

# The Saratoga Review

March 2008



## Priorities and focus within the Uncertain Economy.

Uncertainty in the economy is already impacting on some industries such as construction and financial services. When times get tough it is essential that organisations understand the value of their people and have mechanisms in place to inform decisions and drive productivity. Among the critical questions organisations are currently asking themselves are:

1. How do I prioritise investment and potential cost reductions?
2. How do I manage the workforce risks associated with economic uncertainty?

In this issue we discuss these questions and the role a human capital scorecard can have in helping you answer them.

### 1 - Prioritising investment and potential cost reductions

A human capital scorecard is a collection of targeted metrics designed to provide both leading and lagging indicators of the key people drivers for your business. Organisations use a scorecard to track their progress towards business goals and as transparent, evidence based means of reporting people related issues to the management team and the board. PwC develops scorecards with clients through an iterative process involving members of the senior management team across the business (e.g., CFO, CEO, CIO, Sales/Marketing director). As a result of this process, we have found that decision makers get further clarify about the business critical, people issues. In the majority

of organisations people represent one of the largest costs such that Headcount is one of the first things considered when cost reduction is placed on the management agenda. In this situation management need to understand the linkage between people and productivity in key areas of the business so that they have information on which to set priorities and understand the impact of any proposed cost reduction activities.

In addition to clarifying business issues constructing a Human Capital scorecard will enable you to benchmark spending, quantifying the business impact of both investments and cost reduction initiatives and track results. In times of economic uncertainty priorities are often revisited. Scorecarding will provide an evidence base to communicate the issues with accuracy and credibility to internal stakeholders while providing a framework for robust decision making. Of particular relevance in this respect are metrics that combine both people and financial information (e.g., Revenue per FTE, Learning & Development (L&D) Investment per FTE) because they quantify the linkage between people and financial impact. It is important however to not examine the cost efficiency of a function, without also considering the effectiveness of the function. For example if L&D Investment per FTE is low, but productivity measures such as the time for new sales reps to reach targets are high, then it could be false economy and the current investment in learning and development may be ineffective. Finally the use of a comparative bespoke sample to benchmark against - often one matched on size, geography and sector - can inform how

the business impact of investments or cost reductions compares to current market trends. This context can provide a powerful interpretative guide – for example an increase in voluntary resignations may not solely reflect internal change, but may also result from increased opportunity in the employment market.

## 2 - Managing workforce risks associated with economic uncertainty

As highlighted it is important to prioritise in times of economic uncertainty and this includes focusing the Human Resource Team on mission critical activities. Organisations need to understand and prioritise critical workforce risks at any time but even more so in tough times. Some common workforce risks associated with economic uncertainty include a reduction in productivity and the creation of talent gaps.

A key aspect of maintaining productivity in times of economic uncertainty is focusing line managers on activities that matter most to employee productivity and engagement. It is surprising that a significant number of organisations do not currently have some process and outcome measures of productivity that they regularly report and examine. Process measures focus on the completion rate of tasks (e.g., number of sales calls made) and are broadly leading indicators of productivity in that they are predictive of outcomes such as financial results. Outcome measures typically relate to financial returns (e.g., revenue) and are generally regarded as lagging indicators because once they have been reported little can be done to rectify their impact on the bottom line. Without both process and outcome productivity measures it is difficult to focus line managers on specific activities that maintain or build productivity.

The development of a crucial talent gaps can relate to a number of different factors during times of economic uncertainty. Recruitment embargos, cutting learning and development budgets, and reductions in benefits can be well managed but, done badly, can result in others luring your key talent away. Many organisations are moving towards identifying and monitoring key talent segments within their organisation. Specifically they are identifying leadership potential, key technical capability or other talent groups and providing tailored training as a reward while also monitoring high performer turnover and pipeline succession within these talent groups. A smaller number are designing targeted retention strategies for key talent segments to minimise departure risks. One such way to do this is through the provision of targeted benefits – such as proportional or matched contributions towards student loans to retain recent graduates. Most organisations are still quite tentative in terms of retention strategies and few have moved to fully engaging the workforce in discussions about what is important to them and, why they stay.

Human Capital metrics can assist in addressing these crucial business issues. It is important to note that a lone metric will very rarely, in and of itself, identify and diagnose a business issue. Often metrics need to be viewed in combination and with the wider organisational context and market demands in order to identify symptoms, causes and highlight possible solutions. A Human Capital Scorecard needs to provide the opportunity to look at a range of metrics, build up a picture and combined with strong knowledge of the business, support managers to make good decisions based on valid knowledge.

## The Role of Human Capital Metrics

A desire for evidence based decision making around people related issues has resulted in a demand on Human Resources to become increasingly numerate and link people to financial and other business outcomes. This is an opportunity for Human Resources to communicate hard data on the value of people as well as partner more directly with operational managers in ensuring the business is running a tight and highly productive ship.

### Metric this issue: Performance Related Pay

The proportion of Performance Related Pay received is an indicator of performance incentives and their uptake by employees. There is no ideal proportion of Performance Related Pay. It varies depending on role and the fundamentals of the business model. Where there is a direct correlation between the skill and effort of an individual to the performance outcome, then you would expect a high level of Performance Related Pay. Similarly, a sales focused business, would be likely to have a significant proportion of sales remuneration at risk depending on sales performance.

The formula for this metric is:

$$\frac{\text{Performance Related Pay}}{\text{Salary Costs}}$$

As data from our 2006/7 Human Capital Effectiveness Report demonstrate and the table below notes, there is significant differences between industries and between the top and bottom quartile Performance Related Pay.

| Performance Related Pay     |                 |        |              |
|-----------------------------|-----------------|--------|--------------|
| Industry                    | Bottom Quartile | Median | Top Quartile |
| Banking                     | 7.5%            | 14.1%  | 29%          |
| Engineering / Manufacturing | 6.7%            | 10.6%  | 11.9%        |
| IT & Electronics            | 5.3%            | 8.7%   | 16.6%        |
| Healthcare                  | 1.1%            | 1.4%   | 2.6%         |
| Insurance                   | 9.8%            | 15.1%  | 23.1%        |
| Services                    | 2.6%            | 4.9%   | 19.8%        |
| Telecommunications          | 7.0%            | 8.9%   | 17.2%        |
| Utilities                   | 6.4%            | 8.6%   | 11.7%        |

If you have an idea or topic that you would like us to write about we would love to hear from you! Please send us your ideas and/or topics.

The Review was extracted from the Saratoga Review. Use of content is restricted (see copyright statement below), but we allow sharing in part or whole so long as proper attribution and our copyright are included. You are permitted, in fact encouraged, to forward this information, in its entirety, to as many of your associates and colleagues as you wish. Or, have them sign up for their own copy at <http://www.pwc.com/nz/saratoga>.

© 2007 PricewaterhouseCoopers. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

**Veronica White**  
Director, Performance Improvement  
[veronica.j.white@nz.pwc.com](mailto:veronica.j.white@nz.pwc.com)  
09 355 8194

**Scott Cresswell**  
Associate Director,  
Performance Improvement  
[scott.l.cresswell@nz.pwc.com](mailto:scott.l.cresswell@nz.pwc.com)  
09 355 8018

website: [www.pwc.com/nz/saratoga](http://www.pwc.com/nz/saratoga)