TOWERS WATSON

From Recession to Recovery

How Far, How Fast, How Well Prepared?

Despite signs of a renewed focus on growth, companies worldwide remain cautious about workforce investments.

Executive Summary

While the effects of the global recession are still being felt in the workplace, many employers are expressing cautious optimism about the future. Based on responses to a recent survey we conducted, they are increasingly focused on marketplace growth and planning modest increases in staffing and compensation. Yet it is by no means a rosy picture, with significant numbers of respondents still anticipating strong and continuing pressure on costs.

The study, conducted globally in early January, charts organizational changes since the economic crisis began and expectations for further changes in benefits, compensation and employee engagement over the coming year. More than 450 respondents around the world weighed in, with nearly 200 based in North America.

Overall, the employment picture looks mixed, with hiring picking up at some organizations even while others continue to make targeted workforce reductions. And while the slow job market of the last 12 months has not presented retention challenges for employers, many respondents do expect retention to become more of a concern in the recovering economy.

The survey results also underscored the impact that reductions or freezes in pay and benefits have had on employees. According to respondents, at least a fifth or more of their eligible employees are postponing retirement, prompting increased concerns about the effect this will have on workforce planning and management overall.

"More companies plan to sharpen their focus on customer service than on any other dimension in the coming year."

Interestingly, though, despite the ongoing effects of the recession, most respondents indicated that engagement levels held steady or even increased relative to pre-crisis levels. And most expect this trend to continue. This confirms that organizations can sustain engagement, even during tough times, if they pay attention to the elements in the workplace that most impact it, including trust in leaders' abilities, belief in the vision they put forth, and honest and clear communications about how the company is responding to challenges.

Exhibit 01. Shifts in competitive differentiation strategies signal attention to growth

	All Respondents	
Rank	Pre-financial crisis	One year from now
1	High standards of quality	Customer service
2	Company image/ reputation	High standards of quality
3	Customer service	Efficiency of operations
4	Efficiency of operations	Company image/ reputation
5	Innovative products and services	Innovative products and services

	Canada	
Rank	Pre-financial crisis	One year from now
1	Company image/ reputation	Customer service
2	Customer service	Efficiency of operations
3	High standards of quality	High standards of quality
4	Efficiency of operations	Company image/ reputation
5	Innovative products and services	Innovative products and services

	United States	
Rank	Pre-financial crisis	One year from now
1	High standards of quality	Customer service
2	Company image/ reputation	High standards of quality
3	Customer service	Company image/ reputation
4	Innovative products and services	Efficiency of operations
5	Efficiency of operations	Innovative products and services

Strategy and Staffing

Amid signs of a strengthening economy in many markets, there is a subtle shift in how companies worldwide plan to position themselves for growth. While quality and efficiency remain critical areas, more companies plan to sharpen their focus on customer service than on any other dimension in the coming year *(Exhibit 1)*. This enhanced focus on customers suggests that many companies have begun looking outward again, sensing new opportunities in reviving markets.

> "Half of respondents expect to see increased difficulty retaining good people in 2010 as the economy strengthens."

Delayed Retirement: The Ripple Effect

For years, companies have prepared for the eventual retirement of the baby boomer population. But with the recent economic downturn, delayed retirements are becoming more and more common. While on the surface this could be good for organizations, as the baby boomer "brain drain" won't be as abrupt as once anticipated, what does it mean for the next wave of employees who are ready to fill the shoes of their older colleagues — many of whom are in management or leadership positions?

If companies don't act now and plan strategically, they could face a double talent exodus: first by the employees who see no room or potential for advancement, and second by the baby boomers who will, inevitably, retire.

At the same time, there is clear hesitation about embarking on significant hiring, at least in the near term. More than a third of respondents plan further workforce cuts this year, although the vast majority of those will be targeted reductions *(Exhibit 2)*. What's more, while almost all of the companies surveyed anticipate some hiring in 2010 *(Exhibit 3),* more than a third of those planning to hire expect their level of hiring to be relatively low compared to previous years.

Exhibit 02. Broad workforce reductions are declining, but targeted cuts remain on tap at many organizations

	Broad workforce reduction		Targeted workforce reduction		No workforce reduction		Don't know	
	Since the financial crisis began	This year	Since the financial crisis began	This Year	Since the financial crisis began	This year	Since the financial crisis began	This year
All Respondents	15%	3%	51%	34%	33%	54%	1%	8%
Canada	18%	4%	44%	39%	38%	51%	0%	6%
United States	17%	1%	58%	36%	25%	49%	0%	14%

Increased Productivity: How Long Can It Last?

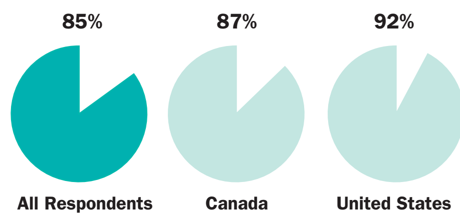
Protracted hiring plans coupled with expectations of sustained or increased levels of productivity may sound like an employer's dream, but continuing these trends for an extended period of time is unrealistic and, eventually, counterproductive. And as demand for products and services continues to rise, the question looms: How lean can companies run, and for how long? There will come a point when workers will burn out, leading to diminished productivity — and engagement — for organizations.

Careful planning and judicious investments in strategic workforce planning can help to alleviate future gaps and challenges as the recovering market dictates even higher levels of productivity. For those who lag in this area, beware — those slower to reinvest in their workforce could find themselves at a competitive disadvantage...and soon.

"Many organizations may never return to pre-crisis norms with respect to their workforce programs and strategies."

Exhibit 03. Most companies plan to hire in 2010

Percentage planning to hire for new positions:



Companies' hiring plans this year compared to past years are:

Significantly increased/ accelerated	3%	2%	1%
Increased/accelerated	20%	18%	16%
Typical, on par with past years	39%	48%	33%
Reduced/slowed	29%	27%	42%
Significantly reduced/ slowed	9%	5%	8%

Productivity, Retention and Engagement

Ironically, perhaps, productivity has increased even as companies reduced their workforces to greater or lesser degrees. Almost half of the global sample report higher productivity levels today than pre-crisis, and slightly more than half expect further gains in the coming year *(Exhibit 4).* Within North America, over half of all respondents feel confident that productivity levels will stay about the same over the next 12 months, with 40% in Canada and 48% in the U.S. expecting higher rates of productivity. These improvements, together with ongoing cost management pressures, probably account for much of the caution about hiring in the near term — and underscore why unemployment levels may not align with an improving economy for some time.

As noted earlier, the recession's impact on employee engagement has been mixed, with almost a third of the companies reporting higher levels of engagement now than before the crisis, and a quarter reporting lower engagement *(Exhibit 5)*. Given the workforce reductions, pay freezes and other actions taken by many companies last year, it may seem surprising that engagement has held up so strongly. But in fact, these findings are consistent with our other research, confirming that engagement is less sensitive to economic variables than to other things — such as leadership focus and communication — and that organizations can positively influence and sustain engagement even in difficult times. Looking ahead, the picture is even more positive, with 42% of those surveyed expecting engagement levels to rise in the coming year.

Not surprisingly, retaining workers was less difficult last year because other employment opportunities were scarce. Forty-one percent of the U.S. survey respondents, for instance, agree that it's easier to retain talent now than it was before the financial crisis. However, half of all respondents, including those in the U.S., expect to see increased difficulty retaining people in 2010 as the economy strengthens *(Exhibit 6)*. Given the strong correlation we've seen between employee engagement and retention in our previous workforce research, retention issues are likely to be especially challenging for organizations where engagement levels have slumped during the recession.

"Most companies also remain committed to ensuring an adequate level of security for employees."

Exhibit 04. Companies report productivity increases during the crisis and expect this to continue

	Higher productivity		About the same		Lower productivity	
All respondents	49%	51%	42%	47%	8%	1%
Canada	38%	40%	48%	57%	15%	3%
United States	55%	48%	38%	51%	7%	1%

■ Now compared to pre-financial crisis ■ One year from now as compared to now

Exhibit 05. Employee engagement levels prove resilient for respondents

	Higher engagement		About the same		Lower engagement	
All Respondents	32%	42%	44%	50%	25%	8%
Canada	27%	36%	51%	56%	22%	8%
United States	28%	39%	42%	56%	30%	5%

■ Now compared to pre-financial crisis ■ One year from now as compared to now

Exhibit 06. Companies expect retaining key talent to get more difficult in the next year

	More difficult		About the same		Less difficult	
All Respondents	19%	52%	49%	39%	33%	10%
Canada	18%	41%	55%	45%	27%	13%
United States	15%	51%	44%	39%	41%	9%

■ Now compared to pre-financial crisis ■ One year from now as compared to now

Workforce Programs

More respondents expect their total labor costs to rise than fall in 2010 *(Exhibit 7).* This marks a reversal from last year, when over 40% of North American companies reduced their overall workforce spending. Reward programs — among the hardest hit last year — show modest signs of improvement over the near term. The number of companies planning no salary increases this year is down from 2009, and merit budgets are up, albeit very slightly *(Exhibit 8)*. Bonus pools, which were down dramatically in 2009, are expected to rise this year *(Exhibit 9).*

While these results underscore companies' emphasis on controlling benefit costs and managing financial risk and volatility, most also remain committed to ensuring an adequate level of security for employees.

Employee Experience

Employees for their part have responded to the economic turmoil and their employers' cost-management efforts in predictable ways, according to our respondents:

- Contributions to company-sponsored defined contribution (DC)/retirement savings plans decreased last year. This was particularly common in the U.S., where almost a third of companies report employees cutting back on contributions *(Exhibit 10).* Not surprisingly, the survey respondents expect employees to increase their plan contributions (on average) in the coming year to help make up lost ground.
- Half of U.S. respondents indicated that more employees in their companies were working past their expected retirement age during the recession, a trend they expect to continue to some extent in the year ahead *(Exhibit 11).* This can be a mixed blessing for employers. On the one hand, it helps ensure a reliable pool of experience and talent. On the other hand, it also creates internal pressures on career progression and development. In fact, about one in five of the companies surveyed reported added concern about the workforce impact of an increase in delayed retirements.

"There is a clear hesitation about embarking on significant hiring."

Exhibit 07. Total labor costs anticipated to hold constant, increase or decrease in the next year

	Higher costs		About the same		Lower costs	
All Respondents	20%	36%	37%	45%	42%	18%
Canada	26%	40%	33%	45%	41%	15%
United States	15%	34%	31%	45%	55%	20%

■ Now compared to pre-financial crisis ■ One year from now as compared to now

Exhibit 08. Merit increase budgets show a small uptick for 2010

	2009			2010 (forecast)		
	Including 0% increases	Excluding 0% increases	% giving 0% increases	Including 0% increases	Excluding 0% increases	% giving 0% increases
All Respondents	2%	3%	32%	2.9%	3%	12%
Canada	2%	2.5%	29%	2.5%	2.5%	14%
United States	1.7%	2.5%	42%	2.8%	3%	11%

All numbers are medians.

Exhibit 09. Bonus plan funding levels as a percentage of target are expected to rebound

	2008	2009	2010 (forecast)
All Respondents	80%	65%	95%
Canada	90%	94%	100%
United States	80%	60%	100%

All numbers are medians.

Exhibit 10. Globally, employee contributions to DC/retirement savings plans remain relatively stable

	Higher employee contributions		No change		Lower employee contributions	
All Respondents	8%	15%	80%	83%	12%	3%
Canada	9%	10%	82%	90%	10%	0%
United States	7%	23%	63%	74%	30%	3%

■ Now compared to pre-financial crisis ■ One year from now as compared to now

Exhibit 11. A growing number of workers are postponing retirement

	More employees		About the same		Fewer employees	
All Respondents	27%	22%	65%	70%	7%	7%
Canada	33%	22%	64%	74%	3%	4%
United States	52%	31%	45%	65%	4%	5%

■ Now compared to pre-financial crisis ■ One year from now as compared to now

Looking Ahead

How a strengthening global economy will affect these trends remains to be seen. But already, many companies recognize the need to make thoughtful investments to retain and engage their existing talent, despite uncertainty about the business climate and the resulting caution about taking on added workforce costs. Notably, for example, relatively few of our survey respondents are reporting pay freezes this year, while merit increases and bonus pools are climbing back toward pre-crisis levels.

However, our recent consulting experience suggests that many organizations may never return to pre-crisis norms with respect to their workforce programs and strategies. In increasingly volatile and competitive world markets, effective cost and risk management will remain a key focus for the foreseeable future. Leading companies are likely to staff cautiously, reward carefully and invest most aggressively in leadership, talent management, career development and other aspects of organizational culture that have been shown to help nurture employee engagement and drive enhanced customer focus and performance.

About the Survey

In January 2010, Towers Watson surveyed HR executives around the world about the state of their workforce and their companies' strategic priorities at the beginning of the economic meltdown and today, as well as their expectations for the coming year. This report focuses on the responses of the nearly 200 survey participants from the United States and Canada. Survey respondents represented a broad cross section of industries.

> "Organizations can positively influence and sustain engagement even in difficult times."

About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.