

Managing people in a changing world*

Key trends in human capital
A global perspective – 2008



*connectedthinking

PRICEWATERHOUSECOOPERS 

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Preface

Maximising the value of organisational resources has never been more challenging. Now, more than ever is the time for innovation and creativity. Keeping a watchful eye on the turbulent world economy and responding effectively is critical to sustainable business success.



Richard Phelps, Global lead partner,
Human Resource Management,
PricewaterhouseCoopers

This third edition of *Key trends in human capital* builds on the critical issues that we have identified in earlier years, and introduces new developments that we consider should be of major interest to all executives involved in people management.

The work is primarily based on data collected from PricewaterhouseCoopers Saratoga's human capital database across Europe, Asia, Africa and the Americas. It is supplemented by secondary sources, such as findings from the PricewaterhouseCoopers 10th and 11th global CEO surveys of 1,150 CEOs, and representing industry sectors including banking, financial services, manufacturing, telecommunications, chemicals, IT, utilities and retail. While the public sector is represented by a relatively small sample of organisations, we are confident from our work in this area that the majority of the trends identified are highly relevant to their current challenges.

Whilst this year's report builds upon earlier publications, it includes further supplementary information from a wide range of additional regions. Reporting on developments in these economies demonstrates the increasing global appetite for human capital information as a tool to help promote sustainable economic performance.

Unlike many other human capital reports, we place particular focus upon financial results and their direct relationship with human capital performance. It is our view that all human capital policies and processes should directly relate to the sustainable business performance and financial objectives of the organisation. It is the only way people will be given the recognition and status that their contribution deserves. In the past, human capital issues have all too often been treated as 'resource absorbing', rather than 'value adding', business investments. However, they require the application of the same disciplines to assess the value of their return as any other investment decision. Increasingly, CEOs, shareholders, analysts and others are likely to demand more rigorous financial assessments.

For ease of reference, the report data is organised within five key headings containing specific trends that are closely interrelated. In summary, they are:

Human capital impact – these constitute major bottom line trends which have measurable financial results. They all contain critical elements of human capital input and reflect the real impact people are having on the organisation.

Human capital drivers – we have identified a limited number of trends which will largely influence the impact people have on their organisation. They are the real drivers of performance.

Human capital foundations – these are background people trends, often affected by demographic or social movements that are already influencing both the way an organisation manages its people and the way those people respond to that management as part of today's sustainability agenda.

Human capital futures – we have identified a limited number of issues that are clearly affecting organisational thinking and are likely to grow in importance.

The HR function – we have once again reviewed the emerging structures and roles of the function which is an ongoing issue in human capital management.

Above all, we intend this report to provide practical guidance to human capital practitioners. We are concerned not with providing a merely encyclopaedic analysis of human capital activity across the globe, but with identifying a limited number of key issues that will have a significant effect upon an organisation's future success, in order to provide insight into where your management attention should focus.

We look forward to sharing the results of this report with you, our future human capital studies, and to continuing our dialogue on this topic.



Richard Phelps

Executive summary

A prime finding of this 2008 report is the growing recognition on a global basis of the undeniably critical role that human capital plays in the sustainability of organisations in all sectors of business and community related activity.

As the globalisation of business and networks continue to gather momentum, all economies, whatever level of maturity they have reached, are recognising their dependence on the people aspects of their strategies to leverage success.

This report raises a range of issues, key messages and implications for all those responsible for human capital management in the immediate future. In summary they are as follows:

Human capital impact – there is a new global business landscape. Asia, Central & Eastern Europe, Brazil, Indonesia, Mexico and Turkey are challenging the mature economies for dominance. The US and Western Europe are re-establishing a competitive place in the new order, looking for low cost solutions in their outsourcing and offshoring initiatives, developing consolidation in mergers and acquisitions (M&A) activity, and recognising the need for greater agility in order to respond rapidly to changing customer demands and sudden, unanticipated, financial crises.

People are critical. However, for Western Europe, levels of productivity, agility of response and innovation continue to lag behind the US, which itself is struggling to adapt to the new world.

Human capital drivers – there are a limited number of human capital drivers that will have the most significant influence upon organisational performance in the years immediately ahead. They constitute leadership, engagement, talent management and learning and innovation. They are closely interrelated and the inability to excel and compete in any single one will result in failure in them all. There is no hard evidence that Western Europe or the US is making the progress required in any of these drivers. There has been much talk, many words written and substantial sums of money spent. To date, the results are largely still awaited.

Human capital foundations – there are a range of people trends of varying intensity in global economies that reflect social and political pressures as much as organisational policy.

Demographic trends, diversity, work-life balance and wellness are having a real influence upon the sustainability strategies for people management in organisations. Successful organisations will claim to gain advantage from positive, proactive policies related to all these trends, suggesting that progressive employment practices correlate with successful enterprise. Others may claim that success simply makes it easier to introduce such policies.

Human capital futures – we have identified a limited number of organisational activities that have strong human capital content and a broader organisational context. Corporate reporting and risk management fall into this category. Both assume a higher level of human capital prominence as the importance of human capital in overall organisational performance gains higher recognition. CEOs, when acknowledging that the people agenda is one of their main personal objectives, are beginning to include it in the context of other business actions. In PwC's recent global survey of 1,150 CEOs across 50 countries, 89% of CEOs agreed that the people agenda is one of their top priorities and 67% agreed that it is where their time would be best spent.

The HR function – the future of the function still remains a matter for speculation. With the establishment of shared service operations to handle increasing amounts of the traditional transactional HR role, the future of the function relies increasingly upon its ability to establish a high level of strategic business presence. To date it has largely failed to do so. The concept of business partnership, as championed by David Ulrich and other HR opinion leaders, is proving challenging to implement successfully. Furthermore, the growing recognition of the importance of people to sustainable business success by the majority of surveyed CEOs, suggests that they themselves may be playing a far more active role in human capital management than previously. Only 43% of CEOs globally in the latest PwC survey agree that their HR function is equipped to handle changes required to compete for talent.

'There are a limited number of human capital drivers that will have the most significant influence upon organisational performance in the years immediately ahead. They constitute leadership, engagement, talent management and learning and innovation'

Background and methodology

PricewaterhouseCoopers Saratoga, part of the Human Resource Services advisory practice, has an established track record in providing global human capital benchmarking and measurement studies, and has one of the world's largest HR consulting businesses and most robust databases of human capital performance measures.

'The trends discussed in this report are highly relevant to all executives involved in the shaping and management of human capital within their organisation'

PwC Saratoga work with 40% of FTSE 100 and Fortune 500 companies and consider intelligent measurement to be fundamental to performance improvement. Benchmarks cover a broad spectrum including country workforce, size and sector. Data is collected according to strict definitions ensuring resultant benchmarks reflect a robust, like-for-like comparison.

In January 2005 we produced the first *Key trends in human capital* report. It was based on human capital measurement and benchmarking work in 2003 and early 2004 in Europe and the USA. In May 2006 we revisited the subject, confirming most of the trends we had identified earlier, indicating at the same time further important human capital movements which appeared to be developing. At the same time we extended coverage to Asia Pacific and South Africa. Analyses were based primarily upon our own measurement work but also embraced other research conducted by PwC or in other organisations that had produced relevant papers. The key objectives of our reports have been to identify those trends that would dominate the human capital agenda for some years ahead.

Background to key trends 2008

This report tracks key human capital trends through 2006 to early 2008. However, as we produce this report we are highly conscious of the major financial disturbances that are occurring across the globe affecting all major business markets. We have therefore studied the early responses to these new challenges and commented upon the impacts we believe they are likely to have upon human capital policies and activities in the immediate future.

As with our previous studies, the trends identified are not always present in every region; sometimes the economies are moving at different speeds and many are at different stages of maturity. In some cases, insufficient evidence is available for clients to collate the data against the strict definitions and standards we apply.

The trends discussed in this report are highly relevant to all executives involved in the shaping and management of human capital within their organisation, and those who are responsible for prioritising the allocation of resources to key issues. We welcome the continued discussion and dialogue some of our observations and conclusions may provoke.

Figure 1a: European database – participants by industry sector

Banking	11.6%
Insurance	2.8%
Life & Pensions	1.5%
Finance	5.1%
Chemicals	7.2%
Eng/Mfg	24.9%
IT & Electronics	20.1%
Public Sector	2.9%
Retail & Leisure	7.7%
Services	6.2%
Telecoms	5.8%
Utilities	4.4%



Methodology

PwC Saratoga is renowned globally for its work on human capital benchmarking and measurement. For some 20 years, it has worked with organisations to gather data upon an increasing range of closely defined quantitative and qualitative measures. The information is interpreted and integrated into the business planning process and relevant balanced scorecards. The only results received from organisations that are included in its database conform exactly to its prescribed definitions. We are therefore highly confident that all its data is consistent and usable for comparison and benchmarking purposes. PwC Saratoga uses an evidence based consulting approach to human capital issues and, where possible, our work is underpinned by data and trends throughout.

This report is based on PwC Saratoga's global database of human capital performance metrics and other secondary sources. This data has been collected by client organisations undertaking measurement and benchmarking projects and also from other PwC Saratoga research activities.

This briefing is based upon an all-industry median. Commercial region, size and sector can have a major influence upon many metrics so where appropriate we include tables that detail results by region and sector that reveal the strong structural and cultural differences that continue to pervade European and other markets. There is solid coverage across European nations and the US, including comparisons for Central and Eastern Europe (C&E Europe). Nearly a quarter of participants are multinational operators, many producing data for multiple countries or business units.

Within this sample, illustrated below, the following industry sectors are covered: banking, insurance, life and pensions, finance, chemicals, engineering/manufacturing, public sector, IT and electronics, retail and leisure, services, telecoms and utilities.

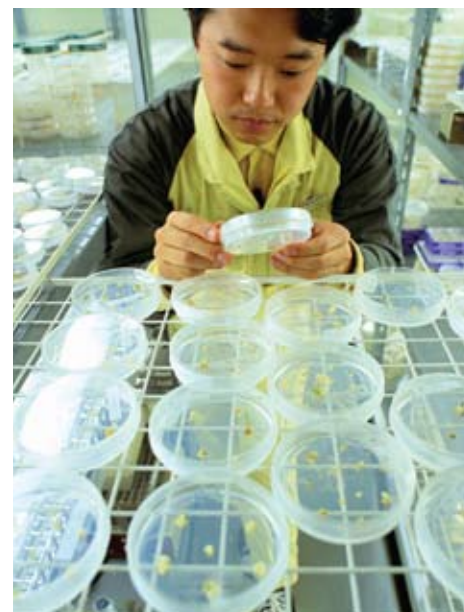


Figure 1b: US database – participants by industry sector

Banking	5.4%
Insurance	10.1%
Finance	4.7%
Healthcare	20.2%
Chemicals	5.1%
Eng/Mfg	11.9%
IT & Electronics	7.2%
Public Sector	11.6%
Retail & Leisure	4.3%
Services	4.3%
Telecoms	7.6%
Utilities	7.6%



1. Human capital impact

2005 and 2006 stand out as years when the burgeoning economies of Asia and Central & Eastern Europe consolidated their positions of high revenue growth outpacing the more mature Western economies and offering huge opportunities for inward investment. These years also witnessed the rapid advance of other emerging economies, including Brazil, Russia, Indonesia, Mexico and Turkey which are joining the ranks of high growth centres.

The early signs of economic slowdown in 2004 and 2005, affecting the US and Western Europe, were partially rebutted in 2006 but in the latter half of 2007 presents further evidence of an economic slowdown. Growth throughout 2006 gave way in early 2007 to uncertainty and turbulence, with the US in particular encountering waves of internally generated financial pressures.

Financial performance trends

Throughout 2006 and through to mid 2007, the US remained competitively well placed, maintaining a higher growth of revenue per Full Time Employee (FTE) (15.2% from 2005 to 2006)

than Western Europe (2.0%) and C&E Europe (11.0%), and holding a profit per FTE (18.5%) higher than European competitors (12.9%). The complete picture is illustrated in figure 2.

The traditional productivity gap formula (the Conference Board defines productivity here as GDP – see page 11 for further details) between the US and Europe narrowed during 2005 and 2006 but continued to be significant. US productivity growth in 2006 reduced to 1.9% from 3.1% in 2005, whilst the enlarged European Union registered overall productivity growth of 2.8%, bolstered by the new entrants (EU12), registering 4.6%.¹

Figure 2: Financial trends 2002-2006

	2002	2003	2004	2005	2006	% change 02-06	% change 04-05	% change 05-06
Revenue per FTE (€)								
UK	129,024	135,888	142,008	146,054	153,194	18.7%	2.8%	4.9%
C&E Europe	32,408	51,298	58,796	81,464	90,441	179.1%	38.6%	11.0%
Western Europe	145,766	157,187	169,546	173,434	176,955	21.4%	2.3%	2.0%
All Europe	134,074	154,315	166,916	172,031	176,298	31.5%	3.1%	2.5%
US	218,217	233,332	260,543	228,937	263,689	20.8%	-12.1%	15.2%
Costs per FTE (€)								
UK	126,071	134,500	138,999	142,061	147,095	16.7%	2.2%	3.5%
C&E Europe	31,837	51,512	55,122	76,384	85,860	169.7%	38.6%	12.4%
Western Europe	142,353	153,838	164,152	166,768	168,376	18.3%	1.6%	1.0%
All Europe	130,067	150,499	161,989	165,747	167,570	28.8%	2.3%	1.1%
US	162,941	171,140	181,481	162,233	169,452	4.0%	-10.6%	4.4%
Profit per FTE (€)								
UK	3,112	3,248	3,495	4,062	4,519	45.2%	16.2%	11.2%
C&E Europe	302	612	719	2,123	2,724	802.0%	195.3%	28.3%
Western Europe	3,696	4,238	4,827	5,586	6,283	70.0%	15.7%	12.5%
All Europe	2,926	4,045	4,700	5,520	6,232	113.0%	17.4%	12.9%
US	24,631	35,625	55,128	31,571	37,396	51.8%	-42.7%	18.5%

Source: PwC Saratoga data

Over the broad range of human capital financial measures, the US demonstrates impressive comparative performance, placing itself across the mature business economies as best positioned to respond to new and emerging competitive challenges. As indicated in previous reports, the US continues to respond more quickly and robustly to downturn situations than its European counterparts, possibly due to its highly entrepreneurial culture and heritage.

The importance of agility and flexibility in work force policies and practices becomes increasingly relevant as economies face a turbulent period.² Nations with institutionalised social benefit programmes are generally struggling to gain higher flexibility to compete against aggressive global competition, to afford

high cost social benefits and to maintain their core business base. France and Germany are heavily affected, Sweden and Finland are under pressure, whilst the UK has to-date preserved higher levels of workforce flexibility than the majority of its Western European counterparts.

It is predicted by PwC that by 2050 the BRIC economies (Brazil, Russia, India and China) plus others, such as Indonesia, Mexico and Turkey will outstrip those of the current G7 (US, Japan, Germany, UK, France, Italy and Canada). Foreign direct investment into these countries continues at a pace likely to continue as they offer lower cost resources, increasingly highly skilled workforces and, an increasingly aspirational consumer base.

‘Nations with institutionalised social benefit programmes are generally struggling to gain higher flexibility to compete against aggressive global competition’

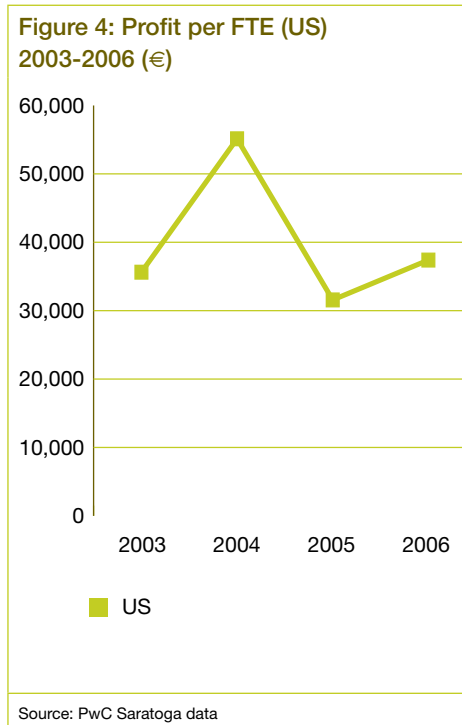
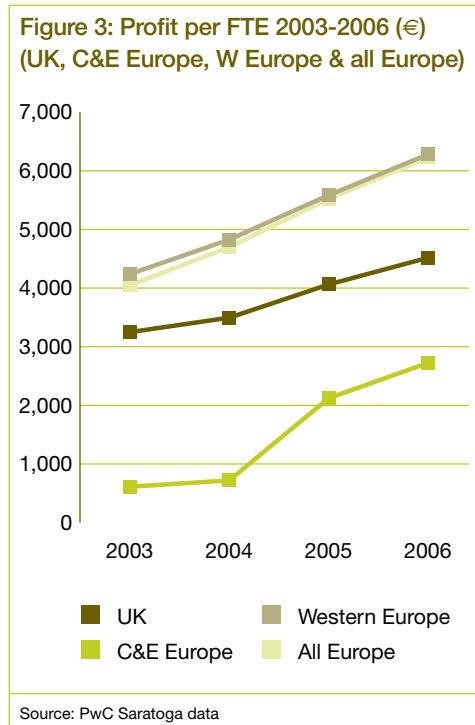
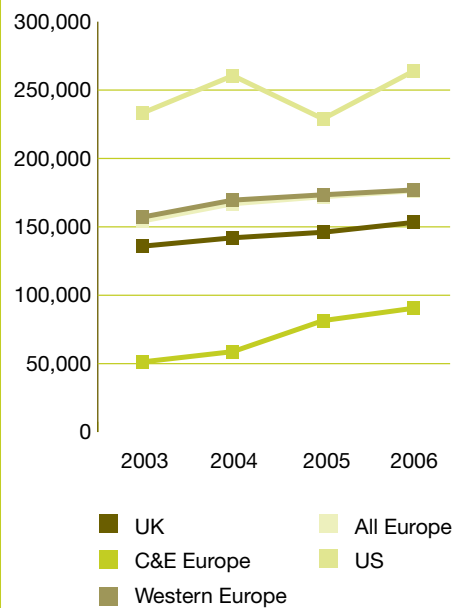


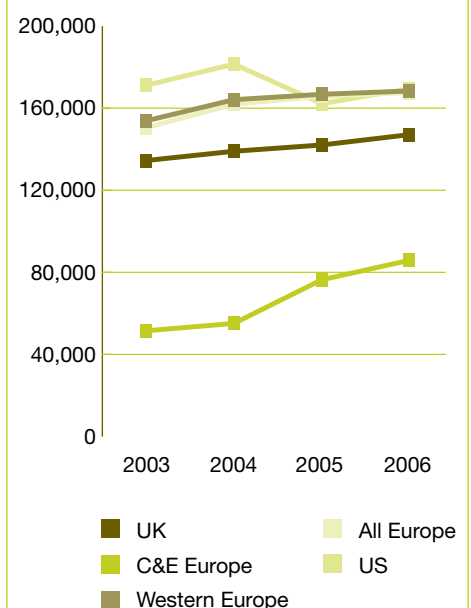


Figure 5: Revenue per FTE 2003-2006 (€)



Source: PwC Saratoga data

Figure 6: Costs per FTE 2003-2006 (€)



Source: PwC Saratoga data

Added-value performance trends

PwC Saratoga uses a unique methodology, the Human Capital Return on Investment (HC ROI), to provide a comparative measure of added value per FTE. HC ROI compares the pre-tax profit generated before employment costs, with the investment in compensation and benefit costs. It is normally presented as follows:-

$$\frac{\text{Revenue} - \text{Non-wage costs}}{\text{Number of FTEs} \times \text{Average remuneration}}$$

Number of FTEs x Average remuneration

This ratio states how much pre-tax profit or earnings are produced for every unit of currency paid to an employee. In other words, for every unit of currency e.g. \$, € or £ etc. paid to an employee, how much profit is produced. The currency is therefore irrelevant and the ratio facilitates a cross comparison between different commercial sectors, regions or nations. It is a key ratio for all HR executives, since it covers all the major elements of their potential contribution. How much revenue are we producing? How much cost are we

incurring? How many people are we employing? How much are we investing in our reward structures? And then critically, how can we improve each element of the ratio to improve our position against the competition?

PwC Saratoga's 2006 report showed how 2004 witnessed a higher performance in the ratio for all regions other than the UK which remained static on 1.11, with Western Europe on 1.14 and the US further ahead on 1.52. In 2005 the US slowdown was reflected in a reduction in the ratio to 1.36 with C&E Europe moving to 1.23 and Western Europe recording 1.16. The value added per FTE based upon the formula continued to demonstrate a high differentiation between the performances of the US and Europe, with the US having a performance some 17.2% above that of Europe. In 2006, Western Europe demonstrated minimal improvement over its 2005 performance whilst the US improved its own performance by 15.4%, exceeding Europe by 34.2%. See figure 7.

Figure 7: Human Capital ROI 2002-2006

	2002	2003	2004	2005	2006	% change 02-06	% change 04-05	% change 05-06
Human Capital ROI								
UK	1.08	1.11	1.11	1.13	1.13	4.7%	1.8%	0.1%
C&E Europe	1.05	1.10	1.11	1.23	1.25	18.9%	10.8%	1.5%
Western Europe	1.08	1.13	1.14	1.16	1.17	8.4%	1.8%	0.9%
All Europe	1.07	1.13	1.14	1.16	1.17	9.4%	1.8%	0.9%
US	1.31	1.42	1.52	1.36	1.57	19.8%	-10.5%	15.4%

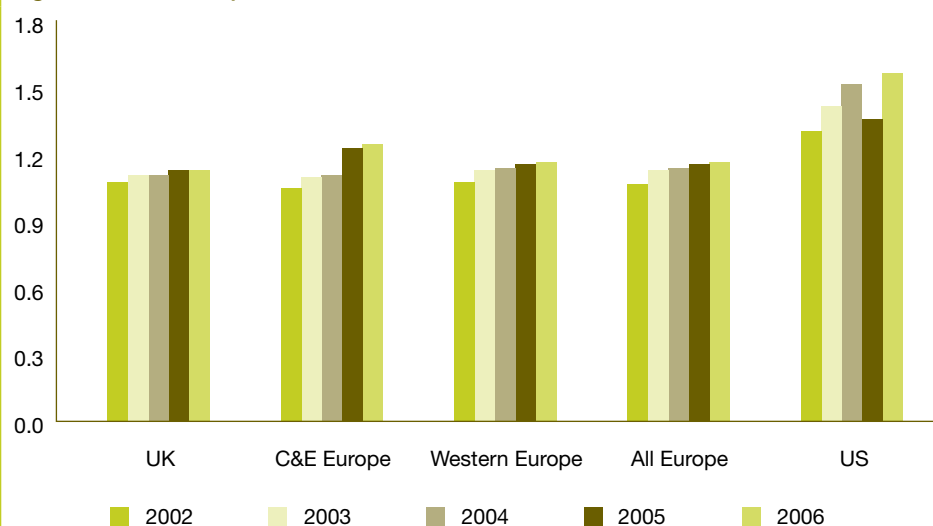
Source: PwC Saratoga data

With the expected higher remuneration levels in the US (see figure 9) than anywhere in Europe, the superior performance of the US is largely down to stronger levels of revenue generation combined with stringent control of people costs and numbers. These have been long term advantages enjoyed by the US over its European counterparts, due in part to its advanced progress in information and communication technology, but also its more developed competitive performance related culture.

The key to the superior performance of the US over a number of decades has been its

ability to respond rapidly to changing global challenges and to adjust market offerings, cost infrastructures and employment levels to the demands of the time. It is a response level which Western Europe has not matched. The growth of the new economies will test US resilience but observers are already becoming aware of the US developing rapprochement strategies of “collaboration to assess and mitigate risk, and their advanced positioning in integrating new organisational capabilities for managing geographically and culturally diverse organisations.”³

Figure 8: Human Capital ROI 2002-2006



Source: PwC Saratoga data

‘High revenue growth accompanied by high remuneration is a sustainable success formula, providing revenues continue upwards’

Figure 9: Average remuneration per employee 2006 (€)



Source: PwC Saratoga data

Productivity performance trends

By using the metrics of Remuneration/Revenue and Remuneration/Total Costs, it is possible to establish whether organisations are maintaining a sustainable relationship and levels of competitiveness between their people costs and the outputs they produce. Whereas added-value metrics demonstrate the relationship of profits to employee remuneration, productivity metrics look at the relationship of remuneration to total revenues and costs. PwC Saratoga looks at the added-value metrics to measure the relationship between pre-tax

profits against total remuneration – in other words whether the employment costs are actually producing profit for the organisation. Productivity metrics look at the relationship of employee remuneration (i.e. inputs) against the amount of revenue produced (outputs) and the relationship of those employee costs to the total costs of the business.

The following table shows that in 2006, Western Europe held a 21.7% level, whilst C&E Europe moved to 13.3%. Meanwhile the US moved upwards from 29.3% in 2005 to 29.8% in 2006.

Figure 10: Remuneration/revenue 2002-2006 (%)

	2002	2003	2004	2005	2006	% change 02-06	% change 04-05	% change 05-06
UK	24.7	23.9	24.1	24.0	25.0	1.2%	-0.4%	4.1%
C&E Europe	17.5	15.1	14.6	12.7	13.3	-23.9%	-13.0%	4.8%
Western Europe	23.0	21.8	22.2	21.8	21.7	-5.5%	-1.8%	-0.3%
All Europe	22.6	21.6	21.6	21.6	21.6	-4.3%	0.0%	0.1%
US	24.1	26.1	28.0	29.3	29.8	23.7%	4.6%	1.7%

Source: PwC Saratoga data

These remain critical metrics in any assessment of human capital effectiveness. In a healthy economy it would be expected that remuneration would move either at a lower rate or similar rate as revenue growth for human capital productivity to maintain impetus. Western Europe has been seen to be relatively successful at maintaining a stable relationship since 2002, whilst C&E Europe have been successful in improving the Remuneration/ Revenue ratio even though rises in remuneration levels have been accelerating. The US has demonstrated a far higher relationship of remuneration to revenue since 2002, but has historically enjoyed far higher levels of revenue growth. High revenue growth accompanied by high remuneration is a sustainable success formula, providing revenues continue upwards. However, if the US economy continues to slow, leading to lower revenue growth, a stronger control of remuneration levels will be essential.

Commercial metrics

The common use of GDP per employee and GDP per hours worked as indicators of productivity on a national and regional basis correlate closely with our revenue per FTE and costs per FTE metrics (see figure 5 and 6). PwC Saratoga measures both regional and national financial performance, and can also benchmark performance across commercial and industrial sectors to give a more specific view of an organisation relative to its nearest competitors.

Figure 11: GDP 2006

	GDP per Hour (€)	GDP per Person Employed (€)	Growth in GDP per Hour	Growth in GDP per Employed
Country	2006	2006	2005/06	2005/06
Australia	22.33	34,042	1.76	2.47
Austria	25.44	35,446	0.96	3.31
Belgium	27.34	33,284	1.64	3.17
Canada	22.32	34,190	1.93	2.76
Cyprus	15.00	21,109	1.64	3.85
Czech Republic	9.62	13,098	1.61	6.30
Denmark	24.53	45,628	2.68	3.57
Estonia	17.50	12,248	5.46	11.19
Finland	23.34	35,930	1.71	5.00
France	28.58	32,626	1.10	1.99
Germany	23.55	31,720	0.47	2.87
Greece	15.53	25,608	1.30	4.38
Hungary	10.50	10,848	0.43	3.89
Iceland	19.68	50,381	5.14	2.80
Ireland	28.03	47,106	4.12	5.71
Italy	23.18	28,309	0.90	1.87
Japan	20.49	27,218	0.92	2.19
Latvia	12.11	9,461	4.30	11.93
Lithuania	10.74	8,378	0.89	7.66
Luxembourg	29.25	81,827	5.95	6.17
Malta	15.41	12,839	0.65	3.15
Mexico	7.39	6,741	2.04	4.93
Netherlands	26.03	36,343	3.03	3.01
New Zealand	16.08	23,758	0.82	1.92
Norway	31.73	63,323	2.42	2.13
Poland	9.46	8,686	2.92	6.12
Portugal	13.80	16,532	1.04	1.28
Slovakia	12.85	10,582	1.63	8.27
Slovenia	16.20	17,663	1.19	5.72
South Korea	12.73	15,699	-0.81	4.99
Spain	17.34	25,177	3.74	3.86
Sweden	24.69	37,655	1.23	4.19
Switzerland	21.95	45,369	2.17	3.23
Turkey	10.49	5,238	1.17	6.09
UK	24.10	36,241	0.44	2.84
US	28.23	36,475	1.86	2.87

Source: The Conference Board and Groningen Growth and Development Centre, Total Economy Database, January 2008



Outsourcing and offshoring trends

The business rationale behind both outsourcing and offshoring has changed significantly in recent years. Originally the drive for both initiatives was focussed upon the financial benefits arising from the opportunity created through exporting commoditised transactional activities – either from the organisation or from high-cost operational regions. In its *11th Global CEO Survey*, PwC reports a marked shift in the motivation of CEOs to outsource or offshore from simply “a mechanism to lower cost, to a means of achieving a more strategic, collaborative framework”. At the same time, CEOs report an increasing trend to expand the scope of activity that is covered by outsourcing arrangements, from the traditional component supplies and IT infrastructure to other activities that, in the past, were held sacrosanct including HR management, R&D and even marketing and sales. This willingness to allow normally tightly protected activities to migrate outside the company is a convincing signal of the degree to which the nature of outsourcing is changing.

Furthermore, a new concept of “Connected Sourcing” is emerging which primarily sees organisations focussing harder upon those things they do best and then “orchestrating a portfolio of relationships” with third parties for the rest. Collaboration with a range of external suppliers to provide solutions to complex issues will increasingly require higher levels of “transparency, trustworthiness and reciprocity”.⁴

Outsourcing is clearly a strategy that has been widely accepted by global companies and that acceptance is growing. According to a 2003 survey conducted by Forrester Research Inc., just 40% of Fortune 1,000 companies had either offshored or outsourced any business. However, in 2006, a subsequent study published by the India Institute of Management (IIM) indicated that 55% of Fortune 1,000 companies now sourced service activities from other countries. According to PwC’s *10th Global CEO Survey* “this dramatic increase can mean only one thing, the global impact of outsourcing is rising and rising fast”. In addition,

data from the PwC Saratoga database indicates that the proportion of total costs attributable to outsourcing and offshoring grew from 2.7% in 2004 to 3.1% in 2006.

The Organisation for Economic Co-operation and Development (OECD) believes that as many as 20% of all jobs in the US, Australia and Canada in addition to the 15 pre-accession EU member states could be affected by the international sourcing of labour by service industries. Perhaps even more significantly Knowledge Process Offshoring (KPO) is expected to grow significantly over the next few years. KPO is the process whereby businesses outsource high end knowledge or judgement services such as, research, sales and marketing, case writing and even animation design.

Evalueserve predict that KPO will grow to \$16.7 billion in revenue by 2010 – 2011, implying an annual growth rate of 39%, employing some 390,000 professionals by March 2011. Interestingly the major reason for this huge growth is the vast pool of educated and experienced professionals available. Areas such as India, China, Russia, Poland, the Philippines, Hungary and many republics from the former Soviet Union provide high levels of skills at comparatively low cost, and fill critical skill gaps increasingly experienced by western economies.⁵

All the above factors have moved the integration of services upwards. Increasingly, call centres in major corporates comprise multi-disciplined teams, providing both employees and customers with answers to a cross-section of problems and introducing them to other services which are on offer.

However, areas of concern continue to exist. They continue to include questions involving management control, service quality, depth of labour pools and customer service issues caused by diversity of cultural values. For example, India despite its high output of graduates per annum, still struggles to satisfy its own and internal investors’ demands for skilled resource.

⁴ Source: PwC “Collaborate and Innovate a new world of sourcing”, 2007

⁵ Source: Evalueserve, the growth and future of Knowledge Process Offshoring industry, 2007

People – human capital – remain at the core of outsourcing/offshoring decisions. Access to cohesive business processes may tempt organisations to move a functional activity offshore, however, it is the relative cost of labour and skills availability that are the overwhelmingly dominant factors. Both advantages are of course likely to reduce over time, as labour rates are pressurised upwards and skills become dispersed across the broad business world. For the foreseeable future however, the advantages are clearly identifiable. Few organisations have sufficient trust in demographic profiling to forsake opportunities that are likely to provide significant short-term performance advantages.

Merger and acquisition trends

PwC's 11th Global CEO Survey 2008, shows around half of companies with \$10 billion or more in revenues have completed a cross-border M&A in the past 12 months. Organisations are now balancing their efforts between 'business as usual' and integration activities. In the immediate future, hardened global business conditions may have a reductive effect upon the number of deals and the extent of M&A activity. However, globalisation is almost certain to demand higher levels of resource and structural consolidation, leading to an inevitable explosion of activity in this business dimension in the years ahead. In China, for example, employment matters have traditionally taken a back seat in M&A deals. However, the New Labour Contract Law introduced in January 2008 will ensure these are given more form and substance to enhance the legal protection of employees' rights and combat potential exploitation.⁶

It is now widely accepted that people and cultural factors constitute major obstacles to the realisation of value gain that any M&A aims to achieve. More than 50% of the CEOs surveyed worry about handling cultural conflicts and capturing the value of the deals they undertake. In addition, when asked what they

think are the biggest threats to business growth, CEOs regularly put the availability of key skills at the top of the list. Thirty-four percent of all CEOs also say that poor management of human resources is a source of anxiety, while 30% are concerned about conflicting workforce expectations.

However, M&A activity moves an organisation out of the sphere of business as usual. In fact, it is the ability of an organisation to adapt to change that concerns 75% of surveyed CEOs. The requirement of success in future M&A work will firstly be that the strategy is viable, but more importantly, that the impetus of change and innovation is maintained. Barriers to change are clearly people related (see figure 12). Even the most common sense merger or acquisition in the business world will fail or at best disappoint, unless the people involved are brought on board and managed as a key part of the process. There is clearly a vital role for HR professionals to play in these transactions.

Innovation is often the first casualty of integration. Due to today's competitive deal environment, CEOs are often forced to give away the value of the cost synergies of a merger in the bid. Added value can therefore often only come from achieving future revenue synergies. Some of these benefits may come from a widened product or customer base, but a key driver of revenue growth will be innovation, which is highly dependent upon people. The dilemma for top management is that the rigorous discipline needed to deliver on those already committed cost economies can demotivate people and stifle the organisation's ability to innovate. In such circumstances, the retention and integration of identified talent is a critical success factor. No matter how astute the merger or acquisition may be, the loss of key talent following the completion of the deal has often proved to be disastrous, leaving only the existing product or service and its technical or structural alignment with the acquired or the acquirer to produce value gain.

'Innovation is often the first casualty of integration. Due to today's competitive deal environment, CEOs are often forced to give away the value of the cost synergies of a merger in the bid'

‘CEOs say that it is difficult to find people with the right combination of technical and commercial skills’

Management stretch is an important aspect of talent management which may potentially affect an organisation’s ability to successfully expand. As companies grow, the constraints on human resources, specifically at the management level, become tighter. CEOs say that it is difficult to find people with the right combination of technical and commercial skills. Leaders and all-around performers prove hardest to find, and senior or middle management weaknesses are blamed most often for hindering change programmes. In addition, the number of people who have experience of doing deals is only about 10% of the management population. Organisations need to develop a pool of managers who are globally aware and have skills relevant for dealing with the M&A environment, such as the integration and technical skills to mitigate risks.

As illustrated in figure 12, these barriers were identified as competing resources (which can have a negative business impact caused by

stress, lack of clear direction, and burn-out), management of staff and resistance to change from employees. So often in post-deal environments, the focus of the people (whether working in the deal team or impacted by the change) is on integration following the deal, rather than on the core strengths and growth targets of the business. Integration teams must consider and address these barriers early to enable the delicate balance of business as usual and a successful integration. This will help organisations prepare for continued innovation, retention of key talent, and the development of a qualified management pool.

Key trend messages

This section has dealt with financial performance through human capital metrics. It has focussed attention upon a series of key metrics which will be useful to any organisation in an enviable “business as usual state”. It is also relevant to those seeking opportunities to globalise their operations and structures via outsourcing and offshoring actions, and those who will increasingly become involved in M&A activity.

- The new economies of Asia and C&E Europe are strongly challenging the mature economies of the US and Western Europe in the majority of markets. Furthermore, the BRIC economies, plus others such as Indonesia, Mexico and Turkey will outstrip G7 by 2050.
- PwC Saratoga’s 2006 report stated that the US was in a better position in terms of Revenue/FTE and Profit/FTE compared with European competitors. This is still true, however whilst the gap between both economies is reducing, it is still significant (Europe is being strengthened by new entrants). Although the US may currently be experiencing a slow down, it is still able to respond more quickly to competitive challenges than its European counterparts, as stated in the previous section.

Figure 12: Top barriers to change

Top 10 Barriers	Percentage of companies
Competing resources	48%
Functional boundaries	44%
Change skills	42%
Middle management	38%
Long IT lead times	35%
Communication	34%
Employee opposition	33%
People issues	32%
Initiative fatigue	32%
Unrealistic timetables	31%

Source: PwC survey focusing on large change projects in 500 multinational and public sector companies covering all industry sectors in North America, Europe and Asia.

- In 2004, the UK's HC ROI remained static at 1.11, whereas C&E Europe and the US were on the rise, with the US further ahead. In 2005, economic slowdown in the US meant the US HC ROI dropped and European HC ROI increased. However the gap between the US & Europe still remains. In 2006, there was no improvement in Western Europe, whereas the US experienced a further increase in HC ROI, further widening the gap.
- Although remuneration is extremely high in the US, it has undergone stronger advantages in terms of performance due to high revenue production and stringent controls over people costs and numbers.
- The future competitive advantage the mature economies should seek to exploit is in the realm of know-how, innovation and services.

Human capital impact implications

It is apparent once again that the most important challenge facing human capital practitioners is the competitive positioning of their organisation. That competitive positioning is strongly influenced by its measurable productivity performance as it affects bottom line performance. It is the requirement to drive that performance continuously upwards that should dominate the human capital agenda. All human capital policies should be able to demonstrate their positive, measurable contribution to higher levels of people efficiency and effectiveness.

The implications of all these impact issues are considerable. Structures and policies designed with agility in mind will need to be accommodated and addressed by HR functions. It becomes possible to imagine the vision of a network of people and organisations from varied cultural backgrounds, seeking diverse employment relationships, with often limited knowledge of, or even interest in, any identifiable parental corporate image.

In such an environment, human capital practitioners will need to be comfortable with numbers, apply increasingly sophisticated measurement to all human capital activity, forecast and assess the ROI of actions taken, and concern themselves primarily with initiatives that have a direct impact on the bottom line performance of the organisation. If people are now recognised to be a key contributor to an organisation's competitive performance, then human capital practitioners will need to be the initiators of change, seeking low cost solutions across the globe, establishing where appropriate skills and talent are most available, incentivising people (third parties as well as employees) to work more effectively, and continuously encouraging constructive dissent with the status quo. Existing policies which offer comfort and reassurance to established staff will need to be revisited where they no longer deliver the effectiveness to the sustainable business model the organisation now requires.



2. Human capital drivers

We considered that this report would be more useful to human capital practitioners if we were to lead with the critical trends that we believe will dominate the next two to three years of organisational activity.



They are:

1. Leadership
2. Engagement
3. Talent management and learning
4. Innovation

These trends are interdependent. Effective leadership is essential to gain the full engagement of employees and others. Engagement is essential if talent is to be attracted and retained, and it is specific talent and skills that will contribute to the development of innovatory breakthroughs to produce essential competitive results.

Leadership trends

The leadership issue remains at the top of the human capital agenda where it has been for the last decade. Countless books, articles and seminars are still produced on the subject.

There is no indication that the preoccupation is diminishing, and it is probable that a tightened global business environment will produce even greater demands for enhanced leadership skills. Leadership has been defined in various ways but it is essentially the ability to influence people to work effectively towards the achievement of an organisation's goals. Leadership in the 21st century is increasingly seen as a shared responsibility and not the domain of a single person. Effective leadership emerges through the key players of an organisation, who are committed to its purpose and competent to do what it takes to deliver the 'followership' to make it happen.

There is limited evidence that the significant sums invested in leadership development programmes are delivering value for money. The CIPD report *UK Global Comparisons*

Leadership Forecast 2005-2006 stated that three in ten leaders fail to demonstrate the key qualities necessary for effective leadership, and PwC records in its recent *Managing tomorrow's people* report that "globalisation has led to a need for global leaders in a commercial world when there are not enough people with sufficient skills". PwC Saratoga has little evidence in any field of organisational activity be it commercial, public or political, that the quality of leadership is developing at the pace required by the rapidly changing, globalised and networked world.

Over many years, PwC Saratoga has consistently set out to measure the impact of human capital investment. Therefore with leadership, it has been concerned with measuring the impact of effective leadership upon the people they are supposed to lead, rather than the characteristics and behaviours of effective leaders. PwC Saratoga measures the effectiveness of leadership through an index of metrics, evaluating business or organisational impact (value and wealth creation), follower performance (stay ability and productive outputs), talent and skill development (levels of internal promotion and development actions) and corporate social responsibility actions (diversity and community related initiatives). The index compares generic leadership performance across organisations either operating in the same sector or in diverse sectors.

PwC Saratoga takes the view that if the leadership of an organisation is effective then its comparative positioning against its competition would be superior, and if leadership effectiveness is improving (possibly via leadership development programmes) then its periodic movement in these metrics should be measurably positive.

The evidence overall in 2006 against performance in 2005 indicates a marginal improvement in most of the metrics utilised. However, few demonstrate a consistency of improvement significance from 2003 to 2006 which would suggest that leadership effectiveness is increasing either in relation to the investment made annually, or at the pace which socio-economic challenges demand. Again we believe that these results should raise questions concerning the effectiveness of much of the leadership development investment that is currently taking place at this time.

A selected number of relevant metrics are produced in figure 13, indicating changes in overall performance across Europe between 2003 and 2006. It has to be stressed that these figures are produced for illustrative purposes only, and are generic European 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, and then to track progress over an appropriate time period.

Figure 13: Leadership metrics – Europe 2003-2006

	2003 median	2004 median	2005 median	25th percentile	2006 median	75th percentile	% change 04 and 05 median	% change 05 and 06 median	% change 03 and 06 median
Impacts									
Human capital ROI	1.13	1.14	1.16	1.02	1.17	1.41	1.8%	0.9%	3.5%
Wealth created per FTE (€)	-803	-494	-128	-2,523	35	2,537	74.1%	127.0%	104.3%
Behaviours									
Resignation rate (%)	6.2	6.2	10.0	4.1	8.8	15.7	61.3%	-11.7%	42.4%
Remuneration/revenue (%)	21.6	21.6	21.6	12.9	21.0	31.7	0.0%	-2.8%	-2.8%
Skills									
Training hours per FTE	23.9	19.7	18.3	8.9	20.6	33.3	-7.1%	12.6%	-13.8%
Career Path Ratio (%)	50.0	50.0	66.7	36.1	62.7	100.0	33.3%	-5.9%	25.5%
Corporate social responsibility									
Workforce diversity: Women (%)	39.2	36.3	33.4	22.8	40.5	56.8	-8.0%	21.3%	3.4%

Source: PwC Saratoga data

‘Research has shown a link between a highly engaged workforce and bottom line results, and the close relationship between employee engagement and customer satisfaction’

Engagement trends

Employers over recent years have demonstrated increasing interest in the engagement of their workforces. Engagement has been defined in a variety of ways. The Conference Board sees it as, “a heightened emotional and intellectual connection with a job, organisation, manager or co-workers” and the influences that such a connection brings “to apply additional discretionary effort to his or her work”.⁷ For the purposes of this report, we define an engaged employee as one who will do all that he or she can to deliver the requirements of the employer – and more.

Engagement is currently a popular management topic. Research has shown a link between a highly engaged workforce and bottom line results, and the close relationship between employee engagement and customer satisfaction. It is rare indeed these days to meet any organisation that is not highly customer aware. The theory however continues to outdistance the practice. High levels of customer service normally requires higher levels of employee discretion, which in turn requires higher levels of employee trust and engagement at the very time when employee error can lead to costly repercussion. As Richard Donkin

recently pointed out in his *Financial Times* article, *Recruitment: When engagement doesn't lead to a wedding*, levels of employee engagement are beginning to be perceived among some investors as important indicators of a company's financial health, and longer term sustainability.

Despite the fact that employers are beginning to grasp the importance of employee engagement, a survey carried out by the CIPD in 2006 *How Engaged are British Employees?* found that only 3 in 10 employees are engaged with their work. However, the findings of numerous studies differ dependent upon the definitions adopted, the size of the organisations involved and the levels of employees surveyed and even the length of service of the employees themselves.

Part of the work undertaken by PwC Saratoga has been measuring the impact of levels of employee engagement, and linking this to bottom line organisation performance. We have used the model below as a basis for understanding the complex elements of reviewing employee engagement, and for identifying some of the key quantitative metrics and qualitative survey tools that might be appropriate to a given organisational setting.

Figure 14: Employee engagement

Behaviour Type	Organisational Activity			
	Commitment	Work	Product Service	Identity
Engagement ↓	Limitless	High Output and Flexibility	Innovation and Improvement	Goal Identity
Cooperation ↓	Contractual Attendance	Normal Output	Learning/Seeking	Change Positive
Compliance ↓	Clock Watching	Effort Bargaining	Skill Static	Critical Joking
Discordance ↓	Time Wasting	Added Pay Creation	Fiddling	Change Resistant
Withdrawal ↓	Absence	More-for-Same	Pilferage	Negative Contention
Hostility	Resignations	Sabotage	Theft	Oppositional Solidarity

Source: Adapted from original research by Stephen Ackroyd and Paul Thompson

PwC Saratoga has developed a series of metrics following the work undertaken by Professor Stephen Ackroyd of Lancaster Business School which sets out to assess engagement, not by just what people say, but by their actions and their behaviours (see figure 14). Using a series of PwC Saratoga metrics, it is possible to plot the level of engagement or disengagement for a working group, or even an entire workforce, through their actions and behaviours (see figure 15).

The metrics provide evidence on dimensions of employee engagement, including known drivers (e.g. reward; learning & development) and the outcomes from high / low levels of engagement (e.g. absenteeism, resignation levels and productivity). In combination, these metrics aim to quantify the outcomes of HR policies and practices and management effectiveness and their impact on the positioning of employees.

Figure 15: Engagement metrics – Europe 2003-2006

	2003 median	2004 median	2005 median	25th percentile	2006 median	75th percentile	% change 04 and 05 median	% change 05 and 06 median	% change 03 and 06 median
Time									
Resignation rate (%)	6.2	6.2	10.0	4.1	8.8	15.7	61.3%	-12.0%	41.9%
Absence rate (%)	3.9	3.7	4.0	2.5	3.8	5.2	8.1%	-5.0%	-2.6%
Remuneration/revenue (%)	21.6	21.6	21.6	12.9	21.0	31.7	0.0%	-2.8%	-2.8%
Work									
Performance related pay (%)	5.2	6.5	8.1	6.2	12.4	16.9	24.6%	53.1%	138.5%
Attendance related pay (%)	3.1	2.3	2.6	1.0	2.9	5.8	13.0%	11.5%	-6.5%
Product/service									
Training hours per FTE	23.9	19.7	18.3	8.9	20.6	33.3	-7.1%	12.6%	-13.8%
Learning Coverage (%)	67.1	57.2	61.7	32.0	68.0	95.0	7.9%	10.2%	1.3%
Development hours per FTE	7.9	5.5	5.6	1.9	5.3	10.6	1.8%	-5.4%	-32.9%
Identity									
Grievance rate per 1,000 employees (%)	2.6	2.4	2.9	1.4	2.9	5.4	20.8%	0.0%	11.5%

Source: PwC Saratoga data



Gaining and maintaining employee engagement is a long-term investment, requiring sensitive leadership and a high degree of respect for individual motivation. Understanding that high levels of employee engagement can make a significant difference is a useful first step for human capital practitioners putting in place programmes or systems that have a measurable and real impact upon existing levels of engagement.

Talent management and learning trends

Managing talent effectively is a competitive necessity. Filling your critical roles with competent and committed people every time, all the time, provides a performance edge that is essential for sustainable success. PwC's *10th Global CEO Survey* defines talent management as 'attracting, retaining, developing and promoting outstanding talent'.

Talent management has been a key human capital trend for the last decade. The *War for Talent*, popularised by McKinsey, has gained significant momentum. There has certainly been a very high level of talent acquisition over the last ten years as external recruitment and search activity has flourished, but there is very limited evidence on a global basis that talent identification, acquisition, retention, development or leverage is taking place in a disciplined manner.

Joseph Bower reports in the November 2007 Harvard Business Review as follows:- "I was appalled to learn recently that 60% of the respondents to a poll of 1,380 HR directors of large US companies said their firms had no CEO succession plans in place. As this finding suggests, too many companies have over the last two decades ignored the hard work of building future leaders, while senior executives have focused increasingly on meeting the next quarter's earnings target."

Also fuelling this realisation of the need to improve talent management is the growth of

investment in emerging markets, and a shortage of talented human capital required to successfully manage growth. In addition, there is the increasing challenge of identifying talented individuals who are willing to take international assignments and the struggle of retaining them following its completion. A PwC survey showed that two-thirds of expatriates are not content with the repatriation approach of their firms and up to 75% of expatriates consider leaving their employer, either during or after their work abroad.⁸

The *11th PwC Global CEO Survey* found that 62% of organisations believe that to compete for talent they need to change the way they recruit, motivate and develop their employees. 78% of business leaders in Latin America believe that changing the way they compete for talent is by redefining roles within the organisation while, in contrast, only 63% in C&E Europe feel the same way. More organisations seem to be looking externally for their talent with fewer organisations filling management positions with internal candidates (58.1% were filled internally in 2004 while 50.0% were filled internally in 2006).⁹

At least a decade after the *War for Talent* was identified, there continues to be significant identification with the issue, but little evidence that many organisations have effective talent management systems in place. The problem is not understanding or articulating what the talent issue is. The crux of the matter is that it lies, like so many other complex management challenges, in the practice.

This is reflected in the PwC *11th CEO Global Survey* results which showed that only 43% of CEOs believed their HR organisation is equipped to deal with any change required to compete for talent.

PwC Saratoga has developed a talent measurement index that provides both an internal audit trail of the impact of talent management actions, and an external benchmarking reading of how an organisation's

talent management compares with the competition. It offers a range of metrics to enable organisations to benchmark the performance of their own talent management systems by looking at measuring identification, attraction, retention, development and leverage of talent. Key themes identified by the Talent Measurement Index are as follows:

- On average, 4% of identified talent tender their resignation over a given year
- 25% of top talent (i.e. executive level) are represented by women
- When vacancies arise in key positions, the Talent Measurement Index found that less than 50% are filled by identified internal successors
- Most organisations actively demonstrate speed to value of their talent by promotion through the talent pipeline i.e. measuring the proportion of talent that has progressed up a level over a given 12 month period.

An important new trend identified by PwC Saratoga research is the move away from the identification of high performers and high flyers, towards the identification of “pivotal employees”. These are segments of the workforce that are expected to create value and determine the success of the organisation. They can range from the receptionist to the sales director. Whereas high performers may break the mould of an organisation’s direction, pivotal performers set the standards that ensure the sustainability of the existing business. This employee group always plays a disproportionate role in creating company value and success.

Furthermore, there is a real and growing challenge of the ability of organisations to ensure a sustainable leadership pipeline in light of external population demographics and ageing leadership, as discussed in the demographic section on page 24. Part of the challenge also relates to having a firm definition of what talent means in an organisation i.e. talent pools, emerging talent, succession, key positions and

how the talent management strategy is connected with the HR and business strategy.

PwC Saratoga allies talent management effectiveness with the level of learning activity. Organisations which are active in promoting learning normally demonstrate the most disciplined and successful talent management and pivotal performer systems.

The level of formal learning that took place in Europe in 2006 through to 2007 stood at 20.6 hours down from 23.9 in 2003 but rising from 18.3 in 2005 (see figure 16). Even so, the amount of formal learning and development recorded for the average employee across Europe per annum amounts to less than four days in a year, with development learning (i.e. training preparing individuals for the next position) comprising a recorded 5.3 hours. The level of learning and development investment in Europe reached €302.78 per FTE in 2006. Finally, the proportion of employees receiving at least one day’s learning and development experience in the given period fell from 67.1% in 2003 down to 60% in 2006.

‘When vacancies arise in key positions, the Talent Measurement Index found that less than 50% are filled by identified internal successors’

Figure 16: L&D hours per FTE – Europe 2003-2006



Source: PwC Saratoga data

‘The ability of an organisation to innovate remains one of the major contributors to its continued sustainable economic performance. Innovation cannot of course be viewed in isolation’

Obviously, none of these figures provide any measure of the quality of learning and development programs provided, or the ROI of specified activities. Nor are these metrics able to reflect the level of on-line learning and development that is increasingly undertaken. However, real questions remain since it is rare to find any organisation generous in on-line learning activity that does not also invest heavily in formal learning and development programmes.

Innovation trends

The ability of an organisation to innovate remains one of the major contributors to its continued sustainable economic performance. Innovation cannot of course be viewed in isolation. The ability of an organisation to produce the innovation essential to remain competitive will depend upon a range of other actions it is undertaking, including its leadership development, its talent bank, the engagement of its employees, plus the infrastructures it has in place for exploring new customer offerings.

The characteristics of a successful organisation in the years ahead have recently been seen to cover: agility – the ability to respond quickly to changing needs; customer focus – putting the customer at the centre of the organisation; and innovation – ability to innovate and spot new market opportunities. In a sense, the only innovation that really counts, is that which meets defined customer needs and is agile enough to change direction when those needs change. Understanding where others stand against your own organisation’s ability to innovate effectively is a key indicator of future sustainability.

PwC Saratoga has developed a series of metrics that seek to identify not only how far an organisation has established the capacity to support innovation i.e. the supporting infrastructure, but also the extent to which an organisation fosters the appropriate culture for innovation to take place i.e. “shared experimentation”. The two dimensions provide a balanced perception of innovation competitiveness.

Like many of the other trends identified in this report, innovatory performance will not be achieved unless a disciplined system of investment is established, ensuring among

other factors that finance is made available and that time is provided to both individuals and teams to develop ideas. In this respect, the allocation and decision criteria for R&D spend, remains relevant. It is the outputs of R&D that matter i.e. patents, products, services etc, however, the spend itself is an important metric for identifying the real importance placed by the organisation upon innovation.

In 2006 through to 2007, global R&D intensity (R&D expenditure as a proportion of sales) has remained broadly constant at 3.5%. More than 81% of global R&D occurs in five countries: USA, Japan, Germany, France and the UK. Europe accounted for 33% of the top global 1250 company’s share of R&D for 2006.

The latest Government R&D scorecard uses a measure of R&D as a percentage of revenue. Figures from the 2006 report show the comparative level of investments in R&D across the world’s major economies. Companies in Belgium, Switzerland, South Korea, Italy and Taiwan stand out as having increased their R&D by more than 20% over the average of the previous years.

Key trend messages

- Despite a high level of focus, evidence indicates little improvement in generic leadership skills in most organisations despite significant investment in learning and development over many years.
- Research points towards a close relationship between high employee engagement and bottom line results. However, there is little evidence that workforces are becoming more engaged with their employers. The problem is further exacerbated through the growing complexity of workforce structure with wide geographic dispersion, high third party involvement and multi-cultural working environments.
- Talent management is identified as a top issue by a high number of CEOs worldwide. Most, however, consider that insufficient progress is being made in the identification, attraction, development and retention of talent. There is a growing belief that new talent management strategies are required.

Figure 17: The top 15 Countries by proportion of R&D in the global 1250

Country	R&D	R&D as % sales	Growth 1yr	Growth 4yr*	Companies R&D (or Static)	Number of larger companies†	
						Increasing R&D	Decreasing R&D or static
1. US	£103.0bn	4.4%	8.2%	15.4%	9%	127	30
2. Japan	£48.7bn	3.8%	4.0%	5.9%	13%	58	19
3. Germany	£25.7bn	4.1%	2.0%	-2.2%	29%	23	6
4. France	£14.2bn	2.6%	5.7%	11.0%	31%	16	5
5. UK	£13.1bn	1.8%	8.2%	7.2%	39%	12	7
6. Switzerland	£8.9bn	6.8%	9.2%	21.6%	60%	7	1
7. S. Korea	£7.1bn	3.9%	11.9%	22.4%	64%	6	4
8. Netherlands	£5.6bn	6.4%	0.2%	-0.9%	58%	4	3
9. Sweden	£4.2bn	4.6%	13.7%	1.9%	61%	6	1
10. Finland	£3.2bn	5.0%	3.6%	5.7%	86%	1	0
11. Italy	£2.9bn	2.2%	11.5%	27.4%	72%	2	2
12. Taiwan	£2.6bn	2.5%	30.5%	44.6%	16%	7	0
13. Canada	£2.3bn	4.0%	6.0%	-0.5%	57%	2	2
14. Denmark	£1.4bn	4.4%	15.6%	11.5%	47%	2	0
15. Belgium	£1.1bn	4.2%	20.9%	21.8%	65%	3	0

*2005/2006 compared to the average of the 4 previous years

†Where R&D is > £100m

Source: www.innovation.gov.uk/rd_scoreboard/downloads/2006_rd_scoreboard_analysis.pdf

- Innovation is seen as a major contributing factor in an organisation's sustainable performance. For the mature economies it will become a critical competitive tool in the years ahead. For successful innovation both supporting infrastructure (e.g. R&D investment) and shared experimentation (e.g. people creativity) is required.

Human capital driver implications

All the above four trends are critical to human capital's impact upon an organisation's performance. It is of concern, therefore, that none are considered to be developing at the pace or effectiveness required to meet the demands of the rapidly changing market place. Human capital practitioners need to take a hard new look at these trends, and strongly question current systems and processes that appear to be producing limited results. It is possible that

different approaches may be needed e.g. the identification of 'pivotal employees' in talent management, the concept of shared leadership, identifying more focussed points of engagement for employees, and building innovation requirements into all employee roles. There is no evidence that the time gap between organisational needs and human capital policy development or performance is closing. And this is not necessarily down to the inability of HR to adapt. It is perhaps more related to the market place changing so rapidly that it is impossible to move people related policies at the same pace. There is therefore always likely to be some form of misalignment between HR functional perceived performance and organisational/people expectations in the future. Those organisations that are best able to manage that misalignment most successfully will be the real winners.

3. Human capital foundations

Demographic trends worldwide indicate that populations are living longer. Many of the mature economies, as well as China, due to its 'one child' policy*, are facing a growing ageing and dependent population. They are reliant upon a decreasing pool of working age employees to produce the levels of output and wealth creation required to provide adequate support systems.



In parallel with demographic issues, workforce diversity is providing both opportunities and challenges, potentially providing additional resource at all organisational levels as ethnic, gender, disability and now age barriers are broken down. However, the subject of workforce diversity is also producing intense social pressures in regions at times of rising unemployment, or where there is any sense of social exclusion. Added to such movements, Western Europe is facing demands for greater levels of work-life balance, suggesting that domesticity should be balanced against work demands, potentially reducing hours of work attendance at a time when higher levels of productivity are demanded. The topic of 'Wellness' is now also emerging as a new employment phenomenon in the work place.

Demographic trends

Demographic trends are important for human capital practitioners for two major reasons. In the first instance, workforce availability is essential for economic sustainability and growth. Secondly, longer life expectancy and the growth of dependent groups require working populations and labour forces to produce the increased wealth needed to support general living standards. Higher life expectancy in existing mature economies is evidence of economic success. At the same time, it is a threat to the future sustainability of that success.

The US and Western Europe in 2007 have working age populations i.e. populations between 15 and 64, at about 67% of the total population. In the next five years, it is uncertain in which direction this trend will move. Some analysts see a slow decline by some 1% per annum, whilst others point to population growth, delayed retirement dates and immigration leading to a marginal increase over the same period.

What is certain, however, is that the percentage of the population in Europe and the US aged 65 and over is likely to increase by between 4-12% over the same period. There will almost certainly be a growing dependent population

in western economies in the immediate years ahead, requiring higher levels of marketable outputs or wealth creation if living standards are to be preserved. They are, however, not alone. Japan, China, Taiwan and Russia will also witness an increase in dependent population levels over the next decade, providing some warning signs that demographic issues cannot be ignored when inward investment is being considered.

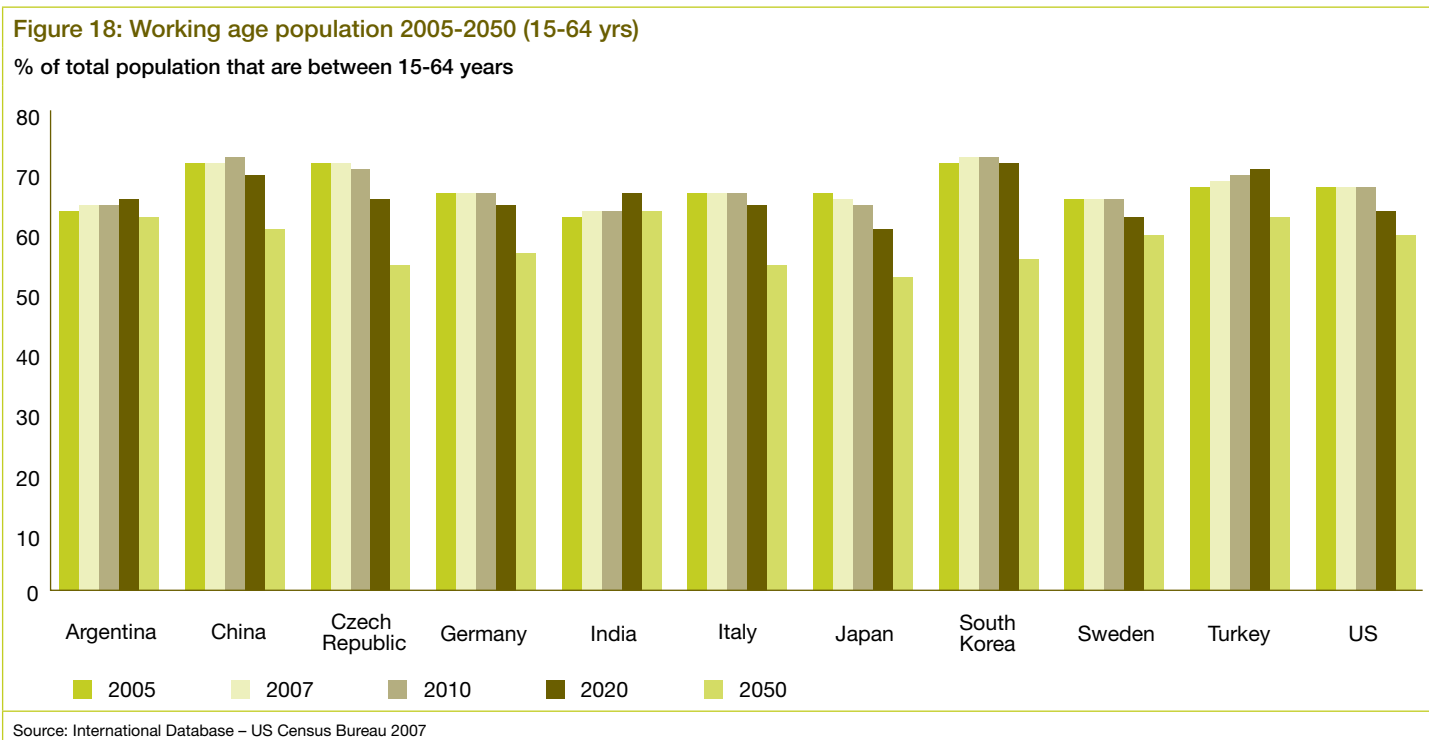
Statistics Canada predict that more workers will leave the country's labour force than enter it over the next 10 years as the latest Census figures showed the threat of an ageing population with over 3.7% of the population being 80 years or older. Almost 80% of respondents to a survey carried out by the Conference Board of Canada (2006), indicated that their organisation will face problems relating to an ageing workforce over the next five years, with 23% admitting they are already experiencing difficulties.

However in the medium term, the working populations in Western Europe and the US will encounter increasing competition from C&E Europe, India, China and others, with forecasts that such nations will have working populations growing by some 2.5% per annum plus over the next five years. For example, India has a more favourable demographic profile with nearly 60% of its population between the ages of 15-59 and more than half below the age of 25.¹⁰

Coupled with the low cost of the skill base in these economies plus the development of more mature skill sets, the challenges facing western economies are high. One favoured solution is that mature economies should make use of the resources plentifully available in the developing countries, whilst engineering the innovative solutions within their own boundaries on which the younger economies are likely to continue to rely. Such a solution relies upon a determined drive to maintain the stated lead they have in professional services, global management, innovative development and advanced skill sets. To do so would appear to require a higher level of corporate performance than is apparent at this time.

10 Source: Nasscom, Knowledge professionals in India, press information note, 2006

* Currently under review



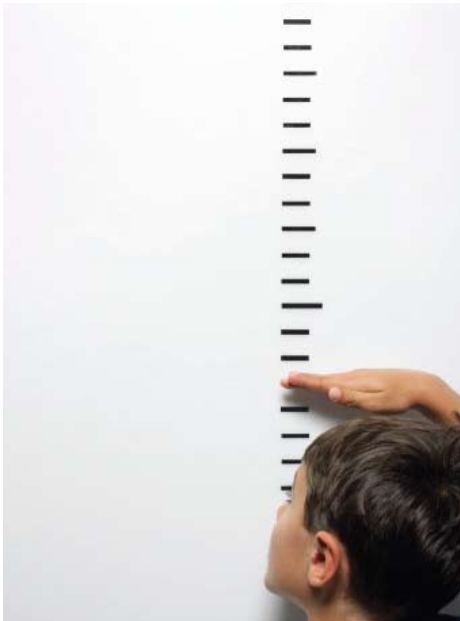
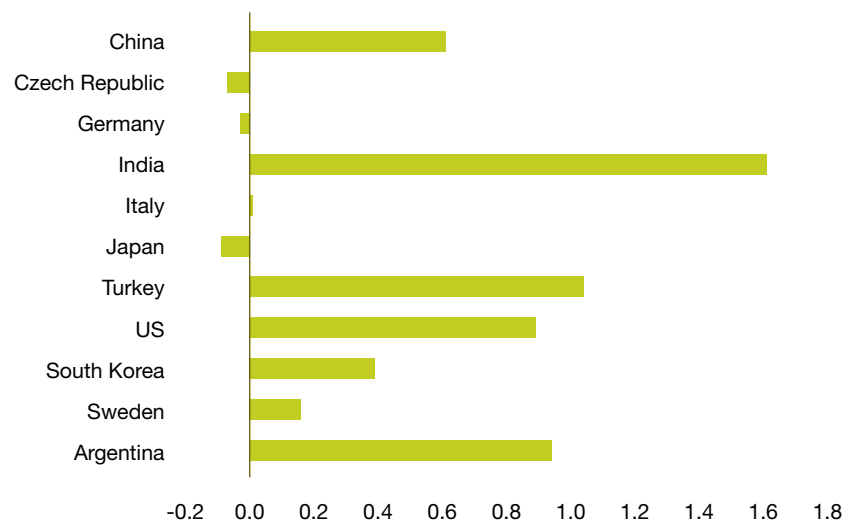
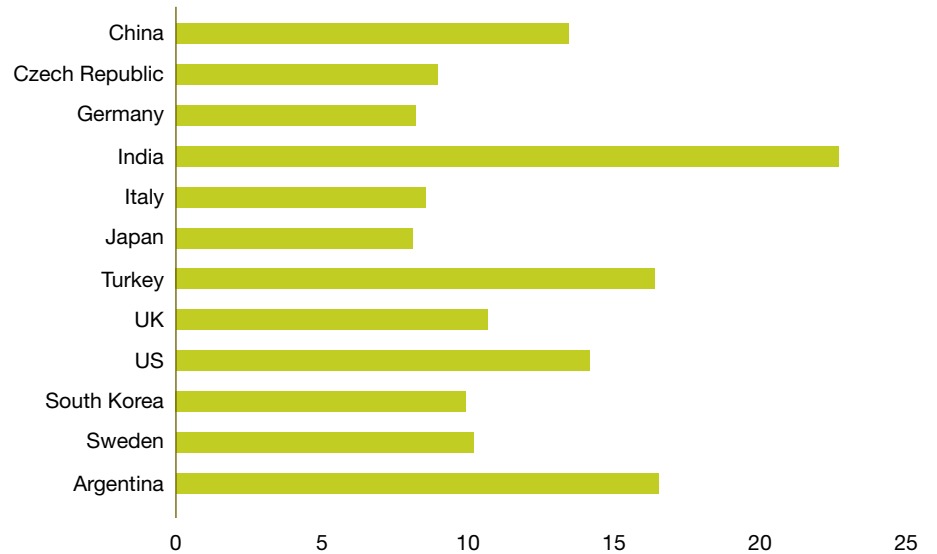


Figure 19: Population growth rate 2007



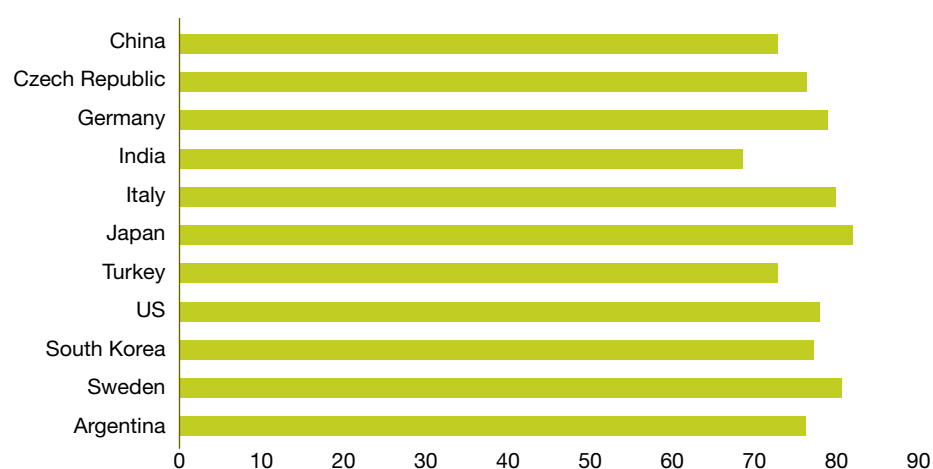
Source: Central Intelligence Agency, 2007

Figure 20: Birth rate 2007



Source: Central Intelligence Agency, 2007

Figure 21: Total life expectancy at birth 2007



Source: Central Intelligence Agency, 2007

‘60% of organisations recognise that effective diversity management makes business sense’

Whatever solution organisations decide upon, it is anticipated that HR executives should be prepared for the challenge of recruiting overseas talent or foreign immigrants, developing cross-culture management programs and competitive HR platforms. This is already the case in Switzerland where nearly one-third of the population is foreign.

Diversity trends

Diversity is a critical global social issue at this time. It traditionally covers disability, ethnicity and gender but importantly is beginning to include age discrimination and immigration issues. The agenda is expanding further. For example, in the UK recent changes in legislative and social change will now include sexual orientation, faith and religious belief, and those with caring responsibilities. With such broad considerations and additional issues such as the drive for increased work-life balance, diversity and equality, it is a subject that affects all of us. This is reinforced by the CIPDs Barometer of *HR Trends and Prospects* (2008) which showed that 60% of organisations recognise that effective diversity management makes business sense.

Overall it is considered that employers should have only one prime objective – to employ the people who will provide the highest level of added value to the organisation. It is of course a simplistic statement to make and employers

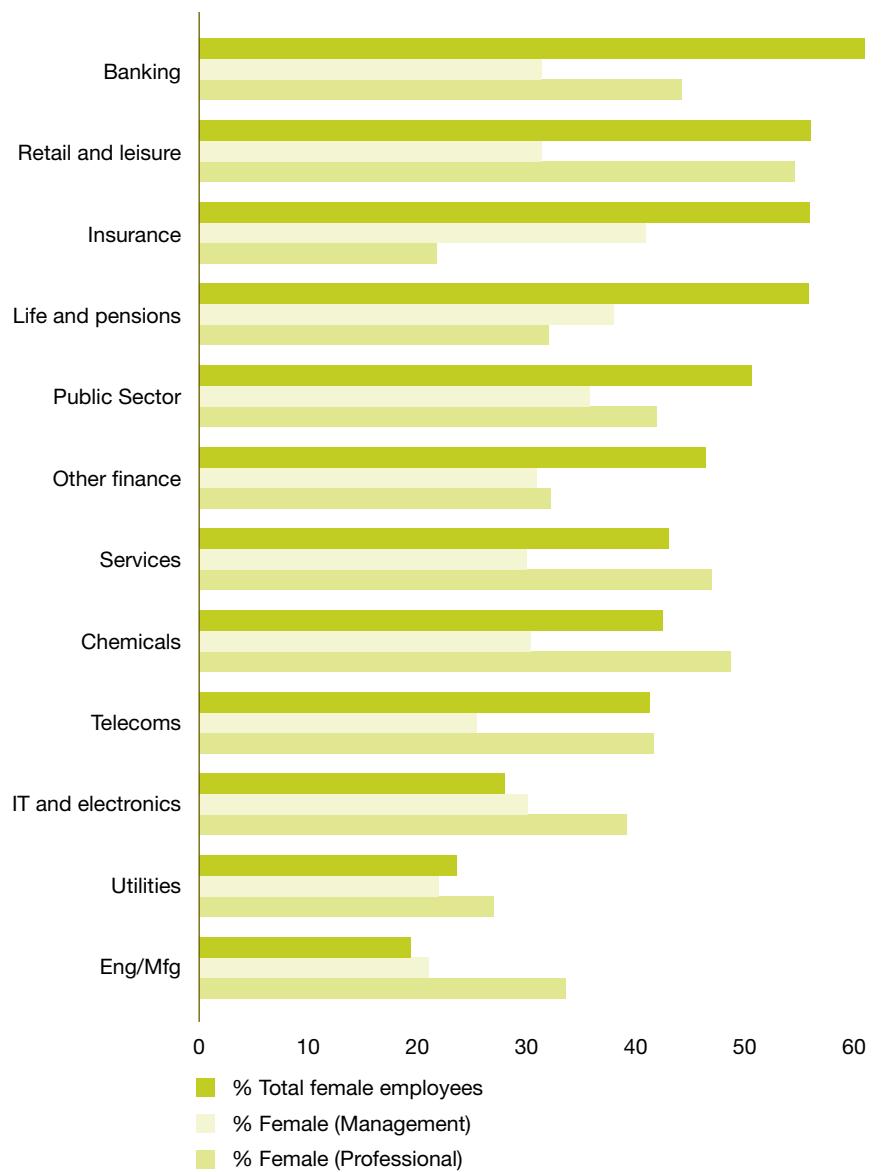
throughout the world are hedged in by cultural and legislative regimens that influence their behaviour. However, there is increasing evidence that the developing commercial need to acquire and maintain an essential skill and talent base is having a greater influence upon selection and development decisions.

Organisations need to consider developing a strategy that takes into account the impact of workforce diversity and equality on their industry and direct organisation. This can include those aspects related to employment and human capital management (such as recruitment, retention and talent management), and also increasingly, integrating workforce diversity and equality thinking into marketing, customer relationship management, procurement, and the wider corporate social responsibility agenda.

PwC Saratoga continues to focus its metric work upon gender diversity as this currently provides the most readily available source of data from employers. It would be dangerous to suggest that gender diversity policies in any organisation would reflect similar organisational behaviours towards other diversity issues. However, it is considered reasonable to suggest that progressive gender diversity actions may reflect a balanced diversity people mind-set overall, plus of course a determined approach to a meritocratic and inclusive working environment.

‘62% of CEOs feel their companies treat men and women equally, but achieving diversity is a much greater challenge than most expect’

Figure 22: European database, gender diversity by sector



Source: PwC Saratoga data



The data for overall gender diversity from 2003 to 2006 demonstrates a trend increase rising from 39.2% in 2003 to 40.5% in 2006, a rise of 3.3%. At the same time, the overall level in the number of professional posts held by women rose from 32.0% to 40.2%, and the corresponding number of managerial posts rose from 25.0% to 29.4%. As indicated previously, the presence of women in management and professional positions differs markedly across sectors reflecting similar disparities for women employed at other levels. Women appear to be making a real representational impact in sectors such as retail and leisure, banking, life and pensions, and public services. In sectors such as chemicals, engineering and manufacturing, utilities etc. the advance is less marked and in some instances regressive (see figure 22). It is clear however that in many major sectors managerial/professional female presence is being seriously felt and the glass ceiling in these sectors is being rapidly shattered.

PwC's *10th Global CEO Survey* showed that 62% of CEOs feel their companies treat men and women equally, but achieving diversity is a much greater challenge than most expect. For the value of diversity to be realised, people must be able to reconcile and discuss their differences.

Additionally, an annual survey of women in the boardroom in the 100 FTSE index conducted by Cranfield School of Management says that one in five new appointments to FTSE 100 boards in 2006 went to a woman, raising the number held by women to 123 – one in nine.

There has, according to the same report, been a surge of more than 40% in the number of women holding jobs on the executive committees that are responsible for running companies on a day to day basis, which are often the incubators for future board members. For example, 80% of Taiwan's companies have women in senior positions, which is an increase of 13% since 2004. Some 29% of senior positions are staffed by women in Taiwan.¹¹

This growth in female presence in the higher echelons of organisational life, may be less reflective of the realisation that gender discrimination has little place in a meritocratic and inclusive working environment, than the

more pragmatic need to muster all the talent available to maintain a competitive and sustainable business. The instinct for business survival may in the end be a greater driving force than endemic prejudice, resulting in higher levels of immigrant employment, less age and ethnic discrimination and less gender distortion.

In the future, with the increasing struggles to find talent, we can expect to see more open organisation structures with diversity levels to reflect this. The PwC *11th Global CEO Survey* shows that larger US organisations see fishing from a wider talent pool as a prime solution to skills shortages.

Work-life balance trends

The debate around work-life balance has intensified since the last *Key trends* report.

Western Europe, influenced by the European Community, is the prime forum for the debate, with major nations now questioning whether well established work-life balance policies are compatible with competitive business performance.

The challenges from the BRICs plus C&E Europe suggest that these regions will attract increasing foreign direct investment and productivity levels as a result of lower human capital costs and their flexible people policies. The UK remains an attractive inward investment location for some major corporates because they have opted out of some of the social legislation of the European Community. Moreover, the US has an outstanding productivity level to-date and appears to be less positively oriented towards work-life balance.

It is argued by some that limitation of working hours, employment protection rights, high levels of maternity and paternity leave and minimum wage legislation, all have a debilitating effect upon competitive people performance, especially when that competition is coming from regions without these legislative requirements. The debates within France at this time, the threatened withdrawal actions of some major German corporates, the straits of the Italian economy are all indicators of socially benign economies coming to terms with the world of globalisation.

'In the future, with the increasing struggles to find talent, we can expect to see more open organisation structures with diversity levels to reflect this'

‘Whether there is any direct relationship between high levels of productivity and high work-life balance after other elements, like good management, have been accounted for, is still a subject for debate’

There are of course counter arguments. A PwC survey in 2007 of circa 2500 graduates, *Managing tomorrow's people*, highlighted that 75% of respondents think that workplace flexibility will not exist; they believe they will be working formal office hours.

A further example shows that South Korean workers have the longest working hours in the world. The OECD reports the average working hours by a South Korean to be circa 2,300 hours per year. This is around 300 hours longer than the next longest working country, Greece, and 34% more hours than the average of the United States. A typical workweek in South Korea is 44 hours or longer. Before legislation which virtually abolished the six-day work week in large corporations, South Korea was the only country in the OECD that worked Saturdays. From the commercial metrics section figure 11, it is possible to see that GDP growth per hour in South Korea is negative at -0.81 compared to 1.86 in the US.

What continues to remain unclear is whether an enlightened employment policy yields higher levels of performance and whether commercially successful organisations are more able to invest in family-friendly policies. Whether there is any direct relationship between high levels of productivity and high work-life balance after other elements, like good management, have been accounted for, is still a subject for debate.

‘Wellness’ trends

Some 9 out of 10 respondents to the UK's 2007 Chartered Institute of Personnel and Development (CIPD) annual survey identified employee absence as a significant or very significant cost to the business. It is easy to see why. Staff costs can be as much as 50 to 80% of overall organisation expenditure, and even ‘average’ absence levels represent a significant cost. In addition to the cost of covering and managing absent staff there are also the costs of damaged productivity and performance, reduced staff retention due to over-stretched staff, and damage to the brand when service levels suffer.

An emerging trend across an increasingly wide range of organisations (size and sector) is to look beyond absence management to investment in broader wellness programmes – typically around core components of health & safety, managing ill health and prevention & promotion. Recent publications such as *Working Towards Wellness – Accelerating the prevention of chronic disease* by the World Economic Forum, in cooperation with PwC, call for business to become more involved in health promotion and chronic disease prevention. A more holistic approach can also yield direct results in the workplace; for example in recent research by PwC (as yet unpublished) companies report reduced absence and reductions in staff turnover as the most common benefits from corporate wellness programmes.

Key trend messages

- Almost without exception, the population of the world is living longer. This implies firstly that people will be active for longer, but secondly that a higher level of dependency will become a global feature.
- Working age population levels will probably increase in the new economies over the short term, but will decline in the mature economies. Generically, it will require higher levels of wealth creation in most economies to support a sustained standard of living for an increasingly dependent population.
- The pressures imposed on organisations to produce or serve more effectively with fewer traditional resources available, will probably have a major beneficial effect upon diversity employment. Employers may be encouraged into positive diversity actions by legislation, but will respond much more confidently if they consider their business interests require the use of talent and skill from increasingly diverse sources.
- Working age people movements across national frontiers will become a significant issue. Freedom of movement will ease skill and employment shortages, but will exacerbate social resistance in times and in regions where there is rising unemployment or social deprivation.

- Work-life social pressures will largely affect Western Europe. The drive for higher levels of domesticity is gaining momentum whilst the competitive market position appears to require greater work focus. The reconciliation of work-life balance and higher levels of productivity is a troublesome problem for many Western European economies. It is an issue which many emerging economies appear not to encounter or appreciate yet.

Human capital foundation implications

Human capital practitioners need to be acutely aware of the demographic movements which are occurring in any of their regions of operation. Critical skills could be lost within short time periods if outdated organisational or state retirement policies were to be implemented or accepted. All policies incurring the unnecessary loss of talent should be questioned.

In a commercial environment which is searching for talent, discrimination of any type other than capability must be challenged. Human capital practitioners need increasingly to be focussed only upon selecting and employing those people, whoever they may be, who can best deliver the results required.

Positive work-life policies should be scrutinised to ensure they are in the best productive interests of the organisation. It should never be accepted that just because a policy is popular that it is automatically right.



‘All policies incurring the unnecessary loss of talent should be questioned’

4. Human capital futures



Corporate reporting trends

The need for greater transparency in corporate reporting has emerged as a major business issue. A particular example of this is in Taiwan where a new law, effective from 1 January 2008, stipulates that employee equity incentive will be defined as expense, and accordingly employee stock options will adopt fair market value. Current accounting policy prohibits deducting employee equity incentive as expense or loss. The new law therefore addresses the need to make corporate financial reporting more transparent to the public and to make accounting policy compatible with global principles.¹²

Disagreements are rife about the value to shareholders and other key stakeholders on the one hand, and the bureaucracy and resource diversion on the other. Driven by a number of corporate scandals and followed inevitably by regulatory initiatives, there has been a growing demand for non-financial information to be provided by trading organisations. Increasingly, stakeholders from shareholders to suppliers through to employees, expect boards to provide them with unambiguous data and insights upon performance, ethical stances, environmental policies and the threats and opportunities that are likely to be encountered. This growing demand and awareness should have a major impact upon the type of human capital information that is made available to an organisation's stakeholders.

The number of organisations now producing extra financial information either through their normal reporting systems or through separate corporate social reports is increasing annually. Within Europe, 90% of the top companies are now reporting on this. However, there are still large differences in practices; Europe is likely to cover broad subjects, and produce longer reports than the US.¹³

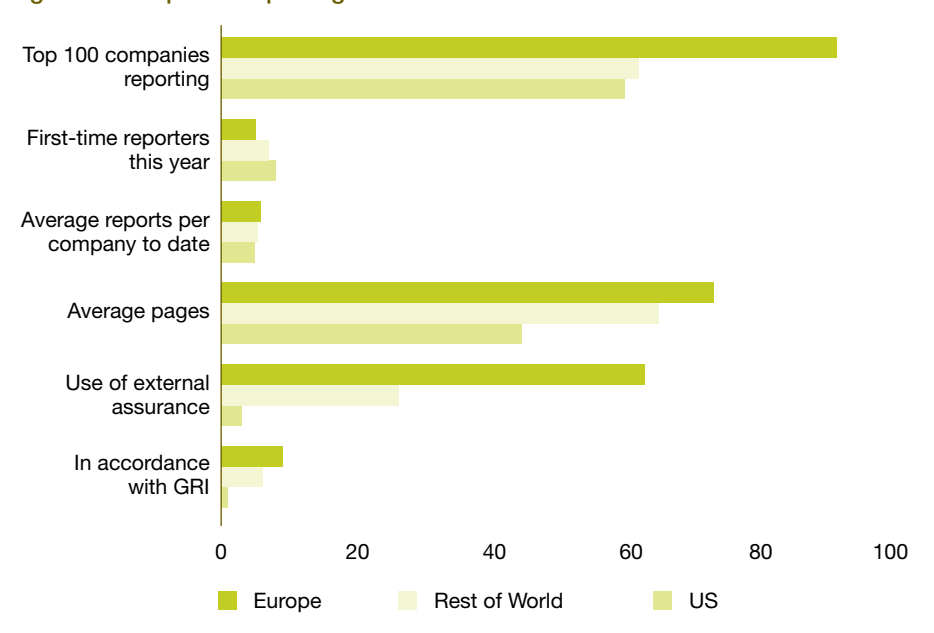
The majority of CSR reports remain short of hard measurable comparative information. It is generally considered unlikely that higher levels of quality corporate reporting will be achieved until a definitive agenda of "best practice" is

promoted by either governments or authoritative bodies, producing a series of measures which will form the basis of a common auditable reporting system. This will also require organisations to sort out their own data systems to ensure there is logical integration of data across and between functions e.g. from finance, sales, and human capital. This will also help to facilitate both co-joined reports that shareholders and others will understand and a fusion of data that will significantly ease the task of major decision making.

The quality of information is still seriously queried by analysts and other commentators, suggesting that there remains a strong tendency for the majority of trading organisations to produce ineffectual generalised statements, making it almost impossible for readers to draw any firm conclusions. The Association of Chartered Certified Accountants argues strongly for "a common language of valuation so the financial implications come through clearly to the global markets". As the business climate changes, companies are being driven to re-evaluate their success criteria. As PwC's *10th Global CEO Survey* states, "The findings of the survey support Michael Porter and Mark Kramer's contention that, to gain competitive advantage, management need to align their strategies to factor in the needs of a broader set of stakeholders including employees and society". To do so, a company needs to keep these stakeholders on board. They need to be well informed and assured of the company's reputation in the market place, since a positive reputation will create real value and reduce risk, whilst a poor or lost reputation can lead to the downfall of an enterprise.

PwC's ValueReporting initiative is firmly based on the view that companies need to promote their reputation to sustain themselves, and a key requirement is "to present their stakeholders with a coherent framework of information that allows the reader to assess corporate – and not merely financial – performance." Perhaps for the first time there is emerging a compelling business argument for greater disciplined transparent reporting.

Figure 23: Corporate reporting



Source: Reporting in Context, 2006

‘As the business climate changes, companies are being driven to re-evaluate their success criteria’

Risk management trends

More than 60% of people surveyed thought risk management processes would be more effective if they were embedded into lines of business.¹⁴

Risk management is now becoming an established organisational discipline. Identifying risk, assessing its likely impact, establishing mitigating options, deciding optimal actions and implementing decisions is becoming part of the normal agenda for all lines of business. People risk is now seen as one of the top 10 threats to an organisation’s earnings.¹⁵ This is hardly surprising since people constitute a significant level of both the cost base and the proactive actions of organisations. However, integrating risk management and human capital management is a major challenge for most organisations. Effective people risk management challenges organisations to be

agile in identifying the sources of risks, their likelihood of occurrence, and the impact they can have on the organisation both financially and in broader sustainability terms.

Human capital management has hardly been strong in any of these requirements historically and therefore requires a significant transformation towards disciplined measurement of activity both in its operational performance and its development of policy. Pension funding, compensation policies, work/life processes, recruitment and retention activities are all key areas requiring higher levels of risk assessment for the future.

‘Human capital practitioners will need to have available systems and databases that will provide the essential information which increasingly demanding stakeholders will require’

Key trend messages

- A number of new disciplines are developing in organisational life both to deal with an increasing public scrutiny of organisational activity and the attendant repercussions of certain investment and operational decisions.
- Corporate reporting is rapidly progressing beyond financials towards a presentation of its sustainability strategies. Inevitably this is leading to greater emphasis upon human capital as an organisational contributor. Stakeholders are therefore likely to demand increasingly detailed information upon the costs and values of people employment.
- As human capital becomes increasingly recognised as a major organisational asset, the assessment of its costs and its value will become the subject of intense scrutiny from its internal and external stakeholders. The application of risk management disciplines will be stringently applied to an asset which could comprise up to 80% of the organisational cost base and be its major revenue contributor.¹⁶

Human capital futures implications

Corporate reporting is beginning to be viewed as a commercial necessity. This has direct implications for human capital reporting, since the same arguments which apply to the need for a lexicon of common language and metrics for CSR and other non-financial reporting clearly applies to its human capital counter-part. The Accounting for People Report of 2003 and the proposed OFR (Operating and Financial Review) implied the need for an extension of human capital reporting by companies on a disciplined basis. They fell short of proposing the common metrics or measures that should be applied. However, there is little doubt that the demand for comprehensible, comparative, disciplined data on human capital as a normal part of an organisation’s periodic reporting systems will be a growing shareholder requirement. It is the view of PwC that those companies that are early in the field will enhance their reputation in the market place.

Human capital practitioners will need to have available systems and databases that will provide the essential information which increasingly demanding stakeholders will require.

There will be an increasing requirement for human capital practitioners to demonstrate the commercial disciplines of other business functions, translating policies and actions into the financial language that investment communities can understand.

Established generic metrics

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

Figure 24: Metric definitions

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

5. The HR function

HR function trends

The recognised importance of human capital to an organisation's overall performance would suggest that the HR function should be essentially moving into an increasingly influential position in the business environment. There are worrying signs to the contrary. The PwC's *11th Global CEO Survey* highlighted that two-thirds of CEOs want recruitment, motivation and development improved. But they give HR a low vote of confidence.

The size and cost of the function per FTE is now declining throughout the majority of Europe (99:1 across Europe in 2006 compared with 88:1 in 2005), with HR costs falling from 1,200 euros per FTE in 2005 to 1,017 euros per FTE in 2006. Whereas the US appears to remain similar in terms of size and show a slight increase in costs.

Figure 25: HR function metrics 2002-2006

	2002	2003	2004	2005	2006	% change 04 and 05 median	% change 05 and 06 median	% change 02 and 06 median
FTEs per HR department FTE								
UK	105	95	96	82	90	-14.6%	9.8%	-14.3%
C&E Europe	99	95	91	99	93	8.8%	-6.1%	-6.1%
Western Europe	96	90	92	87	90	-5.4%	3.4%	-6.3%
All	96	90	92	88	99	-4.3%	12.5%	3.1%
US	NA	88	88	90	89	2.3%	-1.1%	NA
HR department costs per FTE (€)								
UK	1,275	1,258	1,073	1,245	1,110	16.0%	-10.8%	-12.9%
C&E Europe	383	382	524	402	386	-23.3%	-3.9%	0.9%
Western Europe	1,213	1,181	1,143	1,205	1,110	5.4%	-7.9%	-8.5%
All	1,116	1,135	1,108	1,200	1,017	8.3%	-15.3%	-8.9%
US	NA	1,392	1,385	1,280	1,502	-7.6%	17.3%	NA
HR managers and professionals (percentage of total dept FTEs)								
UK	59.8	58.0	63.1	60.9	65.7	-3.5%	7.9%	9.9%
C&E Europe	53.0	60.0	62.6	64.4	45.8	2.9%	-28.9%	-13.6%
Western Europe	61.8	62.1	65.6	63.6	66.7	-3.0%	4.9%	7.9%
All	60.0	62.1	64.5	63.2	66.7	-2.0%	5.5%	11.2%

Source: PwC Saratoga data

There is increasing evidence that CEOs and other senior executives, recognising the importance of human capital, are assuming more active roles in activities that historically were regarded as the precinct of the HR function. Moreover, it is becoming clearer that HR services are increasingly provided by a range of disciplines external to the HR function. Those who can deliver best in class finance and other functional services can also provide best in class HR. With such movements taking place it is hardly surprising that the need for a separate HR function, as distinct from an integrated management discipline, becomes more questionable.

HR reputation trends

Linked to the trend for the HR function to become more accountable in measuring the value it adds to the business, is the need to manage reputation with its key stakeholders: the board, the line and employees. In order to do this well, the HR function needs to be proactively managed and a clear agreement, understanding and communication of the role of HR in the organisation is also required. The HR function needs to focus on the impact and effectiveness of their communications. Furthermore, the role of Head of HR communication is becoming more common but often fails to address the strategic importance of communication to HR.

What is needed is a comprehensive approach that encompasses the following elements:

The board

- demonstrating through quantitative and qualitative measures the strategic value of HR;
- taking a business perspective and communicating succinctly and in business language; and
- talking about the right things.

The line

- engaging managers in the development of policies and processes;
- encouraging dialogue; and
- communicating things in the simplest way possible – in the language of line managers.

Employees

- an employment brand that integrates the employee experience;
- using the language of employees; and
- open, adult communication that achieves consistency while allowing line managers to interpret locally.

The trend for HR to demonstrate its value with robust metrics is closely linked to the need for HR to better manage its reputation.

For HR to become more highly regarded internally, all communications must be of a standard which justifies this. The perception of HR is determined by how it represents itself through communications, both written and verbal; HR is therefore responsible for its own PR through internal communications.

Shared services trends

The move to HR shared services (HRSS) continues. The objectives of lower cost, business process excellence, higher advisory consistency and centralised human capital feedback to energise policy development, all continue to provide the rationale for this shift.

The rise in the number of HRSS operations has been accompanied by a greater number of HR processes being delivered via the HRSS model. On average, participant organisations in PwC Saratoga's HRSS network now report information on seven key HR processes, with recruitment administration, payroll administration and employee data maintenance information topping the list.

‘For HR to become more highly regarded internally, all communications must be of a standard that justifies this’

‘Although the overall HR outsourcing market is continuing to grow, we have observed that due to the competitiveness in the marketplace and requirements of organisations, the overall price for third parties across HR services has decreased over the past year’

Since the last *Key trends* report, more positive results are emerging on performance across a series of measures within HRSS contact centres. However HR functions are struggling to balance this with an effective business partnering service to executives.

Figure 27 shows significant performance improvements across a series of measures within HRSS contact centres. We have seen a drop in the level of outsourcing in alignment with the performance improvements.

Overall we are seeing that many mature (over four years) HR shared services organisation show significant cost efficiencies within key transactional processes such as payroll and data maintenance when compared to less mature (less than four years) HRSS operations.

However, within processes such as recruitment and learning and development, it appears smaller efficiencies are being gained following the initial payback. According to a new study from PwC Saratoga, Czech Republic, shared service centres (SSCs) spend on average almost CZK 40,000 per employee on recruitment, while the market average is CZK 17,000. Furthermore, almost a fifth of new SSCs hires leave during their trial period, whereas market trends show that it is usual for about 5% of employees to leave during this time.

We continue to see organisations that have outsourced HR services to third parties are consistently struggling to drive both cost efficiency and service effectiveness. Of those organisations that reported higher performance when utilising outsourcers, they ensured documented service level agreements were in place, with fixed penalties where these are not met. Although the overall HR outsourcing market is continuing to grow, we have observed that due to the competitiveness in the marketplace and requirements of organisations, the overall price for third parties across HR services has decreased over the past year. This research may provide some of the reasons why organisations are struggling to balance driving lower cost but requiring a higher level service from outsourcers.

Finally, the gap between the successful HRSS operations and others continues to widen. Levels of technology and automation continue to be a significant driver in delivering high levels of service and lower cost. It appears many organisations operate and implement HRSS with above-average levels of complexity within processes (e.g. the number of payrolls, employment contracts and different pension schemes) and this is having a significant impact on cost efficiency and the perceived level of service effectiveness, which is often crucial for newly implemented HRSS operations.

Figure 27: HRSS metrics Europe

The table below shows significant performance improvements across a series of measures within HRSS Contact Centres. As it can be seen we have seen a drop in the level of outsourcing in alignment with the performance improvements.

	2006	2007
Calls dealt with per day per contact centre FTE (no.)	22	26
Contact centre costs per FTE (£)	£42.90	£31.50
% calls answered on first contact (%)	73.3%	75.5%
Average answer time (secs)	27	23
Outsource rate (%)	29.0%	14.0%

Source: PwC Saratoga data

The balance between a “high and low touch” service is clearly having an impact on the efficiencies being gained. This highlights the need for HR to understand what its customers (both employees and executives) want and need from it, to ensure the right level of service is being delivered.

Despite the welcome improvements in results and indications that many organisations are now gaining measurable benefit from their HRSS investment, the observations made in our earlier report appear to continue to be highly relevant. The introduction of shared services requires expert business deliberation, ensuring that purposes and targeted outcomes are fully evaluated, costs are realistically assessed, time to delivery established, and intended impacts measured against actual results.

Key trend messages

- There is a decrease in both the size and cost of HR functions across Europe & US
- There is little evidence to show that the influence of HR has increased in the Boardroom – there has been limited strategic penetration, CEOs have a low opinion upon its contribution and the number of HRDs on the main board of the FTSE 100 in the UK has further decreased to five
- The role of the HR business partner is not rated highly by executives
- HR services are increasingly provided by a range of disciplines external to the HR function
- The success of HRSS depends upon a strategic appreciation of its purpose and a regular and full evaluation of its value.

HR function implications

These are times of real challenge for the HR function. At a time when human capital is being recognised as key to an organisation’s sustainability, the reputation of the function is at low ebb. Its future is in doubt.

To arrest the decline in the status and the reputation of the function, there is little doubt that there is an urgent need to embrace broader business disciplines, adopting a genuine strategy to relate measurable people policies to the goals of the organisation. In a sense, the environment is extremely positive. CEOs appear to realise now that people count. For the HR function to have real impact, it must appreciate what people counting means.



Conclusion

Once again, we hope that many of the trends outlined in this document will lead to constructive discussion and debate, and we urge readers who have detected other trends, or who simply have a different perspective on the views we have expressed, to make contact with us. Our details are listed on page 44.



We believe that discussion and debate lead to breakthrough. PricewaterhouseCoopers continues to search for breakthroughs in human capital thinking. It is our view that, in the immediate years ahead, new thinking and innovative action around human capital contribution will be the best guarantee that people's lives will become meaningful and complete, and that an organisation's human capital will be given the respect, consideration and status that it deserves.

Richard Phelps, Global lead partner,
Human Resource Management,
PricewaterhouseCoopers.

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Contact us



About PwC Saratoga

PwC Saratoga's human capital measurement and benchmarking business has the most extensive database of HR metrics available. We work with organisations to evaluate their human capital and its contribution to organisational profitability. We offer a range of quantitative and qualitative tools which help organisations to identify the strategic impact of their people, as well as to measure and benchmark themselves against peers in the marketplace in order to identify areas of risk or efficiency, and to evidence best practice and innovation. This enables HR leaders to gain a clearer understanding of the effectiveness of their function, and of the HR programmes that they implement. This also enables the HR function to demonstrate the impact that it is having on the business' success, and to ensure and evidence the alignment of HR activities to business strategy.

Further information

To find out more about this report or to discuss any of the issues raised, please telephone or send an e-mail to one of the contacts listed below, or visit www.saratogapwc.co.uk.

UK global

Richard Phelps
+44 (0) 20 7804 7044
richard.phelps@uk.pwc.com

US global

Patrick Meyer
+1 (312) 298 6229
patrick.meyer@us.pwc.com

Europe

Henk Van Cappelle
+31 20 568 62 10
henk.van.cappelle@nl.pwc.com

Africa

John White
+27 (11) 797 4153
john.d.white@za.pwc.com

South and Central America

Olga Colpo
+55 (11) 3674 3699
olga.colpo@br.pwc.com

Asia Pacific

Mark Gilbraith
+86 (0) 21 6123 2898
mark.gilbraith@cn.pwc.com

Debra Eckersley
+61 (0) 409 922104
debra.eckersley@au.pwc.com

Japan

Shinya Yamamoto
+81 (0) 35251 9960
shinya.s.yamamoto@jp.pwc.com

If you would like further copies of this publication, please contact:

Alex Moir
+44 (0) 20 7212 3942

For press enquiries, please contact:

Andrew Smith
+44 (0) 20 7804 7119

pwc.com

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