

Human Resource Services
PwC Saratoga

Managing people in a changing world

Key trends in human capital
a global perspective – 2010

We have approached this fourth biennial series of reports with the same rigour as in previous studies – interrogating our PwC Saratoga database and macroeconomic indicators for people-related trends that might just provide our clients with the kind of insight they need to re-engineer their people strategy and, ultimately, stay ahead of the competition.

About PricewaterhouseCoopers Saratoga

PwC Saratoga is the most extensive HR measurement and benchmarking database available. Our advisers work with business leaders to evaluate the contribution people make to an organisation's profitability.

We use a range of quantitative and qualitative tools to identify the impact of people on efficiency, to identify risk and to evidence best practice and innovation across an organisation.

To identify performance against peers, we benchmark data drawn from an organisation against the market – potentially by department, industry and country.

Our service enables business leaders to evidence the effectiveness of business functions, including the performance of people and the HR function. We can help to identify the impact of programmes such as engagement and skills training, on organisational performance, over time.



At the beginning of the second decade of the new millennium, many organisations find themselves trying to steer a course in a destabilised world. Globalisation is

having an effect on our operating models like never before.

The downturn experienced in many industries and economies has highlighted various market and management imperfections. In this new environment some of the people management practices of the past are not fit for purpose.

In my work with clients, I've discovered an appetite for insight. Away from gloomy headlines, business leaders are looking for trends and evidence to support decisions for the future.

In support of our clients, we've analysed the metrics, gained from PricewaterhouseCoopers Saratoga measurement and benchmarking database, containing data from over 10,000 organisations in 40 countries. We have also compared these insights with major macroeconomic indicators from organisations such as UNESCO.

In the following articles, we explore how organisations responded to the global downturn, the progress of globalisation, how organisations are leading, developing and engaging their people and we discuss the influence the public is having on the people agenda. After considering the evidence, we've also made some suggestions to help proactive organisations stay ahead. I trust this report will help you do just that.

Richard Phelps
Leader, Human Resource Management

In this report

Managing people in a changing world considers the impacts people are having on organisations. We compare the relative performance of the workforce globally, discuss the maturity of emerging economies and examine what this means for the rest of the world. In further articles, we discuss some of the issues employers are tackling in developing and engaging their people in order to compete. And finally, we tackle an emerging trend – the increasing scrutiny and influence of society on the people agenda.

Our next report

Due for release in early 2011, our next report considers the impact of the HR function on organisations. The HR profession has been striving for improved efficiency, service standards, insight and influence in the organisation. Based on evidence, we consider how HR has contributed to business success, draw on some positive examples for others to follow and make recommendations for the future.

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For the record: how did business leaders react to the economic downturn?

The global recession was the most serious downturn many business leaders have ever experienced. So how did the world's CEOs manage in the downturn? In this prologue we put on record the actions companies took around people issues to sustain company performance through to recovery.

From September to December 2009, PricewaterhouseCoopers conducted its *13th Annual Global CEO Survey*. The survey looked at the measures CEOs took in response to the global financial crisis, how they view the future business environment and what changes they are making to adapt their organisations. In total, 1,198 business leaders in over 50 countries were surveyed.

Companies worldwide are emerging from deeper cost-cutting than expected. In the *12th Annual Global CEO Survey*, conducted as the financial crisis unfolded late in 2008, 26% of CEOs told us they expected headcount reductions over the following 12 months. A year later, closer to half of respondents said they actually cut jobs and at least 80% of CEOs in each region of the world initiated cost reductions.

Companies based in North America and in Western Europe took the most drastic action, with 69% of US companies and 63% of UK companies reducing headcount. Despite the drop in consumer spending in many nations, consumer goods businesses were not amongst the leaders in job cuts, with only 43% of companies cutting personnel numbers. Job cuts were most prevalent in the automotive industry (80% made cuts) industrial manufacturing (68%) and in the media/entertainment sector (71%). Utilities proved the most stable, with 21% of companies reporting cuts.

Despite this gloomy picture, 39% of CEOs hope to increase headcount in 2010. However, it is the long-term legacy of these headcount reductions that could impact the recovery and business competitiveness for years to come.

In previous CEO surveys, having access to people with key skills was a key business threat and was cited as the number one

threat by CEOs in 2006. Fast forward to the end of 2009 and only 16% of CEOs reported being 'extremely concerned' with the issue. It appears CEOs are confident of a better talent pool in recovery. Yet we believe that this optimism will be short lived. Talent shortages caused by a general lack of key skills and hampered by demographic change, will return to haunt CEOs once the short-term glut caused by the downturn evaporates.

In the latest survey, CEOs also told us they would change a number of people management practices and processes as a result of the economic crisis. A majority of companies (79%) are intending to increase their focus and investment on how to manage people through change, which includes redefining employees' roles in the organisation. The same number (79%) want to change their strategy for managing talent. And 68% will increase their investment in leadership and talent development as a result of the crisis.

The scale of these anticipated changes suggests that, for whatever reason, existing people management practices did not support the business when the crisis hit.

We believe the CEO survey highlights three major human capital failures which were brought to the surface as a result of the downturn:

- Existing reward models are broken. Whether as a result of regulatory or public pressure, reward models are seen as not fit for purpose in many parts of the world. This is not just confined to financial services; we are seeing criticism of reward models across almost every sector. In addition, the heavy burden of pension and healthcare liabilities are crippling many otherwise successful organisations in the US and Europe.
- CEOs were unable to move talent around quickly when the crisis hit. This led to large-scale layoffs to save cash at one extreme, but also left crucial talent

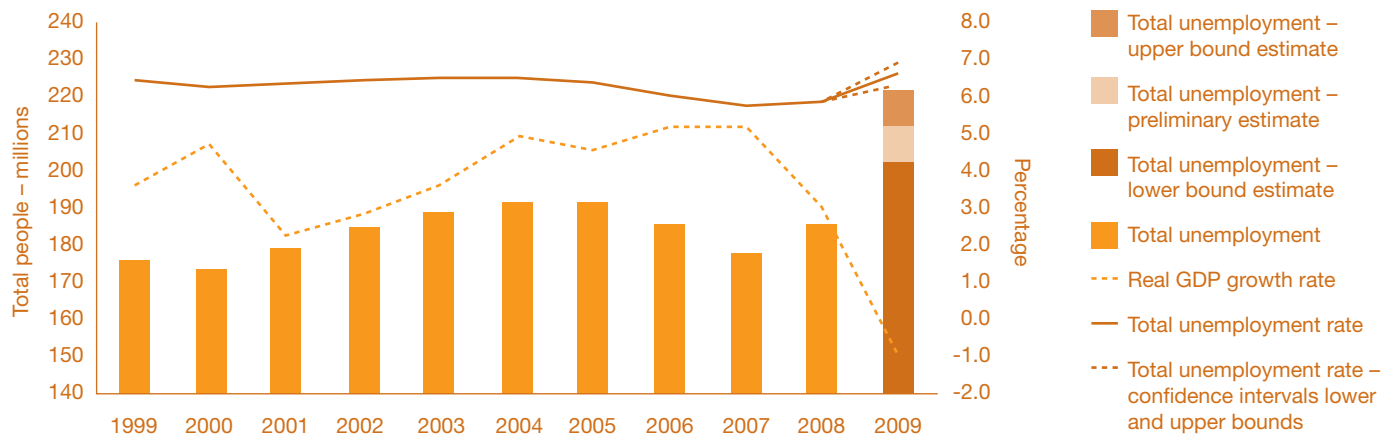
gaps at the other. Organisations will have to find more agile ways of deploying and reallocating talent to where it is most needed. Doing this while keeping employees engaged is key, with 75% of CEOs planning to invest in improving employee morale and engagement. As organisations move through recovery, those that underwent drastic headcount reduction now face the costly exercise of rehiring and reskilling as demand improves.

- Many organisations lack the key skills needed to operate and compete in the new emerging environment. For example – greater risk awareness, market adaptability, change management capability, responding to new customer demands. CEOs in many parts of the world also believe that governments have largely failed to supply a workforce with the right skills (57%). This is likely to support why 76% of CEOs plan to increase their investment in training and development.

Throughout the downturn, CEOs cut headcount and scaled back spend significantly as a result of the global economic crisis. HR has played a vital operational role in helping business leaders get through these challenging times. As companies begin to emerge, CEOs are questioning their existing people management strategies and recognising the need for change. CEOs seem to indicate a change in focus for people management – new approaches and investment will be needed as part of setting a smarter course for growth.

In the following articles we explore the impact people are having on organisations across the world. We use data, including our own Saratoga database, to discover trends and then discuss the strategies the HR function and business leaders need to implement in order to stay ahead.

Graph 1: Global unemployment trends, 1999 - 2009*



*2009 are preliminary estimates

Source: ILO, Trends Econometric Models, October 2009 International Labour Organisation, October 2009

Table 1: Worldwide unemployment rates – the International Labour Organisation estimated that unemployment rose more sharply in developed countries as highlighted below.

| | 1999 | 2000 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 estimate | % increase 08-09 |
|---|------|------|------|------|------|------|------|---------------|------------------|
| World | 6.4 | 6.2 | 6.4 | 6.3 | 6 | 5.7 | 5.8 | 6.6 | 0.8 |
| Developed economies and EU | 7 | 6.7 | 7.2 | 6.9 | 6.3 | 5.7 | 6 | 8.4 | 2.4 |
| Central and South-eastern Europe (non-EU) & CIS | 12.4 | 10.6 | 9.7 | 9.4 | 9 | 8.3 | 8.3 | 10.3 | 2 |
| East Asia | 4.7 | 4.5 | 4.2 | 4.2 | 4 | 3.8 | 4.3 | 4.4 | 0.1 |
| South-East Asia and the Pacific | 5.1 | 5 | 6.4 | 6.5 | 6.1 | 5.4 | 5.3 | 5.6 | 0.3 |
| South Asia | 4.3 | 4.5 | 5.2 | 5.3 | 5.1 | 5 | 4.8 | 5.1 | 0.3 |
| Latin America and the Caribbean | 8.5 | 8.4 | 8.4 | 8 | 7.4 | 7 | 7 | 8.2 | 1.2 |
| Middle East | 9.3 | 9.5 | 9.3 | 10 | 9.5 | 9.3 | 9.2 | 9.4 | 0.2 |
| North Africa | 13.1 | 14 | 12.3 | 11.5 | 10.4 | 10.1 | 10 | 10.5 | 0.5 |
| Sub-Saharan Africa | 8.2 | 8.3 | 8.2 | 8.2 | 8.2 | 8 | 8 | 8.2 | 0.2 |

Source: Trend Econometric Models, International Labour Organisation, October 2009



A pretty good recession

‘The extremes of boom and bust are as sure as the earth is round, even if their timing is unpredictable. So while few people will argue that the first decade of the new millennium saw a boom, there is evidence that the widely predicted worldwide bust, thankfully, didn’t occur. That’s not to say that there were not national, corporate and personal disasters but, in reality, history will tell that this recent period represented a pretty good recession.

The majority of companies in our CEO survey reported that they made job cuts. In my own work with clients, the flip side of the story is that these cuts were potentially less in number than some might think. Companies reacted differently to this contraction than they have previously. Perhaps employers have learnt from the past – retaining employees can help a company rebound more quickly when the worst of the downturn is over.

So, if they didn’t resort to large scale redundancies, how did companies survive the recession? In my experience employers introduced cost-saving initiatives that would achieve similar results to job cuts – with less pain. Among other management decisions, I witnessed companies freezing wages, offering sabbaticals, reducing expenditure on formal training, adjusting employee expenses policies and freezing external in favour of internal recruitment. Invariably, however, at the end of the worst of the downturn, many companies were in a position where natural attrition had reduced headcount.

What will be interesting in the future (remember the exact timing of business cycles can’t be predicted), is if employers will respond to a period of growth by employing more people or if they will make do with existing resources. In my experience, increasing the number of employees does not directly correlate with profitability – perhaps we’re better to grin and bear the grind, for just a little longer.’

Richard Phelps, Leader, Human Resource Management, PricewaterhouseCoopers LLP (UK)

Return on investment

According to the PwC Saratoga human capital return on investment (HC ROI) measure (see table 2), US organisations have proven to be much more agile than their UK and Western European peers at responding to the downturn.

HC ROI measures the return on people investment. It reports the pre-tax profit produced for every euro, pound or dollar paid out in remuneration.

In Western Europe and the UK, despite high growth in revenues during the uninterrupted growth years of 2002 to 2006, the rise in HC ROI was a mere 8.3% and 4.6% respectively. Over the same period US HC ROI increased by 19.8%. In 2007, we saw the first signs of decline in some economies and in 2008, with markets suffering, the index (see table 1) fell in both Western Europe (1.7%) and in the UK (2.8%) but was held steady in the US.

Further metrics from the *Saratoga European human capital effectiveness report*¹ draw the same conclusions. Remuneration over revenue (see table 3) and remuneration over total cost measures, two simple productivity metrics, indicate the United States' ability to quickly reduce costs when market conditions demand.

These statistics highlight a need for Western Europe and the UK to look more closely at how human resources are managed. The differences are not due

to revenue growth divergences but the ability of different economies to flex the level of employment costs to market conditions. The US clearly kept employment numbers under tight control.

Organisations in Western Europe and the UK might suggest the results are a reflection of the more highly regulated employment environment in which their companies operate, and the environment certainly contributes. However, there are many examples of very competitive organisations in these territories that turn to more than just outsourcing to resolve competitive issues.

How organisations can stay ahead

The downturn highlighted the need for companies to take a greater interest in people management employment disciplines. Companies need to assess the costs, productivity and profitability of their various functions against the performance of similar teams in the market. As a result, organisations may be able to identify excess people in underperforming teams, providing a business case for redeployment of people into areas of the business needing

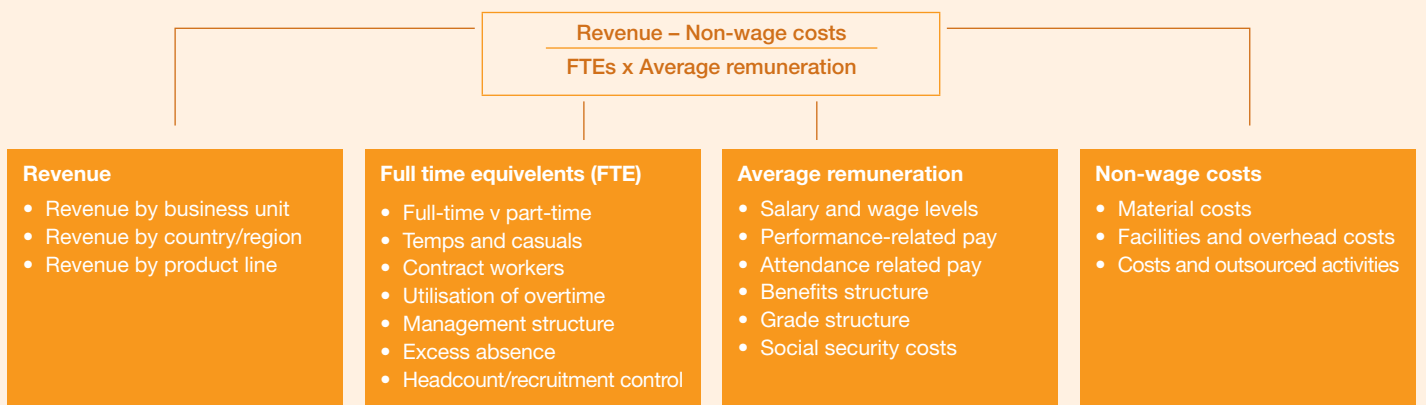
resource. This works particularly well in organisations with headcount freezes, allowing profit centres to grow despite an overall freeze or reduction in staff across the organisation.

Leading organisations use people measures as key performance metrics. Metrics can be used to track productivity differences between peers, production sites and from one team to another. ROI metrics are also used to compare one organisation against competitors – helping to set benchmarks. PwC Saratoga consistently reports 12 key people measures. These can be found on the following page.

The downturn has certainly increased the need for insightful management information. Crisis-weary investors and regulators will demand more transparency of decision making from the CEO and others. Gut feel will not cut it. With the pain of the downturn in recent memory, the human resource profession now has an opportunity to raise the importance of people reporting measures and with such information at hand, HR has the opportunity to make a greater contribution to management decisions.

Diagram 1: Human capital return on investment (HC ROI)

Organisations with a lower than average HC ROI in their given industry and territory have a range of avenues to find improvement. We present below the factors that can be manipulated in order to improve profitability.



1. PwC Saratoga European human capital effectiveness report, PwC, 2009

Table 2: Human capital ROI trend 2004/5 – 2008/9

| Country | 2004/5 | 2005/6 | 2006/7 | 2007/8 | 2008/9 | % change 2006/7- 2008/9 | % change 2007/8- 2008/9 |
|----------------|--------|--------|--------|--------|--------|-------------------------------|-------------------------------|
| UK | 1.11 | 1.13 | 1.13 | 1.14 | 1.11 | -2.1% | -2.8% |
| CEE Europe | 1.11 | 1.23 | 1.25 | 1.22 | 1.57 | 25.4% | 28.6% |
| Western Europe | 1.14 | 1.16 | 1.17 | 1.18 | 1.16 | -0.9% | -1.7% |
| All Europe | 1.14 | 1.16 | 1.17 | 1.20 | 1.16 | -0.6% | -2.6% |
| US | 1.52 | 1.36 | 1.57 | 1.53 | 1.53 | -2.5% | 0.0% |

Source: PwC Saratoga database

Table 3: Remuneration/revenue trend 2004/5 – 2008/9

| Country | 2004/5 | 2005/6 | 2006/7 | 2007/8 | 2008/9 | % change 2006/7- 2008/9 | % change 2007/8- 2008/9 |
|----------------|--------|--------|--------|--------|--------|-------------------------------|-------------------------------|
| UK | 24.1 | 24.0 | 25.0 | 24.7 | 25.1 | 0.6% | 1.8% |
| CEE Europe | 14.6 | 12.7 | 13.3 | 14.1 | 13.3 | 0.1% | -5.7% |
| Western Europe | 22.2 | 21.8 | 21.7 | 21.4 | 21.6 | -0.6% | 1.0% |
| All Europe | 21.6 | 21.6 | 21.6 | 21.1 | 21.4 | -0.9% | 1.6% |
| US | 28.0 | 29.3 | 29.8 | 28.0 | 22.1 | -25.8% | -21.1% |

Source: PwC Saratoga database

Table 4: European medians by sector 2008/9 – core productivity measures

| Industry sector | Human capital ROI (€) | Remuneration/revenue (%) | Remuneration/total cost (%) | Average remuneration (€) |
|------------------|-----------------------|--------------------------|-----------------------------|--------------------------|
| Banking | 1.69 | 34.0 | 44.6 | 86,682 |
| Other finance | 1.19 | 27.2 | 59.6 | 46,372 |
| Insurance | 1.84 | 8.6 | 28.1 | 68,933 |
| Comms/media | 1.17 | 21.8 | 22.1 | 55,646 |
| Technology | 1.11 | 41.9 | 46.0 | 65,670 |
| Pharma | 1.31 | 15.3 | 15.5 | 41,199 |
| Chemicals | 1.42 | 16.1 | 16.4 | 47,096 |
| Eng/Mfg | 1.18 | 20.4 | 21.2 | 45,294 |
| Utilities | 1.35 | 15.6 | 17.0 | 54,863 |
| Retail & leisure | 1.15 | 17.6 | 17.9 | 30,347 |
| Services | 1.14 | 22.8 | 23.7 | 43,918 |
| Public sector | n/a | n/a | 49.7 | 46,360 |

Source: PwC Saratoga database

The 12 Key PwC Saratoga human capital metrics

Over the past two decades, our specialists 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. These measures are most useful when an organisation compares its performance against competitors and organisations with a similar workforce composition. An industry by industry breakdown is provided in Appendix 1, page 19

| Metric | European medians |
|------------------------|------------------|
| Revenue per FTE | €202,500 |
| Cost per FTE | €192,569 |
| Profit per FTE | €6,795 |
| Wealth created per FTE | €-185 |
| Human capital ROI | €1.16 |
| Remuneration/revenue | 21.4% |
| Remuneration/cost | 22.2% |
| Absence rate | 4.4% |
| Resignation rate | 10.0% |
| Acceptance rate | 91.9% |
| Cost per hire | €693 |
| L&D Investment per FTE | €429 |

Source: PwC Saratoga database



'In the US, less prescriptive rules permit greater flexibility in adjusting the workforce to meet marketplace demand. Remaining agile has allowed successful business leaders in the US to consider new approaches to workforce reduction while maintaining the ability to respond quickly. By considering all options for workforce cost reductions and adopting a fact-based approach to support informed decision making based on human capital ROI, successful organisations have been addressing the financial crisis with decisiveness and agility.

However, companies need to be careful that such adjustments do not leave employees disengaged. Strong employee engagement drives business performance and enhances the return on workforce investment'.

John Caplan, partner, PricewaterhouseCoopers LLP (US)

The rise and rise of emerging economies

Within the next decade the global competitive landscape will have changed dramatically. The BRICs (Brazil, Russia, India and China) plus others will have driven their way into the top league. To remain competitive, large and small companies across the world need to decide what this means for their organisation and where their people resource is best deployed.

Using gross domestic product (GDP) as a measure, from 2002 to 2009 the BRIC economies grew by 83%, CEE Europe by 46.9%, Asia by 62.4% and US, Western Europe and the UK by 12.3%, 9% and 9.5% respectively. At the existing rate of growth, it is widely forecast that within 20 years the world's mature economies will be overtaken by resource-rich regions like the Middle East, Brazil, Canada, Australia and Russia, and people-rich regions such as China and India. It appears that the US, Western Europe and Japan, among others, face major challenges.

Globalisation will undoubtedly reduce the clarity of who owns what and where, but will accentuate the importance of the employment centre location. Work is likely to move increasingly to where the skills are available, employment costs represent best value and the social environment is conducive to workforce agility.

In the 13th Annual *Global CEO Survey*, 53% of respondents were somewhat or extremely concerned with the effect of low-cost competition on growth prospects. In order to compete, we expect organisations will favour international locations where the labour force and their government are noticeably orientated

towards innovation and productivity. People will be more internationally mobile too, with employers establishing talent banks drawing on the skills and knowledge of a culturally diverse team.

How organisations can stay ahead

The dilemma for many mature economy governments, specifically in Western Europe, is how to balance entrenched social wellbeing policies while competing with more highly productive and lower-cost territories. For Western Europe, the recession has highlighted how powerful and agile competing countries have become. Governments will need to ensure that elements such as employment law, taxes and education standards are appropriately structured to attract employers and key talent.

Organisations in BRIC and other emerging countries are not without their own challenges. The increasingly talented population are likely to become more internationally mobile, while demographic shifts and reward expectations will drive wage increases.

If they have not already, it is critical for organisations, large and small, to plan for their increasingly globalised future.

Remaining competitive will require organisations to assess their own productivity versus the market and to decide who should produce (the company's own employees or via an outsourced agreement), where to produce (determining the value derived from outsourced services) and when to make changes. The winners will be those organisations that move early to identified locations with the right people for the job.

Companies in emerging economies face competitive challenges too

'What really worries me, and where I think India's long-term competitiveness, particularly as a manufacturing destination might suffer, is the lack of labour reforms. India's outdated labour laws, the ones that seek to protect existing jobs irrespective of market conditions, actually impede the creation of new jobs.'

Pawan Munjal
Managing Director and CEO,
Hero Honda Motors



Brazil didn't become one of the fastest growing economies by accident

'Like many developing countries, Brazil is rich in both natural and human resources. It is the fifth largest country by land size and population and borders every South American country besides Chile and Ecuador. Considering this, it's fair to say that Brazil has taken its time to catch up with similarly resourced countries. So what has triggered the growth that now sees Brazil as the world's eighth largest economy by nominal GDP?

In the past 25 years Brazil has been through a real transformation, including the achievement of democracy, improvement in civil society and national currency stabilisation. Alongside these successes, Brazil has emerged as a relatively neutral and reliable ally and leader of neighbouring countries in dealings with the EU and Americas.

In this more stable economy, Brazil has flourished. Aided by consistently good returns for agricultural and mining products, Brazil has been able to invest in technology and research. Unlike many economies, it now has the natural resources, the people and the know-how to produce finished goods such as petrochemicals, submarines, aircraft and consumer products. This sophistication has spurred continued growth and enabled inward and outward investment.

To aid competitiveness, governments will need to address the administrative burden of labour regulations. In addition, Brazil must continue to invest in talent to sustain accelerated economic growth. Fortunately, schools, technical colleges and universities are receiving the greater government support they need. The private sector has also increased its investment in learning and development and there is now a greater focus on inward talent mobility'.

João Lins, partner, PricewaterhouseCoopers Brazil

Table 5: Global GDP trends 2008/9 – countries with greater than 10% growth of GDP per hour worked are highlighted

| Country | % change GDP | | % change GDP per hour worked | | % change GDP per person employed | |
|------------------------|--------------|-----------|------------------------------|-----------|----------------------------------|-----------|
| | 2008-2009 | 2002-2009 | 2008-2009 | 2002-2009 | 2008-2009 | 2002-2009 |
| Australia | 0.6 | 21.3 | 0.4 | 5.3 | 2.6 | 9.0 |
| Austria | -4.4 | 10.5 | -3.0 | 3.8 | -1.6 | 7.5 |
| Belgium | -2.9 | 9.7 | -2.0 | 3.1 | -1.6 | 4.7 |
| Brazil | 0.0 | 28.3 | 1.5 | 11.3 | 1.5 | 11.3 |
| Canada | -3.1 | 11.0 | -1.5 | 0.8 | -0.2 | 3.2 |
| China | 8.0 | 109.0 | 8.5 | 99.7 | n/a | n/a |
| Cyprus | -0.8 | 24.2 | -0.5 | 3.4 | -0.5 | 7.4 |
| Czech Republic | -3.6 | 28.9 | -1.6 | 24.2 | -1.6 | 23.0 |
| Denmark | -4.4 | 4.5 | -1.8 | 2.3 | -0.6 | 1.5 |
| Estonia | -10.3 | 28.7 | -1.4 | 28.4 | -1.4 | 29.5 |
| Finland | -6.7 | 11.6 | -3.9 | 6.7 | -2.5 | 9.7 |
| France | -2.3 | 8.2 | -0.5 | 6.2 | 0.3 | 6.6 |
| Germany | -4.9 | 3.3 | -4.8 | 0.3 | -2.2 | 4.3 |
| Greece | -1.1 | 24.8 | -0.2 | 16.6 | 0.0 | 16.4 |
| Hungary | -4.9 | 13.7 | -1.9 | 9.5 | -1.9 | 11.6 |
| Iceland | -11.4 | 17.1 | -9.4 | 5.1 | -8.5 | 6.3 |
| India | 6.0 | 72.8 | 3.9 | 46.3 | n/a | n/a |
| Ireland | -7.4 | 16.1 | 0.5 | 6.8 | 1.2 | 10.3 |
| Italy | -4.8 | -0.3 | -3.7 | -5.1 | -3.1 | -2.9 |
| Japan | -5.4 | 4.2 | -2.5 | 6.3 | 0.3 | 11.0 |
| Latvia | -13.6 | 31.2 | -1.9 | 30.2 | -1.9 | 41.8 |
| Lithuania | -13.7 | 34.1 | -5.9 | 34.0 | -5.9 | 26.6 |
| Luxembourg | -3.5 | 21.3 | -4.6 | -1.4 | -4.2 | 2.3 |
| Malta | -2.2 | 12.0 | -1.6 | 3.7 | -1.6 | 4.1 |
| Mexico | -1.5 | 18.0 | -0.3 | 6.0 | -0.3 | 5.4 |
| Netherlands | -4.4 | 9.3 | -3.9 | 4.7 | -3.6 | 6.9 |
| New Zealand | -0.8 | 14.8 | 0.3 | -0.9 | 0.5 | 2.9 |
| Norway | -1.7 | 14.1 | 0.1 | 3.9 | -0.5 | 2.6 |
| Poland | 0.9 | 36.1 | 1.6 | 19.8 | 1.8 | 30.1 |
| Portugal | -2.7 | 2.0 | -0.4 | 4.5 | -0.3 | 6.3 |
| Russian Federation | -3.7 | 44.7 | -3.7 | 39.0 | n/a | n/a |
| Slovakia | -4.4 | 42.1 | -2.4 | 32.2 | -2.4 | 29.5 |
| Slovenia | -5.6 | 23.7 | -3.0 | 18.6 | -3.0 | 20.3 |
| South Korea | -2.9 | 22.7 | -2.4 | 15.9 | -2.6 | 26.4 |
| Spain | -3.6 | 15.5 | 3.2 | 4.6 | 3.9 | 10.8 |
| Sweden | -4.5 | 11.5 | -2.3 | 9.9 | -1.0 | 9.3 |
| Switzerland | -2.8 | 11.5 | -2.0 | 4.6 | -2.1 | 2.6 |
| Turkey | -4.4 | 34.7 | -3.1 | 26.0 | -3.1 | 27.6 |
| United Kingdom | -4.6 | 9.5 | -2.7 | 5.0 | -1.9 | 8.7 |
| USA | -2.5 | 12.3 | 1.0 | 9.5 | 2.6 | 13.9 |
| Economic region | | | | | | |
| Africa | 3.7 | 44.3 | 1.1 | 18.4 | n/a | n/a |
| Asia | 3.8 | 62.4 | -2.9 | 20.4 | n/a | n/a |
| BRIC | 5.7 | 83.0 | 1.4 | 40.4 | n/a | n/a |
| CEE | -2.8 | 46.9 | -2.2 | 34.8 | n/a | n/a |
| Latin America | -0.4 | 32.6 | -2.4 | 15.2 | n/a | n/a |
| Middle East | 2.7 | 40.0 | 0.0 | 13.6 | n/a | n/a |
| North America | -2.5 | 12.2 | -0.1 | 5.7 | 1.4 | 9.1 |
| Oceania | 0.4 | 20.4 | 0.3 | 2.3 | 1.6 | 6.0 |
| Western Europe | -4.0 | 9.0 | -2.3 | 4.7 | -1.6 | 6.3 |

Source: Total Economy Database, The Conference Board and Groningen Growth and Development Centre, January 2010

The future for outsourcing and offshoring

Outsourcing and offshoring is now an elemental part of many organisations' strategy and structure. What more can we expect in the upturn?

In a PwC survey of 266 customers and 66 outsourcing service providers across 19 countries¹, 87% of customers said that outsourcing delivered the benefits projected in the original business case. Given this high level of satisfaction and the need for cost reduction, it was hardly surprising to discover that 35% of CEOs² outsourced a business process or function and 35% entered into a new strategic alliance or joint venture during the downturn to help deal with the spiralling business environment.

At the end of 2009, as the downturn receded, outsourcing and offshoring was again visited with the need for low-cost, and high-quality service from reliable suppliers in any activity. For example, in a mid-2009 survey³, more than 40% of 947 North American and European companies reported an increase in their software application outsourcing efforts. Business process outsourcing (BPO) activity is now forecast to reach \$55.9bn by 2012⁴, up from some \$10bn in 2005. While publishers of the 2009 Palgrave handbook⁵ estimate 20% annual growth in the offshore outsourcing market for IT and business services over the following five years. In downturn and in growth, the impetus towards outsourcing and offshoring appears unstoppable.

However, there are challenges. In our outsourcing study¹, 48% of customers said they continue to be held back from offshoring by challenging cost-benefit justifications and a lack of experience in the market. 45% favoured using in-house employees over outsourced staff, 37% of respondents said they lacked the skills to manage outsourcing and 37% felt they needed to 'clean up' operations before outsourcing them. Interestingly, the ethics

of moving jobs and the public's reaction to offshoring was only an issue for around 20% of companies.

In a sign that we still have a long way to go, customers in the survey¹ admitted that when projects fail, their first inclination is to blame service providers. In our experience, there is too much reliance on the service provider to deliver the cost benefit, when in reality the requirements and responsibilities are not clear to both parties. In possibly a more accurate assessment, service providers in the same study considered the main cause of failure to be poor collaboration with customers.

'It is not solely a matter of communication in the traditional sense between a client and a vendor. Rather than just throwing work to an outside company, clients must bring the outsourcing or offshoring company into the fold...'

Som Mittal, President, Nasscom, India.

Another challenge that organisations face is the balance between cost and quality as both vary in process and provider. For example, a core transaction such as payroll shows better performance when it is implemented by a third party. On the other hand, more complex processes, such as recruitment, show low levels of service quality and satisfaction even though they are cost effective. In the case of recruitment outsourcing, our Saratoga HR shared services index generally finds quality factors such as 'role acceptance rate' decreases, new employee turnover (those leaving in their first 12 months) increases and line managers rate the recruitment process lower. Not surprisingly

the cost per hire significantly decreases compared to in-house recruitment.

How organisations can stay ahead

We have already identified in the previous article that Western Europe, the US and Japan face competitive threat from the fast-maturing emerging economies. For companies who have not already investigated operations in emerging markets, it is wise to at least scope the competitive threat of 'doing nothing' and the human resource opportunities that exist in these markets.

In this next decade, the client needs to evolve its relationship with the outsourced supplier. Healthy long-term relationships in the best interests of both parties should replace contracting the lowest-cost provider. Our outsourcing study has already found evidence of clients and service providers shifting towards more collaborative business models. Organisations using lengthy contracts with detailed specifications should consider moving towards less complex contracts with higher levels of flexibility for both the client and the supplier – more akin to an employment relationship than a rigid contract. Future outsourcing needs to be more focused on product improvement and productivity, rather than pure cost reduction.

The client and the contractor should also investigate the opportunity to share staff between both organisations on short and longer-term secondments. This will not only allow each organisation to start to understand each other better, it will also allow key talent from both organisations to collaborate on projects over the long term rather than within the constraints of a site visit or video conference.



'Offshoring is here to stay but its drivers have changed. The first wave of offshoring was all about cost arbitrage as global companies sought competitive advantage through cost management. After a decade and more of sustained cost reduction, many companies that have offshored their processes are now seeking additional value from their partners that goes beyond cost reduction. Productivity and process enhancements are now as talked about as costs, and other important dimensions such as security, risk, governance and responsible business practice are on the agenda as well. Companies that are planning to offshore must set up a robust and holistic evaluation framework that takes account of all of these factors'.

R.Sankar, executive director, PricewaterhouseCoopers India

1. Outsourcing comes of age: The rise of collaborative partnering, PwC, 2007

2. 13th Annual Global CEO Survey, PwC, 2009

3. Forrester Research Inc., 2009

4. Gartner Inc., 2008 – 2009

5. Palgrave Handbook of Global Outsourcing and Offshoring, 2009

Innovation requires greater investment

In a world of incessant change in customer demand and aspiration, innovation becomes a core competence. Without it survival is threatened.

PwC Saratoga evaluates innovation on two dimensions – firstly, to what extent an organisation invests in innovation, (that is, the supporting infrastructure) and secondly, the extent to which it fosters an innovative culture (i.e. ‘shared experimentation’). The two dimensions provide a balanced evaluation of innovation competitiveness. A key indicator of the level of the supporting infrastructure is the disciplined investment in research and development (R&D) – a bottom line financial measure of real intent. ‘Shared experimentation’ is demonstrated via the actions taken to sponsor ideas and suggestions, establish ‘breakthrough’ teams, involve customers and suppliers, change structures and strategies to bring new products or services to market.

In the period from 2002 to 2007¹ the number of researchers in developing countries jumped from 1.8m to 2.7m, a 45% increase. This equates to a jump from 344 researchers per million inhabitants to 499/m in five years. During the same period the number of researchers in developed countries increased by only 8.6% (although the number per inhabitant is a much higher 3,592/m)

These figures are interesting given that commentators often point to innovation as mature economies’ competitive strength. Few would argue that Western economies current level of investment in R&D is a sustainable approach. The BRICs and others are catching up fast.

So how are emerging economies competing? It appears ‘shared experimentation’ is increasingly benefiting the emerging economies, providing an alternative to traditional R&D vision of new product and service development. It embraces such strategies as reverse innovation, where new products or services are developed locally before being transferred to other markets. It has allowed emerging economies to become,

in former leading consultant CK Prahalad’s words, “laboratories for radical innovation”. It is not long before these economies become centres of innovatory excellence.

Innovation is a critical competitive tool with major effects upon business success or failure. It drives increasing numbers of alliance, joint venture and merger and acquisition activity. The National Endowment for Science, Technology and Arts’ (NESTA) Innovation Index shows two-thirds of the productivity growth between 2000 and 2007 was driven by innovation rather than changes in labour or capital investment. It has of course high cost implications and at times of recession, it is not surprising that it descends the scale of CEOs focus².

How organisations can stay ahead

The future sustainability of most companies, wherever they operate, will rely on the ability to develop a sharp innovatory culture reflected in investment, both in appropriate infrastructure and, increasingly, in the thinking and innovation of a company’s people.

Innovation relies on investment in people who understand the needs of commerce and society as well as the scientists, engineers and creative people who can develop the products and services. In order to devise products that meet

the needs of a global customer base, organisations need to consider the age, sex, race and geographic factors that determine the preferences of their end user. Employers who want to trade worldwide will need to mirror their client’s diversity in their own people, attracting innovative people across the world.

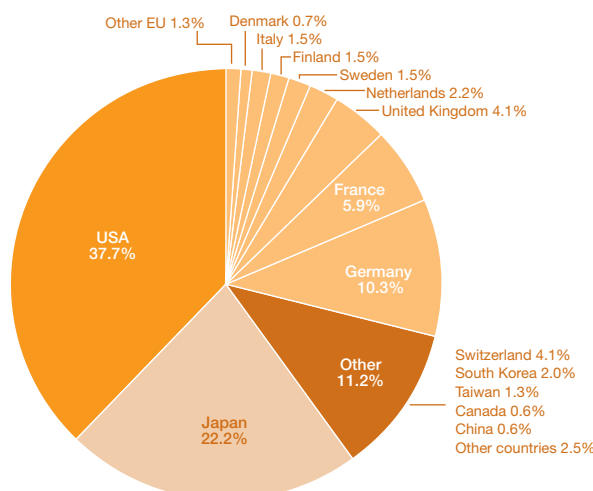
This innovative group of employees could be drawn from traditional economic hubs such as London, New York or Shanghai. However, a more local and more geographically spread talent bank may represent a better investment – workplace locations may need to be reviewed.

We believe the leading organisations of the future are already evident. Those who have embraced change, who have merged or established global ventures and alliances that bring together people from across the world, will be the leading innovators of the future. The laggards need to act now.

‘Companies that hunker down for the duration may wake to find their customers have abandoned them and that their products and services have been bettered by entrepreneurial upstarts.’

Management Consultancy Association

Graph 3: R&D investment by the top 1350 companies in the European Commission industrial R&D investment scorecard



Source: The 2009 EU Industrial R&D Investment Scoreboard European Commission, JRC/DG RTD.

1. UNESCO UIS Institute for Statistics, 2002 – 2007
2. 13th Annual Global CEO survey, PwC, 2009

There is no shortage of talent – just an opportunity to better develop your people

48% of organisations¹ made headcount cuts in reaction to the downturn. This worldwide action has the potential to have a major long-term consequence on the talent pipeline and organisations' ability to recover and compete in the upturn.

In the 12th Annual Global CEO Survey (2008), 97% of CEOs believed that the access to and retention of key talent was critical or important to sustaining growth over the long term. While we expect that talent has been more accessible in recent times, as a result of fewer organisations advertising vacancies, the most recent (2009) survey reported that access to people with the right skills was a key challenge for 51% of CEOs. CEOs are clearly frustrated with the access to skills with 65% wanting to change their talent management strategy.

This desire to change the talent management strategy comes with good reason. Recent PwC Saratoga research raises questions over the quality of talent management programmes. Based on a survey of FTSE 100 and multinationals, on average organisations reported at least one successor for each key position. However, when vacancies arose only one in three were filled by the succession candidates, the remainder being drawn from external sources or from elsewhere within the organisation. Before proclaiming a shortage of talent, perhaps we should be serious about the talent we have.

New challenges lie ahead too. Consider the growth of emerging markets (discussed on page 8). These economies will compete in the talent marketplace to

a greater extent too, developing their own and attracting others from across the globe. With ageing population trends, there will be demographically fewer people working and more people dependent upon them. Prosperity will depend on a more limited number of talented people producing wealth.

'More competitive times mean that we need to have narrow levels of tolerance between good, acceptable and lower performance. We are thinking more critically about how we differentiate, how we incentivise, how we reward top performers and how we identify areas where people who are good can improve further.'

Phil Cox, CEO, International Power.

How organisations can stay ahead

PwC has a clear position. Talent management is not only about projecting fast-trackers, it is about identifying the universality of talent and developing individuals in their role (no matter how modest) to add increasing value to that role and its contribution to company performance. Companies should be identifying pivotal employees – exemplars who set standards for others to follow.

Organisations should think outside of the box. In the search for talent, employers need to challenge their traditional processes. How many organisations exclude talented individuals from the internal or external recruitment process because they do not have country or industry specific experience, or a degree? Companies need to challenge if these practices are still relevant. The identification of talented individuals might even extend to known agency staff, contractors, suppliers and customers.

Talent management is not just another HR instrument. It is a business strategic priority. As such, it is critical to move beyond motherhood statements and understand the hard talent issues ahead. Start by measuring them, then act, then measure the results. And then act again. To date there has been much talk and little action.

'The astonishing reality is that most (companies) are as unprepared for the challenge of finding, motivating and retaining capable people as they were a decade ago'

(McKinsey & Company)

Table 6: Talent development key performance indicators

The key performance indicators in this table provide evidence of the effectiveness of talent management processes across organisations featured in the Saratoga database.

| Metric | Median 2008/9 |
|---|---------------|
| Talent resignation rate (%) | 4.3 |
| Ratio of talent externally hired versus internally promoted | 87 : 13 |
| Percentage of key positions filled by identified succession candidates | 33.3 |
| Gender diversity – % of women among identified talent population | 26.2 |
| Succession pipeline depth (X:1) – for each key position, 1.2 people are identified as potential successors among key talent | 1.2 |

1. 13th Annual Global CEO Survey, PwC, 2009

It appears leadership development programmes do not fit the bill

Recessions do not just happen. Market cycles are influenced by the collective decisions and actions of people over a period of time – specifically, those leaders who have the greatest influence upon economic activity. Governments, regulators and bankers are among those most publically criticised for market failure, but what about wider business leaders? Will investment in leadership help those with influence make better decisions?

It is clear in the flurry of cost-cutting activity, and at times ill-conceived reactions, business leaders did not predict, or put themselves in the best position, to deal with a global economic downturn. Perhaps we thought the economic models of the past were broken? We expect governments, economists and advisory bodies to monitor, regulate and communicate throughout the business cycle. And certainly, accurately predicting market failure is out of reach, but we should have expected more from business leaders. It is now time for us to look searchingly at the qualities future leaders will require.

PwC Saratoga's 2008 *Key trends in human capital* report concluded "(We) have little evidence in any organisational activity that the quality of leadership is developing at the pace required by the rapidly changing globalised and networked world." We made this statement having analysed PwC Saratoga's leadership metrics (see page 14). These metrics evaluate bottom line impact, follower performance, talent and skill development, plus social/environmental involvement. They produce a snapshot of the state of generic leadership within any organisation.

Examining recent results, the period of great upheaval has produced mixed performance, with financial impacts being heavily hit with limited increases in core productivity. Employee retention levels have continued to fluctuate, while the level of training has marginally increased. Two years on from our previous publication, we remain convinced that the millennial decade has failed to produce the improvements in leadership effectiveness that the global business environment requires.

However, the problem does not appear to be a lack of investment in leadership. Over the last decade, leadership development was big business. According to leadership development specialists, Mannaz, from the year 2000, 40% of European companies experienced greater than 10% annual growth in leadership development budgets, with 38% forecasting steady investments going forward. It is reasonable to ask "where did all the money go?" With 63%² of companies reporting that they never measure leadership development ROI, it is hard to know.

How organisations can stay ahead

Fortunately, it appears many business leaders are aware of the problem. In our 13th Annual *Global CEO Survey*, conducted in 2009, 68% of CEOs felt they needed to make moderate or significant change to leadership and succession strategies as a result of the global economic crisis. In a recovery period, organisations must avoid a 'same again' amnesia, forgetting the unpleasant and sidestepping the opportunity to use adversity to advantage. Whether organised internally, through business schools or through professional membership bodies, organisations need to challenge the outcomes of their leadership development programmes.

Before designing a new leadership development programme, our advice is to determine if and how the current arrangement is failing. Secondly, organisations should be determining the extent of the problem – are there comparable organisations performing better across a set of measurable aspects? When all of this is known, it is time to search for the elements of

leading organisation's leadership development programmes that appear to make the greatest contribution to company success.

While the composition of a programme will be different for each employee, territory, industry and company, there are a range of core competencies expected of any senior business leader. We suggest companies should address leadership themes such as financial literacy, scenario planning and decision making, communication throughout the business cycle, embedding long-term thinking as well as legal and regulatory obligations.

Of course, the key to success for any new programme is to have learnt from the past and to continually assess the suitability of the programme for the future. As well as qualitative feedback from leaders, return on investment measures should be established which, collectively, demonstrate the correlation between investment and progress.

On the following page we set out year-on-year performance measures that we believe leaders can influence.

1. 13th Annual Global CEO Survey, PwC, 2009

2. The evolution of leadership development, Strategic HR review, Inger Buus and Scott Saslow, 2005

2 Leading, developing and engaging people in a changing world

Table 7

Leadership index metrics – 2004/5-2008/9

These metrics measure the end result of effective leadership upon the people they lead, rather than the characteristics and behaviours of effective leaders. If the leadership of an organisation is effective then its comparative position with respect to its competitors will be superior.

| | 2004/5 | 2005/6 | 2006/7 | 2007/8 | 2008/9 | % change 2004/5-2008/9 | % change 2007/8-2008/9 |
|---|--------|--------|--------|--------|--------|---------------------------|---------------------------|
| Impacts | | | | | | | |
| Human capital ROI (€) | 1.14 | 1.16 | 1.17 | 1.20 | 1.16 | 2.1% | -2.6% |
| Wealth created per FTE (€) | -494 | -128 | 35 | 448 | -185 | 62.6% | -141.2% |
| Behaviours | | | | | | | |
| Resignation rate (%) | 6.2 | 10.0 | 8.8 | 10.6 | 10.0 | 61.5% | -5.9% |
| Remuneration/revenue (%) | 21.6 | 21.6 | 21.0 | 21.1 | 21.4 | -0.8% | 1.7% |
| Skills | | | | | | | |
| Training hours per FTE | 19.7 | 18.3 | 20.6 | 20.1 | 21.5 | 9.4% | 7.2% |
| Career path ratio (%) – promotion divided by internal appointments | 50.0 | 66.7 | 62.7 | 57.3 | 63.9 | 27.9% | 11.6% |
| Corporate social responsibility – gender diversity | | | | | | | |
| Workforce diversity: Women (%) | 36.3 | 33.4 | 40.5 | 45.2 | 45.5 | 25.2% | 0.6% |

Source: PwC Saratoga database

It has to be stressed that these figures are whole of Europe metrics. To gain major benefit from the use of the PwC Saratoga index, we suggest interested parties consult a sector, national or selected competitor comparison sample of organisations.

If skills shortage really is a problem, why don't we train more?

In successive surveys, CEOs have claimed skills shortages are a significant growth inhibitor. Given 61% of CEOs had this concern in 2008¹ (dropping to 46%² following the global downturn), it would seem logical that organisations would invest in training. Yet there is no indication this is happening.

With such little data available, it is impossible to establish whether there is a genuine skill shortage or whether employers are failing to develop their peoples' skills to fill talent gaps. In Europe in 2008/9, the level of formal training stood at 21.5 hours per FTE per annum³, rising from the recorded figures of 2004/5 (19.7 hours) and 2005/6 (18.3 hours)⁴.

How organisations can stay ahead

The threat of downturn resulted in budget cuts and cessation of development programmes for many organisations. As we enter recovery, gradually reintroducing training budgets and development programmes, HR directors have the perfect opportunity to measure the success, or otherwise, of these initiatives versus the current period. There has rarely been a better time to measure the impact of programmes meant to boost people elements such as productivity, profitability, engagement and increasing the rate of internal succession.

Human resource directors also need to ask their stakeholders, do we really have a skills shortage? And how are we best placed to resolve these? In recent history, recruitment may have been the easy answer. However, in a resource constrained recovery, it is perhaps time to make the best of our existing people and invest in them through, among other things, training and development.

Organisations looking to better control the cost of employment while building capacity for the future might also consider government-backed skills development programmes. There is often a financial incentive for employers to invest in apprentice, trainee and cadetship programmes for young people, with the opportunity to select the best for future leadership roles.

'We have focused a lot of attention on recruiting, training and retaining. Unfortunately in this business environment (2009) we have to reduce headcount due to declining top line revenues. I do have a major concern as we move into the middle part of the next decade, really not far away, about six years from now, or less. The shortage of talented people in many of the markets where we are is going to be a huge concern, just for sheer demographics. That's why the investment in technology is going to be even more critical, so people have the tools to be able to provide more sales per employee with the same amount of demand on hours as they have today.'

Chip Hornsby, former Group Chief Executive, Wolseley PLC – UK-based international construction products, materials and services supplier.

How effective are governments at developing a skilled workforce?

The long-term supply of key talent depends more on education systems than on business cycles, and many CEOs in our *13th Annual Global CEO Survey* stated that governments were not doing enough to create a skilled labour force. Only a staggering 3% of US CEOs agreed that the Government has been effective in creating a skilled labour force. In contrast, least concerned were CEOs in China and Hong Kong – in these territories 52% of CEOs felt the Government was doing an effective job creating a skilled labour force.

1. 12th Annual Global CEO Survey, PwC, 2008

2. 13th Annual Global CEO Survey, PwC, 2009

3. PricewaterhouseCoopers Saratoga database

4. It is recognised that with continued migration to e-learning and on the job coaching, organisations are finding it difficult to capture robust data on learning. A greater effort is required to measure the cost and return on investment.

Engaging employees who have fallen out of love with their employer

Reflecting on the downturn, PricewaterhouseCoopers *13th Annual Global CEO Survey* observed “With uncertainty on future revenue, business leaders had no option but to act on what they could control. Close to 90% of companies cut costs. Cash preservation was paramount as assets were divested and jobs cut.” Given this enormous upheaval, it will come as no surprise that the global economic downturn had a profound effect on the psyche of the workforce.

As confidence starts to return, many are assessing the lessons learned from this extraordinary period and are coming to terms with the collateral impact of those survival decisions on their people.

The Corporate Leadership Council has been running an engagement monitoring report since 2004, regularly surveying 500,000 employees. In its 2008 report², in data collected before the downturn, approximately 10% of the sample were defined as highly disengaged. In data collected in 2008, this figure had grown to 20% and, by the start of 2009, figures had reached an alarming 33%.

Over the same period, retention remained at the same levels and employees reported no greater inclination to leave their employer. Instead, as the disengaged have ‘dug in’, the reported level of discretionary effort has dropped by 53% since its peak in 2005. More alarming still, one in four high potential employees state that they intend to leave their employer during 2010.

How organisations can stay ahead

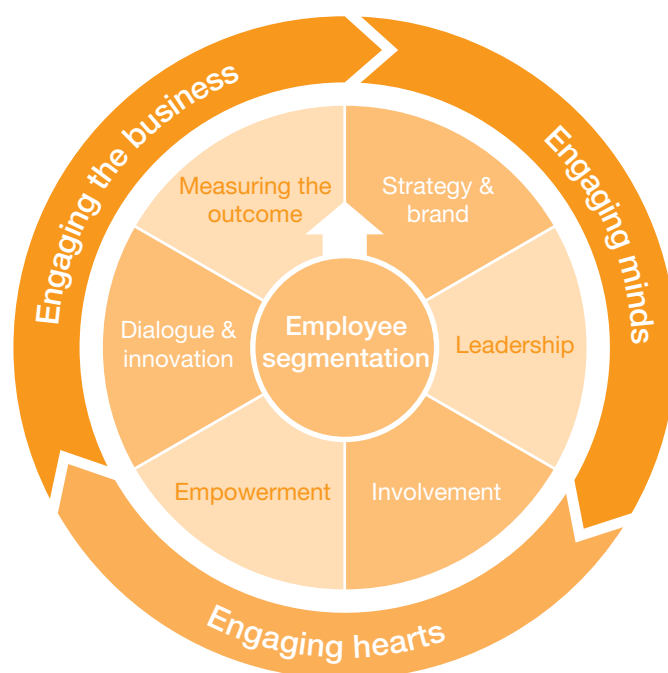
In the upturn, people are the primary source of competitive advantage – intangible assets drive greater value than tangible assets and have held value better. But there is a subtle nuance, which is key to the success or otherwise of any venture. As Dr Theresa Welbourne, President and CEO of eePulse says: ‘it is not people that are our greatest assets, but our relationship with them.’

Where engagement has flourished, it is because it has been a genuine commitment, not a gimmick. Engagement is not something you do; it is something that results when you get the various components of HR, management and communication right. At PwC, we recognise six successful traits of engaging companies (see figure 1). Fundamentally, it begins by adopting an analysis-based approach which segments employees by key characteristics, customises a tailored solution, and regularly monitors for impact and outcomes.

The approach is most successful when it establishes a cohesive brand proposition as the central aligning principle behind engagement and deploys employee ambassadors as advocates to customers and the outside world. Successful engagement encourages participation in decision-making and in the community, which by necessity, requires a degree of latitude and empowerment.

As to how it is done: engagement is driven visibly and charismatically by committed leadership and delivered by co-opting middle management first (as those holding the line relationships and most likely to block any centralised, top down efforts). For evidence, see the success of Sir Terry Leahy’s ‘back to the floor’ style at UK headquartered retailer Tesco.

Figure 1 – PricewaterhouseCoopers six successful traits of engaging companies



1. 13th Annual Global CEO Survey, PwC, 2009

2. Driving employee performance and retention through engagement: Rethinking employee engagement, Corporate Leadership Council, 2004-2009

Greater demand for better reporting

The need for greater transparency in corporate reporting has been a major business issue for the past decade. However, it was a growing realisation that climate change was real and the global financial events of recent times that cemented an expectation, rather than a desire, for appropriate reporting.

In the early part of the new century we saw a shift in reporting. The importance placed on disclosing more than core business and financial statements grew – companies were perhaps realising the importance of communicating with shareholders and the public, particularly around environmental issues. It was, however, economic sustainability or, moreover, risk that changed from being an issue dealt with in the boardroom, to something reported in the public domain.

Corporate scandals, lack of regulatory safeguards and taxpayer funded bail-outs have all added impetus toward greater transparency. While institutional shareholders, regulators and governments had encouraged greater reporting for some time, it was possibly the pain felt by taxpayers in many countries, as a result of bail-outs, that raised the urgency of the reporting agenda.

‘Profit, in good times and bad, is where any discussion of companies’ responsibilities should start. Without profit there is no future for shareholders, employees or customers. But engaging with the community in the pursuit of profit has its place: indeed, it is essential’

Michael Skapinker, *Financial Times*

In the new environment, the corporate social responsibility reports introduced in the early part of the new century look somewhat antiquated. Generally, these were separate from the annual report and were primarily seen as branding documents. Now, how a company deals with its green responsibilities, handles its employees and others, rewards its senior executives and manages risk is not only important to shareholders but to the media and public as well. There is now a direct relationship between corporate sustainability and declared social responsibility.

How organisations can stay ahead

The corporate world has some miles to travel before being convinced that the resources used to provide information wider than statutory financials adds real value.

However, better reporting is beginning to happen. In our review of corporate reporting¹ in the UK’s FTSE 350, we found that 92% of companies set out their principal risks and uncertainties and 84% explicitly identified their key performance indicators (KPIs). However, the same study found that only 18% of FTSE 350 companies reported against their strategy and only 31% clearly aligned KPIs with

their strategic priorities. For HR and the wider organisation, there is an opportunity to provide this greater level of reporting.

Currently, it would appear that legislative change will be the only way to bring about a significant change. Until then, it will be up to CEOs to recognise the benefits that come from addressing the needs of regulators, employees, shareholders and the public before their hand is forced. However, we expect there will be some forward thinking CEOs – those able to identify a link between corporate responsibility and profit.

People reporting should include; a clear statement of business goals and how people have met any of these goals; how the performance of your people contributed to business results; any relevant corporate social responsibility actions undertaken in the past year; and a statement to describe how the culture and values established by the organisation have contributed to performance. For each of these metrics it is important to set relevant measures and key performance indicators.

Building Public Trust Awards

Since 2003, the UK-based Building Public Trust Awards has recognised organisations that build and sustain public trust through clear, honest and accessible reporting of their strategies, activities and future plans. In 2009, mining and natural resource company Anglo American was awarded best people-reporting FTSE 100 company in recognition of the company’s disclosure of challenges and successes in recruitment, training, employee management, performance and reward. The company’s annual report clearly outlined the impact of its people on corporate performance.



1. Joining the dots, a summary of the narrative reporting practices of the FTSE 350, PwC, 2008

A call for fresh thinking on executive compensation

Many executive remuneration models are not meeting their objectives of either motivating executives or aligning their behaviours with shareholders' best interests. Many associated with executive remuneration – shareholders, remuneration committees, executives and the wider public appear to be dissatisfied.

While action is being taken to transform the governance and design of reward, making fundamental changes can be difficult, since in many cases the level of trust between companies and their shareholders in the area of remuneration is low. As such, the current interactions between shareholders, remuneration committees and executives, regarding plan designs and performance conditions, are causing significant frustration to all parties.

Across the globe, we have seen the majority of executives receive lower levels of compensation due to the difficult economic climate. In the UK, PwC's annual report on executive compensation (*Is pay for performance a force for good?*) the 350 largest listed companies in the UK have generally exercised pay moderation in response to the UK recession. Salary increases for FTSE 350 executives were below 1% on average, while bonus payments decreased by 20% in 2009, with one in six executive directors receiving zero bonus.

Notwithstanding this moderation, shareholder opposition to remuneration proposals grew, with 20% of FTSE 100 companies finding that their shareholders withheld support for the remuneration report, up from 3% in 2008. Despite the media focus on remuneration in the banking sector, the majority of contentious AGMs actually arose outside of the banking sector.

In the US, the Forbes analysis of Fortune 500 executive pay¹ saw total compensation (salary plus bonus and long-term incentive plans) fall significantly in the past few years. Falls of 15% and 11% in 2007 and 2008 respectively are sizable, but despite that the average salary for the top 100 CEOs was still over \$23m according to Forbes.

Interestingly, Singapore based PwC financial services partner, Professor Ron Collard, believes the phenomenon of reward models contributing to excessive risk taking is more of a Western trend. "The direct correlation between reward and risk taking hasn't permeated the Asian market to the same degree" he comments. As a result there is less focus on new reward models in the region".

'Executive compensation will always be a controversial subject. Rather than attempting to make all of the various stakeholders happy, companies should focus on a strategic approach to compensation that is centred on what is 'right' for the company.'

Scott Olsen, partner, PricewaterhouseCoopers US.

Simplification is the key to success

PwC UK Reward leader Jon Terry believes companies need to break the mould of traditional thinking in this area and move to a new model if executive pay is to work more effectively.

"This means using simpler plans, with a greater role for remuneration committee discretion in making a rounded assessment of performance. Ensuring executives are significant shareholders will often be more successful in achieving alignment than complex long-term incentive plans".

Scott Olsen echoes the need for simplification. However, this can be a challenge when the executive compensation landscape is becoming even more crowded, with global and local regulators entering the scene alongside shareholders, tax authorities, directors and executives themselves.

In Asia, Professor Ron Collard, comments that as a result of remuneration remaining out of the spotlight, there has been less challenge from regulators. Nevertheless, regulators in some of the major economies have been seeking to follow the Financial Stability Board's guidelines and to demonstrate the importance of good governance. To date the more restrictive measures applied in some western economies have been largely avoided.

How companies can stay ahead

A key challenge for remuneration committees is to balance the need to motivate executives in the face of a shifting business environment. Even if bonuses are reduced overall, we believe that straightforward performance conditions, that link to pay in an easily understandable way, can improve executives' motivation. If companies can achieve this goal, they will go some way to address the frustration of shareholders' that the link between pay and performance is not strong enough.

While the perceived issues with pay are more heightened in certain regions (western economies) and certain sectors (financial services), there are important lessons to be learnt for all companies. While deferral of bonuses is already common in quoted companies, issues such as allowance for risk in assessments of performance, are not adequately addressed in many companies. With shareholder bodies and regulators now making clear the responsibility of remuneration committees to factor risk into performance assessments, we see this as an area for consideration.

With reward aligned to a company's strategy, Scott Olsen encourages companies: "tell your story on executive compensation in a forthcoming and transparent way, engaging all stakeholders in the process".

1. What the boss makes, special report, Forbes, Scott DeCarlo, 22/4/2009

Appendix 1

The 12 key PwC Saratoga human capital metrics

The following 12 key metrics demonstrate the contribution of people and the HR function to organisations across various industries. Any organisation's divergence below the industry median is cause for investigation.

| | European medians | Banking | Other finance | Insurance | Comms/ Media | Technology | Pharma | Chemicals | Engineering / Manufacturing | Utilities | Retail & Leisure | Services | Public sector |
|------------------------|------------------|---------|---------------|-----------|--------------|------------|---------|-----------|-----------------------------|-----------|------------------|----------|---------------|
| Revenue per FTE | € 202,500 | 189,702 | 51,638 | 612,787 | 191,915 | 128,060 | 166,480 | 145,962 | 162,192 | 223,835 | 130,428 | 158,637 | - |
| Cost per FTE | € 192,569 | 161,124 | 196,091 | 98,580 | 183,422 | 118,960 | 160,681 | 134,735 | 154,763 | 192,822 | 126,854 | 149,904 | 66,759 |
| Profit per FTE | € 6,795 | 38,471 | 6,887 | 39,289 | 6,045 | 5,620 | 7,877 | 8,495 | 5,453 | 8,952 | 2,766 | 4,569 | - |
| Wealth created per FTE | € -185 | -8,819 | -1,188 | 3,063 | -493 | 171 | 710 | 1,853 | 138 | -280 | -398 | -181 | - |
| Human capital ROI | € 1.16 | 1.69 | 1.19 | 1.84 | 1.17 | 1.11 | 1.31 | 1.42 | 1.18 | 1.35 | 1.15 | 1.14 | - |
| Remuneration/revenue | % 21.4 | 34.0 | 27.2 | 8.6 | 21.8 | 41.9 | 15.3 | 16.1 | 20.4 | 15.6 | 17.6 | 22.8 | 45.3 |
| Remuneration/cost | % 22.2 | 44.6 | 59.6 | 28.1 | 22.1 | 46.0 | 15.5 | 16.4 | 21.2 | 17.0 | 17.9 | 23.7 | 49.7 |
| Absence rate | % 4.4 | 3.9 | 2.9 | 4.1 | 4.2 | 3.3 | 4.0 | 4.1 | 4.8 | 3.7 | 5.0 | 5.2 | 5.3 |
| Resignation rate | % 10.0 | 11.9 | 9.4 | 10.5 | 12.0 | 15.1 | 7.3 | 7.6 | 10.6 | 4.6 | 27.0 | 13.4 | 9.0 |
| Acceptance rate | % 91.9 | 87.7 | 88.7 | 95.5 | 93.1 | 85.9 | 96.4 | 86.4 | 90.9 | 95.1 | 89.3 | 93.6 | 96.9 |
| Cost per hire | € 693 | 753* | 753* | 753* | 798 | - | 812 | 631 | 276 | 640 | 269 | - | 1,288 |
| L&D investment per FTE | € 429 | 418 | 549 | 614 | 368 | 283 | 480 | 68 | 192 | 434 | 80 | 326 | 529 |

All figures represent the median value

Metric definitions

| Metric | Definition |
|------------------------|--|
| Revenue per FTE | Revenue/total FTEs |
| Cost per FTE | Total costs/total FTEs |
| Profit per FTE | Profit before tax/total FTEs |
| Wealth created per FTE | (Profit after tax – 10% shareholders equity)/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 recruitment costs/external recruits |
| L&D investment per FTE | FTE learning and development investment/FTEs |

Summary of recommendations

The following summarises the conclusions we have drawn in this report from our extensive research and experience in the market.

The world just got a whole lot more competitive

Implement people measures 6

Track costs, productivity and profitability versus competitors, teams and production sites. Identify excess staff in underperforming teams and redeploy your people into areas where they can add more value.

Plan for a globalised future 8

Decide who should produce what and where. Be decisive – know the reasons behind a local versus global manufacturing or service outsourcing decision. Define when to make change.

Rethink outsourcing and offshoring 10

If you have not already done so, evolve your outsourced supplier relationship. Share staff between both organisations in order to engender mutual understanding. Consider a move to long-term collaborative relationships with more fluid contract terms or a profit-sharing arrangement.

Invest in innovation 11

Are you attracting innovative people who understand the needs of your future customers? Employers who want to trade worldwide will need to mirror their customer's diversity in their own employee population.

Leading, developing and engaging people in a changing world

Identify talent 12

Identify talent across the organisation, not just at senior levels. Identify pivotal employees and highlight to their peers the contribution they make. Identify and invest in groups of employees who are going to contribute the most value to the organisation in the future. Challenge traditional processes, for example when seeking new hires, is industry experience really necessary?

Reassess the suitability of leadership development programmes 13

Do not sidestep necessary improvements to leadership development programmes as you reach better economic times. Assess the suitability and results achieved from existing programmes.

Assess the effectiveness of learning and development 15

Many organisations are set to reinvest in learning and development (L&D) after two years of lean spending – there has rarely been a better time to measure the impact L&D spend has on the bottom line.

Engage; or lose your best 16

With more than one in four high-potential employees intent on leaving their employer in 2010, leaders, line managers and HR need to work together to retain talent. Engage your employees by establishing a cohesive brand proposition advocated by employees.

Organisations have a way to go to gain public confidence

Greater demand for better reporting 17

To build public, government and employee trust, consider adopting better corporate reporting. Report how people are aligned to business objectives and clarify how your people have met key performance indicators. Do not wait to be forced into reporting by legislative change, be a first mover and benefit from tackling public perception issues.

Rethink executive reward 18

Key themes of governance, design and performance measurement will be fundamental to the evolution of an effective compensation strategy.

Conclusion

Once again, we hope that many of the trends outlined in this document will lead to constructive discussion, debate and breakthrough. We urge readers who have detected other trends, or who simply have a different perspective, to please make contact with us.

The ever-changing competitive world presents significant challenges and opportunities for organisations, public and private, large and small. We firmly believe that the leading organisations in 2020 will be those that prepared today for a very different future.

Richard Phelps, Leader, Human Resource Management

Further reading

If you enjoyed this publication you may like to read our thoughts on the future of work and talent mobility in 2020. These reports can be downloaded from www.pwc.com/hrs



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The data in this report is drawn from PricewaterhouseCoopers Saratoga databases as well as the following additional sources:

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Further information

To find out more about this report or to discuss any of the issues raised, please contact your usual PwC adviser or one of the contacts listed below.

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