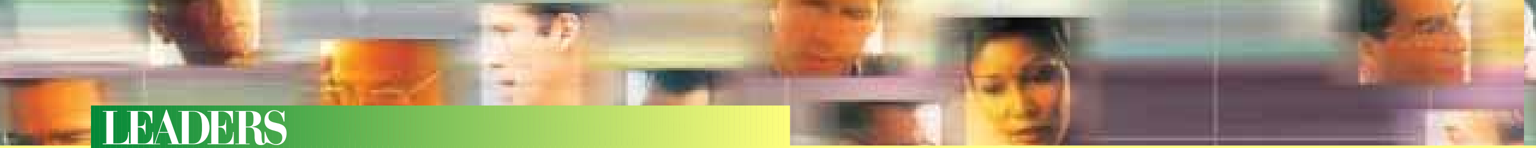


SPECIAL REPORT

TOWERS PERRIN

Managing for Success: Balancing Performance and Risk

An Interview with Mark V. Mactas, Chairman and Chief Executive Officer, Towers Perrin, Stamford, Connecticut

EDITORS' NOTE *"Change brings uncertainty," Mark Mactas readily admits, but "when looked at through a different lens, it also brings opportunity and excitement." As chairman and CEO of professional-services behemoth Towers Perrin, Mactas can speak with some authority on the significant issues that have brought about change in today's business world, namely volatility in the world's financial markets, a tenuous geopolitical situation, and sweeping demographic shifts. In his mind, the key to successfully meeting these challenges is striking, and maintaining, "a fine balance between performance and risk." This is particularly relevant in the context of human resources, Mactas asserts, because "the solution to a vast number of business problems lies in the workforce and its ability and desire to perform at consistently high levels." Accordingly, companies need to strive for that elusive balance between performance and risk, and focus on "managing the workforce for maximum results" – a process he believes depends on raising levels of engagement among employees. The question is: How is that achieved?*

In research into this issue, Towers Perrin discovered that people become more focused on their work if they feel that "management – especially senior leadership – cares about them." Moreover, "they want to feel they have some say in how they do their work, and that their decisions count," Mactas continues, also underscoring the importance of access to training and opportunities for advancement. By taking some very specific steps in these and related areas, companies can "deliver on these needs," he contends, and in doing so, balance the organization's risk exposure and performance to achieve a more profitable future.

Mactas, who holds a B.A. in mathematics and economics from Lehigh University, joined Towers Perrin in 1980 and assumed his present posts 21 years later. A fellow of the Society of Actuaries and the Conference of Consulting Actuaries, he is also a member of both the American Academy of Actuaries and the International Actuarial Association.

COMPANY BRIEF *Founded in 1934, Stamford, Connecticut-based Towers Perrin is a global professional-services firm that helps organizations optimize performance through effective people, risk, and financial management. Employing more than 8,000 people in 24 countries, the firm provides innovative solutions in the areas of human-resource (HR) consulting and administrative services, management and actuarial consulting to the financial-services industry, and reinsurance intermediary services. With a client roster that includes nearly 400 of the world's 500 largest companies and more than 70 percent of the* Fortune *1,000, the privately held firm reported total revenues of $1.5 billion in 2003.*

You've been CEO of Towers Perrin since 2001. What worldwide trends have become apparent to you in that time, and how have things changed?

Everywhere in the world, we're looking at continuing and massive change in three areas: First, there has been continuing volatility in the world's financial markets. This has contributed to financial pressures, which I don't think will abate anytime soon and which, in turn, have led companies to look for ways to cut their costs in an effort to improve profitability. So they've turned to solutions such as the outsourcing of work and jobs to low-cost regions of the world.

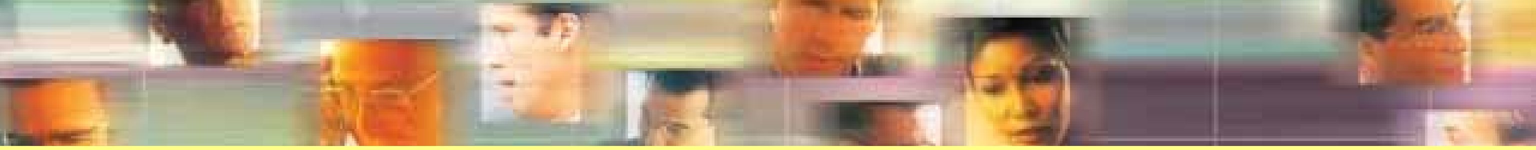
Second, the geopolitical situation is tenuous, and governments are struggling with their response to those challenges. Finally, we're on the verge of a tremendous demographic shift, which I think will ultimately have the greatest impact. In fact, the distinguished thinker Peter Drucker has said that the dominant factor for business in the next two decades will be demographics, specifically the underpopulation of developed countries.

What exactly do you mean by underpopulation?

Europe and Russia comprised 22 percent of the global population in 1950. Now they comprise about 13 percent and by 2050 they will comprise just 7.5 percent. Growth will come primarily from countries in Asia and Africa that, until now, have been largely on the fringe of the global economy. China is emerging as a tremendous economic force, although it has an aging population that will likely slow its economic growth over time. Of course, the populations of Europe, Japan, Russia, and North America are all aging into retirement at the same time that birth rates are declining across these regions. So we're facing a massive group of soon-to-be retirees in developed countries who have significant financial needs, plus a sharp drop in the number of new workers entering the workforce in those countries over the next few decades – a recipe for major economic, geopolitical, and social shifts. These changes will have profound effects on businesses, and no company can ignore them for very long. In fact, some industries will be reshaped by them.

How will companies respond?

Many will embrace these forces as an



opportunity to gain competitive advantage. The off-shoring of certain jobs is a manifestation of this. The first challenge in our country will be filling the upcoming labor gap. In the U.S. alone, as older workers retire, we're looking at a minimum of 6 million unfilled jobs by 2008, and possibly as many as 35 million unfilled jobs by 2025, when the baby-boomer retirement peaks. That's according to the Bureau of Labor Statistics. Human-resource policies will evolve to ensure companies have the continued ability to attract, retain, motivate, and engage their workforces.

Will there be workers from other countries ready to move into these jobs?

In some instances, certainly. We've already seen the shift of manufacturing jobs to developing countries, and English-speaking countries, such as India, have taken on computer- and Web-based work, as well as telecommunications work such as staffing call centers. And that portends a huge shift in global economics. Considering that a company can save between 20 and 50 percent by off-shoring, the immediate ramifications are clear – a tremendous cross-border shift in capital.

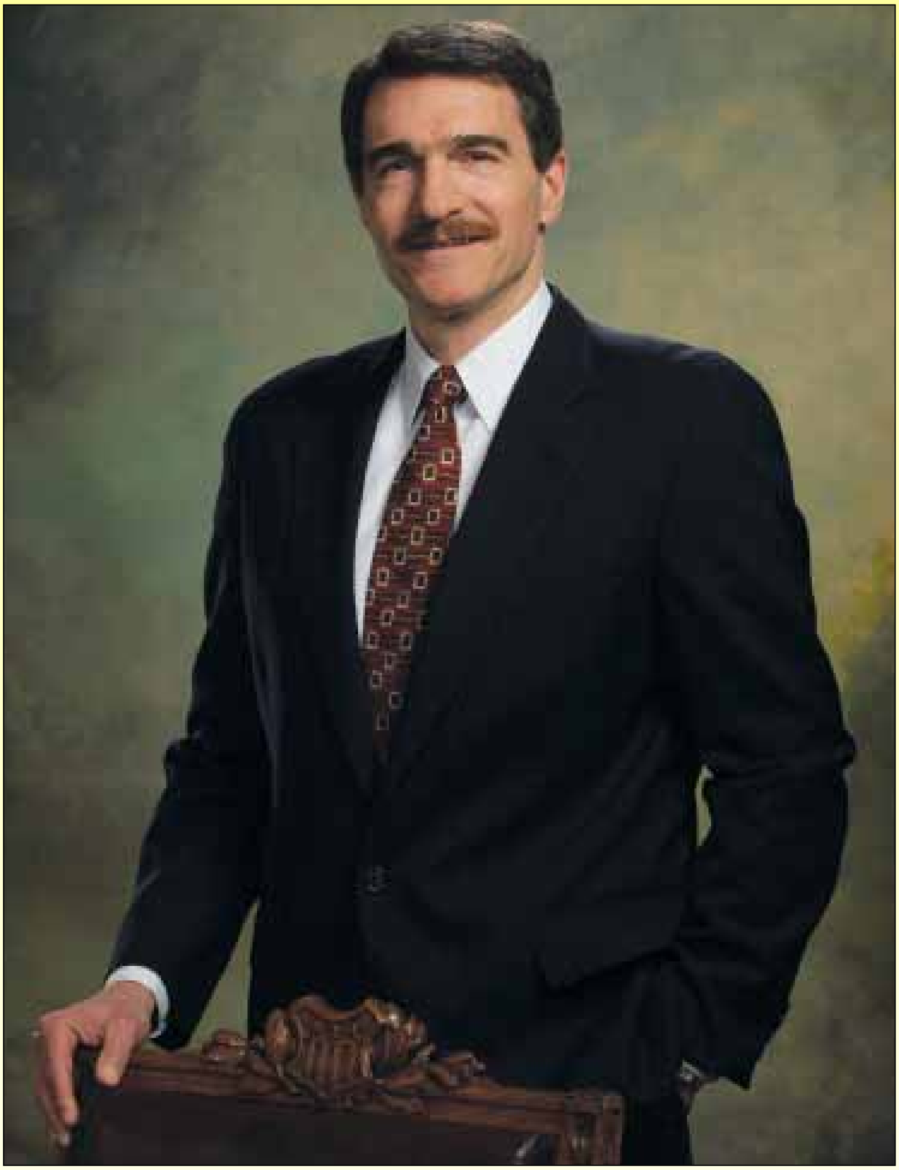
Your firm also consults to the insurance industry. How are these trends affecting insurers?

The insurance industry is certainly affected by these trends, and, in addition, insurance companies have their own issues. For example, in property-casualty insurance we are seeing a decided softening of the market in many product lines, as insurers again begin competing for market share. In the past, periods of intense competition have culminated in further consolidation. At the same time, sales of certain life-insurance products, such as variable life and annuities, have suffered because of poor performance in the capital markets. So competition for customers is fierce and profit margins are under increasing pressure. The challenge facing all insurers is to grow in an extremely competitive market while maintaining margins and without increasing their risks beyond an acceptable threshold.

In other words, we're looking at huge changes coming on top of several years of rapid change. How will companies cope?

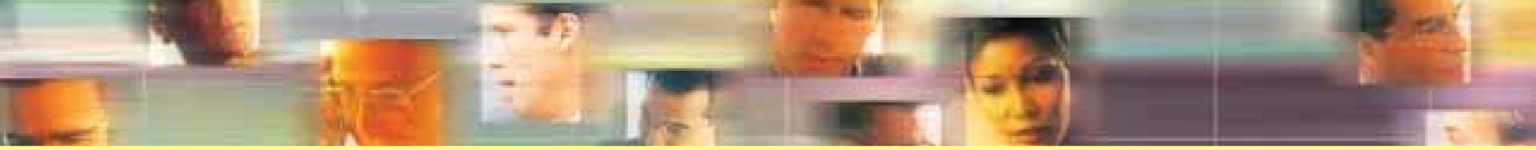
Change brings uncertainty. But when looked at through a different lens, it also brings opportunity and excitement. We're facing a convergence of significant issues. Every CEO I speak to is aware of them. They see these challenges and opportunities every day. Most don't sit and wait for change to happen to them. They get ahead of the curve and let these macro forces fuel their future success. While they wrestle with short-term results, they also position their organizations to successfully compete for the longer term.

Basically, whether we're talking about employers as a whole or the insurance industry in particular, the issue comes down to this: how a company strikes a fine balance between performance and risk, and then maintains that balance. And this is especially true when it comes to workforce demographics. With global political, social, and economic situations in flux, how do you grow, stay profitable, and minimize your risks?



We've done some interesting work in these areas in both our HR-services business and our risk-management business. For example, we've helped some companies look at the totality of their risks across the enterprise – and by that I mean financial risk, operational risk, risk at the department and unit level, and so on – to see where there are naturally occurring hedges and where companies should turn their attention for risk financing and mitigation. The answers are often surprising. Despite considerable progress in this area, there are still many companies that are inconsistent in their approach to different types of risk – insuring some risks that are immaterial to their operations and doing very little to mitigate other risks that are very material.

In the area of human resources, we look at "people risk." This is something companies understand intuitively, but have generally not labeled it that way. Yet for many companies, particularly knowledge-based organizations, risks relating to the workforce are as critical as financial, environmental, or other business risks. Do you have enough people? Enough of the right people? Too many people with increasingly obsolete skills? What skills do you need for further growth, and how will you find and develop them? How will you keep critical talent in a fiercely competitive marketplace?



We've been doing quite a bit of work in these areas of workforce management – focusing broadly on how employers most efficiently attract, engage, and retain top talent. What we're seeing is that, even in this environment, some companies are achieving extraordinary performance. So the question becomes: Who's succeeding and why?

Highly engaged people outperform those less engaged, leading to measurable differences in company performance.

Which companies are succeeding?

The companies that are succeeding, and that I think will continue to succeed no matter what the environment, do two things well: First, they focus on the long term. That can be difficult, especially for public companies. But the organization focused on the long term has a story to tell, and things like market volatility become bumps in the road toward long-term goals. For companies that don't give sufficient attention to the long term, an issue like market volatility becomes the sole focus of shareholders, buyers, competitors, and employees because there's no context.

Second, successful companies tend to view their own situation holistically. They look at the entire enterprise rather than just a small piece of it. Instead of addressing a host of small issues in isolation, they recognize that a decision in one area will have an effect in many other areas.

In our consulting business, we see this in many ways. For example, controlling health-care costs is a major consideration right now, because we're about to enter the sixth straight year of double-digit cost increases in that area. But in deciding how to cope with rising costs, it's important to understand that when you squeeze in one place – by simply passing cost increases along to employees, for example – the balloon expands somewhere else. So an important part of our job as consultants is to ask a number of questions. If you pass along additional health-care costs to employees, how will that affect your recruiting efforts? How should responsibility for costs be shared? What other options are available, and what are other companies doing that works? What do employees want and expect in terms of health-care benefits? And, if costs continue to rise at double-digit rates, what would employees be willing to give up in exchange for some cost relief in the health-benefits area? Educating employees to be better consumers of health care is clearly part of the answer here.

While a focus on health-care costs may appear narrow, it's really part of a much larger issue, and that's the balance between performance and risk that I talked about earlier. In the HR context, it comes down to identifying and addressing people risk and managing the workforce for maximum results. And that's because the solution to a vast number of business problems lies in the workforce and its ability and desire to perform at consistently high levels. Unfortunately, our most recent research with employees shows that, across North America and Europe, there is a persistent pattern of low to moderate engagement among workers and increasing skepticism about leadership's competence and concern for the well-being of its people.

That sounds troubling. Can you talk about the findings in detail?

We surveyed 55,000 full-time employees of medium to large companies in Canada, Europe, and the United States, and we measured their level of engagement – which we define as people's willingness and ability to help the company succeed – based on responses to a defined set of attributes relating to work and the work environment. These employees told us that they believe they're working hard and living up to their part of the employment deal, but they don't believe employers are holding up their end. They have concerns in a number of areas, including leadership focus, managerial support, career and skill development, autonomy, communication, and opportunities for advancement. As a result, engagement is moderate to low in both Europe and North America. These issues are especially acute in Europe, where workers have increasingly lost ground in core benefit protection from both the state and private employers.

How many employees fit your definition of being highly engaged?

Less than one fifth of employees in both North America and Europe are highly engaged, freely and continually giving extra effort. Even more disturbing, just about a fifth are disengaged, meaning they probably are just going through the motions at the workplace. The remainder is moderately engaged at best. Now, you can look at that as troubling, or you can look at those moderately engaged employees as a vast, untapped reservoir. The potential to engage them is there.

Why does engagement matter?

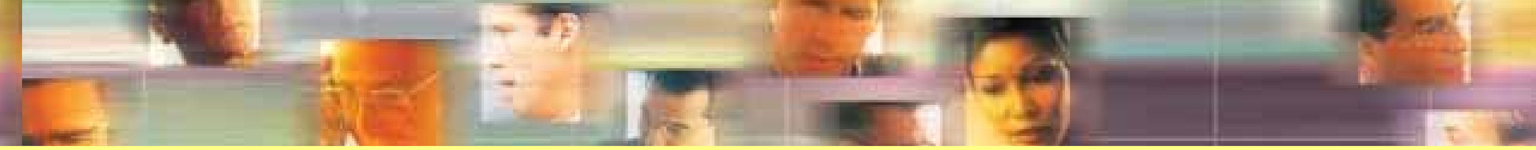
Because engagement remains the human power that drives the financial and operational engine. Our data confirm that highly engaged people outperform those less engaged, leading to measurable differences in company performance. And performance is the Holy Grail. The reality is that companies will have to do more with fewer employees. It's essential that the employees they do have are focused, interested, and working toward common goals.

Equally important, we found that engaged employees are far more likely to stay with their employer, and this becomes increasingly important given the huge demographic changes we'll be facing. Failing to engage people, or accepting low to moderate levels of engagement, is tantamount to accepting lower performance and higher staff turnover – which gets us back to the balance between performance and risk. So the vast middle ground of moderately engaged people represents both a challenge and a big opportunity for employers, as a reservoir of potentially engaged staff, assuming employers can move this group up the engagement scale.

In this environment, maintaining employee engagement will be more critical than ever.

So how do they do that?

The research told us that drivers of engagement cluster in three broad categories: First, leadership and management effectiveness, which is the extent to which management does a good job and demonstrates care and concern for employees. In other words, employees want to know that management – especially senior leadership – cares about them. Second, personal effectiveness, or the degree to



which employees need to feel competent, challenged, and in control. They want to feel they have some say in how they do their work, and that their decisions count. And third, organizational effectiveness, the extent to which the company is perceived as a good employer and provides a supportive and fair work environment. Employees want additional training and they want opportunities for advancement. These may seem like intangibles, but there are very specific steps companies can take to deliver on these needs.

Employees want to hear from senior leaders, and they want to feel that their leaders are concerned about their well-being.

But what about pay and benefits?

There's no question that pay and benefits remain critically important – especially in attracting and retaining people. Think of them as the baseline, or needed-to-play element, in workforce management. The fact is, in a given market, a job seeker is not likely to go to work for a company that does not offer competitive pay and benefits. But once that individual takes the job, pay and benefits are not the elements that get him or her enthused about the work. Indeed, a growing body of research, our own and others', consistently shows that monetary rewards are not engaging in their own right. But the fairness and clarity with which they are delivered do have an impact, especially over time. And if employers get these aspects wrong, pay and benefits can have a material effect on engagement.

The notion of a blend of monetary and nonmonetary rewards – customized to people's differing needs – will become increasingly important in the next few years, given the global economic issues and salary disparities I mentioned earlier. More employers are going to have to cut back on traditional employee programs to withstand global competitive pressures. And, in what amounts to a momentous shift in the nature of the employment deal, employees are going to have to bear more responsibility – and risk – in their pay, benefits, and workplace programs than they have been used to. Our employee survey data clearly show that they recognize this fact and are anxious about it. Still, they have little choice over time but to come to terms with this new reality.

Won't employees have some sort of negotiating power, given the looming labor shortage?

Yes, as will employers. In this environment, maintaining employee engagement will be more critical than ever. So employers need to look carefully now at the large number of moderately engaged – the roughly two-thirds of our samples whom we have termed the "massive middle." Left to their own devices, these employees could easily slide toward the wrong end of the engagement scale, with devastating consequences for productivity and morale. Indeed, the sheer size of this group – probably the single largest group in any organization – means these people will have a disproportionate effect on the mood and morale of the workforce overall. Boosting their level of engagement may be the most critical task employers face today. If just a small proportion of this segment can be reengaged, it could significantly increase the percentage of employees striving hardest to achieve company ambitions.

What can employers do to engage this group?

Based on what respondents told us and our own experience working with companies in these areas, we believe there are a number of actions that will make a difference in setting a successful people-management course for the future.

First, organizations need committed, visible, and involved senior leaders who communicate frequently and believably on a range of business and organizational issues. Employees want to hear from senior leaders, and they want to feel that their leaders are concerned about their well-being. Clear, consistent communications about the company's direction, the state of the industry, and corporate strategy are essential. Second, and closely related, a commitment to providing jobs that are challenging and improving opportunities for advancement give employees a sense that the company cares about them.

Third, companies need to take a holistic view of rewards programs and understand there are a variety of elements that attract, retain, and engage people. There are a number of ways to blend these monetary and nonmonetary rewards to meet both cost goals and employee-management objectives. We work with our clients on optimizing their reward programs, which basically means identifying the point at which a given package achieves the desired impact on people's performance and level of engagement at the right cost level. It's now possible to identify that point using a variety of survey and analytic techniques to be certain that a company isn't providing too much or too little, relative to its goals around productivity, financial performance, retention, engagement, and so on. Again, it's about creating the right balance between risk and performance.

Fourth is building a consumer-based approach in which employee consumers have the knowledge and ability to effectively select, purchase, and manage an interrelated set of workplace programs and services on their own.

Finally, employers must educate their employees. A focus on developing business acumen by providing the education and tools to increase employees' business savvy will go a long way toward making employees partners in the enterprise.

You paint a picture of a world very different from the one we're living in now.

My crystal ball is no better than anyone else's. I do know, though, that tomorrow will be different from today, much as today is different from yesterday. Those who get "comfortable" with the discomfort that change brings will be better equipped to navigate that change than those who don't. When you expect things to change – and consider the options and possibilities in advance – you put yourself in a position to respond positively, even if the changes are different from what you anticipated. Change shouldn't paralyze, it should energize. And a sense of readiness – and enthusiasm – can turn that energy into remarkable accomplishment. ●

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