HEALTH WEALTH CAREER

EMPLOYEE TURNOVER, CAREER SUCCESS, AND PERFORMANCE

THE IMPACT OF KEY HR DRIVERS ON YOUR WORKFORCE

PUBLIC ACCOUNTING FIRMS STUDY 2015

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EMPLOYEE TURNOVER, CAREER SUCCESS, AND PERFORMANCE

THE IMPACT OF KEY HR DRIVERS ON YOUR WORKFORCE

Competition for customers — and qualified talent to satisfy those customers — is an ongoing challenge for public accounting firms (PAF). The need to meet customer demands for high-quality services through employment of a knowledgeable and engaged workforce can lead to critical HR issues, such as:

- **Industry comparisons.** Is our workforce size and structure similar to our peers? Are we top-heavy? Do specific skill shortages persist? Is there a comparable flow of people through the organization as a result of promotions or lateral moves? Is turnover too high? Do we pay too much, too little, or just enough?
- **Industry distinctions.** How are we different from our peers? What do these differences say about the employment proposition we offer?
- **Solutions.** How can we differentiate ourselves from the competition to better attract, retain, and develop our talent?

The answer to these questions can significantly influence the company's long-term success, as well as its position in the market as a desirable employer. Being aware of potential talent gaps will drive workforce planning and require implementation of best practices for attracting, retaining, and further developing high-potential, experienced, and skilled performers.

However, failure to identify competitive rewards and offer opportunities for career growth will eventually lead to costly turnover, loss of critical skills and intellectual capital, and inability to meet corporate objectives. Optimal use of rewards to enhance employee performance requires HR to spend money wisely in order to show a positive return on their investment in human capital. Ultimately, the overall employee value proposition ("total rewards plus") is what will differentiate the organization from its peers.

DATA IS THE KEY

The ability to make informed HR decisions and implement best practices requires data. Many organizations attempt to understand the implications of simple metrics, such as promotion and hiring rates, turnover, and company staffing ratios. But they have nothing to measure themselves against, no standard by which to evaluate their programs. In the absence of comparative peer data (whether analyzed by company size, industry, revenue, or other factor), such percentages and numbers lack context. Consequently, HR professionals are often at a loss to determine if factors like promotion and turnover rates are "good" or "bad." They are unable to tell whether their HR programs are effective.

To help Mercer's PAF clients respond to their HR concerns, Mercer collected workforce data for the audit practices of 26 US peer organizations, with just over 101,000 employee observations per year. The data produced industry-wide statistics on workforce structure, development, turnover, and career velocity. The "deep dive" statistical study of historical employee data from participants merged three years of data (2012-2014) with Mercer's external labour market databases (including, for example, local employment rate, economic demographics).

The analysis explored the predictors of three key outcomes — turnover, career success, and performance management — using Mercer's proprietary Internal Labour Market methodology (ILM). The ILM created a "map" of the PAF workforce organization, showing an "hourglass" structure (a pyramid with more partners on top), a growth mode for the sector over the past two years, and a greater inflow into levels than outflow. (See Appendix.)

TURNOVER: KEY FINDINGS

Turnover — particularly the loss of valued employees — is of utmost concern to employers, who often find it challenging to recruit workers with technical accounting and audit skills. Exacerbating the situation is the continuing growth of a geographically mobile workforce, which increases the difficulty of retaining talent. In some situations, the market is so competitive that HR cannot keep up with offers and counter-offers. In others, employees may be unhappy with management style, company culture, and other factors that go beyond simple rewards.

With the expansion of multinational companies into emerging markets, the global workforce continues to become more diverse in terms of culture and expectations. Not all individuals value the same things, prompting companies to move beyond the one-size-fits-all approach to compete successfully for talent — and retain those valuable employees.

Employee demographics, for example, can affect the perception of what creates a compelling place to work in different ways. Younger employees may value flexible work-style arrangements and career opportunities more highly than benefit plans. Older employees may place more emphasis on retirement and medical benefits. If the employer does not meet their expectations — and other firms are able to do so — retaining these employees in a competitive market may prove difficult.

Employers need to design and deliver a rewards program that will secure the necessary workforce outcomes by minimizing the outflow of valued employees. In other words, reduce turnover with well-thought-out competitive strategies. The analysis of PAF participant responses found that base pay, culture, and the external market have measurable and different levels of influence and impact on employee turnover.

Impact of base pay

Keeping the cost of total rewards affordable and sustainable is a significant challenge for PAFs. Employers need creative solutions to optimize their human capital programs so the company can be financially viable and profitable in the long term.

The starting point for employee cost is base salary, the cornerstone of the reward package. Typically, the way in which companies set pay and employees' salary progress can have a huge impact on how employees engage with work and stay motivated. However, for PAF respondents, base pay does not seem to have a retaining effect. On the other hand, short-term incentives (STIs) — but not long-term incentives — apparently drive retention more strongly.

Impact of culture

Differences in talent strategy can have an impact on turnover. High turnover firms can manage costs and weed out employees more effectively, but they lose firm-specific human capital in the process. In other words, high turnover firms can adjust their wages and workforce to market more frequently, and hence make labor costs more variable.

KEY TERMS

BASE PAY: Monthly base salary multiplied by number of months.

CULTURE: Trends specific only to individual companies.

LONG-TERM INCENTIVE (LTI): Reward to employees who achieve long-term performance objectives in the form of stock options, restricted stock, or cash.

MERCER'S INTERNAL LABOUR MARKET (ILM) METHODOLOGY: ILM requires three conditions before showing that a factor actually drives an outcome (correlation- are correlated; time-one precedes the other; isolation – other factors are ruled out). The process analyzes multiple variables, then isolates those that directly impact the outcome.

SHORT-TERM INCENTIVE (STI): Reward based on the attainment of short-term results in a period of 12 months or less.

TURNOVER: Broadly defined as individuals who left the database.

On the other hand, they lose the higher productivity of a tenured workforce and can increase business continuity risks. These trade-offs imply that optimal turnover can vary across firms even in the same industry.

All else equal, some firms have persistently higher turnover that can be attributed to culture. Although most PAFs show a turnover rate of 20%-30%, some are consistently higher, reflecting differences in firm culture. These effects persist when all other factors are controlled.

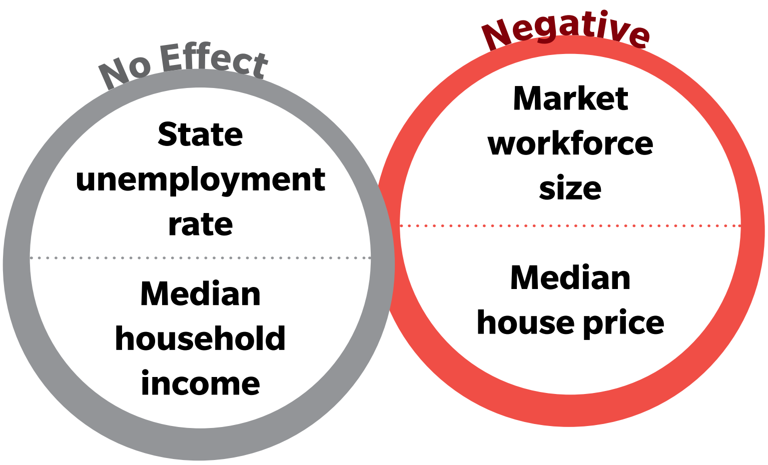
It should be noted that a range of supervisory, social, and workplace influences also affect turnover decisions. During the two decades in which Mercer's Strategy & Analytics practice has studied turnover for clients, these effects have been persistent. However, as with other drivers of turnover, the directions vary by firm. In one company, high spans of control and a balanced mix of ethnicities might decrease turnover; in another, the opposite could be true. Company culture, therefore, impacts not only the level of turnover, but also, critically, how employees react to different influences.

Impact of external market

Mercer's observations have shown that one-third of pay growth occurs through counter-offers (defined, for this purpose, as raises over 15%), mid-year market adjustments, or other off-cycle channels — not through formal pay reviews. To some degree, people use the threat of leaving to force employers to pay more. Mid-year adjustments to an employee's salary in order to match market rates, although usually not prompted by the employee, can also influence motivation. Consequently, external market and "outside options" play a significant role in pay determination. Other, non-reward factors in the market environment have different effects on turnover.

For example, the larger the workforce size in the market (+1,000 employees in the industry within the city) and the higher the home prices (+US$100,000 increase), the harder it is to retain PAF workers. This finding is likely due to a large concentration of employers offering competitive salaries. However, the state unemployment rate (+1 percentage point) has no impact on retention rates. The lack of influence of the unemployment rate indicates that these organizations are very good at keeping a pulse on the prevailing wage where they have employees — and that is pretty rare. Such companies recognize the intrinsic value of benchmarking pay against market peers to attract and retain top talent. This industry seems to be fairly "recession proof." Firms in this sector are very capable of adjusting to market; therefore, resulting in a lack of change in turnover when the unemployment rate changes.

EFFECT OF MARKET ENVIRONMENT ON RETENTION



Solutions

Overall, a better focus on where to allocate salary budgets is necessary. For PAFs, incentives can result in more value for what the company spends on compensation. For example, the study found that a

US$10,000 increase in compensation has a much higher effect on retention when spent on STIs than base pay. Spending on STIs has a significantly higher "retention-return on investment" than base pay; the gap can be more than 10-fold. In other words, since a percentage increase in STI costs less than one-tenth of an equivalent base pay increase, the compensation-related retention investments should focus on STIs. However, this solution can vary considerably by company. Often, base salary is better at retaining employees.

When it comes to culture, in an effort to reduce unwanted turnover at mid- to junior-career levels, some PAF respondents need to clearly articulate and communicate their employment proposition ("we promote you faster," or "we believe in work/life balance"). This starting point would respond to the perceptions — and facts — around relatively slower career progression.

For others, a very top-heavy, expensive workforce (with partners accounting for well over 15% of the entire audit practice) blocks the future progression of high-potential talent — ultimately leading to a search for external job opportunities. Such firms need to explore ways to incentivize retirements in senior ranks, open up career opportunities for more junior talent, reduce the turnover of junior employees, and create a more profitable workforce structure.

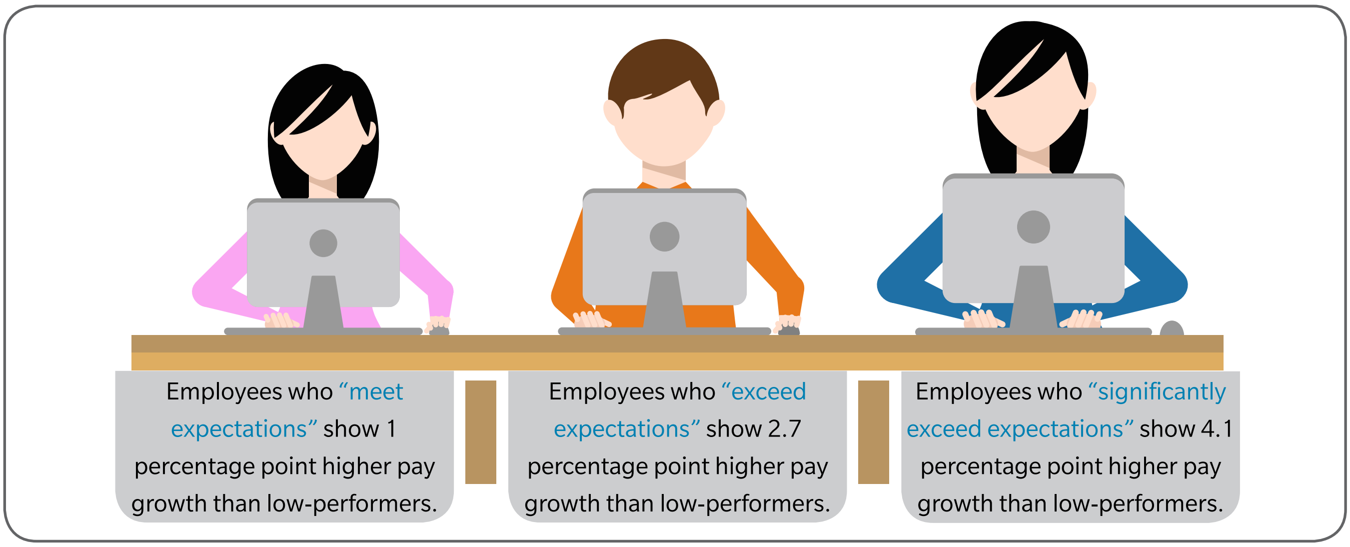
CAREER SUCCESS: KEY FINDINGS

Organizations that can successfully link employees' long-term career aspirations to available career paths, as well as support their desire to improve their knowledge and skills, are more effective in driving long-term engagement and retention. Employees like to know that they have options and that the organization is willing to support their development. Companies that have a diversity of jobs and multiple job levels offer those opportunities to employees who are willing — and qualified — to go further.

But there is more to career success than just having room to grow. The analysis of PAF respondents found that promotions, workplace size, and workgroup have different levels of influence and impact on employees' career success. For many employees, career success means bigger raises over time, increased promotion chances, and higher performance ratings.

Impact of promotions

The study found that pay growth in PAFs has a stronger tie to promotions than to raw employee performance. In other words, significant pay growth is typically only possible through promotions, rather than a steady progression through merit increases. High performers achieve faster pay growth indirectly by quick promotions. For PAFs, the pay growth gap between mid-performers ("meet expectations") and top-performers ("significantly exceed expectations") is 3 percentage points.



Although the direct impact of performance on pay is statistically significant, it is subdued in comparison to the indirect impact of promotions on pay.

Performance drives promotions. The highest promotion rate was for PAF employees who “exceed expectations,” followed by “significantly exceed expectations” and “meet expectations.” In PAF firms, the top performers, therefore, were slightly less likely to be promoted than good performers (“exceeds expectations”). One explanation could be that top performers have been promoted more recently, and since they might have a lower promotion-readiness, they are marginally under-represented among promotees. Another reason could be that good performance is deemed “enough.” In any case, long-term financial career success is intrinsically linked to promotions.

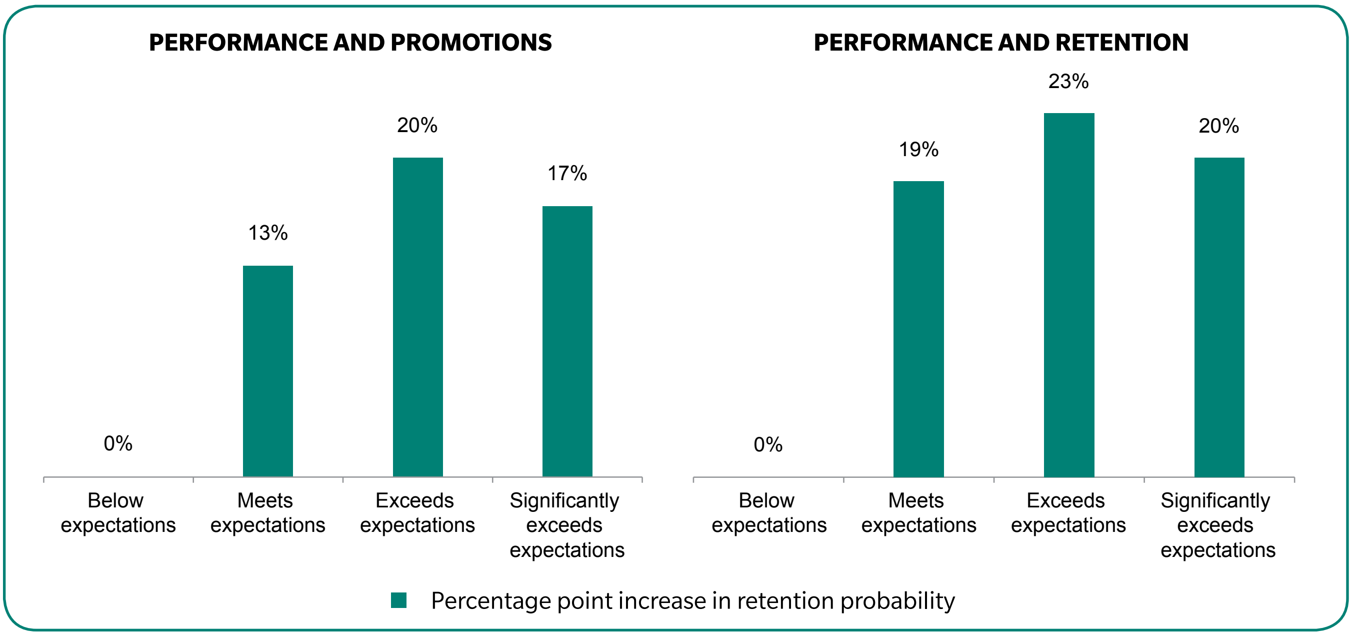
Impact of workplace size

Bigger is not always better. Working in smaller groups performing the same function has a positive effect on all career outcomes, including retention and promotion. However, the firm’s local workforce size has the opposite effect: A larger local workforce (that is, working in offices with a larger headcount but not performing the same function, with several functions mixed together) has a positive impact on career success; PAF employees may more effectively pursue local internal career opportunities outside their function — while remaining with the firm and retaining their seniority.

An additional finding is that location matters. In areas with high unemployment, PAF employees are promoted more often, holding all other factors constant. There appears to be a premium to locating an office in cities that have tight labour markets.

Impact of workgroup

Peers have a clear impact on retention, promotion, and pay growth. Higher turnover among peers results in more promotions, as expected, because it frees up job openings. In addition, working with high performers is a likely factor in decreasing retention in the workgroup; high performers exert competitive pressure, prompting their peers to seek other jobs outside the company. On the other hand, high performing peers accelerate promotions. A high performance work environment polarizes workforce outcomes, prompting some employees to leave; but those who stay benefit from faster promotions.



A further analysis of the PAF study found that lateral moves reduce employees’ chances for promotion. Although movement between comparable job levels may increase employees’ knowledge and skills, it hampers their opportunities for promotion within a career path that requires specific qualifications. And finally, although not quantifiable, a collegial working environment in a tight-knit group is a plus.

Solutions

Whether the workforce is large or small, an effective way to enhance employees' career success — and keep valued talent on board — is development of communication processes. Such processes enable managers to make it clear to employees how their pay is determined and performance appraised. They should emphasize the skills and behaviours recognized by the company, and how employees' growth in skills or change in behaviours can affect their levels of pay and bonus.

PERFORMANCE MANAGEMENT: KEY FINDINGS

In many companies, new hires automatically go on probation for the first three or six months to ascertain whether the new employee is a good fit. Once an employee passes the probationary period, the individual usually follows a performance cycle that measures job performance on a yearly cycle. Performance management, a key tool to motivate and retain talent, not only reviews past performance and sets future goals, but manages the employee through ongoing observation and feedback. It also involves improving employees' performance and skills through development and rewarding performance where merited.

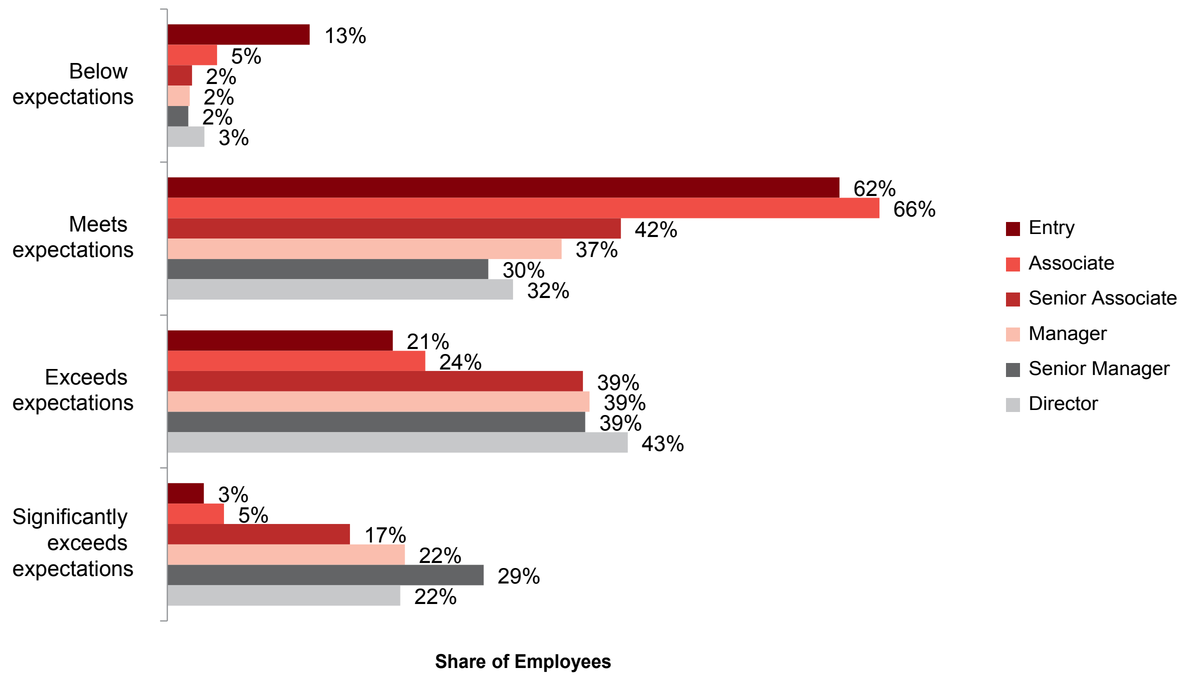
Aspects of performance on which the incumbent is evaluated typically relate to outcomes or behavioural criteria pertinent to the job assignment. For PAF respondents, the study found that performance appraisal systems and culture have different levels of influence and impact on employee performance management.

Impact on low- and high-performers

By identifying high performers, performance management enables these employees to be promoted faster. For PAF firms, performance management resulted in the highest level of increases in promotion (20%) for employees who "exceed expectations." This same category also showed the highest increase in retention (23%). As expected, no employee in the "below expectations" category received a promotion.

Performance management also recognizes low performers. In a performance distribution by career level, PAF respondents rated the majority of employees in the "meets expectations" category: ranging from 30% of senior managers to 65% of associates. Roughly 13% of overall employees fell in the "below expectations" category; the majority of these employees were entry-level employees.

PERFORMANCE DISTRIBUTION BY CAREER LEVEL



Impact of culture

Firms have different standards to evaluate performance. Some firms have "higher" distributions of top ratings. In other words, more employees receive high performance ratings than one would find in a typical managed distribution — that is, a forced distribution where a certain percentage of employees must fall into each rating level. PAFs have a relatively high persistence of top ratings, which is problematic in context of a managed distribution.

Performance in PAF firms does vary modestly year-over-year. Around 60% of employees experience a change in their ratings. Low performers are an exception; only 15% do not improve their performance. The vast majority, 85%, improve their performance, but this finding reflects some sample bias. Most low performers who do not improve their performance are "coached-out." It speaks to a strong culture of performance management among PAF firms.

	CHANGE IN PERFORMANCE RATING				
	Future rating				
Current rating	Significantly exceeds expectations	Exceeds expectations	Meets expectations	Below expectations	Rating Missing
Significantly exceeds expectations	**60.2%**	29.6%	9.0%	0.1%	1.1%
Exceeds expectations	21.4%	**53.4%**	23.4%	0.7%	1.1%
Meets expectations	6.2%	31.8%	**56.5%**	4.0%	1.5%
Below expectations	2.1%	16.2%	64.6%	**14.8%**	2.3%
Rating Missing	6.5%	23.9%	61.2%	3.5%	**4.9%**

Solutions

It is no surprise that firms with a stronger pay-for-performance program often have a more performance-oriented culture. But to optimally use performance management to achieve individual and corporate goals, employers should consider these proactive steps:

- **Build growth and development into goal setting.** Performance management should strive to improve the performance of employees and the company by defining high performance, as well as stating the company's priorities and indicating how/where they cross with employees' priorities.
- **Encourage high-quality dialogue and candid feedback.** A transparent procedure, handled by competent managers, can go a long way to building employee trust and commitment.
- **Identify and develop high-performers.** The process should identify top talent (individuals and teams) who consistently deliver high performance.
- **Link pay and performance.** Consider the appraisal program in the context of other HR programs, such as pay levels, incentives, and leadership development.

In the ongoing effort to attract and retain the talent and skills necessary for company success, the company should make its best efforts to help valuable talent succeed.

UNDERSTANDING KEY DRIVERS LEADS TO BEST PRACTICES

Analyzing workforce metrics to improve attraction and retention of key talent is more than a simple exercise in statistics. A practical approach to using metrics for optimizing a rewards strategy involves identifying the measures that are most valuable to the organization. These may include: compensation and benefits costs by career level, function, and/or per revenue generated; support function costs vs. business function costs; sign on bonus; revenue per headcount; other pay drivers; gender; diversity, and any other relevant factor.

In essence, workforce metrics can help HR determine what is going on, why it is happening, what should be going on, and what action needs to be taken to steer the company on the right path. Building on the foundation of hard, quantifiable data and external benchmarks, metrics brings a fact-based approach to decision making. With managerial expertise added to the analysis of results, the company can optimize its human capital going forward.

Turnover, career success, and performance management all play a significant role in the company's use of its human capital. Understanding causes and effects — and viable solutions — can help HR achieve a successful alignment of employee and organizational goals.

ABOUT MERCER'S WORKFORCE STRATEGY & ANALYTICS

Workforce Strategy & Analytics, part of Mercer's Talent Strategy practice, specializes in linking human capital decisions to business results. Through our proven workforce analytics approach, we help clients ensure that their people strategy is aligned with business strategy, enabling them to identify and address gaps in their talent mix and make targeted workforce investments that drive better business outcomes.

Want to know what drives key workforce outcomes in your organization and how your company compares to the competition? For more information, contact:

Matthew Stevenson at *matthew.stevenson@mercer.com*
Tatu Westling at *tatu.westling@mercer.com*

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APPENDIX: MERCER'S INTERNAL LABOUR MARKET ANALYSIS OF WORKFORCE ORGANIZATION

Public Accounting Firms

High performers | Non-high performers

Career Level	Hires		Active Headcount		Total Exits	
			Promotions			
Director	12.7%	29.3%	57%	43%	13.1%	19.9%
			3.3%	1.5%		
Senior Manager	7.8%	27.2%	64%	36%	17.8%	26%
			17%	10%		
Manager	8.3%	31.1%	56%	44%	19.4%	29.3%
			21.9%	11.3%		
Senior Associate	6.4%	31.3%	50%	50%	23.2%	32.4%
			61.5%	44.7%		
Associate	19.1%	35.9%	26%	74%	18.7%	26.6%
			48.9%	83%		
Entry	94.5%	99.7%	1%	99%	14%	10.6%
Overall	9.4%	46.2%	20.5%	33.5%	20%	25%

ABOUT MERCER

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