Results from PwC Saratoga’s 2012/2013 US Human Capital Effectiveness Report
State of the workforce
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As the US economy slowly recovers from recession, several challenges are emerging for HR. Hiring is trending upward, but productivity is declining. The employment uptick has brought higher voluntary turnover rates, but not for new hires. Organizations that understand and adapt to this seemingly contradictory workforce environment will be able to gain the highest return from their investment in the workforce.

This whitepaper summarizes results from PwC Saratoga’s 2012/2013 US Human Capital Effectiveness Report (as well as past reports), combining objective data and analysis from more than 300 organizations. We offer observations that may help organizations understand the dynamics at play in the labor market today.

Highlights from the report include:

**Return on workforce investment has diminished.** Organizations have incurred higher labor costs, yet productivity has declined in the short term. An organization's level of productivity in the future will depend on its ability to drive profitability at a faster rate than the rise in labor costs.

**Baby Boomer retirement remains an issue, but expectations of its impact have lessened.** Vulnerability to retirement is likely to wane during the next decade. Still, organizations are increasing their focus on succession plans and looking at internal talent to fill key leadership and pivotal roles as baby boomers retire and leave the workforce.

**As unemployment has decreased, voluntary turnover has risen.** As the economy slowly recovers, workers find themselves with more career options. Voluntary turnover has increased for the first time in six years, and high-performer turnover has risen two years in a row.

**Quality of new hires has improved during the past five years.** Results suggest organizations have improved their selection and onboarding processes during the past few years. But hiring cycle times have increased with an improving economy, requiring organizations to bolster their processes, programs, and policies to retain new hires.

**Investment in HR has increased, indicating the changing nature of the function.** Costs have increased as HR organizations have become more global and increasingly focus on strategic activities to enhance return on workforce investment. These include workforce planning, predictive analytics, and workforce intelligence.
PwC Saratoga’s 2012/2013 US Human Capital Effectiveness Report contains more than 200 unique metrics covering a wide array of topics, including:

- Workforce productivity
- Employee engagement
- Diversity
- Succession planning
- Quality of hire
- Employee rewards
- Turnover
- General and administrative cost and structure
- HR function effectiveness
- Span of control

The report includes 2011 data from more than 300 organizations representing 12 industry sectors. The average company in the report has annual revenue of $5.5 billion and 19,500 employees. While many participating organizations are global companies, results included in the report refer only to US operations. PwC Saratoga produces separate global, European, Canadian, Latin American, and Asian human capital effectiveness reports.

The results described in this white paper represent all-industry medians. Individual demographic groups, especially industry groups, can produce substantially different results than the all-industry median. We recommend that organizations analyze results not only in the aggregate, but also by factors such as industry, company size, and revenue growth. For example, the median voluntary turnover rate for the professional services industry was 12.9%, compared with 4.3% for the utilities sector. The full PwC Saratoga study contains more than 17,600 additional benchmark results based on more than 30 demographic segments.

This year’s report also includes benchmarks for nine employee engagement survey questions. We asked employees to rate their agreement with the questions on a five-point scale. We considered the percentage of employees agreeing or strongly agreeing with a given question when analyzing survey results. We can provide benchmarks for an additional set of approximately 40 employee survey questions.

To learn more about PwC Saratoga’s benchmark databases and measurement programs, please visit our website at www.pwc.com/saratoga or contact Nik Shah at (202) 297-2584, Scott Pollak at (408) 817-7446, Ranjan Dutta at (703) 918-3009, or Jon Burton at (312) 298-5259.
Since 2008, the amount of revenue generated per full time equivalent (FTE) in PwC Saratoga’s national US database has fallen by more than 18%, while labor cost* per FTE has increased by more than 14% during the same period. As a result, organizations are seeing a diminishing productivity of their workforce.

* PwC Saratoga’s definition of labor costs includes base, overtime, cash bonuses, payments for time not worked, severance pay, healthcare costs, retirement and savings plan payments, social security, Medicare, unemployment taxes, workers’ compensation premiums, and life insurance premiums.
Labor costs per FTE have increased every year since 2005, rising even during the recession. The compound annual growth rate (CAGR) for the period remains high, even after correcting for inflation. At a time when real income growth is stagnant, these numbers point toward a structural shift in the US labor force: it is becoming more professional and increasingly costly as lower-value roles are gradually outsourced or off-shored.
Compensation costs are trending upward, but revenue per full-time equivalent (FTE) is moving in the opposite direction.

For a typical employee, compensation costs are rising at a healthy clip. Compensation costs* per FTE rose 6.1% last year, while the compound rate of growth since 2001 was 4.1%.

Given the decreasing return on workforce investment, how can organizations balance pay and productivity? External hiring is expensive, and the productivity of new hires usually doesn’t peak until later. Even though a new hire’s productivity generally increases over time, the imbalance could continue because compensation and labor costs per FTE are likely to stay on an upward path.

Performance-oriented compensation can play a role in restoring the balance between pay and productivity. A growing percentage of total compensation per employee consists of incentive-based variable pay. Today, more and more US companies are opting for bigger and more direct variable pay component (in the form of profit sharing, gain sharing, commission income, or bonus plans) not just at the executive level but from the junior most employees. For example, the pay of US management teams is generally goal-contingent, so managers have much more of their pay at risk than just a few years ago. In some cases, the impact of variable pay is so high that if a typical company earns more than one dollar of income above budget, more than fifty cents of it goes to increase payouts under variable pay arrangements.

With variable pay programs, organizations should expect compensation costs to respond to business conditions. Variable pay can be tied to core financial results, shifting some of the related risks from shareholders to employees. Organizations can also base their salary-increase budget on business conditions and align it with their overall compensation strategy.

US corporate profits are sitting at impressive levels, and pay is rising accordingly. Companies are more willing to reward high performers who can boost profits and contribute to the growth of the organization.

* Compensation costs include base pay, overtime pay, pay premiums, commissions, cash performance-related bonuses, sign-on and referral bonuses, profit sharing, payments for time not worked, and severance pay.
Despite recent evidence of a slight abatement in cost trends for many employers, healthcare expenses continue to rise at rates greater than inflation and salary increases. The average net spend per active employee has increased to more than $8,750\(^1\) (up 5% from the previous year), with many employers’ net spend per employee topping $10,000.\(^2\)

To continue to offer health benefits, employers realize that they need to more effectively manage costs to get them down or, at least, closer to the rate of inflation. To that end, employers are using data analytics and deploying a variety of programs and initiatives.

Some initiatives employers might consider to help control healthcare costs are as follows:

**Consumer-driven plans:** Consumer-driven health (CDH) plans, which include health savings accounts (HSAs) and health reimbursement accounts (HRAs) are becoming mainstream. According to the 2011 Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 41% of firms with 1,000 or more employees offer a CDH plan. And PwC’s 2012 Touchstone Survey found that 40% of employers are considering adding a high-deductible plan or an HSA as an option.

**Wellness initiatives:** Through education, self-awareness, coaching, and financial incentives, corporate wellness programs aim to improve or maintain the health status of employees and their families. In addition to lowering plan costs, improved health status can help boost productivity and reduce absences. Progressive wellness initiatives could not only increase productivity, but also have a positive impact on employee engagement, which may help lower voluntary turnover.

**Care management programs:** The effectiveness and ROI of care management initiatives, such as disease management programs, are coming under increased scrutiny. As a result, many employers are beginning to narrow the focus of these programs to manage care for only the most critically ill or those with complex, multiple chronic conditions.

**On-site services:** While on-site clinics and occupational health nurses are not new, developments in on-site services are beginning to look transformational. Traditional occupational and acute-care clinics are evolving into full-service, on-site health and wellness centers. Their personal connections and accountability can help drive higher employee engagement and sustained behavior change.

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\(^1\) 2012 PwC Saratoga US Human Capital Effectiveness Report  
\(^2\) 2012 PwC Touchstone Health and Well-Being Survey
With labor costs per FTE increasing and revenue per FTE decreasing, we see a trend that we anticipate will continue at least for the short term. During the recession, we might have experienced a productivity bubble. As revenue went down, organizations shed staff, and the number of FTEs went down at an even greater rate. As a result, the revenue per FTE of remaining staff went up.

Now that the US economy is gradually coming out of the recession, organizations are hiring more people. Our study shows that the percentage of employee headcount that is new external hires has grown each of the past two years, increasing by 17% from 2010 to 2011.

**Figure 3. External hiring rates**

<table>
<thead>
<tr>
<th>Metric</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
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<tbody>
<tr>
<td>External recruitment rate*</td>
<td>12.9%</td>
<td>9.6%</td>
<td>9.8%</td>
<td>11.5%</td>
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Because new hires take time to reach peak productivity, hiring new employees creates a short-term lag in productivity. A plateau may follow: revenue per FTE may increase as the impact of new hires begins to pay off, but labor costs per FTE will not necessarily stop rising. The return on workforce investment in future years will depend on which rises faster — labor costs or revenue per employee.

The key metric to assess the return on workforce investment is labor costs as a percentage of revenue. This metric measures the investment in the workforce needed to generate each dollar of revenue. For example, a return on investment in the workforce of 20% suggests an organization needs to invest $20 in workforce labor costs to generate $100 in revenue.

When analyzing workforce investment as a percentage of revenue across industries, no clear trend emerges. For instance, the insurance industry was able to reduce the investment in the workforce necessary to generate $1,000 in revenue from $90 to $88 during 2011. In contrast, hospitals had to increase workforce investment from $455 (in 2010) to $477 (in 2011) to deliver the same $1,000 in revenue.

**Figure 4. Labor costs as a percentage of revenue**

<table>
<thead>
<tr>
<th>Industry</th>
<th>2010 median</th>
<th>2011 median</th>
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<tbody>
<tr>
<td>Hospitals</td>
<td>44.7%</td>
<td>45.5%</td>
</tr>
<tr>
<td>Insurance</td>
<td>9.0%</td>
<td>8.8%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>20.8%</td>
<td>18.5%</td>
</tr>
<tr>
<td>Utilities</td>
<td>14.0%</td>
<td>14.9%</td>
</tr>
</tbody>
</table>

The variability across industries highlights the importance of benchmarking against the right peer group. Organizations should make the labor-costs-as-a-percentage-of-revenue metric part of their executive dashboard and use it to drive conversations about employee productivity.

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*PwC Saratoga defines external recruitment rate as the percentage of candidates filling external requisitions relative to the average non-contingent headcount.*
Baby Boomer retirement remains an issue, but expectations of its impact have lessened

PwC Saratoga’s benchmarks show a consistent downward trend in eligibility for retirement.*

Figure 5. Eligibility for retirement

Some of the decrease in retirement eligibility may reflect Baby Boomers retiring or being laid off during the recession. The downward trend might alleviate the fear that Baby Boomers would retire en masse and leave a giant leadership void.

* PwC Saratoga defines eligibility for retirement as employees/management that are aged 62 or above (if no pension plan exists) or those who are eligible for a fully vested pension.
Furthermore workforce participation numbers by the generations seem to indicate that we are already in the middle of a Baby Boomer retirement wave. In 2007, nearly one in two workers was born between 1943 and 1960, but less than one in three made up this cohort in 2012. This means Baby Boomers are departing our workforce every day and leaving behind gaps in leadership, knowledge, and expertise. To fill these shoes quickly, organizations need to find suitable replacements for departing or soon-to-be departing leaders and pivotal employees.

**Figure 6. Generational headcount changes**

![Bar chart showing generational headcount changes from 2007 to 2011.](chart.png)
The future does look brighter from a retirement-vulnerability viewpoint. As Baby Boomer retirement slows, Generation X will increasingly move into senior leadership roles and reduce vulnerability threats. Generation X will likely constitute the majority of the US workforce for years to come because it will take Generation Y quite a few years to fully replace the departing Baby Boomers.

As companies more systematically prepare for retirements and generational shifts, we see a sharp uptake in pipeline utilization numbers. Pipeline utilization is the percentage of key positions filled by succession-planning candidates. In 2010, less than half of the organizations in PwC Saratoga’s database used internal candidates to fill key positions, while nearly two in three reported using them in 2011.

Additionally, we see a rising percentage of organizations with one or more unique candidates per role within their talent pool. Investment in succession programs seems to be paying dividends as organizations select more of their future leaders from within, perhaps as a way to counter the current Baby Boomer retirement wave.

**Figure 7. Succession planning**

<table>
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<tr>
<th>Industry</th>
<th>2010</th>
<th>2011</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pipeline utilization</td>
<td>45.7%</td>
<td>65.5%</td>
<td>43.3%</td>
</tr>
<tr>
<td>One or more candidate succession planning depth</td>
<td>56.3%</td>
<td>69.7%</td>
<td>23.8%</td>
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In mid 2011, PwC Saratoga predicted voluntary turnover trends based on historical US government unemployment and GDP numbers and correlations with our voluntary turnover benchmarks. Our estimates suggested voluntary turnover would increase during 2011 to 7.2%. In reality, the US economy improved at a greater rate, and voluntary turnover increased by one full percentage point (from 7% to 8%, an increase of 13.6%). The trends seem to indicate that perhaps the voluntary separation rates are rebounding faster with an improving economy than historical correlations with US unemployment rates would normally suggest. If these trends continue, we predict considerably higher voluntary separation rates for 2013 and beyond, higher than what we have seen during the past eight years.

Figure 8. Voluntary turnover and unemployment rate

As unemployment has decreased, voluntary turnover has risen

* PwC Saratoga includes resignations and retirements in our definition of voluntary separations.
While the overall workforce is seeing an increase in voluntary turnover rates, high performers* also are increasingly leaving organizations. During 2010, 4.4% of high performers left their jobs — an increase of nearly 19% since 2009 and a rate higher than what we saw in 2008.

**Figure 9. High performer turnover**

* PwC Saratoga defines high performers as those within the top 20% of an organization’s performance management system.
PwC Saratoga also reports turnover rates for key roles within organizations. Results demonstrate that in 2011, organizations lost more than 2% of their high-potential* employees, a number that ideally should not be more than 0%. Additionally, turnover for pivotal roles, such as sales professionals and bedside nurses, increased from 2010 to 2011. This statistic potentially foreshadows turnover issues for other important employee groups.

Figure 10. **Turnover in sample pivotal roles**

![Graph showing turnover rates for sales and bedside nurses](Image)

* PwC Saratoga defines high potentials as individual contributors or management level employees identified by the organization as having leadership potential and who are in line to move into a more senior role.
Leading organizations understand that employee engagement is more than just an exercise in collecting the opinions and sentiments of the workforce. It’s essential to business performance.

Employee engagement is the extent to which employees are willing to expend discretionary effort to achieve an organization’s objectives, which translates into measurable performance. Research — and our own experience building and implementing employee engagement programs — shows that increased employee engagement drives key workforce metrics. It can improve retention, customer service and loyalty, revenue, profits, and safety.

When structured correctly, a comprehensive employee engagement program functions as a significant component of the organization’s strategic goals or stands on its own as a high-priority objective. Aligning business strategy with employee engagement allows organizations to understand and use engagement in ways that directly impact delivery of business objectives.

Forward-looking companies are going further than just employee engagement surveys. They’re gaining a clear view of the pivotal roles within their business — the roles that create (or destroy) disproportionate business value — by applying data mining and predictive modeling to gain insight into the retention, recruitment, and productivity of the workforce.

Here are some techniques you can use to analyze and build employee engagement:

- When reviewing results, focus on the direct market-facing impact employee engagement has on measures of business performance, such as customer satisfaction or product quality.
- After you have completed your analysis, conduct studies to identify barriers to high performance within specific groups of employees and map out tangible improvements that can drive engagement and business performance.
- If your survey includes an intent-to-stay question, develop a retention score for each employee that measures the probability that the employee will leave within the next year.

How are you encouraging employee engagement?
Quality of new hires has improved during the past five years

In the years prior to the recession, US organizations were losing nearly one in three employees during their first year of service. Most employers would expect a lower turnover rate for first-year employees during a period of recession or slow economic recovery, and we found that to be the case. While the voluntary turnover rate rose during 2011, the first-year turnover rate declined for the fourth year in a row. This trend suggests that HR programs that focus on selection and onboarding of new hires may be demonstrating a good return on investment.

Figure 11. First-year turnover rate

Despite the appearance of success, we feel that organizations should not become complacent. Without sustained structural improvements to talent acquisition processes, PwC Saratoga estimates that first-year turnover could reach 29% by 2014. We base this probability on our statistical analysis of historical, current, and projected government economic figures on unemployment, GDP, and first-year turnover.

The hospital industry might already be experiencing this backlash. This industry’s first-year turnover rate has risen from 26.2% to 28.3% during the past year, reflecting an increase of 7.8%. The growth in the healthcare industry and demand for critical staff, such as bedside nurses, radiologists, and x-ray technicians, may foreshadow a trend for other industries.

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* First-year turnover rate includes voluntary and involuntary separations.
** Estimates for first-year turnover rates are predicted by analyzing the correlation between unemployment rates and first-year turnover rates during the previous six years.
The HR function has become more sophisticated as companies have invested in supporting a global workforce and becoming more strategic. The evidence follows:

- As more companies globalize, we are seeing a global and integrated HR delivery model. In the past, many global companies operated HR on a regional basis, which created redundancies in jobs and systems, resulting in inconsistencies and complexities in processes.
- An increasing number of companies are integrating workforce metrics with employee survey data to gain a clearer understanding of the effectiveness of their hiring and retention practices.
- More HR organizations are embarking on workforce planning initiatives.
- Use of HR predictive analytics is becoming mainstream, and HR organizations are driving this trend.
- An increasing number of companies are developing a workforce analytics roadmap and laying the groundwork for workforce intelligence centers of excellence.

As the HR function grows more global and strategic, it must add not only people with new and more advanced skill sets, but also technology to enable the transformation. The addition of new staff and technology has resulted in increased costs. Despite a relatively slow economic recovery, the per-employee investment in HR* increased nearly 8%, from $1,495 in 2010 to $1,610 in 2011.

We expect this increased investment in the HR function to continue in the foreseeable future as HR moves up the maturity scale. A higher-functioning HR organization requires more investment but is expected to deliver a greater long-term return.

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* PwC Saratoga defines HR costs as labor, systems, outsourcing, consulting, and overhead allocations and excludes learning and development, payroll, safety, medical centers, cafeteria, and childcare.
The hidden personnel costs in an acquisition

Personnel costs can have a significant impact on earnings and profitability. When evaluating a potential acquisition target, organizations should understand the extent to which cost savings achieved during a recession are sustainable or reflect short-term business decisions that need to be reversed. For example, during the recent economic recession, companies used a broad range of cost-cutting measures, some specifically focused on personnel. The most common strategies for trimming personnel costs included:

• Suspended or decreased 401(k) plan match or profit-sharing contributions
• Pay freeze
• Shifting additional medical plan costs to employees
• Reductions in force

While these measures can artificially inflate earnings during an economic downturn, many employers have decided to reverse them to retain and engage talent. Some companies are restoring suspended or reduced contributions to 401(k) plans to pre-recession levels. Others are giving “catch-up” raises to employees whose pay had been frozen and rehiring some workers whose jobs had been eliminated.

If your organization is making or considering an acquisition, take a close look at how your target has managed personnel costs during the lean economy to understand any potential hidden costs and what it might take to restore benefits to prerecession levels.
Conclusion

As the US economy stabilizes, quality talent will continue to cost more, while revenue per employee may plateau. Employers will have a more compelling need to refine their workforce management processes to find the right balance between the organization’s and employees’ goals.

This balance will become more critical as turnover continues to increase. With more jobs available, employers will need to devote time, money, and attention to keep their high performers, high potentials, and pivotal employees and to keep them happy and productive.

To fill senior leadership roles, companies will need to assess their pipeline of qualified talent, replenish it as needed, and provide the training necessary to bring candidates for critical positions up to speed. Now more than ever, succession planning programs and ability to source leaders from within will be vital for organizational success.

Companies that have already increased their investment in their HR organizations are well on their way to obtaining and retaining the talent that will enable them not only to survive in a challenging economic environment, but to grow and prosper.
As a leading provider of HR consulting services, PwC’s Human Resource Services’ global network of 6,000 HR practitioners in over 150 countries, brings together a broad range of professionals working in the human resource arena — retirement, health & welfare, total compensation, HR strategy and operations, regulatory compliance, workforce planning, talent management and global mobility — affording our clients a tremendous breadth and depth of expertise, both locally and globally to effectively address the issues they face.

PwC is differentiated from its competitors by its ability to combine top-tier HR consulting expertise with the tax, accounting, and financial analytics expertise that have become critical aspects of HR programs.

PwC’s Human Resource Services practice can assist you in improving your performance across all aspects of the HR and human capital spectrum through technical excellence, thought leadership, and innovation around five core critical HR issues: reward effectiveness and efficiency; risk management, regulatory and compliance; HR and workforce effectiveness; transaction effectiveness; and global mobility.
As part of PwC’s Human Resource Services, PwC Saratoga is the world’s leading source of workforce measurement, 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 used technology and meaningful metrics to help organizations improve return on HR investment for more than 30 years.

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

**Metrics and benchmarking**
- Regional measurement available for the United States, Canada, Europe, Asia, and Latin America
- Industry consortia
- Metrics selection workshop
- Dashboard strategy support

**Employee surveys**
- Employee engagement surveys
- Exit surveys
- New joiner surveys
- Employee financial fitness assessments

**Predictive analytic solutions**
- Employee flight risk
- Quality of hire
- Employee performance

**Workforce planning**
- Workforce demand
- Technology and process roadmap

**HR department efficiency**
- HR activity analysis
- HR voice of the customer
- HR/payroll total cost of ownership
To have a further conversation regarding your company’s human capital effectiveness efforts, please contact

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