

Key trends in human capital: A global perspective

Executive summary



Foreword

At many levels, human capital, by which I mean the ‘science’ of people in organisations, is a relative mystery. We know a great deal about for example, marketing, production management, information technology, the financing of businesses and the formal governance and organisation of business entities. We know how to measure, evaluate and report on all of these areas. If a chief executive wants data and analysis, whether on his own business or on a peer group or on his key competitors, he will receive it.

Increasingly, the same demands are being made by executive management of the HR function. People are often the largest cost in a business and will always be one of the most significant. The challenge offered is to bring some rigour and consistency to investment in the people domain.

Saratoga is in the business of human capital measurement and benchmarking. This brings the discipline of objectivity to the management of people in organisations and encourages the application of systematic measurement methodologies, pinpointing not only existing performance strengths and weaknesses, but how that performance has moved over time. As we grow the stock of evidence on the best way to craft and implement interventions and processes, we will increasingly be able to measure and then improve their effectiveness.

It is not just within organisations that human capital measurement and reporting has relevance. Recent corporate misdemeanours have led to the Sarbanes-Oxley Act in the US and to a growing recognition in much of the rest of the world of the need for higher and more effective corporate governance. Add to these factors the forthcoming introduction of Operating and Financial Reviews (OFRs) in the UK and one can easily see a future where human capital reporting to shareholders and other stakeholders will be the norm. Measuring and reporting on human capital is not only a fundamental ingredient of sound corporate governance, but an essential step towards building sustainable organisations deserving the confidence of their stakeholders.

Owain Franks
Business strategy leader, Human Resource Services
January 2005



Background

PricewaterhouseCoopers Human Resource Services has had a track record in providing global human capital benchmarking studies since 1996 and has one of the world's largest HR advisory businesses.

In 2003 PricewaterhouseCoopers acquired Saratoga Institute, recognised as the world's leading authority on human capital metrics. Later in 2003, PricewaterhouseCoopers acquired EP-First, a European-based provider of human capital metrics. What followed was an intense period of integrating the technologies and experience of each business to create a definitive methodology and data source for HR measures. The new proposition, known as Saratoga was launched in October 2004. This briefing represents, for the first time, the combined thought leadership resulting from the alliance of these three leading HR brands. It provides our perspective on key human capital measurement trends. The trends discussed in this briefing should assist human capital executives to shape their future strategies and to create value for their business through people.

This work is based on data collected from over 10,000 organisations across Europe and the US, representing industry sectors including banking, financial services, manufacturing, telecommunications, chemicals, IT, utilities, retail and some selected public service operators. The data is organised under a range of categories and provides valuable information on financial performance, added value, productivity, remuneration and people behaviour. It also analyses the structure and role of the HR function. Increasingly, Saratoga's clients are using selected measures not only to provide insights into bottom line performance and basic people behaviours, but also to gain a measurable appreciation of critical organisational forces such as motivation, commitment, innovation, talent management and leadership. The result provides a powerful combination of information on both existing organisational human capital profiles and those required in future to produce and maintain a sustainable human capital advantage in the marketplace.



The key trends in detail

The trend data in this briefing throws out some exciting findings. Evidence of an economic recovery has certainly filtered down to organisational human capital and the turmoil of uncertainty, downsizing and reorganisation seen in recent years seems to have subsided for the time being. But having weathered the storm, there are now greater indications than ever before that CEOs and their colleagues have a growing desire to demonstrate value with hard metrics and to be able to justify, in financial terms, the human capital actions they take.

On both sides of the Atlantic, Saratoga reports an increasing demand for human capital data, not only for the traditional purpose of benchmarking against the competition, but as a source to justify every business case, every new people programme, and every effectiveness evaluation.

Financial performance.

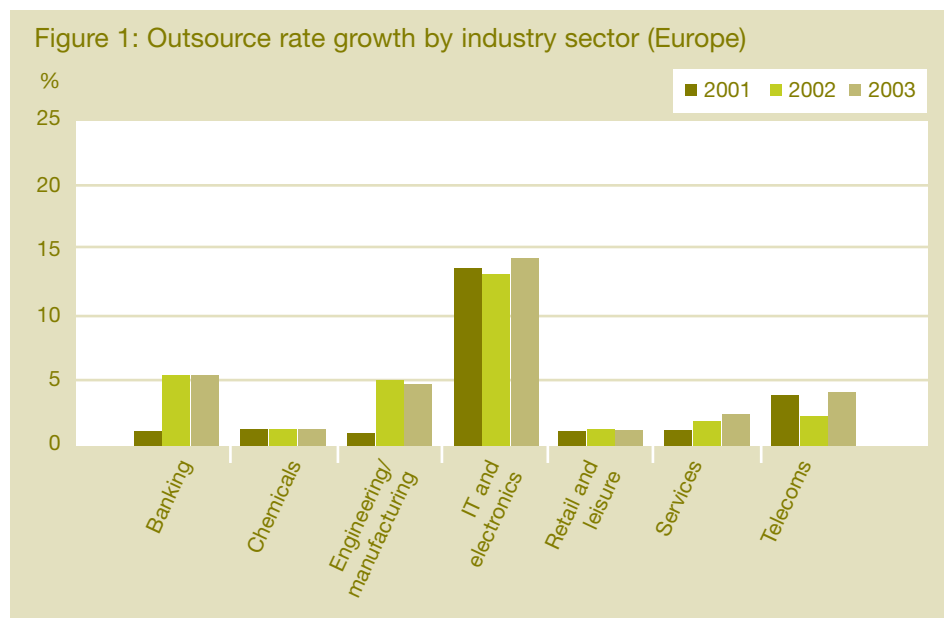
The slash and burn downsizing and restructuring of 2000 – 2002 has been replaced by a more stable period which has continued into 2004. Our evidence demonstrates that the US has recovered both revenue generation and bottom line profit growth faster than Europe. Revenue per Full Time Equivalent employee (FTE) has increased by 18% in the US and 11.3% in Europe. Staggeringly, pre-tax profit per FTE in the US has increased significantly by 156% (in Europe by 26%). The Saratoga view is that US organisations move faster and more flexibly than their European counterparts, both when responding to adverse economic conditions and subsequently when implementing innovative propositions for growth. European organisations, working within a heavier legislative environment, many with a state controlled background, often find it harder to respond to rapidly shifting market movements. The US ability to move more rapidly to meet changing market demands reflects, in part, such contrasting structural and social environments, but also suggests a higher level of executive and shareholder ambition.

Added value performance.

The Saratoga Human Capital ROI (value metric) shows an improvement since 2001, moving to \$1.48 in the US in 2003 (from \$1.31 in 2001) and to €1.13 in Europe (from €1.12 in 2001). The metric takes pre-tax profit generated for each denominator of currency invested in compensation and benefit costs – in other words how many Dollars or Euros each employee produces for every Dollar or Euro paid to that employee. The worrying issue, certainly in Europe, is that the compensation and benefits bill for employers is increasing at a greater rate than the remuneration: revenue ratio is decreasing, indicating once again that employers are rewarding employees more highly than revenue growth justifies. In the US, there is a stronger correlation between reward and added value growth. In Europe, Saratoga believes there has been an uncomfortably disproportionate mismatch between pay and value which, in 2004 has already produced some relatively dramatic responses from some key organisations. In fact, there is increasing evidence in Western Europe of major employers taking steps both to limit earnings growth and to obtain more for the pay they offer. The offshoring trend in both the US and Europe is evidence of employers on a global basis searching for a higher return on their remuneration investment.

Outsourcing and offshoring.

Although outsourcing and offshoring are different concepts, both continue to demonstrate major expansion. Offshoring in some sectors has more than tripled in the last 12 months, whilst outsourcing in Western Europe, not surprisingly, has continued to grow in the majority of sectors. Both are set to have a major influence on human capital structures and thinking in the years ahead, raising major people related issues. Figure 1 provides information on the Outsource Rate of selected Sectors within Europe. Since Saratoga is primarily concerned with human capital movement, the percentage calculations shown reflect the reported level of human capital outsource costs against the sector's total cost.



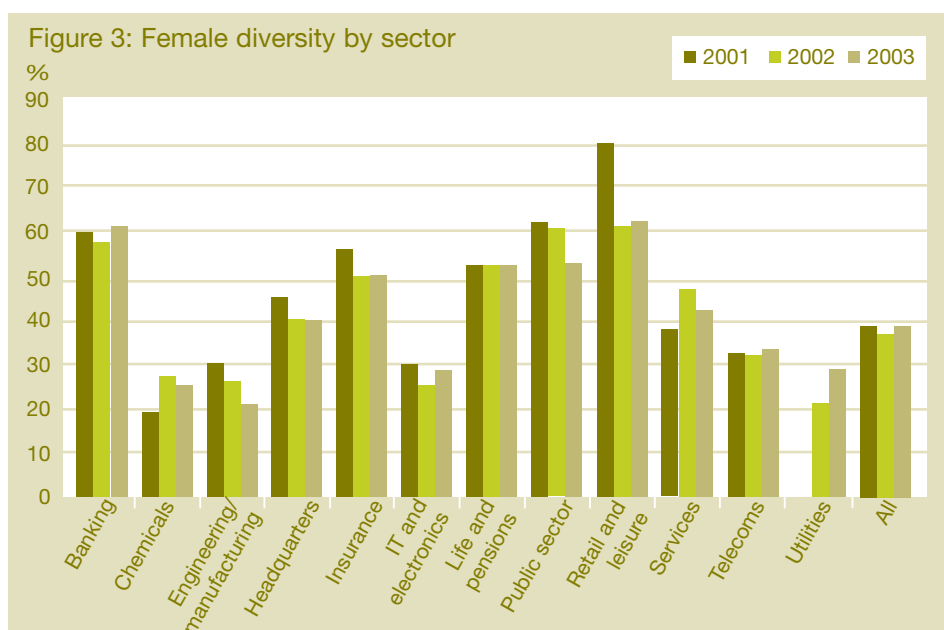
Leadership.

Leadership has been one of the hottest issues in the last two years, with many organisations devoting high resources to this area. It is calculated that European organisations are spending some €1.5 billion on leadership training and development activities each year. In the US, although data on spend is not available, it is thought the figure could run into several billion Dollars. Saratoga's findings show little evidence that this investment is currently demonstrating any major return.

Diversity.

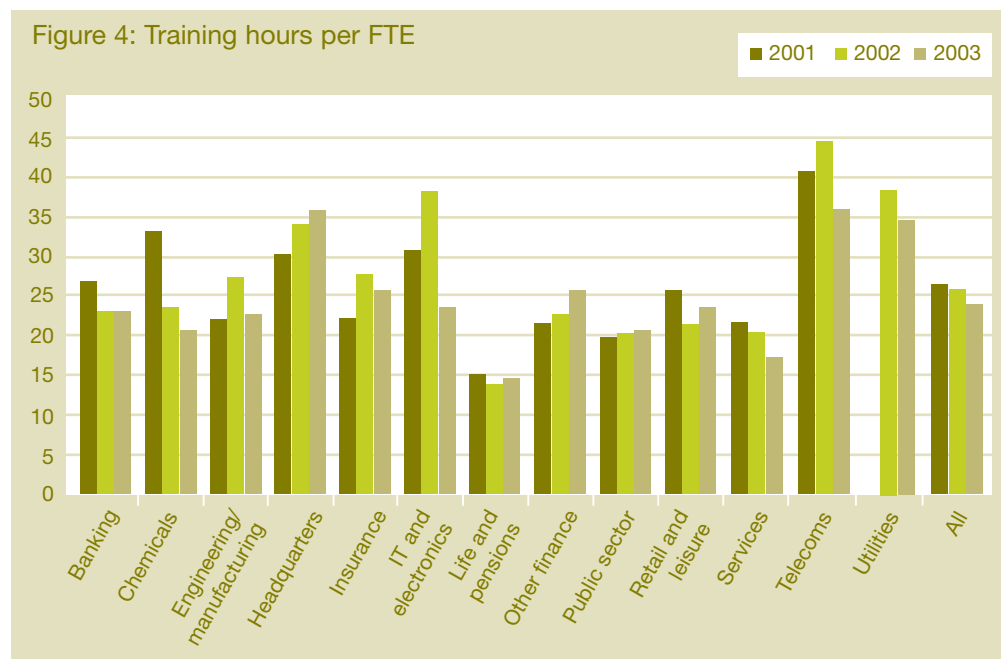
A well balanced diverse workforce is normally a strong indicator of a meritocratic and inclusive organisation. Saratoga has been collecting gender diversity figures in Europe since 1999. The collected data indicates that women represented 39% of the total European workforce in 2003, a proportion little changed since 2001. However, the number of females in managerial and professional positions has declined since 2001, from 26.5% to 24.6% in

management posts and more significantly from 33.6% to 29.3% in professional positions. Women appear to have suffered from the extensive functional organisational restructuring of the last two years, when many specialist back offices were severely rationalised; 50% of Saratoga's clients report that they have undertaken major organisation structure change since 2001. There are, however, large diversity variances according to sector. For example, the banking sector is the highest employer of females with 44% of women in managerial positions, compared with only 10% in chemicals and 14% in utilities.



Talent management and learning.

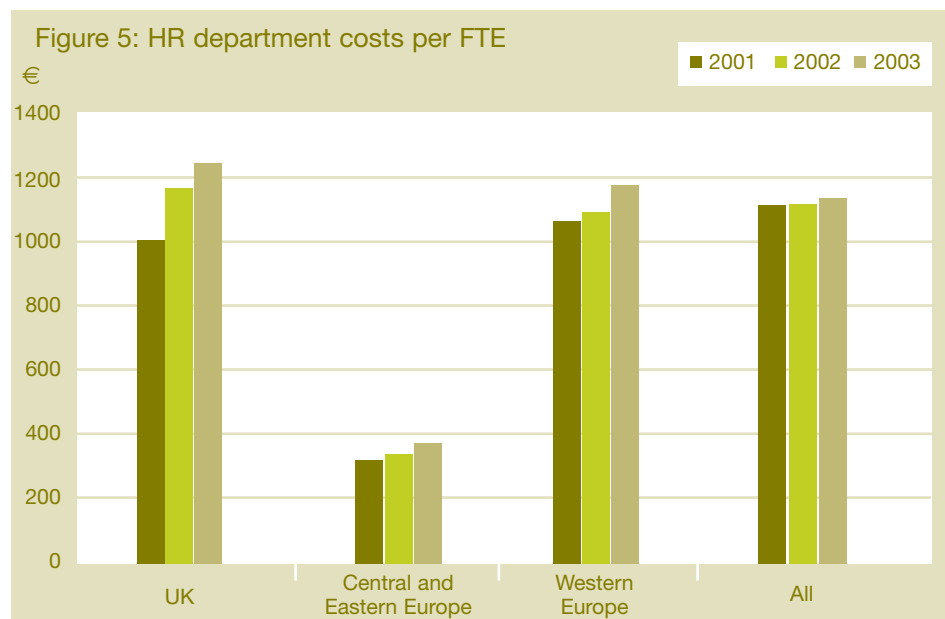
Talent management continues to be described as a key human capital issue. Yet it remains difficult to obtain any reliable data on the extent of organisational talent investment. Certainly if formal training data is analysed, there appears to be an alarming decline in training investment since 2001, with the level across Europe falling by some 7.4%, and the UK declining by some 11.1%. These cuts have been particularly apparent in certain sectors such as chemicals (38%) and IT and Electronics (25.4%). Even the banking sector appears to have cut learning and education investment, with a reduction of some 14%. It must be understood that the figures quoted purely constitute formal training and development activity, since these are the only figures generally available and therefore they may have been replaced by an equivalent increase in e-learning and on-line training packages. However, the fact remains that few organisations are able to produce hard data on their training investment and are rarely able to demonstrate the return on investment gained. It is unlikely that any Board will take an investment seriously if the cost is largely unknown and the payback uncalculable.



The HR function.

The size of the HR function in the US is increasing, with figures indicating a 3% growth in numbers since 2002 and a 22% growth in investment since 2000. In Europe however, there has been insignificant change. In 2001, the ratio of FTEs to Full time HR employees was 88:1 and in 2003 it rose slightly to 90:1, indicating a small reduction in numerical strength. During this time, HR department costs in Europe per FTE have increased marginally from €1,107 in 2001 to €1,135 in 2003, generally in line with inflation.

The HR function in both the US and Europe face major change demands. In an environment in which people are described as an organisation's major asset, it would be expected that the HR function would have gained considerable influence. In fact in Europe the last 12 months have produced little evidence that the HR function is playing a more prominent role in organisational life. In Europe the number of HR Directors operating at the most senior levels in companies continued to decline for the third successive year, whilst the drive to create a more strategic contribution, has not shown any consistent progress. In the US more success does appear to be materialising.



Shared services.

Analysis of the impact of shared services in Europe is mixed and it is difficult to find evidence that outsourcing services or centralising work have reduced HR function costs significantly or impacted on the size of HR functions. Neither is there evidence that the introduction of shared services enables the remaining HR professionals to have a greater business impact.



Driving human capital forward

People in organisations will not be regarded as human capital in reality, until and unless, their contribution to value can be measured with the same confidence as any other organisational asset. The drive towards meaningful human capital measurement is gaining pace, witnessed by the many major initiatives that are taking place both in the US and Europe. It is essential therefore that human capital practitioners respond and embrace the opportunity which these initiatives offer. The trends outlined in this briefing raise a number of real challenges, which must be addressed.

They include:

- The recognition that competition in any sector is increasingly global. Survival will be about creating working environments with high employee commitment, high productive effort, low cost and total customer focus. Work will move to those centres that do it best.
- A propulsion towards an inclusive and diverse working environment, which rewards merit and attracts, develops and uses talent; an admixture most likely to produce competitive endeavour.
- The continuous development and search for competent and committed key players and leaders, without whom success will not be sustained.
- A repositioning of the HR function to become more externally focussed and more respected for its ability to promote human capital as a real business asset.

PricewaterhouseCoopers Human Resource Services practice works with clients who strive to make their people a sustainable source of competitive advantage. Our strategy is built on our own belief in developing our people to be creative and effective team players committed to outstanding client service. We bring the ability to take fresh perspectives, to think differently, and to develop and implement new and value adding solutions.

We work in close relationships with clients to offer practical, multi-disciplined approaches to the increasingly complex challenges facing businesses. One of the main challenges is to create environments in which their people can work most effectively. Our Human Resource Services practice brings together all of the professionals working in the human resource service arena - tax, benefits, retirement, communications, financial planning, international assignment, equity, culture and change, compensation, strategy, regulatory, legal, and process management - affording our clients an unmatched breadth and depth of expertise, both locally and globally.

Our expertise in tax, law, actuarial, accounting and compliance issues, combined with our knowledge of employment best practices, sets us apart.

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