State of the workforce

Results from PwC Saratoga’s 2013/2014 US Human Capital Effectiveness Report
### Summary

As the US economy recovers from recession, organizations are experiencing several positive outcomes. For example, employee productivity has increased for the first time in five years, and hiring is trending upward.

These successes, however, put pressure on organizations. The employment uptick brings higher turnover rates, leaving HR departments to address retention and hiring quality challenges. While organizations consider strategies to engage and retain their high performers and pivotal employees, traditional rewards, compensation, and benefits packages are shrinking in real terms. Increased turnover also requires organizations to boost hiring, which often reveals process weaknesses in recruiting and onboarding.

This whitepaper summarizes results from PwC Saratoga’s 2013/2014 US Human Capital Effectiveness Report, combining analysis with objective data from more than 300 organizations. We offer observations that may help organizations understand the dynamics at play in the labor market today.

Although financial results are improving, looming vulnerabilities, if not addressed, will erode that performance. We see indications that employers are making investments to mitigate these pressures.

### Evidence of these labor trends includes:

#### #1 Employee productivity has risen for the first time since the recession

While labor costs stabilized during 2012, overall productivity of the US workforce increased for the first time in five years. However, potential workforce vulnerabilities could halt productivity gains.

#### #2 Key employee retention is fast becoming a major challenge for organizations

While voluntary turnover increased during 2012 at a faster rate than anticipated, high-performer and high-potential separation rates climbed even more rapidly. Increased turnover of high performers and high-potential employees threatens to place additional strains on employee rewards, hiring quality, and HR costs.

#### #3 Healthcare costs have continued to rise and erode the value of other benefits provided to employees

While overall benefit costs shrank for two consecutive years, healthcare costs continued to increase by as much as 7% in 2012. To control total rewards costs for employees, US organizations appear to be reducing their investment in non-healthcare benefits. Although such actions reduce immediate costs, they potentially erode the employee value proposition and further affect the voluntary turnover rate.
Although organizations had seen sustained improvements in their selection and onboarding processes since 2007, increased turnover and higher external recruitment rates during 2012 indicated declines in hiring quality for the first time in five years. With increased voluntary turnover, organizations faced growing pressure to hire quickly, resulting in greater numbers of poor hires. The lower contributions of these poor hires will likely negatively affect future employee productivity metrics.

US organizations are effectively using their diversity programs not only to source talent and deepen the pool of prospective candidates, but also to develop greater ability to tap into global resources. Increases in ethnically diverse representation are especially noteworthy at the management and executive levels.

To address high-performer turnover, poor hiring quality, and rising workforce costs, HR organizations in the US are investing in higher-value functions and programs, such as talent management, leadership, workforce planning, and advanced workforce analytics. These advancements represent net additions to the HR budget but help drive greater returns on workforce investment.
PwC Saratoga’s 2013/2014 US Human Capital Effectiveness Report contains more than 200 unique metrics covering a wide array of topics, including:

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

The report includes 2012 data from more than 300 organizations representing 12 industry sectors. The average company in the report has annual revenue of $5.3 billion and 19,300 employees. While many participating organizations are global companies, results included in the report refer only to US operations. PwC Saratoga produces separate global, European, Canadian, Latin American, and Asian human capital effectiveness reports.

The results described in this white paper represent all-industry medians. Individual demographic groups, especially industry groups, can produce substantially different results than the all-industry median. We recommend that organizations analyze results not in the aggregate, but by factors such as industry, company size, and revenue growth. For example, the median voluntary turnover rate for the professional services industry was 14.5%, compared with 4.9% for the utilities industry.

The full PwC Saratoga study contains more than 16,600 additional benchmark results based on more than 30 demographic segments.

This year’s report also includes results from a new talent maturity assessment, gathering data related to HR and talent management practices. Participants were invited to submit responses to a variety of qualitative questions covering business operations, HR structure and technology, change management, and talent processes. Aggregate results are available as part of the full study.

To learn more about PwC Saratoga’s benchmark databases and measurement programs, please visit our website at [www.pwc.com/saratoga](http://www.pwc.com/saratoga) or contact Nik Shah at (703) 918 1208, Scott Pollak at (408) 817 7446, or Ranjan Dutta at (703) 918 3009.
Employee productivity rises for the first time since the recession

Productivity indicators moved in a positive direction during 2012, with revenue per FTE increasing from $338,773 to $370,399.

Although this measure differed across sectors, the increasing trend was fairly consistent across industries included in the study. The trend represented a rise to prerecession levels (though full impact of the recession was not evident until 2009).

With increased revenue per FTE, labor costs as a percentage of revenue also stabilized, coming back to historical norms. Revenue per FTE usually indicates current state but is not a guarantee of future performance.
Voluntary turnover rises faster than anticipated, to an even greater extent for higher performers

Though seemingly positive, improvement in productivity might become an albatross for HR departments. Increased productivity gives employers a reason to remain optimistic, but other workforce indicators suggest vulnerabilities that will likely manifest during the next few years.

One such indicator, voluntary turnover, has continued to rise at a fast rate during the last two years—from 7% in 2010 to 8.4% in 2012. The voluntary turnover rate has already exceeded our prediction from 2010; we expected an increase to 8.1% in 2012, but actual numbers were higher.

This trend suggests that 2013 voluntary turnover could exceed our original estimate of 8.7%. As market conditions improve, increasing turnover will place greater strains on the workforce, which could potentially negatively affect employee productivity.

The situation becomes even more significant when we compare overall voluntary turnover patterns to trends in separation rates of high performers and high-potential employees, who are critical to the success of the organization.

High performers represent the top 20% of the organization within the performance management system, and high potentials are those individuals identified by the organization as having leadership potential and in line to move to more senior roles.

The high-performer separation rate increased from 4.4% to 5.0% during 2012—a 13.6% rise. Compared with the 5% increase in overall voluntary turnover, this rate is almost three times higher. We see a similar pattern for high-potential employees, with voluntary separation climbing from 2.4% to 2.8%, a 16.7% increase for this group from 2011 to 2012.

High performers and high potentials will be critical populations to engage and retain, especially as the economy recovers and talented employees are most in demand within the marketplace.

With increased voluntary turnover, we also see higher hiring demand, leaving HR departments struggling to keep up with quality recruiting and onboarding. Contributing to this struggle, we see compensation and benefits packages decreasing in real terms.
As organizations face retention challenges, tracking and improving engagement levels, especially among high performers and pivotal employees, will be extremely important in coming years. Our analysis shows that most organizations embrace the idea of employee engagement, with 86% measuring it in some way. However, remarkably fewer organizations take steps to create accountability for taking action as a result of their engagement surveys. The majority—59.8%—say they don’t require managers to develop a plan for employee engagement.

Our research and extensive experience in helping organizations assess and improve employee engagement show that increased engagement can have numerous positive business results, including improvements to retention, customer service and loyalty, revenue, profits, and safety. However, if organizational leaders don’t actively work to address issues uncovered on engagement surveys, these benefits can’t be realized.

Importantly, senior leadership and HR shouldn’t forget about engagement after an employee survey ends. They should drive the planning process throughout the organization by holding business leaders accountable for implementing positive change. We recommend a structured method that incorporates several stages:

- Cascade communications of results to managers and employees
- Develop an enterprise plan to preserve strengths and improve priority areas
- Develop individualized local plans, especially at sites with low engagement
- Approve plan timelines
- Establish ownership and create accountability for follow-through
- Implement plans and monitor progress
- Regularly communicate updates to employees
- Conduct a follow-up survey to measure improvements

Measuring employee engagement creates an expectation that leadership will act upon the feedback. To avoid potential repercussions from a lack of employer response, organizations must coordinate resources to develop and implement a post-survey course of action.

**Figure 4: Measuring employee engagement**

<table>
<thead>
<tr>
<th>Does your organization measure employee engagement?</th>
<th>Are directors/managers required to develop an action plan for engagement of employees who report to them?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes 86.0%</td>
<td>Yes 40.2%</td>
</tr>
<tr>
<td>No 14.0%</td>
<td>No 59.8%</td>
</tr>
</tbody>
</table>
Healthcare costs have continued to rise in an uncertain environment

Companies have been able to keep compensation and benefit costs down to improve their return on workforce investment. However, this tactic will pose a challenge as organizations struggle to retain employees in a competitive market.

Compensation per FTE decreased 2% during 2012 after reaching an all-time high in 2011. Last year marked the first time it stopped growing since 2005.

Several factors could account for this trend. One is salary level, perhaps indicating how competitively organizations pay employees. This data point could also reflect workforce structure: organizations choosing to staff more lower-level rather than higher-level employees.

Similarly to compensation, benefits per employee dropped from $18,364 to $17,176 in 2012. As organizations look to reduce labor costs, they most likely will need to strike a balance between growing turnover rates and an increasingly competitive marketplace.

Employees who sense a degraded value proposition will become more dissatisfied and more likely to leave for another opportunity. Because replacements typically require higher pay, organizations should consider increasing efforts to engage and retain their employees, thereby curtailing costs associated with turnover, hiring, and onboarding.

The only components of labor costs that continued to grow in 2012 were healthcare related, with costs rising from $8,767 to $9,350 per active participant. As the cost of delivering healthcare climbs, organizations appear to be offsetting these expenditures by reducing other benefits (suggested by overall benefits per employee, a measure that has decreased).

Given the uncertain nature of the healthcare environment as the Affordable Care Act (ACA) becomes fully implemented, the future of employer-provided healthcare benefits isn’t clear. Similar to controlling pay levels, organizations will need to monitor their employee value propositions and the perceptions that individuals have about changing total rewards packages.

*PwC Saratoga’s definition of labor costs includes base, overtime, cash bonuses, payments for time not worked, severance pay, healthcare costs, retirement and savings plan payments, Social Security, Medicare, unemployment taxes, workers’ compensation premiums, and life insurance premiums.
The renewed emphasis on performance-based pay, which varies payouts (and company expense) based on performance, is helping companies manage costs in line with profits. During the recession, increased use of performance-based pay helped companies manage costs. Yet, as companies adjusted performance expectations so that employees would see some form of payout, compensation expense rose at an accelerated rate when the economy and company profitability improved. To stabilize compensation costs, companies have begun to raise expectations and more closely align them with profits, resulting in the first year-to-year decrease in overall compensation spend in eight years. Organizations are hoping that enhancing the alignment between company performance and payouts will energize high-performing employees, helping to improve the quality of their workforce and further boosting performance and profits.

In 2012, healthcare spending per employee increased by 6.6%. But the abatement we saw in healthcare trend during the past few years continued in 2012. This was partially related to the recession but more directly to greater cost-sharing in health plans, which led to lower utilization of medical services, as well as substitution of lower-cost services (e.g., generics rather than brand-name drugs).

To make their employees partners in the battle to control healthcare costs and to encourage them to be healthier, companies are bringing consumerism strategies mainstream. For example, many employers are replacing traditional plans with health savings account-compatible, high-deductible plans. They are doubling down on such strategies to help offset additional costs arising from ACA mandates and to position themselves to avoid or defer the ACA’s 40% “Cadillac plan” excise tax scheduled for 2018 and beyond.
Hiring process quality falls for the first time in five years

As market conditions improve, organizations are looking to hire more people, but increasing turnover is adding more strain to the process. Demand for new hires is rising as departing and retiring employees leave more holes to fill. Recruiters must move more quickly than they have over the past few years and expand talent sources.

The 2012 external recruitment rate increased from 11.5% to 12.9%, reflecting hiring and growth trends. Organizations appear to be filling more positions with outside candidates versus using internal talent, which is helping them keep up with turnover while potentially expanding their headcount. Companies may be trying to meet new revenue growth objectives with the upturn of the economy and increasingly looking to external recruits to help them do this.

Rising external recruitment appears to be placing a burden on the hiring process, evident in a decrease in quality of hire. A good post hoc indicator of quality of hire is turnover during the first year of service. An employee’s leaving within the first year either voluntarily or involuntarily typically signifies poor fit. First year of service turnover increased to 22.6% in 2012 from its historical low of 21.5%. Although it is a small increase, this reversal of trend may actually indicate breakdowns in hiring and onboarding processes now becoming more apparent as hiring is going up.

As organizations continue to evolve the skills and talents they need, hiring quality may suffer if requirements are not adequately understood or communicated. An influx of new hires also puts pressure on assimilation and learning, creating a greater need for extended onboarding programs.
As quality-of-hire measures decline, organizations might need to focus on hiring processes and onboarding programs to improve new-hire success. These efforts should have major business impacts, helping to sustain high productivity levels and lower turnover costs.

First year of service turnover rates show that nearly one in four employees leaves voluntarily or involuntarily within the first year of tenure. Measuring and enhancing the new-hire experience can help mitigate some of this turnover by:

- Improving employee assimilation within the first months of tenure
- Accelerating the time to full productivity
- Setting the stage for high employee engagement

Despite these benefits, our study reveals that half of organizations’ onboarding programs last one week or less. Although this is an improvement from the one-day orientation program, much more can and perhaps should be done. Our work shows that high-performing organizations facilitate employee integration throughout the first year with such initiatives as:

- Mentor assignments
- Networking opportunities
- Recognition programs
- Formal goal-setting and career development discussions
- Training courses

To gain the most benefit from these programs, evaluation and continual improvement are essential. Our experience in building onboarding and engagement assessment programs shows that logistic and integration processes influence the new-hire experience. It is important to examine both. We recommend running two assessments, one shortly into an employee’s tenure (e.g., one month following the start date), and another once the employee has settled into the role (e.g., six months later).

Songs and drivers of engagement—and adjusting onboarding programs appropriately—will help HR effectively spur productivity and retention in new hires, a critical factor as the workforce faces vulnerability in coming years.

The duration of the onboarding program, as well as multiple assessments of its efficacy, is critical to assimilating new hires into the organization. Unfortunately, based on our 2012 results, nearly 60% of organizations have only transactional onboarding programs that last one month or less.
Diversity programs are helping to ease the strain of higher turnover

Our survey indicates that the percentage of ethnically diverse leaders is rising after a dip last year: Ethnically diverse management headcount rose to 15.1%, and ethnically diverse executive headcount increased to 10.5%.

The percentage of female leaders also is moving upward. Female management headcount grew to 35.2%, and female executive headcount rose to 25.4%.

This upward movement suggests that organizations are attempting to ease the strain from increased turnover by creating more effective diversity programs to expand and deepen the talent pool. Organizations are viewing diversity less as a compliance requirement and more as a tactical way to effectively broaden their talent base. Companies are also tapping into global resources to increase efficiency.
Investment in HR has continued to increase, rising by almost 20% per person in 2012

HR costs per employee increased from $1,610 during 2011 to $1,923 during 2012. Companies are investing more in HR and directing those dollars toward high-value functions and programs to help engagement and retention. Functions such as talent management, leadership, workforce planning, and workforce intelligence are gaining attention at organizations that want to become more strategic in their HR practices.

Furthermore, many organizations are restructuring their HR departments to deliver services more strategically, with transactional activities sitting in a shared-services center and higher-level HR activities in centers of excellence. Of the organizations in our study, 61% said that their HR department went through a reorganization or redesign during the past two years.

While a shared-services model will save money on administrative costs, costs typically spike to accommodate the set-up, and for many the savings are reinvested in talent programs.
Amid several positive indications that the US economy is recovering from the effects of the recession, employee productivity and return on workforce investments are improving for the first time in several years. Organizations are reaping monetary benefits in the form of increased revenue; however, trends in retention, hiring quality, employee rewards, and healthcare costs suggest that improved productivity may be only a short-term benefit of economic recovery. Our study of the state of the workforce indicates that HR organizations should prepare for several potential vulnerabilities over the next few years.

Voluntary separation rates are increasing at a faster rate than anticipated, indicating that employees are seeing more job opportunities within the marketplace. This trend is especially pronounced among critical populations, such as high performers and high potentials. Turnover for these groups increased substantially in 2012. With more job movement, these individuals become even more valuable, and organizations will have to compete to attract and retain this key talent.

Employee rewards will be an important factor in competing for these employees. However, organizations are facing challenges in this area, with healthcare costs increasing. With increased costs for the employer, many organizations appear to be dealing with the issue by decreasing cost for other benefits. While these strategies may be cost-efficient in the short term, they could have longer-term negative implications if employees feel that such actions diminish the overall employee value proposition.

To sustain increased productivity levels, organizations also will need to address hiring quality. While improvements have been made over the past several years, increasing first-year turnover levels indicate that hiring quality is once again declining. Concern among HR organizations will grow as turnover continues to rise and recruiters work to replace employees exiting at a faster rate. Furthermore, organizations should pay attention to their onboarding processes to identify poor-quality hires early on and help high-quality hires ramp up to full productivity more quickly.

Organizations are tapping diverse talent pools to help ease some of the strains that increased turnover presents. Management and executives are becoming increasingly ethnically diverse. As organizations use their diversity programs to deepen their talent pool, they also gain the benefit of drawing on more global resources.

Our analysis reveals that organizations are also staffing their HR functions more strategically to meet these challenges.

HR investment per employee increased significantly during 2012 and focused on high-value functions and programs. Talent management, leadership, workforce planning, and workforce intelligence received a large piece of the HR budget. These high-value investments will be important to sustain as organizations brace for additional human capital challenges. Employee engagement, retention, and rewards programs will be necessary to maintain recent productivity gains.

Positive signs of economic recovery look encouraging for employers, but they should be aware of the possibility of looming problems with talent—especially critical talent—as high performers may increasingly find new job opportunities. Organizations are counteracting this issue by investing in more high-value HR functions and programs and using diverse resources; however, decreasing hiring quality and increasing costs continue to strain employers.

To sustain recent productivity improvement, HR will need to focus on engagement efforts and bolster employee value propositions.
About PwC’s Human Resource Services (HRS)

As a leading provider of HR consulting services, PwC's Human Resource Services’ global network of 6,000 HR practitioners in more than 150 countries, brings together a broad range of professionals working in the human resource arena — retirement, health and welfare, total compensation, HR strategy and operations, regulatory compliance, workforce planning, talent management, and global mobility — affording our clients a tremendous breadth and depth of expertise, both locally and globally to effectively address the issues they face.

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

PwC's Human Resource Services practice can assist you in improving your performance across all aspects of the HR and human capital spectrum through technical excellence, thought leadership, and innovation around five core critical HR issues: reward effectiveness and efficiency; risk management, regulatory and compliance; HR and workforce effectiveness; transaction effectiveness; and global mobility.
About PwC Saratoga

As part of our Human Resource Services practice, PwC Saratoga supports organizations to maximize workforce engagement, productivity, leadership, and retention. We provide services to harness the power of workforce data—metrics, surveys, forecasting, and predictive analytics—to improve your organization’s return on workforce investment. We help build and align your workforce analytic programs. We assist organizations in answering key business questions:

• Do we have the necessary workforce to achieve our goals successfully?
• Are we hiring quality talent and can we predict the best sources of hire?
• Are we developing our existing pipeline for future talent needs and engaging that talent?
• Is employee engagement driving financial and operational outcomes?
• Are we losing top performers? How do we better anticipate or predict turnover? What changes can we make to retain and engage top performers?

PwC Saratoga delivers various services to help leaders make better workforce decisions that drive business performance. Offerings include:

• Metrics/benchmarking
• Executive dashboards
• Workforce surveys
• Workforce planning
• Predictive analytics
• Workforce intelligence center of excellence development
• Saratoga Academy training courses
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