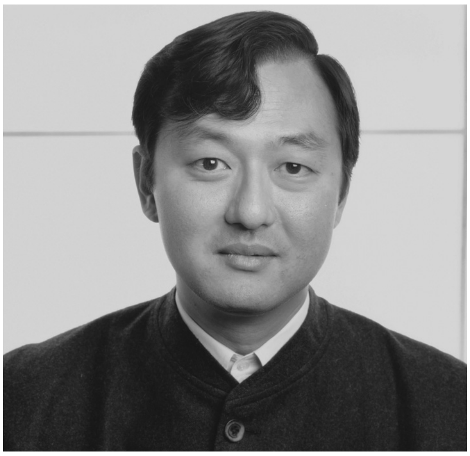


Key trends in human capital: A global perspective

Saratoga

PRICEWATERHOUSECOOPERS

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 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 issues 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 between 2001 and the first quarter of 2004, 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.



Key trends in detail

This briefing provides more detailed information on each of the trends illustrated in the executive summary, with statistical evidence to support our findings. In addition, it includes commentary on other identified human capital issues which are seen to be growing in importance.

The trends identified are not necessarily present in both the US and Europe; sometimes the markets involved appear to be moving at a different pace or even in different directions. Nor are they all currently supported by fully authenticated data since, for some, insufficient time has elapsed since their identification to permit the collation of data against the strict definitions and standards which Saratoga applies. However, since Saratoga actively encourages debate on emerging trends, more than 300 clients across Europe and the US have been involved in dialogue over the past 12 months; the resulting consensus is that the subjects identified are live and vibrant.

The trends discussed in this briefing are considered by Saratoga to have important relevance to all executives who are involved in shaping and managing human capital within their organisation, and who are attempting to prioritise the allocation of critical resource to key issues.

Regional variations.

The briefing is largely based upon an all-industry mean across the US and Europe. Industrial region, size and sector can have a major influence upon many metrics, so where appropriate, we include tables which detail results by region and sector and which reveal the strong structural and cultural differences which pervade the European market. The significant differentiation between Central/Eastern Europe and their Western European counterparts in many metric results is particularly interesting and reflects, in part, the mounting human capital pressures across the continent. The US has less dramatic internal regional differentiation, but nonetheless shares pressures of globalised competition.

Financial performance.

Despite steadily rising revenues and profits in the late 1990s across Europe, the application of the human capital metrics of revenue and profit per employee to the same basic figures produced the reverse result – that of decline. Saratoga concluded that during the economically prosperous years of the late 1990s, organisations had generally lost control of their human capital cost base; recruiting wildly and losing essential workforce disciplines.

In 2000 and 2001, the US, Europe and elsewhere reported a widespread downturn in economic activity, resulting in recruitment freezes, people downsizing, and the implementation of rigorous cost management. Revenues declined and profits generally plummeted as business was lost more rapidly than organisations were able to adjust their total cost base. However, downsizing and other cost management actions, combined with experienced financial management, meant that deep recession was avoided in most lead markets.

In 2002 and 2003 both the US and Europe experienced a resurgence in revenue and profit growth amongst businesses in most sectors.

- Since 2001, revenue per employee increased by 18% in the US and by 11.3% in Europe.
- More dramatic profit per employee growth is reported over the same period; with the US reporting an increase in pre-tax income per employee of 156% (slowing to 25% growth in 2002) and Europe improving its position by some 26%.

Although the significantly different rates of recovery per employee between the US and Europe require further study and analysis, it would seem that in times of economic transition, the US is able to move faster and more flexibly than Europe, both when responding to adverse economic conditions and subsequently implementing innovative propositions for growth. New markets mirror these characteristics, while the more mature, early state-dominated business environments appear to have greater difficulties responding positively to rapidly shifting market movements.

Figure 1 demonstrates the total revenue, costs, profit, added-value and productivity profile for Europe from 2001 to 2003.

Figure 1

Financial Metrics (Europe)		2001	2002	2003	2001-2003 % change*
Revenue per FTE[1] (€)	UK	123,852	129,024	135,888	9.7
	C&E Europe	34,847	32,408	51,298	47.2
	Western Europe	144,576	145,766	157,187	8.7
	All	138,686	134,074	154,315	11.3
Costs per FTE (€)	UK	121,995	126,071	134,500	10.2
	C&E Europe	34,178	31,837	51,512	50.7
	Western Europe	139,293	142,353	153,838	10.4
	All	133,539	130,067	150,499	12.7
Profit per FTE (€)	UK	2,538	3,112	3,248	28.0
	C&E Europe	375	302	612	63.4
	Western Europe	3,515	3,696	4,238	20.6
	All	3,202	2,926	4,045	26.3
Human Capital ROI (€)	UK	1.10	1.08	1.11	0.8
	C&E Europe	1.07	1.05	1.10	3.2
	Western Europe	1.12	1.08	1.13	1.1
	All	1.12	1.07	1.13	0.9
Remuneration (Comp & bens) (€)	UK	31,453	32,852	33,914	7.8
	C&E Europe	6,119	5,712	7,588	24.0
	Western Europe	34,017	34,737	36,000	5.7
	All	33,227	32,883	35,519	6.9
Remuneration /revenue	UK	24.7	24.7	23.9	-3.2
	C&E Europe	17.6	17.5	15.1	-14.1
	Western Europe	23.3	23.0	21.8	-6.5
	All	23.1	22.6	21.6	-6.7
Remuneration /costs	UK	24.9	25.0	24.4	-2.0
	C&E Europe	17.1	17.7	14.7	-14.0
	Western Europe	24.0	23.5	22.4	-6.8
	All	23.7	23.0	22.1	-6.6

[1] Full Time Equivalent * All % changes are rounded to nearest decimal place

Added value performance.

Saratoga uses an added value metric, called the Human Capital ROI, which takes pre-tax profit generated for each denomination of currency invested in compensation and benefit costs. The resultant ratio indicates how many Dollars or Euros or any other currency are produced for every Dollar or Euro or any other currency paid to an employee. Therefore, when pre-tax profits fall, the Human Capital ROI should also fall – unless compensation and benefits unravel at the same pace. This did not happen in either the US or Europe from 1999 to 2001. As a result:

- the Human Capital ROI fell dramatically in the US from $1.65 in 2000 to $1.31 in 2001;
- in Europe the metric has always been lower and declined steadily from 2000 to 2002, reaching €1.07 in 2002 from €1.12 in 2001 and €1.15 in 2000[2].

Subsequently and not unexpectedly, both metrics have shown improvement with the US moving rapidly upwards to $1.48 in 2003, and Europe improving marginally to €1.13 over the same period. Again, the different recovery rates for both markets appear to reflect a different speed of response to changing market demands overall, although the complex structural diversity of Europe clearly produces different response levels between regions and national states. A key element in the denominator of the Human Capital ROI is the size of the total compensation and benefits charge, which grew by 18% in the US and 6.9% in Europe between 2001 and 2003. Despite the comparatively modest rise in remuneration in Europe since 2001, European organisations will need to maintain a level of disciplined cost management overall and specifically over remuneration growth, if they are to match the types of improvements experienced in the US. In future, higher remuneration bills must be firmly related to profit generation.

Productivity performance.

Added value calculations differ from productivity figures. For Saratoga, the added value metrics measure the relationship between pre-tax profit in relation to total compensation and benefits – whether the goods or services offered are selling at attractive margins. Productivity metrics on the other hand look at the relationship of compensation and benefits against revenues and total costs – whether the products or services offered are being produced at a cost that the organisation can tolerate.

Both added value and productivity analyses are important over time, to establish whether remuneration levels in totality are under control and, in benchmarking terms, whether the control exercised produces a sustainable competitive positioning.

In Europe, from 2001 to 2003, both remuneration to revenue and remuneration to total costs moved from 23.1% and 23.7% respectively, down to 21.6% and 22.1%, showing an improvement of some 6.7% over the total period. These improvements reflect the rationalisation programmes which took place during 1999 and 2000, resulting in a reduction in the total remuneration bill in most organisations. However, the improvement gained was lower than the revenue per employee improvement over the same period which leaves question marks over the level of sustainability of such positive movements. Again these figures appear to strengthen previous conclusions that, despite revenue growth over the period, the size of the remuneration bill is accelerating faster than revenue growth levels justify.

[2] It should be noted that the formula is a ratio, and therefore exchange rate comparisons are irrelevant.

It is important to appreciate that the relationship of remuneration to revenue and to costs will reflect the commercial sector of operation and, at a national level, the make-up of commercial activity overall. Changes in the ratios, either positive or negative, should be set against any overall change in revenues or profit to ensure that the remuneration bill is not spinning out of control.

Importantly, evidence suggests that the relationship between the remuneration bill and productive output is seen as a key competitive issue in both the US and in Europe. Consequently we are now witnessing some major organisations in Europe either moving operations to lower labour cost regions or attempting to negotiate longer working-hour deals for the same reward. In the US, the move towards offshoring is both a commercial and political reality.

Outsourcing and offshoring.

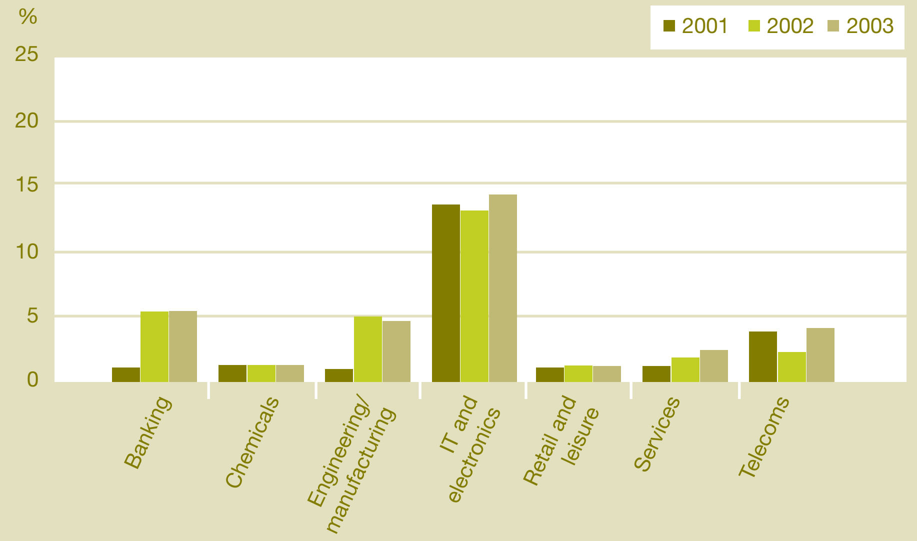
Both these concepts will affect organisational structural strategic thinking into the future and although both outsourcing and offshoring are essentially different concepts, they primarily have the same end objective of improving efficiency by reducing operating costs. Most organisations involved in the research, approximately 80%, cited that the main objective in their outsourcing and offshoring activity, was cost reduction.

The major drive towards offshoring in 2003 saw the number of organisations doing so almost treble over 2002 in some significant sectors including banking, financial services, IT, and telecommunications, with most organisations regarding it as a means of creating a new global operating model. This movement will undoubtedly continue with both low-cost Asian and Central European countries attracting not only administrative call-centre business, but offering hard-pressed corporates attractive core operational bases with low costs and high indigenous skills. In 2003, outsourcing in Europe continued to increase in most sectors and despite some commentators stating that outsourcing has potentially passed its peak in Europe, there is no evidence to suggest that these contingent employment trends will not continue.

Outsourcing and offshoring raise major human capital issues. Organisations need to acquire new competencies and skills to manage third parties successfully, recruit skilfully through agents in new environments, ensure that global quality assurance systems are in place and counter potential negative customer reactions.

Outsourcing trends in Europe over a three year period are shown below in figure 2. 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 costs.

Figure 2: Outsource rate growth by industry sector (Europe)



Corporate social responsibility.

Generally, corporate social responsibility is considered to be clearly distinguishable from the subject of corporate governance and business ethics. However, in the context of human capital interventions, the three are convergent. Human capital policymakers are increasingly influenced by the negative effect of adverse publicity on sensitive governance, ethical, and social issues which clearly impact upon the total employment brand image of the organisation, including its ability to attract and retain key talent. Inevitably, a higher level of shareholder scrutiny will demand higher levels of transparency in the majority of human capital actions. The drive for greater transparency, post Sarbanes-Oxley, will require policies, processes and procedures sufficiently robust to emerge unscathed from both internal and external audit, with the equity and fairness of management performance increasingly judged against a global backdrop. In such an environment, human capital policies and actions on diversity, work-life balance, reward, and talent will have a direct influence upon shareholder perceptions, their investment decisions and consequent organisational long term sustainability. There is clear evidence that this agenda is moving forward rapidly, and we are encountering numerous organisations reshaping their policies to respond to these emerging demands.

This has led Saratoga to devise a suite of metrics which indicate the definitive actions that organisations are taking to measure the real impact of their corporate social responsibility statements. A sample of these metrics is listed below in figure 3.

Figure 3

Total investment in social/environmental projects/profit before tax

Level in organisation of senior executive responsible for policy

Number of community hours per FTE

Workforce diversity

Lowest wage and highest wage

Hours worked per FTE

% of homeworkers per FTE

% of life aid benefits/total benefits

There is currently insufficient data to populate many of these metrics at this time; however, those that are becoming relatively robust are included in the context of the other trends detailed below.

Leadership.

In 2002 Saratoga launched the Leadership Index. This Index measures the effectiveness of leadership actions via the use of a limited number of metrics, covering business and organisational impact, follower behaviour, skill development, and corporate social responsibility actions. If the leadership is competitively effective, it is likely that all these metrics will be fully positive against other relevant organisations. To date, the literature of leadership has focussed hard upon the behaviours, characteristics, and traits of leaders. The work undertaken by Saratoga is one of the first serious attempts to look at the impact of effective collective leadership in any organisation.

The focus upon leadership as a critical ingredient of organisational success remains largely unchallenged. Investment in leadership training and development continues to be high, broadly estimated at €1.5 billion in 2003 across Europe. In the US, data is unavailable, although it is thought to run into billions of Dollars. Saratoga’s findings show little evidence that this investment is currently demonstrating any major return.

Figure 4 presents preliminary results obtained by Saratoga from a range of clients across Europe applying the Leadership Index. Eight metrics are used, and the results are spread over three quartiles – the 25th, the 50th and the 75th - indicating the range of results obtained from the organisations involved. By plotting their positioning, organisations are able to assess where they stand by quartile against other organisations in each metric. For example, taking the Human Capital ROI metric, organisations in the bottom 25% of performers, will be scoring 0.99 or less in whatever currency they use. The highlighted numbers indicate recommended positioning. Please note that figure 4 is for illustrative purposes only and organisations using the Index for serious analytical purposes should compare themselves only against relevant organisations, utilising Saratoga's standard definitions.

Figure 4

	Metrics	25th	50th	75th
Impacts	Human Capital ROI Wealth created per FTE (€)	0.99 -6,366	1.13 -803	**1.35** **2,638**
Behaviours	Resignation rate Remuneration/revenue	**3.1%** **12.9%**	6.2% 21.6%	12.7% 31.9%
Skills	Training hours per FTE Internal promotion rate	14.5 30%	23.9 50%	**34.4** **72%**
Corporate social responsibility	Gender diversity Community donations/ profit before tax	26.0% 0.5%	39.0% 1.1%	**54%** **3.0%**

Diversity.

Saratoga has been collecting workforce diversity data since 1999, finding in the early years that the UK public sector and specific US organisations provided the most comprehensive data banks of information. Since then the diversity agenda has become a live issue for most European businesses, with many devoting space in both their annual reports and accompanying corporate social responsibility reports. In mainland Europe the prime focus has been upon gender diversity, which therefore remains the source of the most readily available data.

Data taken from organisations in a cross section of sectors in Europe revealed:

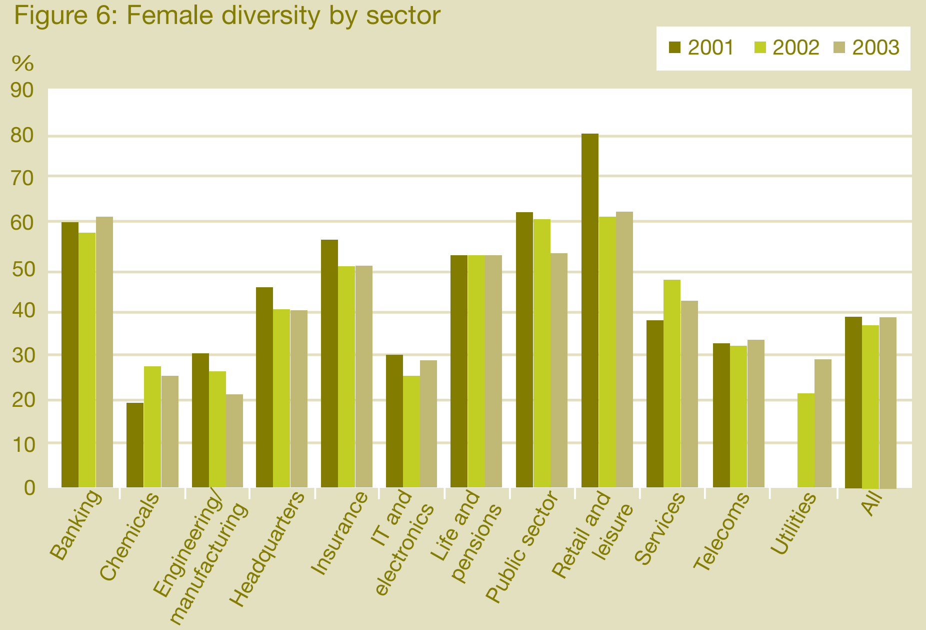
- the number of females in the total headcount remains relatively stable from 2001 onwards at approximately 39%;
- for managerial posts, females occupied 24.6% in 2003 a 1.9% reduction since 2001, and in professional posts, the 2003 figures have fallen to 29.3% from 33.6% in 2001;
- large variations occur across sectors; banking has 44% of females in managerial posts, with chemicals and utilities recording a relatively low 10% to 14% respectively.

The gender diversity reduction over the period in managerial and professional ranks may prove to be insignificant in the medium or long-term, and may well be a reflection of the high level of restructuring taking place both in Europe and the US from 2001-2003, when many specialist back office functions were severely rationalised. Certainly, all indications are that female diversity strength at senior organisational levels lies in functional specialisms and therefore their numerical presence will remain vulnerable whenever functional strengths are attacked. Saratoga in the US reported that 50% of their clients changed their organisational structure from 2000-2003.

More detailed illustrations of European movement are provided in figures 5 and 6.

Figure 5: Female diversity — management and professionals

Figure 6: Female diversity by sector



Talent management and learning.

Interest in talent management is increasing rapidly in the US and Europe, with consequences for other global markets. The end of the baby boom generation, ageing populations, the need to reinvent and innovate, and the requirement to replace muscle with brain, all have indicated for some time that attracting and retaining talent is becoming a competitive necessity.

Many organisations are now either refreshing their approach to talent management, or revising existing policies, systems, and processes to ensure they successfully use the talent they employ. Measuring the effectiveness of the management of talent has therefore gained momentum. In response, Saratoga has developed a limited number of metrics to enable organisations to begin to benchmark themselves against others on the key ingredients of a disciplined talent management system i.e. the identification, attraction, retention, development and usage of talent.

Some preliminary results of this work are displayed in figure 7 using ten metrics, which indicate recommended percentile positioning. The table represents results from 300 organisations across Europe for all sectors and suggests where you should attempt to position yourself against other organisations if you are managing your talent effectively. Thus we suggest, for example, that you should aim to be in the top 25th percentile (i.e. 1.35 or above) in the Human Capital ROI, the bottom 25th percentile for talent resignations, and the top 25th percentile for succession back up (i.e. 3 to 1).

Please note that, as previously stated, the table is for illustrative purposes only and for serious analytical purposes organisations are strongly advised to compare themselves against selected relevant organisations, utilising standard Saratoga definitions.

Figure 7

Metrics	25th	50th	75th
Human capital ROI	0.99	1.13	**1.35**
Graduate recruits % total workforce	0.10%	0.30%	**1.10%**
Acceptance rate	87.9%	93.6%	**97.5%**
Talent resignations	**3.0%**	4.2%	7.5%
Development actions	4	9	**17**
Internal promotions	30%	50%	**72%**
Capability index			
- identified top talent high performance	1%	2.50%	**5%**
- back up	0.7 to 1	1 to 1	**3 to 1**
- reactive ratio	0.3%	0.7%	**1.8%**
- high incentive ratio	2.6%	6.4%	**14.9%**

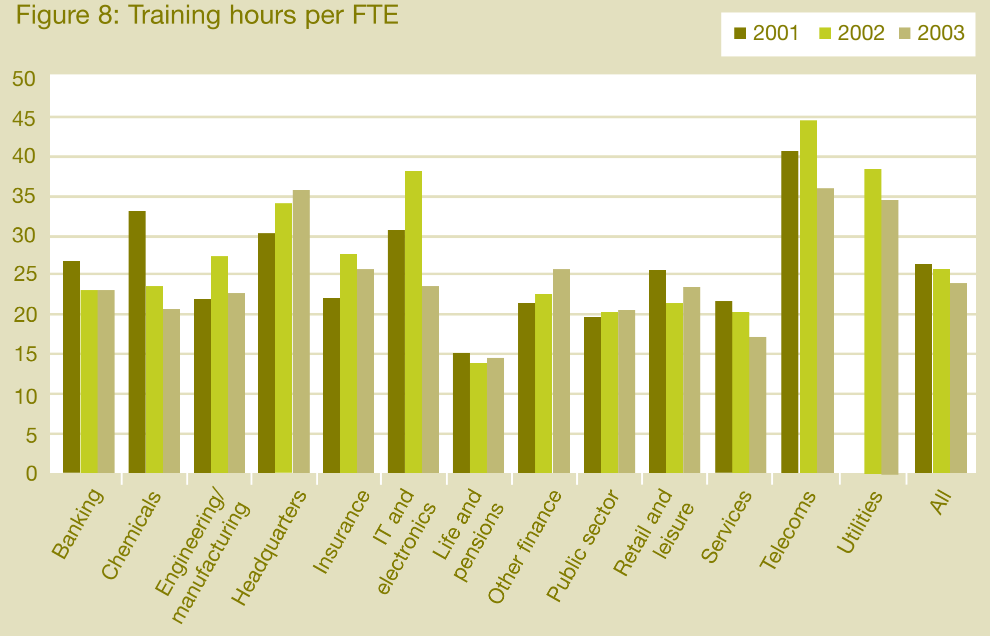
Talent management is closely related to investment in learning in most organisations and it is consistently found that organisations most advanced in the management of talent are foremost in learning, training and development initiatives.

In 2003, European organisations showing serious intent and falling in the top 25th percentile of those measuring their training investment, undertook an average of 34.4 hours of formal training per employee per annum, at an average cost of €2,048. These figures varied widely between sectors and no organisation was able to trace the amount or cost of its e-learning or work-sited training, although most organisations investing resource in such endeavours claim that it would add some 50% to the levels of training quoted.

Overall across Europe the level of formal training activity in 2003 appears to have reduced and has done so consistently since 2001, now standing at 23.9 hours in 2003, reducing from 25.8 in 2001. Unfortunately, despite the significant growth of interest in talent management, there are no indications that for the majority of organisations this interest has been transferred into action. This is a particularly concerning trend at a time when many businesses are claiming critical levels of skill shortages.

Figure 8 offers further guidance:

Figure 8: Training hours per FTE



Innovation.

Creating an innovative working environment has been seen as a critical factor for success and survival for some years. There are few organisations that would not regard innovation as a major challenge. Innovative workplaces require the 'capacity' to innovate which itself requires both an environment of shared experimentation and a supporting infrastructure - innovation rarely prospers without such capacity. Although only a limited number of organisations appear to combine these ingredients, the perceived need to do so is evidentially growing stronger, with real practical impact upon the way many organisations both structure and organise themselves.

Again in response to the increasing demand from clients to provide some guidance upon their competitive positioning in their innovation endeavours, Saratoga is developing a range of measures to address both elements of the innovation 'capacity' framework. Figure 9 shows the proposed metrics, for which Saratoga is currently researching data.

Figure 9

Supporting infrastructure	Shared experimentation
R&D costs/total costs	Full time project involvement
R&D costs/FTEs	Managerial/professional ratios
Number of new projects per FTE	Staff suggestion rate
Graduate intake/total intake	Staff suggestion success
Staff competence levels	Levels of commitment/engagement
Training hours per FTE	

Indications are that the metrics in figure 7 will provide valuable guidance on the level of innovative activity which is ongoing in any organisation. Such measures must then be set against other output and impact metrics.

Engagement and commitment.

Saratoga has developed an Engagement and Commitment Matrix, based on valuable work initially undertaken by Professor Stephen Ackroyd of Lancaster Business School. The matrix sets out to demonstrate, by the use of hard metrics, the existing level of engagement and commitment of an organisation's human capital. The matrix avoids simple linear measurement and instead evaluates engagement and commitment against four organisational dimensions; the time offered by people, the level and type of their outputs and reward bargains, their behaviour towards the employer's products and services and their identity with their employer. Using a series of metrics related to each dimension, it is possible to plot the observed level of engagement and commitment of employees not through their words and perceptions but through their actions. Using metric results, it is possible to assess whether an organisation has a fully engaged workforce, whether the workforce is just 'cooperating', whether it has declined to 'compliance', or whether in worst cases there is a level of 'withdrawal' or even 'hostility'. The matrix is shown below in figure 10.

Figure 10: Engagement and commitment matrix

	Time	Work	Product/service	Identity
Engagement and Commitment	Limitless	High output and flexibility	Innovation and improvement	Goal identity
Cooperation	Limited extension	Output plus	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	Terminations	Sabotage	Theft	Oppositional solidarity

The following European data indicates the type of information which can produce real behavioural indications of the level of engagement and commitment in any organisation. Thus the metrics produced under each organisational dimension in figure 11, provide examples of the type of data which will enable an organisation to plot its positioning.

Figure 11

	Metrics	25th	50th	75th
Time	Resignation rate	**3.1%**	6.2%	12.7%
	Absence rate	**2.9%**	3.9%	5.3%
	Remuneration/revenue	**12.9%**	21.6%	31.9%
Work	Performance related pay	2.1%	5.2%	**9.0%**
	Attendance related pay	**1.0%**	3.1%	5.6%
	Staff suggestion rate	10.1%	101.2%	**461.8%**
Product/service	Training hours per FTE	14.2	23.9	**35.5**
	Learning coverage	51.2%	67.1%	**91.2%**
	Development hours/FTE	3.7	7.9	**15.9**
Identity	Grievance rate	**1.1%**	2.6%	6.0%

From the research undertaken within Europe, the organisations which feature in the recommended quartile of high engagement and commitment performers tend to be dominated by global operators, many of them with American or Japanese parenthood, organisations with multinational coverage and organisations with a record of sustained commercial success. It is invariably found that these types of organisation invest considerably more resource in broadly entitled engagement and commitment programmes than others.

The HR function.

The size of the HR function in the US is increasing, with figures indicating a 3% growth in numbers since 2002, resulting in a ratio of 85 employees to every HR practitioner in 2003. Investment since 2000 in the HR function in the US has grown by some 22%. In Europe however, there has been insignificant change. In 2001, the ratio of FTE employees to FTE HR employees was 88:1 and in 2003 it rose slightly to 90:1. During this time, HR department costs in Europe per FTE have increased slightly from €1,107 in 2001 to €1,135 in 2003.

The Human Resource function in both the US and Europe faces major change demands. In an environment in which people are described as an organisation's major asset, it would be expected that the specialist function responsible for people policy, 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 significant 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 internal drive to create a business partnership with line executives, intended to create a more strategic overall contribution, has not demonstrated any consistent progress. In the US, more success does appear to be materialising.

Shared services.

In both the US and Europe, considerable HR functional effort has focussed upon the introduction of the Shared Services concept. The original objectives of the drive were to reduce costs, provide higher levels of consistent informational and advisory services to both employees and management, and enable the HR function to move to a higher level of business strategic contribution. To date in Europe, there is little evidence that these objectives are being realised. It is difficult to find evidence that outsourcing services or centralising work has reduced HR function costs significantly or impacted on the size of the HR function. Neither is there evidence that the introduction of Shared Services enables the remaining HR professionals to have greater business impact. Although perception measures of employee satisfaction with Shared Services is presently sketchy, there is certainly no evidence that satisfaction levels have improved. It is recognised that the ROI may take a longer period to emerge. However, there is mounting evidence that the introduction of any form of Shared Service in any function requires measured consideration and a recognition that offloading or outsourcing traditional roles does not automatically catapult those functions into higher levels of influence in any organisation or have a major effect on the cost of operation.

Tables providing greater detail upon the above trends are below in figures 12 to 14.

Figure 12: FTEs per HR dept FTEs (X:1)

Country	2001	Median 2002	2003	% change 2001-2003
UK	92.0	105.0	95.0	3.3
C&E Europe	91.0	99.0	95.0	4.7
Western Europe	85.0	95.0	92.3	8.3
All	88.0	96.0	90.0	2.3

Figure 13: HR dept costs per FTE (€)

Country	2001	Median 2002	2003	% change 2001-2003
UK	1,096	1,275	1,258	14.8
C&E Europe	348	383	382	9.6
Western Europe	1,190	1,213	1,181	-0.7
All	1,107	1,116	1,135	2.5

Figure 14: HR managers and professionals (%)

Country	2001	Median 2002	2003	% change 2001-2003
UK	57.3	59.8	58.0	1.3
C&E Europe	54.6	53.0	60.0	10.0
Western Europe	57.5	61.8	62.1	8.0
All	57.1	60.0	62.1	8.8



Driving human capital forward

We anticipate and hope that many of our trend interpretations will lead to discussion and argument, so for those who have detected other trends as a result of reading this paper, please do contact us as we believe that discussion leads to breakthrough. Saratoga is searching for new breakthroughs in human capital thinking, since much of the people thinking in organisations in recent years has become somewhat traditional, relying more upon the newest idea of the latest guru, than upon anything that will bring real value to an organisation and its people.

If there is a consensus that the trends outlined above have any foundation, then we believe that the following are the implications for human capital practitioners in the immediate future:

- 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. The Accounting for People Report in the UK, the Nouvelles Regulations in France, the European Multi-Stakeholder Forum work and the pressures arising from Sarbanes-Oxley in the US, all provide strong indications that human capital reporting and measurement will be a standard requirement within years. HR practitioners must ensure that they are ready to respond, with systems and thinking in place.
- Human capital requires a strong internal guardian which ensures that its cost never exceeds its value and that the margin is the best in the business.
- Competitive advantage is likely to rely increasingly upon human capital contribution and success will depend upon high engagement, low cost, and competitive return. The global offshoring movements will intensify, forcing organisations to demand higher performance returns from workforces in existing locations.
- Productivity which measures how much output is obtained per hour of work, requires a very disciplined control over the hours of work, the cost of those hours and the numbers of people employed to produce the outputs. HR practitioners in Europe have to date seemingly failed to control number expansion in the good times – with obvious negative consequences in the bad times. It is critical that organisations learn from their past mistakes.
- Corporate social responsibility actions will move from largely a public relations exercise to an organisational reality, requiring organisations to recognise the negative impact on shareholders of unacceptable ethical behaviour and the competitive advantage of a positive socially responsible image. HR practitioners need to be influential enough to ensure that policies are in place which provide practical demonstration of an organisation's social responsibility, without reducing productive effort.

- Diversity will become an intensified issue and HR practitioners will increasingly face the need to ensure that the best person for the job is always selected. This will require HR practitioners to have both organisational influence and strength of purpose.
- Leadership development investment is and will continue to be high in the majority of organisations. However, there is no evidence that the quality of leadership is improving. New thinking is required to ensure that such investment produces acceptable shareholder and social return against the investment being made year on year.
- Successful talent management will require performance/potential systems which produce the information to facilitate the identification, development and utilisation of talent. Saratoga finds little evidence that such systems exist and again HR practitioners need to think afresh.
- The HR function is facing a major change challenge. In Europe, it is in danger of becoming at best a peripheral activity. It therefore needs to re-evaluate its role rapidly, become less influenced by organisational gurus, and more influenced by what a business needs from a professional function to promote the highest achievable level of contribution from its people.

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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