HR Quarterly

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A quarterly journal published by PwC South Africa, providing informed commentary on local and international developments in the Reward arena.

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People strategy for the digital age

***Today's new dynamic environment requires original decisions that have never been made before.* Alexey Repik, Chairman of the Board, R-Pharm Russia**

Just as the industrial revolution did a century and a half ago, the digital revolution is reshaping the way we live our lives and the way we work; it's also forcing a fundamental transformation of business – changing the relationship with customers, bringing new entrants and their disruptive technologies, driving new channels, products and services, breaking down the walls between industries and, in many cases, forcing a basic rethink of the business model.

The speed of change makes it almost impossible to predict the future with any degree of certainty. In such a climate, organisations need a credible and forward-looking leader; a role that has never been more critical. CEOs need to understand how technology can improve their business and the customer experience, and plan for things that seem a distant dream. Denise Ramos, CEO of ITT Corporation, puts it like this: "You have to create multiple futures and multiple options for your company, because you don't know how the world is going to look like three to five years from now."

One of the biggest headaches for CEOs is making sure that the organisation has the right people to cope with what lies ahead. There's the basic question of planning for the skills that are needed now and in the future: Which roles will be automated? What new roles will be needed to manage and run emerging technology? What skills should the company be looking for, and training their people for? Where will we find the people we need?

But more importantly, CEOs need to be sure that the business is fit to react quickly to whatever the future may throw at it – and that means filling it with adaptable, creative people, working in a culture where energy fizzes and ideas spark into life. If they can't be found, they must be created. Whatever technological innovations are ahead, it's the people that will make the difference between eventual success and failure. That's why CEOs need a people strategy for the digital age. Consider for example, the change in the workforce and the number of millennials who are striving for work-life balance.

The fact that CEOs worry about where they will find the talent and skills they need isn't new; but over the past three years the issue has developed from a nagging worry to a crisis-level priority. 50% said they expect to increase headcount this year and just one in five expect to cut back on staff. CEOs based in the fastest-growing regions and countries were far more likely to have plans to increase headcount: 67% of those in the ASEAN region, 70% in Mexico and 73% in India said they planned to expand their workforce.

CEOs need people but are increasingly worried about where, and even whether, they'll find the types of talented people they need. The availability of skills is now the second biggest concern for business leaders, cited by 73% of all CEOs and rising to 84% in the UK, 90% in China and 93% in South Africa and Japan. Are you ready for the digital age? If not now is the time to devise your people strategy.

This is a time for bold decisions; a 'business as usual' people strategy won't serve any organisation well. We've already seen that those leading the way in the digital world are companies that are rewriting the rulebook, nowhere more so than in the way they find, manage, organise and reward their people.

The PwC Reward team

Is executive pay coming down?

For the proof that the world can change in unexpected ways, those concerned about executive pay need to look no further than a 1976 Harvard Business Review article entitled The 'devaluation' of the American executive.

In this lament for the plight of the corporate CEO, David Kraus observes that 'the worth of the American executive, as measured by his pay, has declined in both relative and absolute terms over the past decade', with consequences for executive motivation and the ability to attract executives to take the top jobs in corporations. He goes on to assert that 'compensation compression and relative decline in executive pay are probably here to stay[1]'.

These sentiments might seem bizarre today. Executive pay in the UK has doubled since the millennium in real terms, while average earnings have increased by only 10%. But equally in 1976, would anyone have thought that within a decade the great executive pay inflation would be underway?

Starting with the Greenbury report of 1995, the last two decades have seen a slew of governance reports, best practice guidance and regulations on executive pay for UK companies. Equally in South Africa the emphasis on governance relating to executive pay has increased significantly. Recent legislation build on the advisory vote introduced in the UK in 2003: from 2014, UK listed companies will have to put their executive pay proposals to a binding shareholder vote and report on pay policy and outcomes in a much more transparent way. This will arguably give the UK the toughest and most transparent executive pay regime in the world. At the same time there's a new brand of activist on the rise in South Africa, but they aren't fighting for human or environmental rights. They're investors and profit-seekers, and they are making it their mission to ensure that companies are creating the greatest possible returns for their clients.

This movement of so-called "shareholder activism" is growing in South Africa. Concerns over mismanagement and governance are sparking new interest in executive pay and in a number of cases this has seen shareholders voting against proposed pay packages and bonuses for executives. In most cases the company's performance in the current economic climate forms the basis for the "no vote". It is evident that shareholders can, and do hold opinions and they are entitled to a voice. Five or ten years ago this would rarely have been the case and it is an indication that investors are actually scrutinising company results quite carefully.

With stock markets recovering strongly over the last couple of years, rising share prices will inevitably lead to increases. Will these be single figure increases as strongly favoured by new disclosure rules? There will be plenty of opportunity for those who wish to do so, to make the case that executive pay continues to be spiralling out of control and that more must be done to manage the phenomenon.

So is executive pay going to decline in real terms? A comparison between executive guaranteed pay between 2008 and 2015 extracted from the REMchannel® survey indicates that the median guaranteed pay has increased with 51%. Considering that this spans a period of 7 years executive pay has increased on average with 7% per annum. With shareholder activism and regulatory requirements we will continue to report on the impact on executive pay.

[1] Kraus, D, 1976, The 'devaluation' of the American executive, Harvard Business Review

Making the case for wellness

In our experience, South African organisations are increasingly taking a more strategic approach to wellness, recognising wide-ranging impacts that it can have on the business. However, many organisations still find developing a robust, evidence-based business case for investment challenging.

Motivations for investing in wellness

Although the objectives of wellness initiatives vary, from improving engagement and the employee value proposition to achieving a wider social objective, most companies at least aim to reduce costs and/or improve productivity through investing in wellness. Increasing healthcare costs are a significant issue.

During our 2014 survey of medical scheme principal officers, almost all respondents stated that increasing costs related to chronic conditions was one of their three biggest concerns in the industry. However, the costs to employers of ill-health and wellness issues can be much higher than just the direct costs of healthcare provision, such as medical scheme benefits. For example, PwC research found that productivity losses associated with workers who have chronic diseases are as much as 400% more than the costs of treating the chronic diseases (PwC, 2014a). Other examples include:

- **Absenteeism**

A PwC study conducted in Australia found that unhealthy workers take nine times more sick days than healthy workers (PwC, 2010). In the UK, we conducted a review of case studies that covered multiple industries and more than 50 organisations and found positive returns on investment in organisations where wellness programmes were implemented to target factors such as medical costs, absenteeism and presenteeism. Eighty percent of the organisations reviewed noted a decrease in days lost through sickness, with an average decrease of approximately 30-40% (PwC, 2008).

- **Reduced engagement and productivity**

Numerous links between employee engagement and well-being have been identified, and both impact individual and organisational performance (Engage for Success, 2014c). We view well-being to be a key

component of engagement and vital for ensuring sustained engagement. However, an organisation's efforts to engage can also influence the well-being of its employees.

Productivity in turn can be impacted by all aspects of well-being, including physical health, emotional and psychological well-being and personal financial health. The study performed in Australia showed that on average six working days are lost per employee per year due to presenteeism (Medibank, 2008). In Canada, a study investigated the link between an employee's emotional well-being and their work productivity and found that a 20% reduction in a person's well-being led to a 10% drop in their performance. Conversely, a 20% improvement in morale led to a reduction in absenteeism, employee turnover rate and worker compensation (Wright, 2002).

Financial issues can increase stress levels and result in employees being distracted at work. Both will impact engagement, well-being, absenteeism and productivity. In 2014 in the US, we found that 39% of employees in a nationwide survey spent three or more hours per week considering or dealing with personal financial issues and nearly a quarter stated that such issues had been a distraction at work (PwC, 2014b). Financial wellness can therefore impact both employees and their employers.

Employers often have access to more health-related data than they realise and/or are not making best use of the data to build a comprehensive picture of their health-related costs and needs, for example, by integrating the many different sources of internal and service provider data.

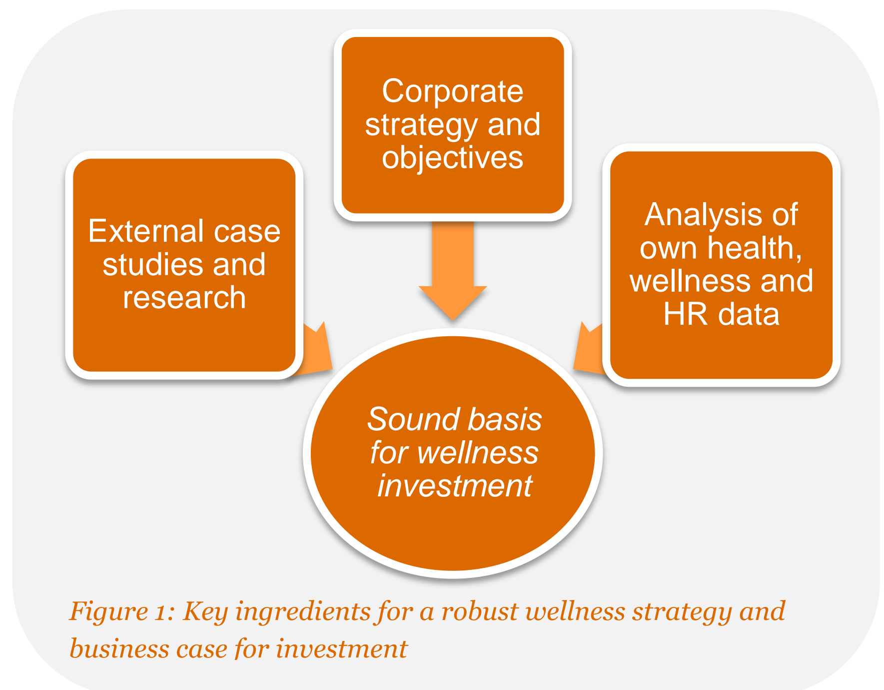

Figure 1: Key ingredients for a robust wellness strategy and business case for investment

In the UK study, eight organisations reported improvements in productivity and a further four increased competitiveness and profitability due to wellness initiatives (PwC, 2008).

- **Staff turnover**

Global research by the World Economic Forum found organisations that do not promote wellness are four times more likely to lose talented staff over the following year (World Economic Forum, 2010) and close to a third of UK organisations in the case study review found a reduction in staff turnover rates, with an average of approximately 20-25% due to wellness initiatives. Over 25% of organisations in the latter study found a positive increase in employees' opinions of the organisation as a result of the wellness programme interventions and participation (PwC, 2008).

- **Accidents and injuries**

The PwC UK case study review found that close to 30% of the organisations reviewed reported a reduction in accidents and injuries as a result of worksite wellness initiatives, with an average reduction of around 50% (PwC, 2008).

Applying the evidence to develop a stronger business case

Given that every organisation is unique in terms of its purpose, strategy, activities, workforce demographics, locations and environments, it is important to first understand its unique health and wellness profile and risks and then to develop a wellness strategy which is consistent with the overall strategy of the organisation and the needs of its employees.

Employers often have access to more health-related data than they realise and/or are not making best use of the data to build a comprehensive picture of their health-related costs and needs, for example, by integrating the many different sources of internal and service provider data.

A thorough analysis of internal HR and service provider data, together with external information, can be used in actuarial modelling to confirm key issues and estimate the potential impact of interventions: an expected return on investment (ROI) where cost reduction is the main objective or value of investment (VOI) where there are wider objectives. It can also be used in setting outcomes-based targets and for ongoing monitoring of outcomes to ensure that interventions are effective and provide the best value for money.

For more information please contact Carolyn Clark at carolyn.clark@za.pwc.com

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Are your short term incentives aligned to market?

The complexity of short term incentives continues to grow exponentially with the structure needing much explanation detailing the drivers and their respective weightings as well as the associated thresholds, targets and stretch levels. The unstable economic environment further complicates matters as it becomes increasingly difficult to meet these targets and guarantee pay-outs as a key performance driver.

Over the past few years the creation of wealth and the wage gap in South Africa has been a focal point, in fact it can be said that globally fixed and variable remuneration, specifically for executives has been under constant scrutiny.

When providing employees with incentives, equity or other incentive awards, companies often establish provisions that allow them to recoup all or a portion of the award under certain circumstances. These provisions are referred to as clawbacks or otherwise described as compensation repayment or recoupment policies and are described by most public companies in their annual proxy statement.

During 2014 PwC conducted research pertaining to proxy disclosures relating to this practice for executive remuneration.

Clawbacks are nothing new – companies often adopt clawback provisions voluntarily to encourage or deter certain actions or behaviours. These provisions may also be included to comply with various laws and regulations. The Sarbanes-Oxley Act of 2002 requires public companies to claw back CEO and CFO awards earned in the one-year period prior to a financial restatement as a result of their misconduct. The more stringent requirements for companies receiving assistance under the Troubled

Are your short term incentives aligned to market? (cont)

Asset Relief Programme of 2008 (TARP) expanded the clawback requirements to the top twenty most highly paid executives and eliminated the need to provide misconduct by the executive. Dodd-Frank will significantly expand repayment provisions by requiring clawbacks from all executive officers (current or former) of any erroneously awarded compensation in a three year period prior to a restatement, without consideration of their misconduct.

The SEC is charged with writing the clawback rules mandated by Dodd-Frank, an initially announced an expected rulemaking timeframe of mid-2011. Though many expected a proposed rule sometime in 2014, the timing remains unclear. Without final rulemaking, questions such as the ones below will continue to be asked:

- Will a clawback be required if financial results contained an error, but a restatement was not required?
- Will the clawback apply if the incentive compensation was not based on financial results but rather on operational results as a performance metric?
- Will the clawback policy apply to both cash and share-based compensation?
- Who will be considered an “executive” for purposes of the clawback provision?
- Does the three year period start when the error originated, the date when the restatement was filed or something different? If the latter, how will it be defined.

Notwithstanding the lack of clear financial rules the companies sampled in the PwC study features a wide range of clawback triggers in their clawback policies, but the most common reason companies seek to clawback is when there is a restatement, either with or without employee involvement or misconduct. Restatement and misconduct remain the most common clawback triggers in each of the industries studied. With the current focus on accountability in a down-turned economy it is envisaged that incentives both short term and long term will continue to be subjected to clawback provisions. These also attempt to ensure that inappropriate risk taking by executives is addressed.

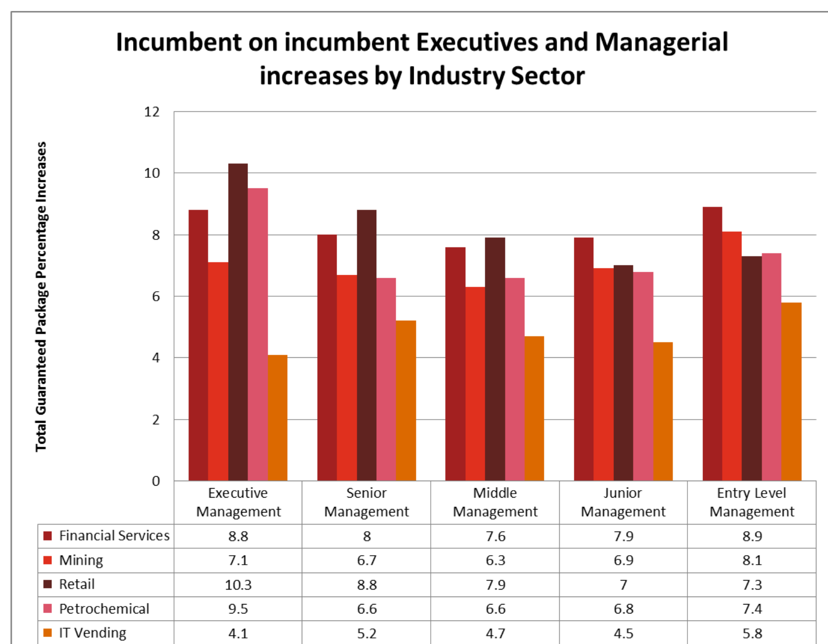
To ascertain what organisations are doing in these difficult economic times, PwC has conducted the flagship biennial Short Term Incentive and Commission survey this year. Industry sector analysis will be provided on request on the proviso that there are sufficient participants in each sector. Should you require a copy of the study please contact Theresa Kite at theresa.kite@za.pwc.com. Please note that terms and conditions apply.

Containing cost in a downturned economy – how does this impact salary increases in the coming months?

The current economic climate and the contraction of the economy over the past 12 months have raised serious concerns for South African businesses. The latest forecasted economic growth has been reduced to 1.5% for 2015. This is on the back of the electricity crises, lack of capital projects and the weaker rand in recent weeks.

Statistics SA (Stats SA) revealed at the beginning of March that electricity consumption contracted by 1.3% y-o-y in January and by 1.2% y-o-y in the three months to January. The availability of electricity is considered to be one of the most crucial constraints to economic growth in SA, and it is evident that the supply of electricity will remain constrained. In reality the current economic climate and socio economic challenges that South African companies are facing means that costs and specifically salary costs are being curtailed.

The graphical illustration below provides the actual increases by industry sector for Executives and Managerial staff as extracted from PwC's on line salary survey over the past 12 months.

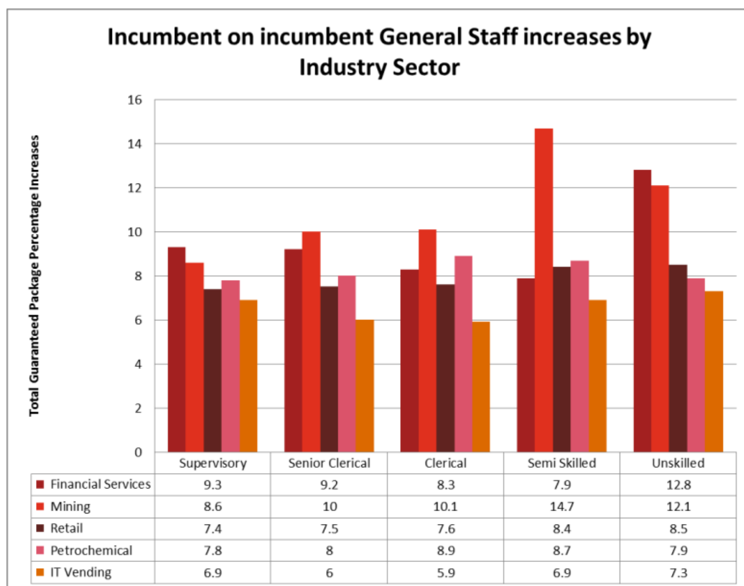


	Executive Management	Senior Management	Middle Management	Junior Management	Entry Level Management
Financial Services	8.8	8	7.6	7.9	8.9
Mining	7.1	6.7	6.3	6.9	8.1
Retail	10.3	8.8	7.9	7	7.3
Petrochemical	9.5	6.6	6.6	6.8	7.4
IT Vending	4.1	5.2	4.7	4.5	5.8

Although consumer inflation was moderate on account of lower fuel costs and South Africa's headline consumer inflation slowed to its lowest level in almost 4 years in the first quarter there are signs that CPI will again rise in the coming months. This is supported by some of the price increases of food, higher education, insurance, water and it is evident that the real economic impact on employees is significantly more severe than originally thought. Primary education increased with 8.2% whilst tertiary education increased with 9.4% year on year. Similarly insurance increased with 8.1% and water and other services increased with 8.5% during the same corresponding period. Some food products such as milk, eggs and cheese increased with 12.1% and meat and fish on average increased with 7.5% during the past 12 months.

Industrial action is expected to escalate based on employee and union pressure. This continues to impact salary and wage costs quite significantly as can be seen from the actual increases for these employee categories over the past 12 months.

Containing cost in a downturned economy – how does this impact salary increases in the coming months? (cont)



	Supervisory	Senior Clerical	Clerical	Semi Skilled	Unskilled
Financial Services	9.3	9.2	8.3	7.9	12.8
Mining	8.6	10	10.1	14.7	12.1
Retail	7.4	7.5	7.6	8.4	8.5
Petrochemical	7.8	8	8.9	8.7	7.9
IT Vending	6.9	6	5.9	6.9	7.3

Finance Minister Nhlanhla Nene tabled the 2015/16 national budget in Parliament. In short, he delivered on his October promise of fiscal consolidation. Mr Nene explained that even after lowering the expenditure ceiling there is a structural gap between South Africa's revenue requirements and projected tax proceeds. Of course as a result he introduced a number of tax increases, of which the most significant of which were the fuel and RAF levies, as well as the personal income tax rates.

Against these economic challenges reward professionals have a very difficult task ahead of them in the next few months. To ascertain the quantum of salary increases we are conducting the bi-annual Salary and Wage movement survey to be published in September 2015. Should you wish to participate, please contact Theresa Kite at theresa.kite@za.pwc.com for the fee structures and participation form. REMchannel® and REMeasure® subscribers will be able to participate at a reduced fee.

Job evaluation, the revived buzzword

The code of good practice on equal pay/remuneration for work of equal value was gazetted on 1 June 2015 after extensive input from various organisations, including PwC. The objective of the code is to provide practical guidance to employers and employees on how to apply the principle of equal pay/remuneration for work of equal value in their workplaces.

The legal framework and principles clearly states that every employer must take steps to promote equal opportunity in the workplace by eliminating unfair discrimination in any employment policy or practice and that pay/remuneration policies and practices are applied consistently without unfair discrimination on the basis of any one or combination of the listed or on any other arbitrary grounds.

This has major implications for employers and the only way to ascertain whether unfair practices exist is to analyse payroll information in detail. This includes gender, race and a myriad of other analysis by both job and by grade. For organisations who do not have a grading system this presents quite a few challenges. Equally if a grading system is in place but has been based on hierarchical slotting system employers are at risk. The reason for this would be based on the following three issues:

- Are the jobs that are being compared the same, substantially the same or of equal value in terms of an objective assessment?
- Is there a difference in terms and conditions of employment, including pay/remuneration (as defined by the act) of the employees in the jobs that are being compared?
- If there are differences in the terms and conditions of employment, can these be justified on fair and rational grounds? (Bearing in mind that the onus is on the employer to provide proof of such rational grounds)

The code of good practice provides specific guidelines on the evaluation of jobs. This is based on Article 3 of the ILO Equal Remuneration Convention 1951 which requires that "measures shall be taken to promote objective appraisal of jobs on the basis of the work to be performed".

The code indicates that best practice would include the following four elements of every job evaluation performed and are generally regarded as being sufficient for evaluating all the tasks performed in an organisation, regardless of the economic sector in which the enterprise operates:

- The responsibility demanded of the work, including responsibility for people, finances and material.
- The skills, qualifications, including prior learning and experience required to perform the work, whether formal or informal.
- Physical, mental and emotional effort required to perform the work.
- The assessment of working conditions may include an assessment of the physical environment, psychological conditions, time when and geographic location where the work is performed.

The process for evaluating jobs for the purpose of equal pay/remuneration for work of equal value is also outlined in the Code of Good practice. For a copy of the Gazetted document please contact Minda Botha at minda.botha@za.pwc.com or René Richter at rene.richter@za.pwc.com.

PwC's REMeasure® is becoming a sought after job evaluation tool and it can probably be attributed to the fact that the system is internet-based and provides a quick, easy and balanced method to accurately measure and evaluate any position from cleaner to top executive level. More importantly the management of the system and the reporting allows for record keeping should proof be required in terms of the new EE legislative changes.

Current and forthcoming attractions

The following thought leadership and survey publications have been released or will be released in the next few months. Should you wish to download a copy of any thought leadership publication, please go to our website www.pwc.co.za and select the "Publications" tab. For enquiries regarding survey publications, please contact Margie Manners at margie.manners@za.pwc.com.

Thought Leadership

- Annual South African executive Director's Survey: July 2015 (Published – please visit the PwC Website to download a copy or contact René Richter at rene.richter@za.pwc.com)

Surveys

- Short Term Incentive Scheme Survey: July 2015 (Published)
- Salary and Wage Movement Survey: September 2015
- South African Employee Benefits Guide: December 2015

If you would like to participate in any of these surveys, please contact Theresa Kite at theresa.kite@za.pwc.com or Margie Manners at margie.manners@za.pwc.com

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