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Breaking out of the talent spiral
Key human capital trends in Asia-Pacific

PwC Saratoga Asia-Pacific

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Foreword

Gautam Banerjee

Executive Chairman,
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Much has been said about the uncertainties that businesses around the world are currently facing. The sluggish US recovery and the eurozone sovereign debt crisis are issues that organisations have to grapple with. Organisations in Asia-Pacific are not exempted. What has been more fortunate for Asia-Pacific organisations though is that they are buffered by the regional economic development as markets in the region are still expected to grow.

Amidst this cautious optimism, Asia-Pacific CEOs have cited that a key challenge to achieving this growth is the talent factor. The competition for talent in Asia-Pacific is intensifying. Although there is an abundance of raw talent in absolute terms, the current profile of skills and capabilities is poorly matched to the demands of the economy.

More than ever, Asia-Pacific organisations will need to be agile in their talent management strategies, in order to ensure that they have the human capital to adapt to the changing forces in the business environment.

In this report, we will examine the human capital trends in Asia-Pacific to identify important people challenges faced by companies operating in the region, as well as the perspective of CEOs on these key issues. After considering the evidence gathered through our research programme, we will share with you suggestions on how businesses might overcome these hurdles.

I hope this report serves as a useful reference for the dialogues you will be having as you map out the human capital plans for your organisation.

Gautam Banerjee
Executive Chairman,
PricewaterhouseCoopers Singapore

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Introduction

This report is the Asia-Pacific edition of a global series of PwC thought-leadership focused on key human capital trends. It is produced by PwC's Saratoga Asia-Pacific Centre in Singapore.

Underpinned by PwC's Talent Management Framework (see page 6), this paper examines human capital trends in Asia-Pacific to identify important talent challenges faced by companies. It also looks at the perspective of CEOs on these key issues. Where appropriate, we compare these trends against those in two major Western markets: the United States and Western Europe. We offer our perspectives on the key issues and make suggestions on how businesses might overcome them.

In addition to PwC's human capital consulting experience, the analysis in this report draws upon a number of data sources. These include:

- PwC Saratoga Asia-Pacific Human Capital Effectiveness Programme, 2011 (see Appendix I)
- PwC 15th Annual Global CEO Survey, 2012
- PwC Saratoga global human capital database

The report includes data from more than 240 organisation entities representing 11 industry sectors. The average company in the report has an annual revenue of US$1.9 billion and 6,900 employees. While a number of participating clients are global companies, results included in the report refer only to Asia-Pacific operations (see Appendix I).

The research and preparation of this report was led by a team which included Alywin Teh, Partner; Thorsten Barth, Director; Abu Amin, Senior Manager; Gary Chua, Manager; PeiXian Chow, Senior Associate; and Isabel Lim, Senior Associate. Richard Phelps, a Partner in our London firm and Global Leader of the HR Management practice, provided key guidance throughout this project.

We are grateful for the invaluable input and support we received from the Singapore Economic Development Board and the Human Capital Leadership Institute over the course of this research project.

Executive summary

Economic development across Asia-Pacific will continue to create considerable opportunities for companies over the coming years. Yet business leaders cite talent as a key challenge to that growth. How they respond to this critical issue will shape future opportunities for their organisations.

Cautious optimism

The changes underway across the Asia-Pacific region, and in particular the growth in economic access, have been exciting to witness during the past decade. Despite uncertainties in the global economy, the future for the region continues to look bright. In a recent PwC survey, nearly half of Asia-Pacific CEOs surveyed report they are 'very confident' in revenue growth over the next three years.[1]

Talent: a critical pressure point

Despite the optimism surrounding future growth opportunities in the region, CEOs consistently cite a critical pressure point: talent. Several forces are converging to significantly change the workforce dynamic in the region:

- **Demographic shifts.** In many economies such as Japan and Singapore, declining population growth is creating a labour shortage.
- **Rising people costs.** Compensation is rising rapidly as talent has become scarce.
- **Large-scale skills mismatch.** Outdated strategies for education and training are no longer adequate for satisfying business or employee development needs.
- **Shortage of qualified employees.** In the fast-growing economies, many organisations are facing mounting talent challenges especially shortages of qualified managers.

[1] PwC 15th Annual Global CEO Survey 2012, where 1,258 CEOs in 60 countries were interviewed to understand how they see the future for their businesses in the region. The survey statistics throughout this report relate to Asia-Pacific CEOs unless indicated otherwise.

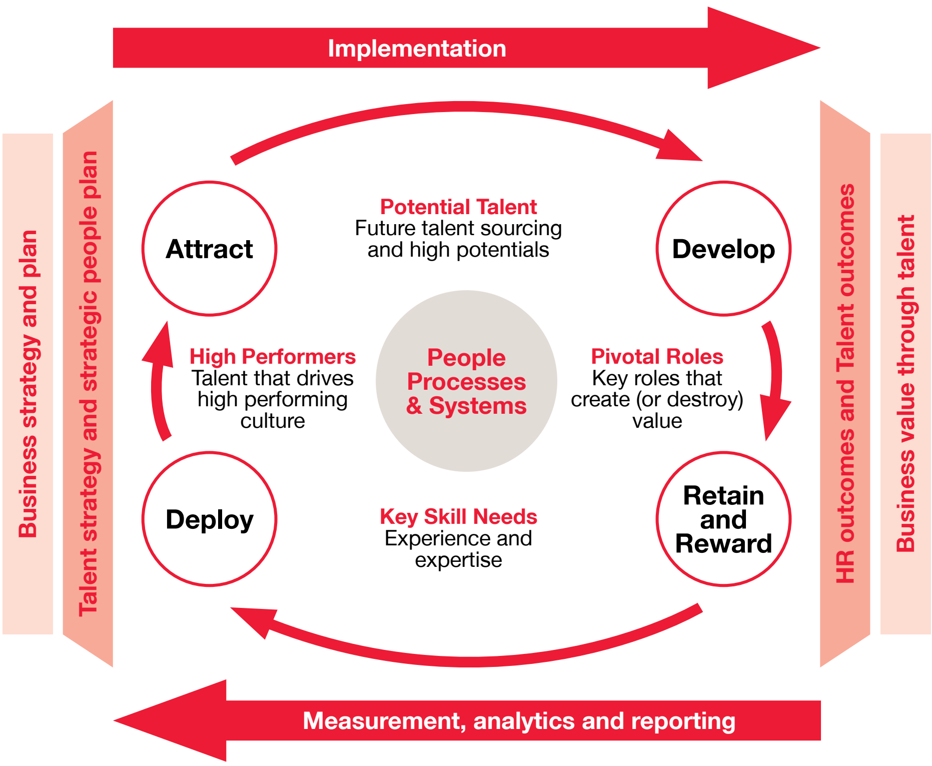
Key findings

To better understand these forces and over-arching challenges, we gathered data and analysed key human capital trends and HR practices in Asia-Pacific across the core sections of PwC Talent Management Framework, as described in Figure 1.

Our research revealed challenges in three critical areas: attracting talent; retaining and rewarding employees; and people processes & systems.

PwC Talent Management Framework

Figure 1



1. Attracting talent

- The ability to attract the right talent is fundamental to executing your growth strategy. Asia-Pacific companies continue to recruit external talent aggressively. Hiring levels in the region are twice as high as the West. However, only half the recruitment activity is growth driven. The other half is to replace leavers in existing roles.
- Despite economic uncertainty, hiring pressure is unlikely to ease. More than 50 percent of CEOs intend to increase headcount over the next year. Yet, the competition for talent is intensifying. The majority of CEOs say it has become more difficult to recruit talent.
- Given this difficulty, a striking finding is that one in five hires leaves in the first year. This new-hire turnover comes at considerable direct and indirect costs to organisations.

Our research revealed challenges in three critical areas: attracting talent; retaining and rewarding employees; and people processes & systems.

2. Retaining and rewarding employees

- Workforce engagement helps businesses ensure they continue to be productive and competitive. However, Asia-Pacific businesses face a significant engagement problem, specifically in terms of high levels of turnover. Contributing factors include poaching from competitors and lack of loyalty. Resignations are around double that of the United States and Western Europe. Also notably, we observe that high-performer resignation rates in Asia-Pacific are higher than average levels for the overall workforce in the West.
- Variable pay features heavily in Asia-Pacific organisations in terms of incentivising the workforce. It accounts for almost a fifth of compensation, compared with 13 percent and 11 percent in the United States and Western Europe respectively. However, employees are placing increasing importance on non-financial incentives. Yet, current reward strategies do not appear to have caught up with this shift. Three out of four companies in our study do not use flexible benefits as part of their reward model.

3. People processes & systems

- Given the importance of talent, the HR function plays a key role in managing and engaging the group. However, while Asia-Pacific HR functions are not significantly larger than their Western peers, we found they tend to be mainly operational and non-strategic. Talent management processes are not formalised. Our analysis reveals four out of five companies do not have dedicated resources responsible for the talent management process.
- CEOs are demanding more and better information to support decision-making around talent strategies. They are looking to HR for a better understanding of the scale and effectiveness of their investments in talent. But the gap between expectations and reality is concerning. Eight out of ten CEOs rate this information as important, yet only 16 percent receive comprehensive reports on Human Capital Return on Investment (HCROI), i.e. the commercial return received for every dollar (or equivalent currency unit) that is invested in the workforce.

Impact on business value

So what does this mean in terms of bottom line? A key indicator of organisational health is whether business achieves sustainable returns on its people investments.

When assessing human capital impact on the bottom line, our analysis found that HCROI is higher in Asia-Pacific compared with the West. An underlying driver for this is the combination of impressive top line growth combined with lower employee remuneration costs. However, increased competition, coupled with high levels of turnover, means many organisations are trapped in a talent spiral of rising cost and declining productivity. This emphasises the difficulty in sustaining competitive levels of human capital impact in the long-term.

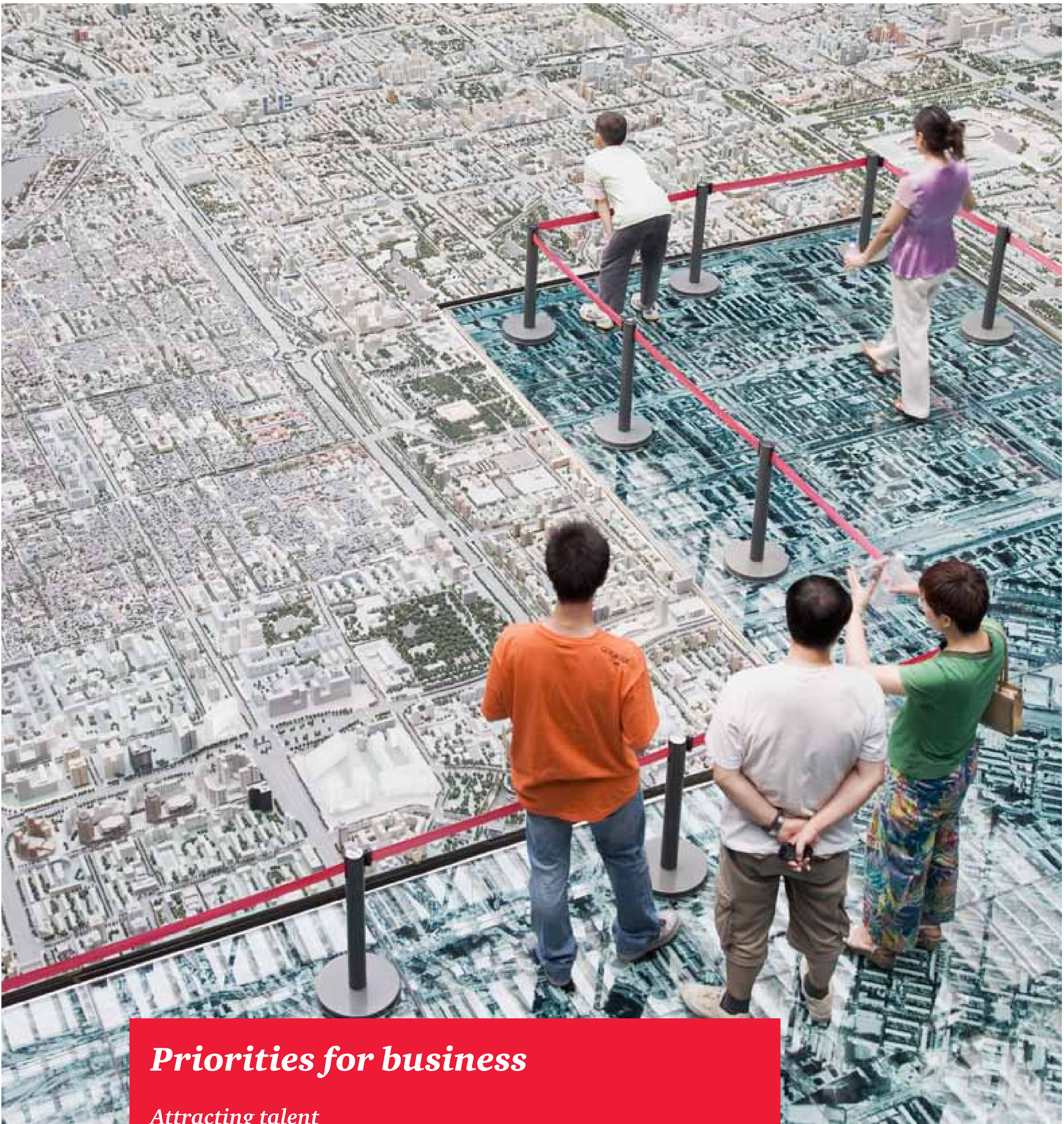
Priorities for business

The findings highlighted in this report around the increasing challenges in attracting, rewarding and retaining talent all point to a fundamental imperative: Asia-Pacific organisations need to do more in terms of developing and executing a strong, differentiated employee value proposition if they are to attract the best talent in the market and engage their existing talent.

To help organisations achieve this, we highlight five priorities for business leaders to help them break out of the talent spiral:

Attracting talent	1. Upgrade hiring and on-boarding processes
Retaining and rewarding employees	2. Pay attention to internal talent 3. Look beyond financial incentives
People processes & systems	4. Take a systematic and analytical approach to talent management 5. Make targeted investments in strategic HR processes

Despite the challenges, the current landscape creates important opportunities for organisations to take bold steps and radically re-invent their approach to talent. Getting this right is perhaps the most complex and urgent challenge companies in the region face. In the following sections, we examine these findings and their implications in greater detail.

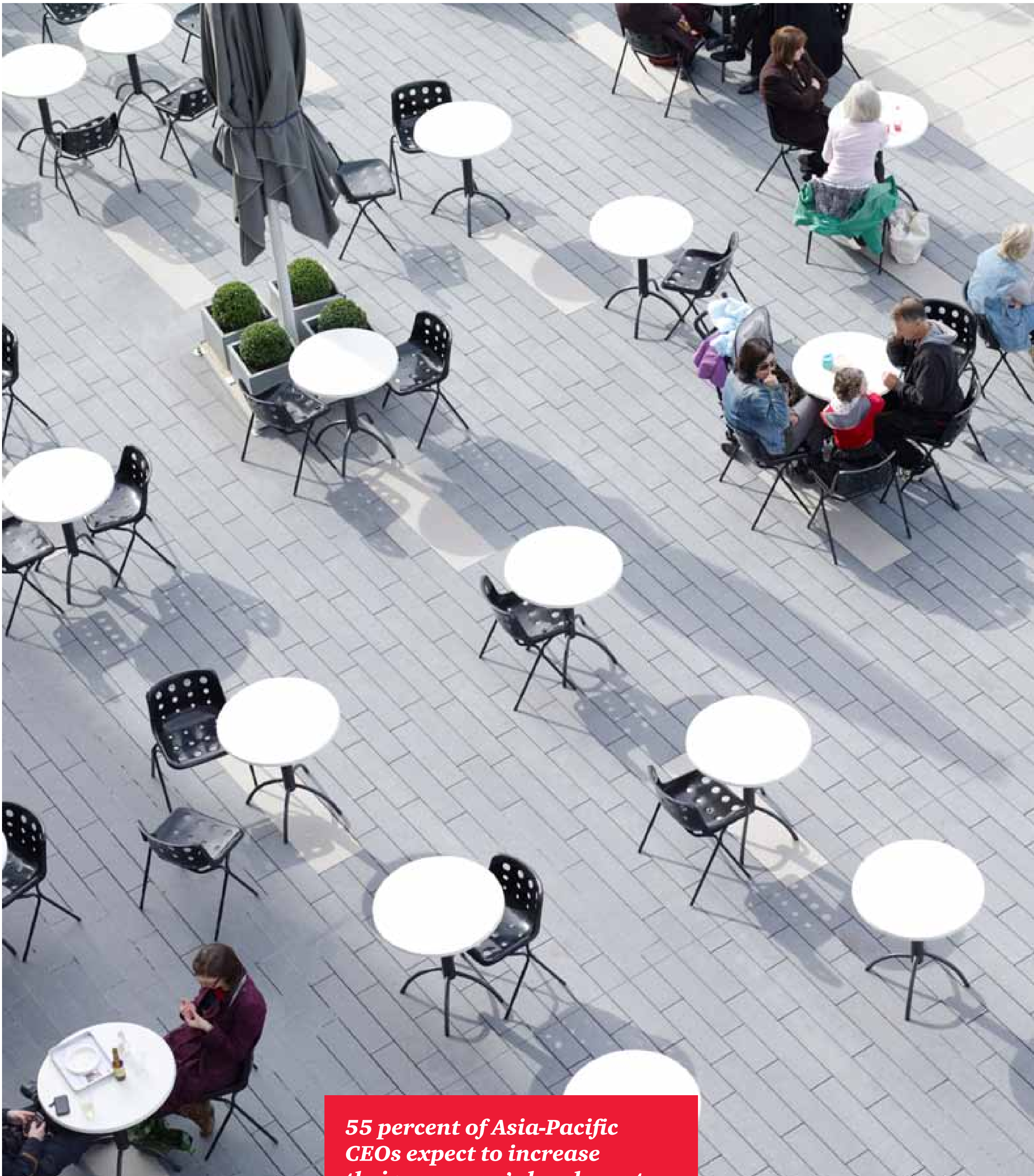


Priorities for business

Attracting talent
1. Upgrade hiring and on-boarding processes

Retaining and rewarding employees
2. Pay attention to internal talent
3. Look beyond financial incentives

People processes & systems
4. Take a systematic and analytical approach to talent management
5. Make targeted investments in strategic HR processes



55 percent of Asia-Pacific CEOs expect to increase their company's headcount over the next 12 months.

1. Attracting talent

Based on our analysis of key Asia-Pacific human capital trends, the first critical area where organisations face significant challenges is in the acquisition of talent.

Unabated hiring

As businesses in the region set out ambitious growth plans, the ability to attract the right talent becomes increasingly crucial.

Asia-Pacific companies continue to hire at a frenetic pace. As detailed in Figure 2 below, the median external recruitment rate (the number of external hires compared to overall workforce) is 22 percent in the region. This is twice as high as the rate observed in the United States and Western Europe. The rate is slightly higher in emerging Asia-Pacific markets[2] at 24 percent.

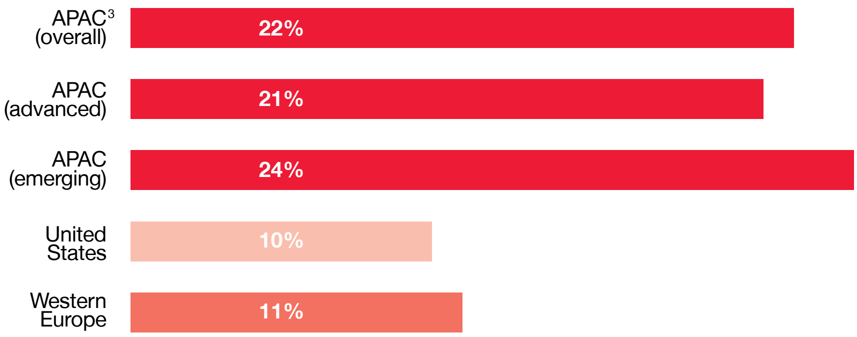
Strong business confidence and unprecedented growth opportunities in the region are driving this remarkable level of hiring. Nearly half of the CEOs in our survey said they are very confident about their company's prospects for revenue growth over the next three years.

Interestingly though, while growth is clearly an important driver, it is not the only contributor to the high recruitment rate. Our analysis suggests that excessively high turnover also plays a substantial role.

Hiring levels are twice as high as the West

Figure 2

External Recruitment Rate (%)



Source: PwC Saratoga analysis

[2] This is based on the Organisation for Economic Co-operation and Development (OECD) classification. Please refer to Appendix I for the list of countries included in our study.
[3] Asia-Pacific. This abbreviation will be used throughout the entire report.

43% of CEOs tell us that it has become more difficult to hire talent in their industry. The problem is particularly acute in China & Hong Kong and South-East Asia where the proportion rises to nearly **60%**.

Detailed examination of the recruitment volumes reveals only 50 percent of hires was made to fill a newly created role; the remaining hires were to fill existing roles that became vacant.

We explore the factors behind the high turnover in more detail in Section 2 of this report.

Pressure unlikely to ease

Despite the prevailing economic uncertainty, we expect hiring demand will continue to rise. CEOs in our survey are projecting robust growth plans in the region. Even as labour costs rise in some fast-growing economies, business leaders have set out ambitious plans to expand workforces: 55 percent of Asia-Pacific CEOs expect to increase their company's headcount over the next 12 months.

But demand is increasing at a time when finding and winning critical talent is becoming more challenging and expensive. The region faces a unique paradox where there is an abundance of raw talent in absolute terms, yet the current profile of skills and capabilities is poorly matched to demands of the economy. In high-growth markets where demand is outstripping supply and with young people feeling little loyalty to corporations, firms have found it more expedient to poach talent from competitors. However, rising costs have rendered this not sustainable.

43 percent of CEOs tell us that it has become more difficult to hire talent in their industry. The problem is particularly acute in China & Hong Kong and South-East Asia where the proportion rises to nearly 60 percent.

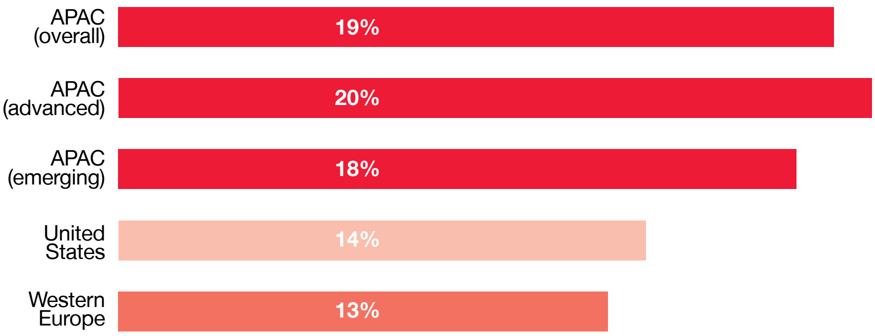
This degree of competition has the effect of driving up salaries to the point where some specialised roles are more expensive in Asia-Pacific than in more traditionally expensive labour markets such as London or New York. The story is the same across many markets in the region. This situation not only drives up costs but also means companies have to spend a lot of time and effort to establish teams and the competencies they need to compete.

> ***"Your business needs to nurture and hold close the talent that you have – it's hard to fill the bath with the plug out."***
>
> ***Michael Rendell***
> PwC Partner, Global Head of HR Services practice

One out of five hires leaves in the first year

Figure 3

Resignation Rate < 1 year (%)



Source: PwC Saratoga analysis

One in five newly hired employees leaves the company voluntarily before the end of their first year.

Retaining new hires

Given the increasing difficulty in hiring talent, it is vital for businesses to focus on retaining the talent already acquired.

Instead our research shows that while companies are busily recruiting in the marketplace, not enough is being done to retain and engage existing talent. This is particularly relevant in the case of new hires - only 50 percent of Asia-Pacific organisations measure the effectiveness of their on-boarding process.

Given this lack of focus, it is perhaps not surprising that one in five newly hired employees leaves the company voluntarily before the end of their first year.

True cost of new-hire turnover

The high rate of new-hire leavers poses a tough test for businesses. It is only exacerbated by the underlying dynamics of the labour market. Companies typically have little opportunity to recoup their investment in new employees who leave after a short period of time. This has a negative impact on return on workforce investment, workforce stability, and ultimately, organisational results.

The costs of new-hire turnover are immediate and significant. Calculating the business impact covers many components, including the cost to hire a replacement, compensation and benefits paid to the departed employee, cost of training, cost of facilities, systems and tools, cost of on-the-job training and more.

PwC Saratoga's analysis suggests that these costs, depending on the importance of the job, can be up to 100 percent of annual salary for managerial and professional staff and up to 150 percent for senior management.

Often, the company sees very limited returns in the first year of employment, especially in comparison to the investment made.

2. Retaining and rewarding employees

As competition for sourcing external talent intensifies, it is increasingly important for businesses to focus on retaining the talent acquired. In this section, we will explore the issues businesses face in relation to engaging their existing talent.

"The central challenge facing us is how to transform our corporate culture to a more open one. As recently as 10 years ago, we were intent on recruiting the best talent from around the entire country. But we experienced some setbacks. We hired experienced, talented people and gave them large salaries. But did we retain them? No."

Dr Sun Mingbo
President, Executive Director and Chairman of the Strategy & Investment Committee of Tsingtao Brewery Co Ltd, China

Source: PwC 15th Annual Global CEO Survey 2012

Disengaged talent pool

Compounding the challenges surrounding talent acquisition is increased dissatisfaction amongst the existing talent pool. A study conducted by the Corporate Executive Board found that the employees who are most committed to their organisations give 57 percent more effort and are 87 percent less likely to resign than employees who consider themselves disengaged.[4]

Resignations are a key indicator of the low levels of engagement and satisfaction. Our analysis reveals that the rate of Asia-Pacific resignations is around twice that of the West. As outlined in Figure 4 on the next page, the Asia-Pacific median resignation rate is 15.2 percent. This compares with 7.0 percent in the United States and 6.6 percent in Western Europe.

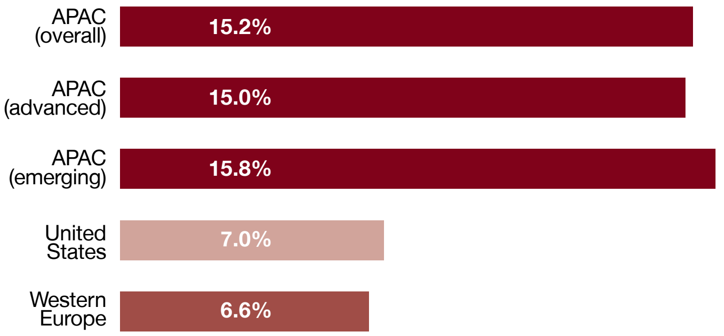
Also noteworthy is that the talent churn issue appears to be a consistent theme across the region. There is little difference observed in resignation rates between the dvanced and emerging Asia-Pacific economies.

[4] Corporate Executive Board, 'The Role of Employee Engagement in the Return to Growth', Bloomberg Businessweek (August 2010).

Asia-Pacific resignations are approximately twice as high as West

Figure 4

Resignation Rate (%)



Source: PwC Saratoga analysis

Asia-Pacific high performer turnover is also significantly higher than the West

Figure 5

High Performer Turnover Rate (%)

Source: PwC Saratoga analysis

Perhaps, more critical is our observation that the turnover rate amongst the high performer segment of the workforce is 9.1 percent. This is significantly higher than the West.

While the loss of poor performers may be desirable, letting high performer talent slip away will have a direct and tangible impact on an organisation's bottom line.

Three out of four

companies in our study do not use flexible benefits as part of their reward model.

Changing loyalties

Frequent job-hopping appears to be endemic to many markets, at all levels of the organisation, in Asia-Pacific.

Our findings are backed up by other market studies. For instance, a 2010 survey of over 2,200 mid to senior level managers in mainland China found that two-thirds had received at least one competing job offer in the last 18 months, and that nearly half (46 percent) had moved to a new role with a more than 30 percent increase in compensation.[5] Employee loyalty to their employer is changing everywhere. Only 18 percent of millennials (defined as those who entered the workforce after 1 July 2000) in a global survey of new graduates said they intended to stay with their current employer.[6]

Managing the rookies

The issue of high turnover is further underscored by our analysis of the rookie ratio, defined as the proportion of the workforce with less than two years tenure.

In Asia-Pacific, three out of ten employees would be classed as "rookies". This is 50 percent higher than the Western benchmarks.

While an injection of fresh talent into the workforce has its advantages, excessively high levels can create problems in maintaining a strong organisational culture and retaining critical knowledge and relationships. The loss of productivity and time when a valuable employee leaves, as well as expenses related to retraining need to be better appreciated.

A further consequence of high rookie ratio is learning and development activities become biased towards technical learning ('learning for today') at the expense of developmental learning ('learning for tomorrow'). This is because businesses are forced to focus on the immediate needs of establishing core operational knowledge amongst their short-term employees, further exacerbating the issues around the development of the future talent pipeline.

Mismatch of incentives

Lower engagement levels are caused by the convergence of a number of factors, but an important driver appears to be an increasing gap between what employees want and what employers are offering. While employees are placing increasing importance on non-financial and life-style focused incentives, employers have been slow to respond.

For instance, three out of four companies in our study do not use flexible benefits as part of their reward model.

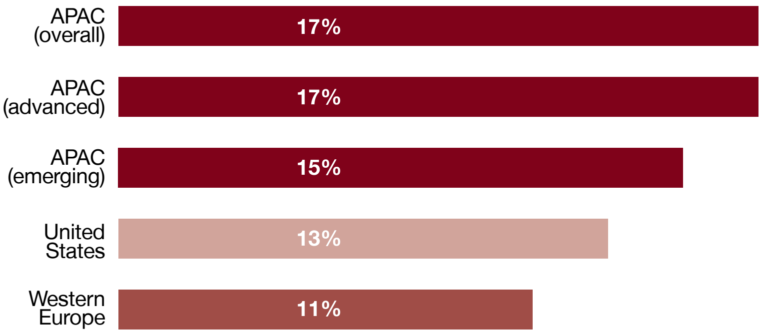
At the same time, many companies believe their reward strategy drives a high performance culture – our research shows that Asia-Pacific employers place greater emphasis on variable pay compared with the United States and Western Europe. Variable pay made up nearly a fifth of the compensation package, compared with 13 percent and 11 percent in the United States and Western Europe respectively.

[5] MRI China Group Talent Environment Index, 2010.
[6] 'Millennials at Work: Re-shaping the workplace', PwC survey of over 4,300 graduates aged 31 or under (December 2011).

Variable pay makes up almost a fifth of compensation

Figure 6

Variable Pay (%)



Source: PwC Saratoga analysis

Yet workforce preferences are rapidly changing. Often, we find that incentive models are not focused on what motivates key talent – millennials for example, are driven by different needs and expectations than previous generations. While this does not mean that pay is not important, the biggest draw for millennials is the opportunity for progression – 52 percent said that they feel this makes an employer an attractive prospect.[7]

In fact, when it comes to motivation, an increasing body of research shows that financial incentives may not always be most effective and, in some cases, can even be counterproductive. One study found that, as long as a task involved only mechanical skill, higher bonuses led to better performance. But for tasks that required even basic cognitive skill, higher bonuses actually led to poor performance.[8]

The case for improving engagement

The key implication for businesses is that there is a 'churn' of short-term employees who are leaving without reaching full productivity. In addition, organisations are losing experience and knowledge from within the critical manager and professional levels, quite often to direct competitors.

The upshot is poor return on investment on employee selection and development activities. If unchecked, this translates into lower engagement, higher costs and lower productivity. This in turn raises the cost of business, and constrains an organisation's ability to meet its growth objectives. The challenges presented raise serious questions on the extent to which high productivity can be sustained at current levels of workforce engagement. Without radical action to improve human capital engagement, companies cannot ensure that they have the talent base needed to achieve their ambitious growth plans.

[7] 'Millennials at Work: Reshaping the workplace', PwC survey of over 4,300 graduates aged 31 or under (December 2011).

[8] The upside of irrationality – The Unexpected Benefits of Defying Logic at Work and at Home. New York: HarperCollins. Ariely, D. (2010).

3. People processes & systems

The previous two sections outlined challenges regarding attracting and retaining key talent. Our third section covers key findings in the area of people processes & systems including the HR function and the role it can play in addressing these challenges and supporting the organisation's strategic goals.

Making talent strategic

Against the backdrop of the issues highlighted in the previous two sections, it is important that HR functions are equipped to meet the business' needs.

"Notwithstanding that all the organisations recognise the challenges in trying to meet their growth plans in the Asia-Pacific region, we have found that, generally speaking, it is a fairly ad-hoc approach in the way companies manage the challenges related to talent."

Debra Eckersley
PwC Partner, Asia-Pacific Leader, People and Change Consulting

In our research, CEOs told us they are determined to be more strategic in the way they manage their workforce today and plan for future needs. Up to now, most businesses would invest in thorough market analysis when drawing up a business strategy, but neglect the strategic people plan required to drive it through. Now, leading businesses are looking beyond the next budget round to plan talent needs. Companies are recognising that talent plans need to be incorporated in the business strategy, if they want to close the gap today and map how talent needs will change.

As part of this effort, more Asia-Pacific CEOs are integrating HR with business planning at the highest levels of the company: 84 percent of CEOs in Asia-Pacific say that the chief human resources officer, or equivalent, is one of their direct reports, compared to 77 percent of CEOs in Western Europe and 73 percent in North America.

Establishing a direct reporting line is a positive development, but is it enough? Our research suggests HR functions in the region continue to be largely operational and not sufficiently strategic. There appear to be a couple of key factors. Firstly, with the pressures of a highly competitive talent market, HR functions are trapped in a reactive and operational cycle, focused around resourcing. Secondly, HR often lacks a sufficient degree of credibility with the business.

Four out of five companies in our study do not have dedicated HR resources responsible for talent management strategy and process.

Trapped in a reactive cycle

With the high levels of recruitment activities and churn in Asia-Pacific organisations, often it is unsurprising that HR functions are pre-occupied with simply trying to keep up with these operational business demands. This in turn hampers their ability to focus on proactive strategic initiatives.

Our analysis suggests that Asia-Pacific companies tend to have HR functions which are slightly larger in terms of staff. On average, one Asia-Pacific HR team-member serves 83 employees or full-time equivalent (FTEs). This is compared with 90 and 88 employees in the United States and Western Europe respectively.

While the difference in overall HR department size is not significant, the contrast in the profile and composition of the function is more striking. In Asia-Pacific, the tendency is towards a greater proportion of operational and administrative staff, focused on transactional HR activities. Whereas in organisations that demonstrate strong HR business partnering, we see a trend towards fewer and more senior resources in HR, as they try to reduce the operational burden on HR through rationalising administrative processes, and focus on being closer to the business.

Additionally, given the importance of talent management, a surprising finding is that many organisations do not have a sub-function dedicated to managing talent.

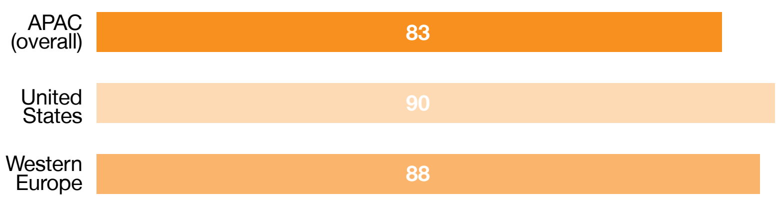
Specifically, four out of five companies in our study do not have dedicated HR resources responsible for talent management strategy and process.

Without dedicated focus and prioritisation, businesses cannot be certain that their current processes are effective or if they are delivering value. The reality is that many companies do not know what talent will be needed to deliver the longer term business strategy – their 'talent pipeline'. This means that key talent will be lost while 'non talent' may be over-incentivised.

Asia-Pacific HR functions are slightly larger than their Western peers

Figure 7

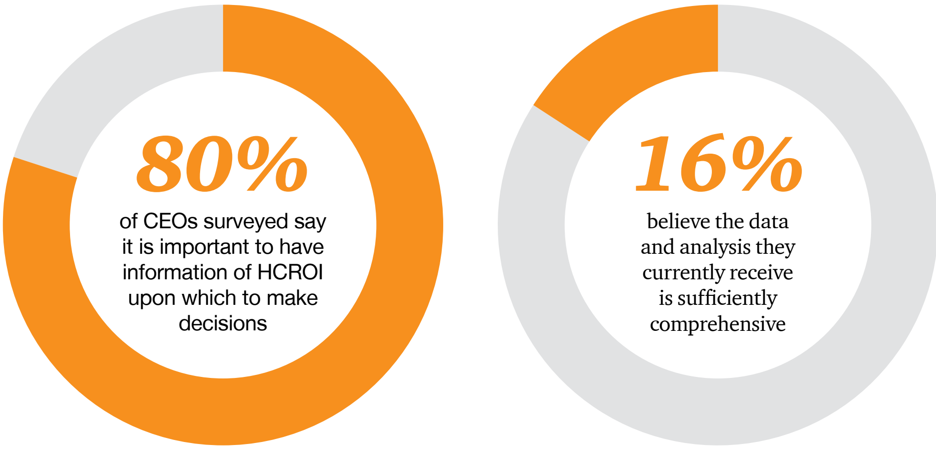
FTEs per HR Department FTE (X:1)



Source: PwC Saratoga analysis

A minority of CEOs get comprehensive reports on their human capital return on investment (HCROI)

Figure 8



Source: PwC 15th Annual Global CEO Survey 2012

Establishing business credibility

Lack of quality information is making it very difficult for businesses to anticipate strategic talent needs and plan ways to meet them in a timely, assured and cost-effective way. In short, many businesses are operating in the dark.

Notable gaps include information on HCROI. As Figure 8 shows, 80 percent of CEOs surveyed say that it is important to have information on human capital return on investment (HCROI) for making decisions. However, only 16 percent believe the data and analysis they currently receive is sufficiently comprehensive. Providing better decision support is key to improving HR's credibility with the business.

The majority of CEOs in our study are seeking a better understanding of the scale and effectiveness of their investments in talent. Productivity and labour cost remain important measurements; these are the tools investors, lenders and businesses use to benchmark progress (or the lack of it). They are largely standardised in many industries, and thus easy to implement. Yet for many CEOs, these tools are not enough.

Measures such as productivity and labour costs are very good at telling a CEO how the business is performing today relative to its peers. However these measures do not tend to indicate whether the organisation is investing enough in employees to generate future growth.

Such measurements cannot isolate skills gaps. In addition they struggle to identify the pivotal jobs that drive exponential value, and they do not measure employee engagement or team performance, both of which are critical for investments to foster innovation. These measurements are much harder to make, which is one reason why they have been neglected. It is also why today, so many CEOs are frustrated with the lack of analytical support received from HR to support decision-making around the issue of talent and how to better engage them.

Organisations do a much better job of measuring their physical assets and segmenting their customers. HR now needs to support the organisation to level up its global and real-time people measurement capabilities if it is to determine the true impact of people on business results.

A rethink of HR is overdue

HR functions have changed significantly over the past decade; however, there are still serious questions about HR's ability to drive the change needed to deliver growth.

CEOs need to consider the future of the HR function – many HR teams are failing to deliver the strategic thinking needed to drive growth.

We believe a rethink of this function is overdue in many businesses to align it directly to the business plan. While this has always been on the agenda of CEOs, it is becoming increasingly critical as Asia-Pacific businesses mature. How HR responds will determine whether the organisation thrives (and even survives) in the next phase of global economic development. HR faces a bleak future if it is not focused on the strategic business issues that directly impact overall value. With CFOs taking a much wider role around growth and business transformation, HR leaders need to become more strategic or face becoming purely functional.

4. Impact on business value

In the earlier sections, we outlined the key issues that Asia-Pacific businesses face amidst the pressures of operating in a highly competitive talent market. This increased competition, coupled with high levels of turnover, means many organisations are trapped in a talent spiral of rising costs and declining productivity. In this section, we review the specific impact these factors may have on the bottom line results for businesses in the Asia-Pacific region.

Business leaders' concerns

Talent and skills shortages continue to be seen as a top threat to business expansion. For instance, only 31 percent of CEOs in our study are 'very confident' they will have access to the talent needed to execute their strategy over the next three years.

CEOs have always talked about the 'war for talent', but now they are telling us it is having a real impact on growth. Three out of ten CEOs said they have had to cancel or delay a strategic initiative because of talent constraints.

To give a measure of the scale of the problem: almost all CEOs we spoke to in our survey are changing talent strategies to tackle high turnover and skills shortages, with 38 percent saying they are making significant changes.

Human Capital Return on Investment

Figure 9

HCROI measures the Commercial Return received for every dollar (or equivalent currency unit) that is invested in the workforce. It has greater value in combining all of the primary business drivers where improvements can be targeted, as it captures the dynamic nature of sustainable profit i.e. bottom line performance improvement in combination with a managed investment in people.

- Revenue by business unit
- Revenue by region
- Revenue by product line

- Materials costs
- Financing costs
- Facilities and overhead costs

$$\frac{\text{Revenue - Non-people costs}}{\text{FTEs x Average remuneration}}$$

- FTEs by business unit, region & function
- Temporary, casual & contract workers
- Utilisation of overtime

- Salaries and wage levels
- Variable compensation
- Benefits structure

Sustaining return on people investments

Achieving competitive and sustainable returns on workforce investment will be a key lever in the long-term success of companies in the region.

Our analysis shows that in terms of return on workforce investment as measured by HCROI, Asia-Pacific comes out ahead of the Western markets. This means for every dollar (or equivalent currency unit) invested in the workforce, Asia-Pacific organisations report a higher commercial return.

Overall workforce ROI in the region is 31 percent and 55 percent higher compared with the United States and Western Europe respectively. But there are two sides to the story.

In Asia-Pacific's emerging markets, HCROI is nearly twice the level observed in the West. A contributing factor is a combination of strong business growth and competitive workforce costs. In contrast, in the advanced Asia-Pacific markets, HCROI is only slightly higher than the United States and Western Europe.

If pay packages continue to rise at current rates, sustaining competitive levels of HCROI is going to be a challenge for Asia-Pacific economies: 44 percent of CEOs believed that talent-related costs have risen to higher than expected levels. Notably, the proportion goes up to 53 percent in China & Hong Kong and 67 percent in South-East Asia. In the short-term, organisations may be able to mitigate the impact of this on the bottom line.

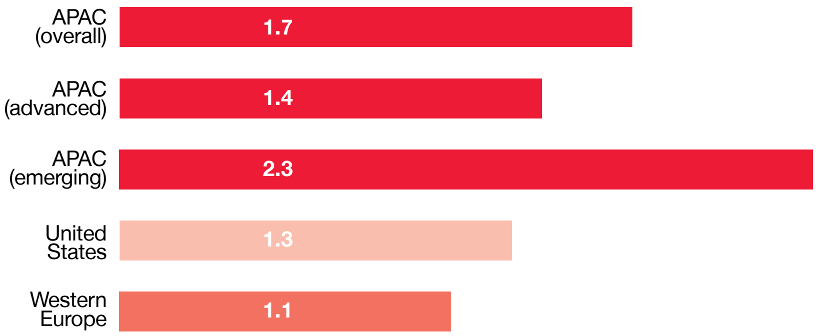
But in the long-term, rising talent-related costs, especially loss of productivity and total replacement cost (both direct and indirect) associated with high turnover, will impact businesses' ability to sustain the currently competitive HCROI position.

Against the backdrop of escalating talent competition, and thus rising talent-related costs, the status quo is clearly not good enough. The pressing question now for business leaders is how their talent management strategies might be re-shaped to break out of the talent spiral, and better adapt to the changing forces in the business environment.

Return on workforce investment is higher in Asia-Pacific

Figure 10

Human Capital Return on Investment (X:1)



Source: PwC Saratoga analysis

5. Priorities for business

The findings highlighted in this report around the increasing challenges in attracting, rewarding and retaining talent all point to a fundamental imperative: Asia-Pacific organisations need to do more to develop and execute a strong, differentiated employee value proposition if they are to attract the best talent in the market and engage their existing talent.

Without a clearly defined proposition, and holistic and clearly aligned talent management approach to underpin it, the pressures of operating in a highly competitive talent market will only be amplified. Ultimately, this will mean organisations will struggle to sustain competitive levels of HCROI.

Companies need to refocus efforts and investments on those employees who will be most valuable to their businesses in light of their growth ambitions. This push into new markets brings with it a need for a more global mindset across the whole business – HQs are moving east and hierarchies are becoming flatter. This means that employees are more empowered. Equipping an organisation to compete successfully in three to five years requires fundamental changes today in the way businesses manage talented people.

To illustrate the business opportunity, we will highlight five priorities. We believe these priorities will help business leaders better manage talent to meet future growth plans.

> ***"We have now radically changed that by developing a global HR training process to screen potential candidates and send them abroad to gain work experience for a year, beginning in 2012."***
>
> ***Yoshio Kono***
> President and CEO, The Norinchukin Bank, Japan
>
> Source: PwC 15th Annual Global CEO Survey 2012

Attracting talent

Upgrade hiring and on-boarding processes
Greater importance must be placed on ensuring that newly hired employees get up to speed rapidly and become productive members of the workforce. PwC Saratoga research shows that it costs companies between 30 percent and 40 percent of an annual salary to hire an employee, and leading companies know that they need to guard that investment. Companies are under extreme pressure to retain the employees they recruit and hire, though there are several factors in today's workforce that make retention efforts difficult.

An effective on-boarding process is a worthwhile investment that can help companies transform newly hired employees into dedicated members of the workforce and reduce the costs associated with turnover. Based on our experience, best practice organisations typically assign a mentor/buddy to newly hired employees and engage their new hires beyond their first day of work.

Retaining and rewarding employees

Pay attention to internal talent
The high turnover levels are a pressing call for companies to lead efforts in the creation of internal job markets and lateral redeployment career paths. Additional emphasis and visibility on employee talent profiles and workforce supply/demand will enable companies to transform their sourcing and retention strategies to focus more heavily on redeployment and internal talent management. Building talent from within the company has the added advantage of improving engagement through increased development opportunities for employees. This in turn improves retention, reducing the urgency around external hiring, thus creating a virtuous cycle.

Given current economic volatility, resignation rates are expected to go down in the short-term. However, this is due to declining market confidence rather than high employee engagement. If employees are not better engaged and satisfied with their current employer, when economic growth steps up the churn will irrevocably start again. Hence, it is important for employers to focus on improving their employer value proposition and offering a more holistic package.

Focusing efforts and investment on your top talent – those employees positioned to add the most value and determine the success of a company – can provide a major competitive advantage over the next 12-18 months. This might involve strategically exposing them to different areas of the organisation, promoting when ready, and providing cross-cultural and foreign assignment opportunities.

Look beyond financial incentives
Compensation – while important – is just the first step in attracting and retaining pivotal talent during tough times. For example, in a PwC survey, "competitive wages/other financial incentives" lagged behind "opportunities for career progression" as the factor millenials consider when deciding if an organisation is an attractive employer.[9] Most CEOs we surveyed say they plan to use more non-financial rewards to improve employee engagement and retention.

These approaches can take many forms, but often involve training and mentoring programs, with a closer focus on career trajectories. Instilling a deeper sense of ownership by spreading forms of employee stock ownership more widely is another important retention tool. Introducing flexibility to reward and work structures, thus enabling employees to tailor to lifestyles, is increasingly being seen as an important engagement driver.

9 'Millennials at Work: Reshaping the workplace', PwC survey of over 4,300 graduates aged 31 or under (December 2011).

People processes & systems

Take a systematic and analytical approach to talent management

To succeed in an environment of higher talent churn, organisations need to pay greater attention to talent-related issues in their business strategies. The goal must be to improve a company's understanding of how talent will affect the bottom line, create new opportunities for growth and innovation, mitigate new risks, and generate competitive advantage. Many organisations are failing to understand what talent management really means and are unclear about how they can create a sustainable talent pipeline for the long term. The approach will vary from company to company, of course. But a starting point is simply to adopt a systematic approach towards understanding the inputs and outputs of talent strategies.

Organisations need to manage their talent supply chain with the same rigour they would with other parts of the organisation. They must focus on making their organisations the most attractive to the best local talent.

Make targeted investments in strategic HR processes

A true strategic business partner understanding the company's business, industry and strategy. To achieve this, HR needs to be actively involved in investment and business decisions and look to financial measures to gauge results. A strategic HR function should act as a consultant to the company on all people issues providing insights that can help business leaders make the right decisions and helping to craft the right business strategy.

If a particular process is critical to an organisation, sufficient investment should placed to bring it up to the best practice. Using the resourcing process as an example, leading practices observed in organisations include designing recruitment to build the broader talent pipeline; up-skilling the internal resourcing mechanism through the use of advanced talent identification processes, role profiling and competence matching to positions; and developing a continuous presence in the job market through external third parties or internal search functions.

In summary

Low talent engagement and development may constrain the growth ambition of businesses. Without mitigating actions, this will result in the growth potential of the organisation not being fully capitalised. The size of the challenge should not be underestimated as we enter a period of growth with a lot of uncertainty. Organisations cannot be complacent and reactive.

Business leaders in forward-thinking organisations are actively pursuing a variety of approaches to break out of the talent spiral. Many are changing benefits schemes and pursuing non-financial incentives, such as greater opportunity for international experience, to remain attractive employers.

Others are redoubling measures to train employees with the skills their businesses need to compete, beginning with a greater emphasis on apprenticeships and internships.

Our insight suggests organisations which do not adopt a radical shift from the status quo risk getting left behind. Rethinking the talent management approach and redefining your organisation's value proposition are critical, and businesses should take urgent steps.

Appendix I: Research methodology

Saratoga, PwC's human capital analytics arm, established a dedicated regional centre in Singapore in 2010 to address the growing demand for an evidence-based approach to human capital management in Asia-Pacific. As part of the launch, we invited clients from a range of sectors to join our inaugural Asia-Pacific Human Capital Effectiveness Programme 2011. The objective of this programme was to bring together leading organisations in the region, and provide a mechanism through which participants can measure and benchmark key workforce and HR metrics with peer organisations in a confidential manner.

Data was collected from more than 240 organisation entities. The average company in the report has annual revenue of US$1.9billion and 6,900 employees.

Adopting a consulting-led approach, we worked closely with these organisations to ensure alignment of collected quantitative data to Saratoga definitions. In addition, we posed qualitative questions to glean insights on best practices.

With the information gathered, we examined human capital trends in Asia-Pacific to identify important human capital challenges faced by companies operating in the region, as well as the perspective of CEOs on these key issues, based on PwC's Talent Management Framework (see page 6). Where appropriate, we compared these trends against those in two major Western markets: the United States and Western Europe, drawing on Saratoga's global human capital database which comprises data from more than 2,400 organisation entities.

Figure 1 – Our study included organisations from the following industries
Banking
Comms/Media
Engineering/Manufacturing
Insurance
Other Finance
Pharmaceutical
Public Sector
Retail & Leisure
Services
Technology
Utilities

Figure 2 – Our study included organisations from the following countries[10]
Advanced
Australia
Hong Kong
Japan
Korea
Singapore
Taiwan
Emerging
China
India
Indonesia
Malaysia
Philippines
Thailand

[10] This is based on the Organisation for Economic Co-operation and Development (OECD) classification.

Appendix II: Metrics formulae

As part of our research, we analysed data submitted by client organisations for over 60 metrics. For the purpose of this report, we have focused on eight key metrics.

The following table provides the formulae for these key metrics.

Human capital impact		
Human capital return on investment (HCROI)	X : 1	(Profit before tax + Compensation + Benefits) ÷ (Compensation + Benefits)

Human capital engagement		
Variable pay	%	(Performance related pay + Attendance related pay) ÷ Compensation
Resignation rate	%	Resignations ÷ Headcount
Resignation rate < 1 year	%	Resignations less than 1 year ÷ Headcount less than 1 year
High performer turnover rate	%	High performer turnover ÷ High performer headcount
External recruitment rate	%	External recruits ÷ Headcount

Organisation and workforce structure		
Rookie ratio	%	Headcount less than 2 years of service ÷ Headcount
FTEs per HR Department FTE	X : 1	FTEs ÷ HR Department FTEs

For further information

PwC Saratoga is the world's leading source of workforce measurement and analytics, teaming with hundreds of executives and HR departments each year to apply a more vigorous, evidence-based approach to decision-making around their workforce.

PwC Saratoga has leveraged technology and meaningful metrics to help organisations maximise return on HR investment for more than 30 years.

Today, we integrate employee attitudinal research and metrics to drive execution action and support clients who are looking to develop and deploy dashboards, employee surveys, predictive solutions, conduct workforce planning initiatives and benchmark the workforce and HR function.

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To learn more about PwC Saratoga, please visit us at **www.pwc.com/saratoga**

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15th Annual Global CEO Survey: Delivering results Growth and value in a volatile world, 2012

This report seeks to understand how businesses are preparing for growth in their priority markets. It explores CEO's confidence in their company's growth prospects, and how they are building local capabilities and creating new stakeholder networks in new markets.

Millennials at work: Reshaping the workforce, 2011

This report looks into the mind of the new graduates from all over the world who are entering the workforce for the first time, and how their attitude and expectations shift as a result of the economic downturn in many parts of the world.
It also addresses what strategies employers could consider to employing to continue attracting and retaining their key talents.

Securing the talent to succeed: Making the most of international mobility in financial services, 2011

Whilst financial services organisations continue to evolve and grow in the fast-changing environment, there is a lack of talent supply to help meet the organisations' growth aspirations. This report examines the workforce management issues and the role of talent mobility to help organisations close this gap.

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