continuity	27%
5. Improved quality of service	25%

Figure 13: Top five risks experienced by companies from outsourcing

1. Finding and attracting people of the right quality	39%
2. Deteriorating quality of service	31%
3. Cultural differences between home and host markets	30%
4. Retention of top employees in offshore markets	29%
5. Rising wages	23%

Figures 12 and 13: PricewaterhouseCoopers “Offshoring in the Financial services Industry”, 2004

“The drive to divulge more and clearer human capital information to shareholders and other stakeholders is gaining momentum.”

Corporate transparency

The need for greater transparency in corporate activity has emerged as a major business issue, sparking disagreements about its value to shareholders and other key stakeholders on the one hand, and its bureaucracy and resource diversion on the other. Driven by a number of regulatory initiatives and a series of calamitous corporate scandals, there has been a growing demand for extra-financial information to be included alongside the financial information provided by companies. Increasingly, shareholders and others expect company directors to provide them with clear and precise insights into how they are running their businesses, including the general operating environment and, particularly, the opportunities and threats they face. This trend has a direct bearing on both the prominence of and the manner in which human capital information is presented.

Though it is clear that companies are aware of the need for transparency, they don't all think this requirement will provide them with any commercial advantage. Some organisations have taken a far more proactive and positive stance than others. This is evidenced by their willingness to provide detailed extra-financial information in their annual reports, corporate social responsibility (CSR) reports and other forms of public disclosure. Interestingly, members of the Enhanced Analytics Initiative (EIA)*

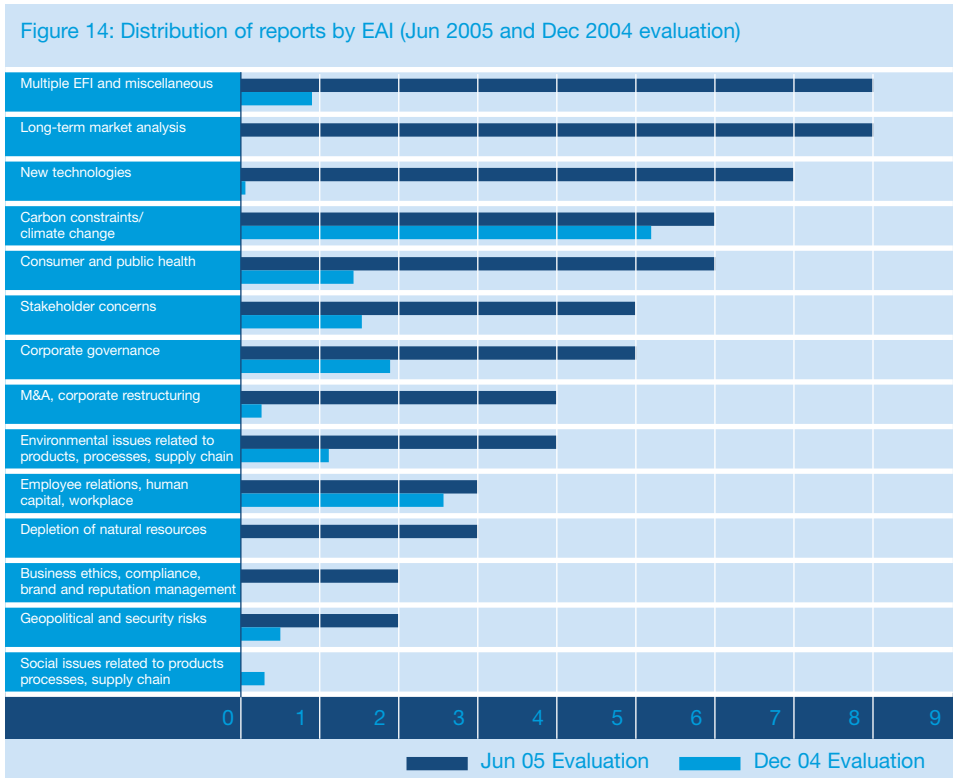
believe there is strong evidence that good management of extra-financial performance can generally reduce risk and may, in some circumstances, deliver added-value. They state: “If brokers can analyse and make more transparent the materiality of extra-financial issues and show where these may enhance or detract from value, this should help investors to better differentiate companies on the basis of risk management capabilities, reputation with key stakeholders and therefore brand strength and business development strategy and innovation.”⁷ Figure 14 indicates progress on extra-financial reporting over 2004-2005.

We have no doubt that the drive to divulge more and clearer human capital information to shareholders and other stakeholders is gaining momentum – and will continue to do so. Although the “Accounting for People” report 2002⁸ was disappointing for many advocates of human capital measurement, it at least promoted a debate that moved the subject forward. Despite the recent demise of the Operating and Financial Review (OFR) in the UK, the drive towards greater transparency continues. For instance, the EU Accounts Modernisation Directive of 2003 mandates increased levels of extra-financial reporting. The debate is now more about which human capital measurement could be most usefully produced, as opposed to whether there is any point in producing it at all.

*The Enhanced Analytics Initiative is an international collaboration between asset owners and asset managers aimed at encouraging better investment research, in particular research that takes account of the impact of extra-financial issues (EFIs) on long-term investment

⁷Enhanced Analytics Initiative, June 2005 evaluation

⁸Department of Trade and Industry “Accounting for People” report, 2002,



“The link between transparency and sustainable commercial success is becoming increasingly convincing.”

Figure 14 reproduces the EAI's evaluation of extra-financial data provided in company reports submitted in December 2004 and June 2005

We have found some indication of the rising level of support for contextual and extra-financial information. Ongoing PricewaterhouseCoopers research on value reporting – spanning 3,100 investors in 16 industries across 14 countries – demonstrates very positive reactions.

The PricewaterhouseCoopers Building Public Trust Awards for 2004/2005 attracted entries from 8% of the top UK companies for the people reporting award, against a mere

2% the year before. Indeed, the PricewaterhouseCoopers “World’s Most Respected Companies” (2005)⁹ research demonstrates that those companies attracting the highest respect from CEOs worldwide for their corporate governance and corporate social responsibility actions, have demonstrated an impressive level of continued commercial success. The link between transparency and sustainable commercial success is becoming increasingly convincing.

⁹PricewaterhouseCoopers “World’s Most Respected Companies” research, 2005

Established generic metrics

Over the past two decades, our experts have developed a range of metrics with agreed global definitions to form the basis of human capital reporting for companies, enabling shareholders and others to form an objective appreciation of a company's human capital profile and its strategic positioning. Some of these recommended generic human capital metrics for all organisations are listed below

Metric	Definition
Wealth created per FTE	(Profit after tax – 10% shareholders equity)/total FTEs
Profit per FTE	Profit before tax/total FTEs
Revenue per FTE	Revenue/total FTEs
Cost per FTE	Total costs/total FTEs
Human capital ROI	(Revenue – non-wage costs)/(total compensation + benefits)
Remuneration/revenue	(Total compensation + benefits)/total revenue
Remuneration/cost	(Total compensation + benefits)/total costs
Absence rate	All absent days/FTE workdays
Resignation rate	Resignations/headcount
Acceptance rate	Job offers accepted/job offers made
Cost per hire	External recruiting costs/external recruits
Training hours per FTE	Learning & development hours/FTEs

Leadership

Defining the characteristics of effective leadership remains a major priority amongst the business leaders of most organisations – one that is served and promoted by a multibillion dollar industry in the US and Europe. Participating organisations in this year’s research gave no indication that the level of preoccupation is in any way diminishing, with 53% of US respondents saying that their senior management had attended one or more leadership development courses in 2004. Neither is there evidence to suggest that the European investment in leadership development, estimated at €1.5 billion in 2003, fell in 2004.

Rather than trying to define the characteristics or behaviours exhibited by effective leaders, we have developed a leadership index that indicates the impacts of good leadership and then measures performance against those indicators. This index focuses on identifying what effective leadership looks like and demonstrates the impacts derived by the organisation across the broad leadership roles in a company. Using a set of metrics that cover business

and organisational impacts, corporate social responsibility, skill development and follower behaviour, the index compares generic leadership performance across organisations operating either in the same sector or in diverse sectors.

Effective leadership in an organisation would show a positive score relative to other comparable organisations. The evidence suggests that, as in 2003, there has been no significant improvement in overall leadership in organisations. This result may call into question the efficacy or focus of some leadership development initiatives.

In 2004, we applied the leadership index to a range of clients across Europe. Eight metrics were used, and the results were spread across three quartiles – the 25th, the median and the 75th – indicating the range of results obtained. By plotting their position, organisations are able to assess where they stand compared to other organisations for each metric. For example, taking the human capital ROI metric, organisations in the worst 25% of performers will be scoring 1.01 or less*.

“Defining the characteristics of effective leadership remains a major priority.”

Figure 15: Selected leadership metrics

	2003 median	25th	2004 median	75th	% change between medians
Impacts					
Human capital ROI	1.13	1.01	1.14	1.36	1%
Wealth created per FTE (€)	-803	-4876	-494	2455	38%
Behaviours					
Resignation rate (%)	6.2	2.9	6.2	12.1	0%
Remuneration/revenue (%)	21.6	13.1	21.6	32.0	0%
Skills					
Training hours per FTE	23.9	12.5	19.7	32.3	-17%
Internal promotion rate (%)	50	30	50	72	0%
Corporate social responsibility					
Gender diversity (%)	39.2	23.3	36.3	52.4	-7%
Community donations before tax (%)	1.1	0.5	1.1	3.0	0%

Figure 15: PricewaterhouseCoopers Saratoga data

*Please note that this figure is for illustrative purposes only and organisations using the index for serious analytical purposes should compare themselves against relevant organisations, using our standard definitions

“A high consciousness of gender diversity may indicate an awareness of the advantages of a balanced diversity human capital mind-set.”

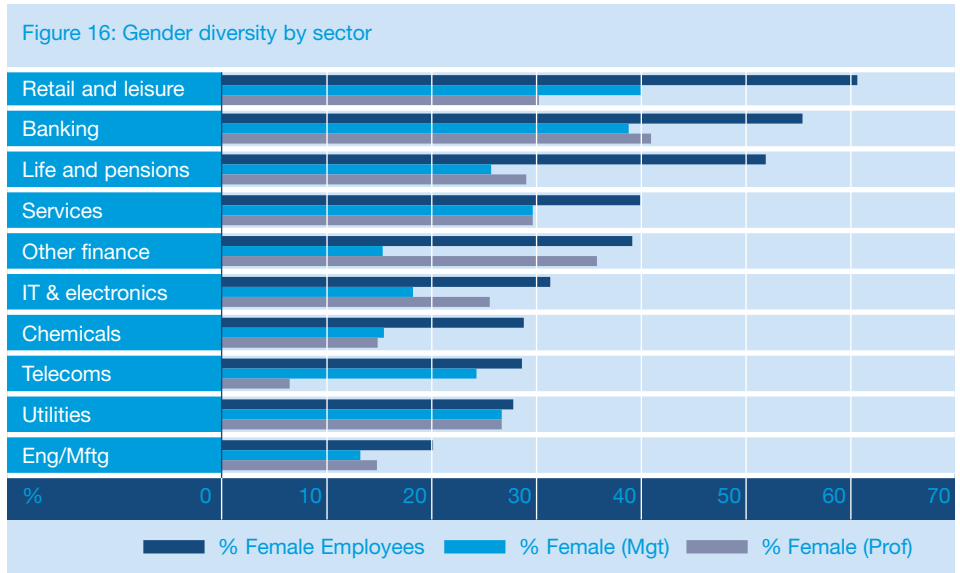


Figure 16: PricewaterhouseCoopers Saratoga data
Management Employees – Have some level of formal management responsibility
Professional Employees – Typically professionally qualified employees that perform analytical, technical, conceptual or creative tasks

Diversity

Diversity, as with other debates on corporate social responsibility, is a high-priority issue for many organisations. Diversity should be measured across a range of dimensions. However, we currently focus on gender diversity as this provides the most readily available source of data. It would not be accurate to conclude that emphasis on gender diversity policies would reflect a similar emphasis on ethnic and disability considerations in organisations. But it is reasonable to suggest that a high consciousness of gender diversity may indicate an awareness of the advantages of a balanced diversity human capital mind-set overall.

The data for gender diversity from 2001 to 2003 demonstrated a relatively stable level of female employment across Europe, at about 39.2% in commercial activity. This year’s data shows that proportion marginally decreased to 36.3%. However, this has been compensated

in part by a small rise in the number of professional and managerial posts occupied by women. The presence of women in professional positions (qualified but not supervisory) has risen from 29.3% to 32.03% and in managerial positions (supervisory and higher) from 24.6% to 25.0%. As indicated last year, the presence of women in managerial and professional positions differs widely across sectors reflecting similar disparities for women employed at other levels (see Figure 16). It is likely that in times of retrenchment in specific sectors, diversity levels will fluctuate.

Women account for more than half the total employees in the banking, insurance, retail & leisure industries, and 40% of managerial positions in banking and retail & leisure sectors. In other sectors, the proportions of women are significantly smaller. Women fill only 28% of positions in the utilities sector and 20% of positions in the engineering & manufacturing industries (see Figure 16).

Although, overall, women showed a slight increase in their occupation of senior roles, the observation last year that these tend to be in specialist back-office functions throughout an organisation holds true. When those areas are subject to rationalisation, their position is vulnerable. It isn't just within the back-office function that this appears to be true. According to Cranfield Business School¹⁰, the number of female executive directors of FTSE 100 companies in the UK rose from 11 in 2000 to 17 in 2004, yet in 2005, it reduced slightly to 14, a mere 3.4% of total executive directors in FTSE 100 companies. However, it also reported that the percentage of FTSE 100 companies with no women directors reduced from 42% in 2000, to 22% in 2005. Companies still have some way to go in fulfilling their gender diversity objectives.

Talent management and learning

Commitment to talent management continues unabated, with most companies now voicing their commitment to promoting talent management programmes. Innovation, flexibility and agility are seen as key attributes required of organisations to

compete successfully in the global economy. These vital qualities are largely agreed to derive from the capabilities of the people an organisation employs.

With this in mind, the need to measure the effectiveness of talent management systems and processes continues to gain momentum. We have developed a suite of 10 metrics to enable organisations to benchmark the performance of their own talent management systems by looking at measuring identification, attraction, retention, development, and use of talent. We are currently working with clients to develop these further.

Some results for 2004 are shown in Figure 17. This uses 10 metrics to assess data from approximately 300 organisations from all sectors across Europe. The findings illustrate the recommended percentile positioning that would reflect effective talent management. So, for example, organisations should aim to be in the highest quartile (i.e. 75th) for human capital ROI (i.e. 1.36 or above), the bottom quartile (i.e. 25th) for talent resignations and the highest quartile for internal promotions (i.e. 75th).

“Innovation, flexibility and agility are key attributes required of organisations to compete successfully in the global economy.”

Figure 17: Selected talent management metrics

	25th	50th	75th
Human capital ROI	1.01	1.14	1.36
Acceptance rate (%)	88.0	93.9	97.7
Talent resignations (%)	3.0	4.2	7.5
Development actions	4.0	9.0	17.0
Internal promotions (%)	30	50	72
Critical talent performance	1.0	2.5	5.0
Pipeline succession	0.7:1	1:1	3:1
Backup succession (%)	72	88	100
Reactive ratio (%)	0.3	0.6	1.8
High incentive ratio	4.1	8.6	18.7

Figure 17: PricewaterhouseCoopers Saratoga data

This table is for illustrative purposes only. For serious analytical purposes, organisations are strongly advised to compare themselves against selected relevant organisations using our standard definitions

¹⁰Cranfield Business School, “The Female FTSE Index 2005”, page 4

Figure 18: Training hours per FTE in Europe

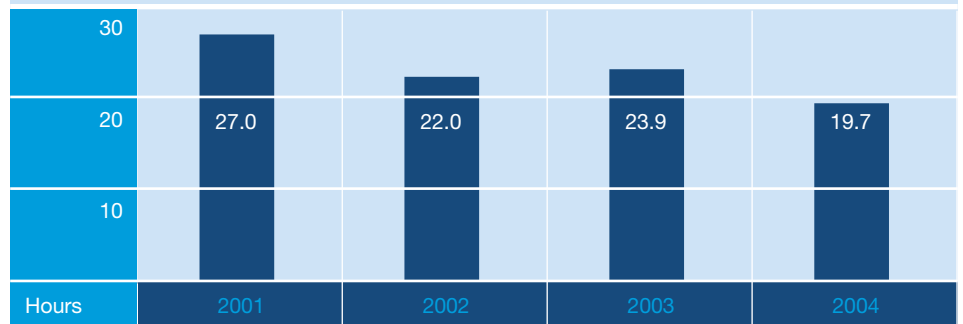


Figure 18: PricewaterhouseCoopers Saratoga data

“We consistently find clear correlations between high investment in learning and development and competitive business results.”

On a wider platform in 1999, the European Union Council of Ministers meeting to agree the Lisbon Agenda pledged to make Europe, the “leading knowledge-based economy in the world by 2010”, and underpinned this declaration with a commitment to the importance of training. Given this widely agreed aim, it is surprising and disappointing to see that all indicators of training investment continue the downward trend shown in last year’s report. In Europe, the average number of training hours fell from 23.9 in 2003 to 19.7 in 2004 (see Figure 18), development training hours fell from 7.9 in 2003 to 5.5 in 2004 and the proportion of employees receiving at least one day’s training experience in the given period fell from 67.1% in 2003 to 57.2% in 2004. Overall investment in training also fell in absolute terms from €704 per employee in 2003 to €552 in 2004.

The situation in the US presents a markedly different picture. The 2005 key trends in human capital report showed a leap of 35% in training investment during 2003; 2004 shows a less dramatic but nonetheless robust increase of 5.6%.

Of course, none of the above metrics provide any indication as to the quality of the training undertaken, or the ROI

of specified activities. Nor are these metrics able to reflect the level of non-formal training undertaken. However, it is generally the case that the organisations that demonstrate the highest levels of learning, training, and development investment experience the greatest success in talent management. Part of the US economy’s ability to bounce back, adapt and respond quickly may also be attributable to US organisations’ apparent willingness to invest in increasing (and replacing) the skills and aptitudes of their employees. Europe has to date shown less tendency or willingness to react in this way.

Although no causal link has been established, we consistently find clear correlations between high investment in learning and development and competitive business results.

Innovation

The ability of an organisation to innovate is seen as a major contributor to the achievement of sustainable economic performance. Measuring the level of innovation within any enterprise is complex. We have developed a series of metrics that seek to identify not only the evidence of investment in innovation (i.e. the “supporting infrastructure”)

Figure 19: Selected innovation metrics

Supporting infrastructure	Shared experimentation
R&D costs per total costs	Full time project involvement
R&D costs per FTE	Managerial & professional ratios
Number of new projects per FTE	Staff suggestion rate
Graduate intake/total intake	Staff suggestion success
Staff competence levels	Levels of commitment & engagement
Training hours per FTE	

Figure 19: PricewaterhouseCoopers Saratoga

but also the extent to which an organisation fosters the appropriate culture for innovation to take place (i.e. “shared experimentation”). Both measures are critical if a practical assessment of innovation levels within an organisation is to be established (see Figure 19).

Innovation is often evaluated by looking exclusively at an organisation’s investment in research and development. Whilst it is true that the outputs from R&D (i.e. what it produces – patents, new products, etc.) are more important than the level of R&D activity itself, R&D investment remains an important metric for identifying commitment to innovation.

In 2004, European R&D investment as a proportion of total costs was 3.3%, largely unchanged from the 2003 figure of 2.3%. The 2005 DTI R&D Scoreboard¹¹ uses a measure of R&D as a percentage of revenue. Figures from this report show comparative investments in R&D across the world’s major economies, and highlights a continued lack of European investment in R&D. European investment grew by only 2% (UK investment by only 1%) compared to 7% in both the US and

Asia, and a staggering 40% in South Korea. Perhaps more encouragingly, particularly for those who believe that R&D investment is no real indicator of innovatory growth, the same report found that recorded ideas (measured in terms of patent registration etc.) per 1,000 employees rose significantly in Europe during 2004. It grew to 101.22 – a 200% increase over 2003. Reinforcing this, in Europe, we recorded a 47% increase in ideas and suggestions from company employees. From this, we conclude that a level of innovatory momentum is developing within workforces, which will need to be backed by higher levels of infrastructure support if commercial and other benefits are to be gained.

However, the overall picture for European innovation is less than encouraging given the intensifying global competition. People, as the source of innovation, are again at the centre of the challenge. The commitment of individuals to an organisation, i.e. their willingness to ‘give more’ of themselves, is also a key ingredient in the development of innovation.

“A level of innovatory momentum is developing within workforces, which will need to be backed by higher levels of infrastructure support if commercial benefits are to be gained.”

¹¹Department of Trade and Industry, “2005 R&D Scoreboard” report, www.innovation.gov.uk/rd_scoreboard

“Our metrics measure the existing level of commitment and engagement of an organisation’s human capital as demonstrated by its actions and behaviours.”

Engagement and commitment

We have developed an engagement and commitment matrix to provide an objective assessment of the degree of commitment and engagement among employees. Most existing models are largely based upon measuring expressed attitudes and perceptions. Originating from valuable work initially undertaken by Professor Stephen Ackroyd of Lancaster Business School, our metrics move beyond attitudinal assessment, and measure the existing level of commitment and engagement of an organisation’s human capital as demonstrated by its actions and behaviours. The metrics avoid linear measurement, and instead evaluate commitment and engagement against four organisational dimensions: the time offered by people, the level and type of their outputs compared with their reward bargains, their behaviour related to the organisation’s products or services, and their displayed identity with the employer (see Figure 20).

These metrics are based on what employees do and how they behave within an organisation, rather than what they say about it. The results for these four metrics are:

- Time: With absence and resignation levels remaining stable, there is no indication from the research that employees are willing to give more of their time to employers. Indeed, resistance to the extension of working hours in some European economies and the focus on work/life balance with the bias towards life rather than work, suggests that the opposite may be true.
- Work: this measures employees’ levels of output and agility. There has been a slight increase in productivity in Europe. Further, performance-related pay – how far people are receiving reward for effort – has increased as a percentage of total remuneration (from 5.25% in 2003 to 6.5% in

Figure 20: Engagement and commitment matrix

	Time	Work	Product/service	Identity
Engagement & commitment	Limitless	High output and flexibility	Innovation and improvement	Goal identity
Co-operation	Limited extension	Output data	Learning seeking	Change positive
Compliance	Clock watching	Effort bargaining	Skill static	Critical joking
Discordance	Time wasting	Added pay creation	Fiddling	Change resistant
Withdrawal	Absence	More for same	Pilferage	Negative contention
Hostility	Terminations	Sabotage	Theft	Oppositional solidarity

Figure 20: PricewaterhouseCoopers Saratoga

2004), suggesting a willingness by employees to accept the link between their inputs and outcomes.

- **Product/service:** There is evidence that European employees are contributing more ideas towards organisational innovation. However, the downward trend in formal learning and development investment in Europe suggests that such positive indicators may be transient. Reliable data on other forms of learning and training outside formal channels is difficult to accumulate at this time. If such substitution is not in place then the development of the agilities to absorb essential change will be limited.
- **Identity:** The perceptions of employees and other stakeholders over time inform this metric. Measures such as grievance and acceptance rates have improved marginally, but neither major improvement nor crisis is suggested by the data.

Figure 21 shows the percentage change from 2003 to 2004, at the median level, drawn from a similar population of organisations across Europe. It reflects the type of metrics an organisation can use to plot the engagement and commitment levels of its people.

Taken together, these generic results indicate some positive movement at the median level in relation to the time and work dimensions, reflecting a willingness of employees to deliver higher levels of productivity for higher levels of reward. Organisation identity also shows marginal improvement. Longer term, however, the measures related to product/service indicate a lower level of organisational investment, and whilst workforce co-operation in 2004 appeared positive, the low level of skill improvement could build resistance to essential change in the future. It is worth noting that the majority of organisations that feature in the upper quartile of high engagement and commitment tend to be global operators, many of them Japanese or US-owned.

“The majority of organisations that feature in the upper quartile of high engagement and commitment tend to be global operators, many of them Japanese or US-owned.”

Figure 21: Selected engagement and commitment metrics

	2003 median	25th	2004 median	75th	% change between medians
Time					
Resignation rate (%)	6.2	2.9	6.2	12.1	0%
Absence rate (%)	3.9	2.6	3.7	4.9	-4%
Remuneration/revenue (%)	21.6	13.1	21.6	32.0	0%
Work					
Performance related pay (%)	5.2	3.1	6.5	10.8	26%
Attendance related pay (%)	3.1	0.9	2.3	5.3	-26%
Staff suggestion rate(per 1,000 FTEs)	101.2	25.0	148.7	562.1	47%
Product/service					
Training hours per FTE	23.9	12.5	19.7	32.3	-17%
Learning coverage (%)	67.1	38.1	57.2	82.5	-15%
Development hours per FTE	7.9	2.6	5.5	10.4	-30%
Identity					
Grievance rate (%)	2.6	1.0	2.4	6.1	-8%

Figure 21: PricewaterhouseCoopers Saratoga data
These metrics are shown for illustrative purposes only

“Without higher productivity, Europeans are unable to support the standard of living they demand.”

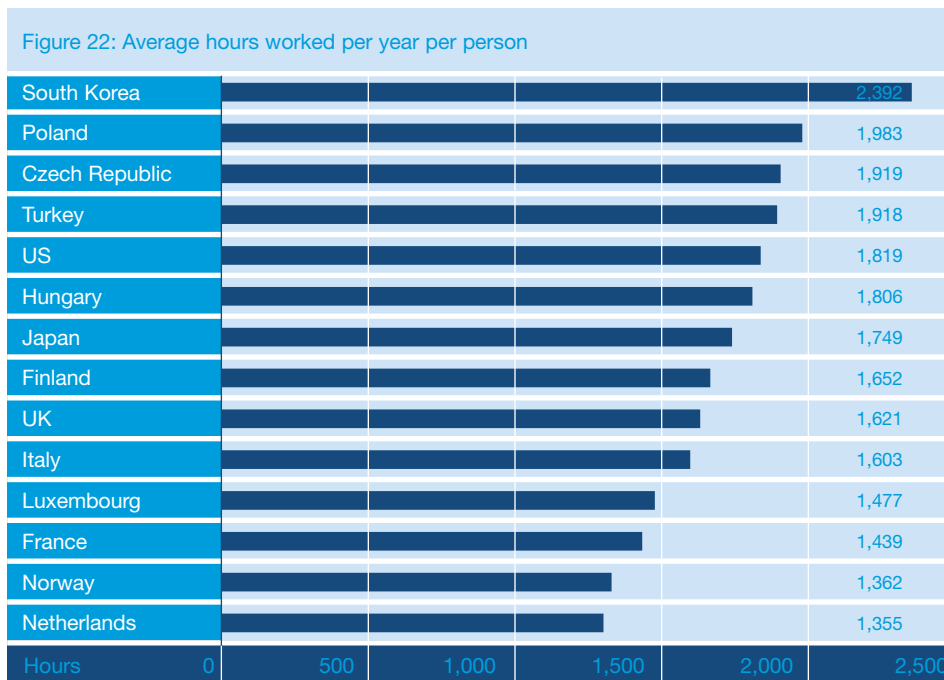


Figure 22: Economic Intelligence Unit, Country-by-Country Analysis, 2005

Work/life balance

The debate over what constitutes a healthy divide between time commitments to work and life outside work intensified in 2004. The debate in Europe between the Anglo-Saxon model favoured in the North and the US, which presses for focus on work commitment (i.e. high productivity, high work ethics, longer working hours, devotion to duty), and the social model of other European nations – which favours more family hours, relaxation, longer holidays, fewer working hours, etc. – may be a demonstration of fundamentally different attitudes to life. Critics of the European social model suggest that, without higher productivity, Europeans are unable to support the standard of living they demand. On the other hand, some commentators point out that companies in the FTSE 100 that operate ‘family friendly’ policies and working practices outperform their competitors.

An important constituent of work/life balance relates to the hours worked

in various societies. Figure 22 shows the latest available information on the average annual hours worked in a selected range of countries around the world.

Whilst it is true that economies with longer working hours and lower levels of measurable social care produce more, it is also true that positive employment policies and high performance are closely related. We have found the top 25% of performers in each sector have the most advanced work/life balance policies.

Figure 23 represents a comparison of the financial indicators of a sample of perceived high work/life balance performers and the reported medians from our database.

What is not clear is whether an ‘enlightened’ employment policy yields higher levels of performance or whether commercially successful organisations are more inclined to spend on family-friendly activities.

Figure 23: Comparison of high work/life performing companies with all-Europe sample

	High work/life performers	All-Europe sample
Revenue per FTE	272,735	166,916
Cost per FTE	207,163	161,989
Profit per FTE	38,775	4,700
Wealth created per FTE	4,497	-494
Intellectual capital per FTE	75,659	65,086
Human capital ROI	1.99	1.14

Figure 23: PricewaterhouseCoopers Saratoga data
High work/life performers were shortlisted by PricewaterhouseCoopers Saratoga

The debate has been enlivened recently by the published research of the Centre for Economic Performance at the London School of Economics.¹² Its findings suggest there is no relationship between productivity and work/life balance once “good management” is accounted for.

Though the debate is intense, to date there has been little objective data to provide support for one model over the other. We are currently developing

a series of metrics that will bring greater objectivity to this subject across Europe.

The HR function

This year’s survey shows a drop in the average size of the HR function per FTE. In the US it fell from 84:1 in 2003 to 87:1 in 2004, and in Europe from 90:1 to 92:1. The cost of HR between 2003 and 2004 rose 35% in the US against a 2.4% fall in Europe.

“This year’s survey shows a drop in the average size of the HR function per FTE.”

Figure 24: HR function metrics

Financial metrics	2001	2002	2003	2004*	% change 2003-2004
FTEs per HR dept FTE					
UK	92	105	95	96	1.2%
C&E Europe	91	99	95	91	-4.1%
Western Europe	85	96	90	92	2.4%
All	88	96	90	92	2.4%
HR dept costs per FTE (€)					
UK	1,096	1,275	1,258	1,073	-14.7%
C&E Europe	348	383	382	524	37.2%
Western Europe	1,190	1,213	1,181	1,143	-3.2%
All	1,107	1,116	1,135	1,108	-2.4%
HR managers and professionals (percentage of total HR dept FTEs)					
UK	57.3	59.8	58.0	63.1	8.7%
C&E Europe	54.6	53.0	60.0	62.6	4.3%
Western Europe	57.5	61.8	62.1	65.6	5.6%
All	57.1	60.0	62.1	64.5	3.9%

Figure 24: PricewaterhouseCoopers Saratoga data
*FTE rounded to nearest decimal place

¹²Daneshku, S., “Work/life balance called into question”, Financial Times, 10 January 2006, page 4

“There is little evidence in Europe to show that the HR functions have been able to move to a higher level of organisational strategic influence.”

The centrality of human capital to organisational strategy would suggest that the HR function would move to a more influential position. There appears to be little evidence of this, with a few exceptions. Though the number of HR professionals and managers has increased in Europe (from 62.1% in 2003 to 64.5% in 2004), there is little evidence to suggest that their influence within the organisation has similarly increased. The number of HR directors on the main boards of FTSE 100 companies has fallen to only six. In the US, 63% of HR directors have a direct reporting relationship to the CEO, compared with 81% in 2003. Of course, the strategic importance of human capital may mean that CEOs and other senior executives are taking more personal responsibility and control over human capital issues, obviating to some extent the requirement for HR executives to sit at or close to board level.

In both the US and Europe, there is no indication that the internal drive to build business partnerships with line executives to create a more strategic overall contribution is having any marked effect. HR effectiveness cannot, of course, be measured by its cost efficiency (average costs in Europe are approximately at 0.36% of total costs) or its FTE size. It can only be measured by its impact upon key business decisions. It is difficult to find any consistent evidence that this is increasing in overall terms.

Shared services

The move to shared services has continued. The objectives of lower cost, business process excellence, higher advisory consistency and centralised human capital feedback

for policy development all continue to provide the rationale for this shift. However, as was the case last year, there is little evidence in Europe to show that those objectives are being achieved or that the HR functions have been able to move to a higher level of organisational strategic influence. HR functions operating shared services centres still tend to be larger in terms of FTEs than other functions, and do not operate at a lower cost. In addition, the proportion of HR professionals and managers tends to be lower amongst HR functions operating shared services (53% against 65%).

In terms of the service that they provide, no measurable change in satisfaction levels among internal clients or other stakeholders has been detected.

There is little hard data at this time to suggest that shared service operations produce any mainstream benefits. Some organisations have now been operating such services for more than 72 months and, in normal investment terms, returns are expected to be demonstrated soon. An interim conclusion must be that the introduction of shared services requires expert business deliberation, ensuring that purposes and targeted outcomes are fully evaluated, costs are realistically assessed, time to delivery established and intended impacts measured against actual results. All organisations making shared service investments are advised to ensure that lessons are learned from early ventures in the initiative and that any experience of broader usage of customer service centres is not discounted.



Summary reports

The following summary reports from Japan, South Africa and Asia Pacific are included to provide additional insight into the unique and varied role of HR around the world.

Japan

In terms of human capital, Japan faces many of the challenges of other developed economies. The demographic profile for Japan exhibits an even sharper trend towards an ageing population than Western Europe. This is accompanied by increased leisure time for the existing working population – with average annual leave moving upwards from 14.4 days in 1980 to 18.2 days in 2003, whilst the number of companies granting workers two days off every week rose from 47.6% to 88.4% over the same period.

Two distinct aspects of Japanese working culture continue to influence – and to some extent constrain the development of – human capital policies: life-time employment and consensual management styles. The former has a powerful impact on talent management, as companies tend to promote on the basis of seniority and longevity of career. On-the-job training is routinely provided as senior employees are confident that transfer of knowledge and skills will not lead to their role being supplanted by junior colleagues. However, as the commitment to life-time employment wavers under economic strain, there is some debate about the future direction of talent management in Japan.

The stability of the life-time employment culture has historically produced the commercial benefits of depth of experience and knowledge, which in turn has fostered an environment of high and continuous process improvement. However, as globalised competition intensifies, the search for organisational models that produce faster and more frequent innovatory breakthroughs is intensifying. Many organisations are investigating how to adapt their culture to create an environment in which innovation can flourish.

The consensus-based style of management presents a different slant on the issue of leadership. The concept of ‘charismatic’ leadership – as seen in the US and Europe – is less well-developed in Japan, with the role more widely seen as fostering the co-ordination of different opinions. How effective this is as a means to confront global competitive challenges is a live issue in Japan.

The HR function in Japan is, much like its counterparts in the US and Europe, trying to create a more strategic role for itself and to become more closely aligned with business decision-making processes. However, most HR departments remain focused on administrative operations.

“As the commitment to lifetime employment wavers under economic strain, there is some debate about the future direction of talent management in Japan.”

“Talent management is a key issue – influenced by the need to empower previously disadvantaged racial groups.”

South Africa

The specific legislative and regulatory requirements in South Africa accord HR a relatively high profile in many organisations and there is also pressure on the cost of HR with a demand for greater efficiency.

South Africa's recent transition from apartheid has resulted in an emphasis on certain areas of human capital, which are different from other economies. Diversity issues are racially focused and government legislation endeavours to redress the discrimination that existed in the workplace prior to 1994. Sector Charters (i.e. reflecting a business sector or industry) have been implemented that apply a scoring system to evaluate the extent to which black empowerment targets are achieved – businesses are required to report on a race-based headcount. In addition, skills development legislation requires reports to be submitted to the Department of Labour outlining training delivered to the various race groups. The importance of transparency in reporting has thus been heavily influenced by these circumstances.

Talent management is a key issue, again, influenced by the need to empower previously disadvantaged racial groups. This is especially so in professional fields, for example, finance and engineering.

The Asia Pacific Region

(including Singapore, China, Hong Kong, India, Philippines, Taiwan, Vietnam)

These comments are based upon a Human Capital Effectiveness Survey (Needs Assessment Survey) conducted between July and August 2005 in the financial services industry across Asia Pacific. With Asia high on the world's agenda, and the Financial Services industry a key growth engine in all the economies involved, the Survey has particular relevance.

The key people issues identified in all regions were retention of talent, performance management, and leadership.

In the highly competitive Asian environment, it is becoming increasingly difficult to keep good staff, particularly those in senior positions where skills and experience are most valued. Simultaneously, mobility from job to job is seen to increase career value. The importance of talent management to the achievement of strategic business objectives is recognised and as such, high on the agendas of both government and corporations.

Consistent with the current trend to move towards more performance-based working cultures, many organisations are citing performance management as a key people priority.

In the same context, building and generating high employee engagement and commitment in the competitive talent market is seen to fall squarely on the shoulders of corporate leaders. Therefore, the identification of leadership as a key people issue is consistent with the focus of most organisations in the region – high recognition that effective leadership ultimately results in superior stakeholder returns.

Interestingly, the survey undertook an evaluation of the “usage of some key issue programmes” against the “perceived effectiveness of the same programmes”. The results, in brief, were as follows:-

- 78% of organisations reported the existence of leadership development programmes, with 64% considering them to be effective
- 76% of organisations had succession planning, with 61% considering them to be effective. Organisations in China and Taiwan had a poorer perception of the effectiveness of their succession planning, with organisations in Singapore and Vietnam believing that more could be done
- 76% of organisations had talent management programmes, with 61% considering them to be effective

The survey also reports that a measurement scorecard is the least common human capital initiative undertaken by organisations, implying that reports are likely to be measured through qualitative instruments or on a “gut-feel” basis.

In addition, the survey undertook some initial measurement of the Asian Pacific financial services results compared with European financial services using a range of Saratoga metrics for the early 2005 period. The following generic results are produced for illustrative purposes:-

- Revenue per FTE – the European financial services sector is 1.3 to 2 times higher than Asia Pacific
- Cost per FTE – the median cost in Europe is 2 to 3 times higher than in Asia Pacific
- Human Capital ROI (limited Asia Pacific data) – the Asia Pacific financial services sector is some 33% higher than their European equivalents
- Performance Related Pay (PRP) – as a percentage of compensation, PRP in Asia Pacific is some 4 times higher than in Europe
- External Recruitment Rate – the rate can be twice as high in Asia Pacific as compared to Europe

“The identification of leadership as a key people issue is consistent with the focus of most organisations in the region.”

Conclusion

Maximising the human capital contribution

Again, this year, we hope that many of the trends outlined in this document will lead to discussion and argument, and we urge readers who have detected other trends – or who just plainly disagree with the views expressed – to make contact. We believe that discussion leads to breakthrough. PricewaterhouseCoopers continues to search for breakthroughs in human capital thinking. It is our view that, in the immediate years ahead, new thinking and innovative action around human capital contribution will be the best guarantee that people's lives will become more complete and that an organisation's human capital will be given the respect and status that it has so rarely previously received.

References

The majority of the data in this report is drawn from the PricewaterhouseCoopers Saratoga European and US databases. Additional sources of information are detailed below:

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Human Resource Services

PricewaterhouseCoopers Human Resource Services practice works with clients who strive to make their people a sustainable source of competitive advantage. Our strategy is built on our own belief in developing our people to be creative and effective team players committed to outstanding client service. We bring the ability to take fresh perspectives, to think differently, and to develop and implement new and value adding solutions.

We work in close relationships with clients to offer practical, multi-disciplined approaches to the increasingly complex challenges facing businesses. One of the main challenges is to create environments in which their people can work most effectively. Our Human Resource Services practice brings together all of the professionals working in the human resource service arena – tax, benefits, retirement, communications, financial planning, international assignment, equity, culture and change, compensation, strategy, regulatory, legal, and process management - affording our clients an unmatched breadth and depth of expertise, both locally and globally.

Our expertise in tax, law, actuarial, accounting and compliance issues, combined with our knowledge of employment best practices, sets us apart.

