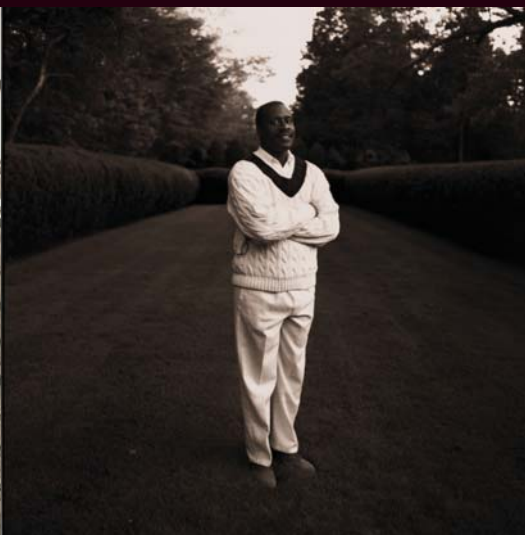


Sustaining value through people

Turning corporate responsibility into corporate opportunity



human resource services

creating Value for your Business through People

New Europe: New Challenges, New Opportunities

Sustaining value through people

Turning corporate responsibility into corporate opportunity

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Acknowledgements

We would like to thank all the senior executives of those companies and organisations that contributed for their help with this study.

Foreword

In an increasingly pressured business environment, it is no surprise that European business leaders feel that there are simply not enough hours in the day to address all the issues at their door. A few years ago it was the dotcom boom, then it was the Euro, the global economic slowdown and, most recently, issues around corporate governance in the spate of corporate scandals that have rocked the business world globally. If there is one thing we can learn from recent history, it is that things are constantly changing (at an ever more rapid pace) and, as such, the key challenge is to create business strategies that are capable of ensuring long-term success. The other factor to note here is that all of these phenomena are essentially short-term responses to crises and are not conducive to long-term value creation.

Creating a sustainable business model must be an integral part of businesses' approach to long-term value creation for shareholders and other stakeholders alike. A sustainable business values and respects its people – they are one of the most important influences on business value. People and people policies can make or break businesses. Of course, we all know that, but it is only recently that the need to manage people as an asset rather than treating them as a 'workforce' has started to be reflected in new approaches to management. Capturing and reporting on the value people bring is a different question and one which governments, academia and the business community are only just beginning to address. Accounting for people is a new subject and one around which there will be much debate before real clarity emerges on what is the right information to report, and in what format.

What follows is our attempt to explain our view of the critical people-related success factors that business needs to embrace and to suggest a framework within which to address them. A distinctive feature of our suggested approach is that it integrates consideration of shareholder value with that of a broader set of stakeholders.

During our research we have been impressed by the forward-looking approach taken by many organisations as evidenced through the case studies in our report. We believe that these innovators in the workplace are taking a crucial first step towards creating and capturing value for business through people.

A handwritten signature in dark ink, appearing to read 'Owain', with a stylized flourish below it.

Owain Franks
Chairman
Human Resource Services

September 2003

Is business getting the message about people policies?

Why do people policies matter?

“People are our number one asset.” A cliché perhaps but in many companies, in many industries, people really are the lifeblood. But how do organisations demonstrate that their people and people policies are really generating shareholder value? And is this focus at odds with a parallel increase in attention to sustainable development and business’ broader social responsibilities?

This raises two key questions that are the focus of this paper:

- How do people policies enhance value for shareholders and stakeholders alike?
- What, if any, compromise should businesses make between developing and implementing people policies that respond to all stakeholders’ interests and achieving and demonstrating business success?

The business imperative

Diverse external pressures are adding to the challenges facing business:

- Global geo-political developments, continued terrorist threats, health scares and the economic slowdown make the future for business less certain than it has been for some time
- Customers’ expectations are becoming ever more demanding thereby increasing the onus to find new sources of potential differentiation
- Recent global capital market adjustments combined with high profile corporate scandals (such as Enron and WorldCom) have altered shareholder expectations and heightened the need to re-build trust between business and its stakeholders through improved transparency
- The ageing population, changing preferences between work and leisure and increasing mobility are among many forces altering the shape of the potential workforce
- Other diverse stakeholders, including governments (see Box 1), are showing growing interest in businesses’ performance and their rights and responsibilities with regards to their employees

Box 1 Governments’ interest in people policies and sustainability

In July 2001, the European Commission presented a Green Paper ‘Promoting a European Framework for Corporate Responsibility’ highlighting a broad range of issues including quality of employment, lifelong learning and worker participation. The subsequent White Paper in July 2002 confirmed the Commission’s interest in employee-related sustainability issues and launched a European Multi-Stakeholder Forum consisting of trade unions, NGOs and consumer groups. Part of the Forum’s remit is to identify and explore areas where additional action by businesses in relation to employees is needed in Europe. The Forum is due to report in 2004.

At the national level, several European countries have already introduced legislation to address employee-related sustainability issues: for example, in France, the Nouvelles Regulations Economiques require all French listed companies to publish information on aspects of employee policy such as employment status, working hours, remuneration, training and health and safety. Several other countries are expected to introduce initiatives in the near future. For example, in the UK, following the Company Law Review, a Task Force has been established to investigate 'Accounting for people'. The Task Force is due to report in November 2003 and its conclusions are likely to have significant implications for businesses' reporting of their people policies.

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Against this background, European business leaders face a constant search to find new, better ways to secure sustainable value for their shareholders. This requires innovating to protect and build their sources of competitive advantage by:

- Enhancing revenues, for example by developing new products and services and exploring new markets
- Controlling costs by running efficient operations
- Reducing risks, for example by ensuring compliance with laws

Evidence from recent studies shows that businesses' people policies can play an important role in achieving improved business performance. For example, Becker, Huselid and Ulrich have found correlations between alignment by businesses to a "high-performance work system" and higher market values per employee (The HR Scorecard 2001). In addition, as Figure 1 shows, other studies have found important links between people policies and business performance.

Figure 1 Linking business performance to people policies

<i>Findings</i>	<i>Study</i>
Companies with a documented HR strategy have 35 per cent higher revenues per employee, 12 per cent lower absenteeism and more efficient performance management and reward systems. Three-quarters of those firms with a documented HR strategy also feel that their performance management systems are "very effective". Companies with lower absenteeism have higher profits per employee.	PwC Global Human Capital Survey, 2002
Companies that scored highest against the "people scorecard" ¹ earned higher total shareholder returns than lower scoring companies: top scoring companies had an average return of 27 per cent whereas those at the bottom earned just 8 per cent.	Bilmes (2002), The People Factor
Employee satisfaction is positively correlated with training, performance related pay and individual responsibilities: 86 per cent of German workers in companies that provided training, individual responsibility and linked pay to performance said they were "very loyal" compared to only 66 per cent in other companies.	Penn, Schoen and Berland (1998), Poll of 2,000 German and US workers ²
Firms with the best equal opportunity policies (including absence of legal infringements) had a five year annualised return of 18.3 per cent while those firms with the poorest records had returns of 7.9 per cent.	Covenant Investment Management (2000) Diversity study

¹ Bilmes, Struven and Wetzker developed a "people scorecard" based upon a set of quantifiable criteria including the number of training days provided and the type of training to measure how well companies manage their employees.

² Quoted in Mastering People Management, FT/Prentice Hall 2002.

“70 per cent of chief executives drawn from 600 companies agreed that people were their firms’ most important asset. But only 10 per cent said that they considered people issues in the same way as they did more traditional concerns such as finance.”

Source: Chartered Institute of Personnel Development³

The business response to date

Taken together, the forces for change and the emerging evidence are having some important impacts on business:

- More business leaders recognise that their people policies will affect their future success: not only does access to skills remain a live issue despite recent slower economic growth, but employee satisfaction and commitment are recognised as important drivers of business performance
- Interest is heightening in the long-term sustainability of businesses’ value creation rather than historic, short-term performance: for example, in a recent PricewaterhouseCoopers global survey of around 1,000 CEOs, 79 per cent said that sustainability was vital to the profitability of any company, up from 69 per cent a year before, and 71 per cent would consider sacrificing short-term profitability for long-term stakeholder value
- Pressure is increasing for business to improve transparency and accountability, for example by moving away from a reliance on historic quarterly financial returns to a broader range of forward looking indicators of business performance

Our evidence, however, suggests that many businesses are failing fully to understand the potential ways in which their people policies can influence the generation and sustainability of business value. By addressing this shortcoming, better understanding the value to be gained as well as the potential risks, business can demonstrate to all their interested stakeholders, both internally and externally, the key people-related value drivers that impact on business performance.

The following pages address two further questions:

- Why do people policies matter?
- What should businesses be doing?

³ Quoted in Human Capital: from cutting edge to mainstream practice (2001) Institute of Chartered Accountants of England and Wales.

Why do people policies matter?

Understanding the link to value

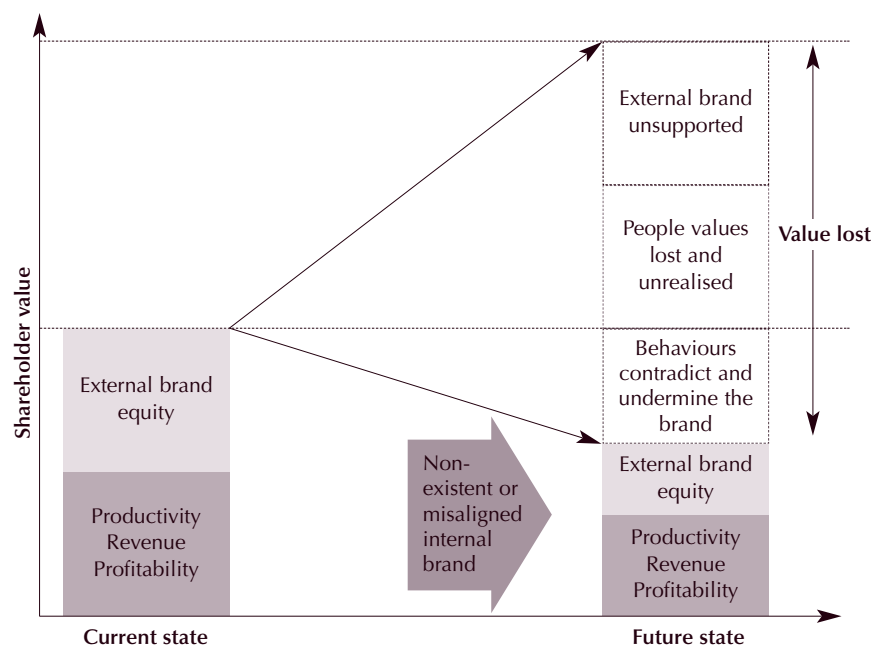
When considering how value is created in today's business environment, the role of people policies has moved closer to centre stage driven by two sets of inter-connected forces:

- As the economic base of most developed economies has shifted away from mass manufacturing towards high value goods and services, the emphasis on tangible assets such as plant and machinery has broadened to include less tangible assets linked to brand and reputation and to intellectual and human capital. Moreover, a considerable proportion of this value is embedded in people since employees are key revenue generators, especially in knowledge-based businesses, as well as being important influences on the perception of the brand (see Box 2)
- The perceived conflict between the perspectives of value held by shareholders (investors) and other stakeholders, including employees, has weakened. In the case of employees, for example, they are increasingly seen as key business stakeholders whose perceptions, attitudes and behaviours can significantly affect businesses' performance. This has been driven, in part, by the more widespread use of employee share ownership schemes. As a result, the alignment of the interests of shareholders and stakeholders' over the longer-term is becoming more apparent and widely accepted

Box 2 The importance of the employer brand

There are many potential interpretations of a firm's brand including the external brand, corporate reputation and the employee experience, but only one underlying set of brand values. For example, the employer's brand can mirror the customer brand in such a way that a company that views its customers as a potential relationship may also view its people as an asset. As a result, as Figure 2 illustrates, a strong internal brand can add value to the business but insufficient attention to it can undermine the business.

Figure 2 The value of the brand



“A company that loses all its equipment but retains the skills and know-how of its workforce could be back in business relatively quickly but one that loses its workforce, while keeping its equipment, will find it much more difficult to recover.”

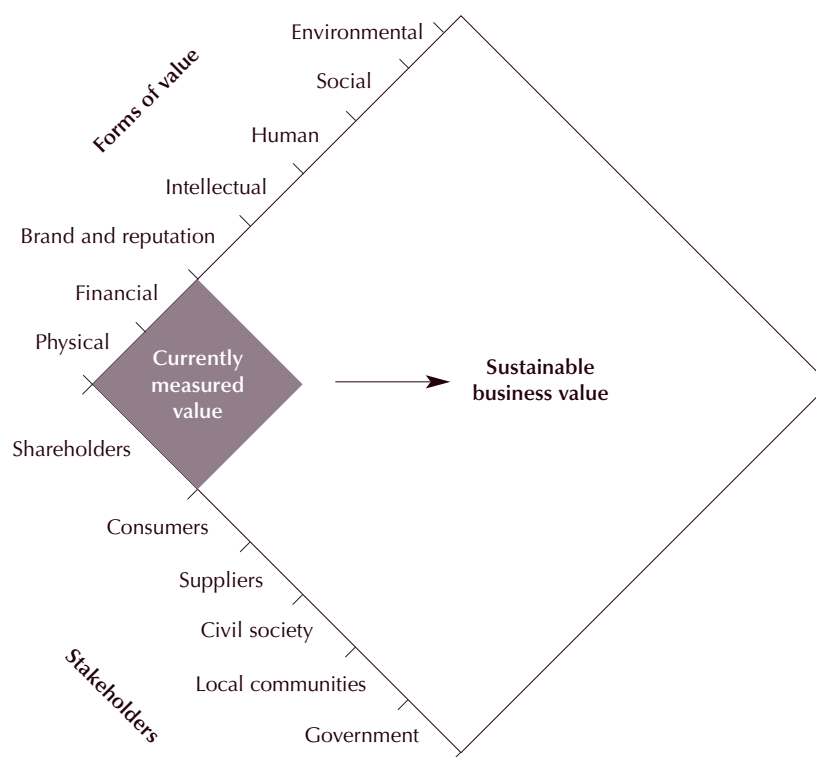
Source: Becker, Huselid, Ulrich (2001), *The HR Scorecard*

Figure 3 illustrates the role played by employees in the creation of business value. It also highlights the relationship between current measures of value and the notion of sustainable business value. As such, it emphasises the limitations of existing financial and management reporting: the contribution of people, especially employees, to future business performance is seen as poorly reflected in historic accounting information.

To some extent, these limitations are reflected in the attitude of institutional investors to the information that is currently being reported by companies. PricewaterhouseCoopers’ research with institutional investors shows that 72 per cent of the performance related information they regard as important covers non-financial measures compared with only 28 per cent which are financial (*VALUEREPORTING*®). Moreover, many of the most frequently cited non-financial measures relate to people, such as management credibility and expertise, alignment of compensation with shareholder interests and ability to attract and retain talented people.

Although businesses are taking the first steps towards reporting the broader impact of their people policies on their business performance, our global industry surveys of the global investment community and interviews with other stakeholders suggest that few robust and reliable indicators of the impact of people policies are currently available either within business or externally. As a result, the long-term contribution of people, and people-related policies, to sustainable business success is perceived as difficult to evaluate and only limited progress is being made.

Figure 3 Understanding sustainable business value



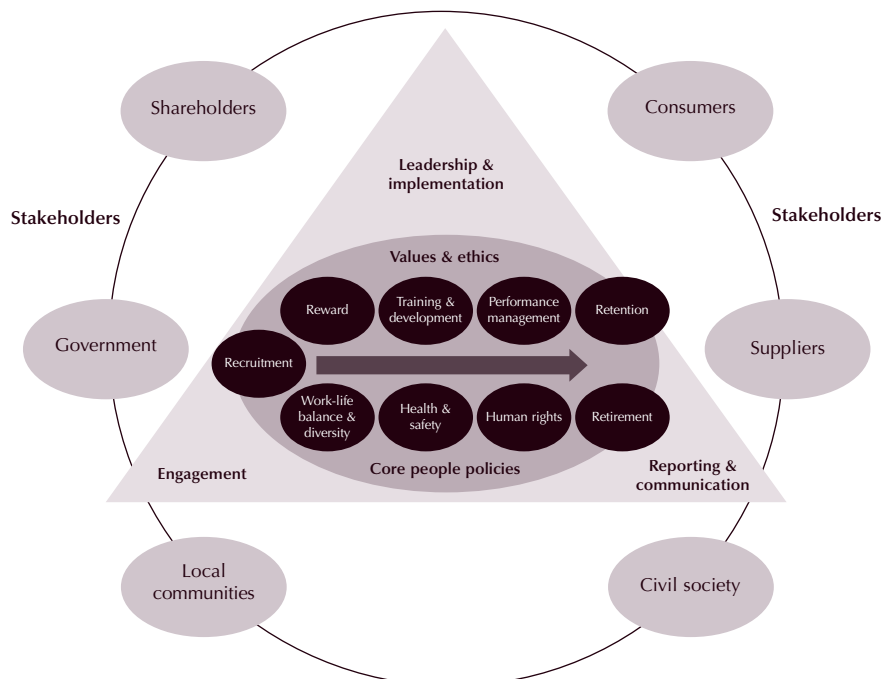
Getting comfortable with complexity

The difficulties with measuring the impact of people policies on business value generation reflect three fundamental factors:

- Many different dimensions to people policies potentially affect businesses' value. They include those directly linked to all aspects of the employee life cycle from recruitment to the point where the employees and the employer part company, for example through retirement or a change of job. They also include aspects such as leadership, reporting and communication and engagement that are central to the contribution of employees to business success
- People policies can affect business value by enhancing revenues (for example, through increased sales resulting from improved customer service), lowering costs (for example, by reducing recruitment costs if retention is improved) and mitigating risks (for example, through reduced risk of litigation). These effects can be both immediate and spread over a longer period of time. A good illustration of this arises in relation to retirement and pension provision. Depending on the type of scheme, the approach of business in this area has important short-term implications for costs as well as its attractiveness as an employer. Failure can be costly in the longer-term if there is a mismatch between pension fund assets and liabilities, and this can have knock-on implications for governments as (last resort) providers of welfare support for the elderly
- Diverse stakeholder interests in employees and their well-being mean that the route to value creation can be both direct and indirect. For example, businesses' policies on health & safety not only affect their costs directly but also impact on other stakeholders in different ways, for example through their effects on the risk of damage to the health of employees and local communities, on potential healthcare expenditures and through their impact on corporate reputation. To the extent that businesses are potentially liable for some or all of these costs, they affect business value

These factors are reflected schematically in Figure 4, which provides a holistic framework for identifying how people policies can generate value for businesses' different stakeholders, including their shareholders and employees.

Figure 4 How people policies add value

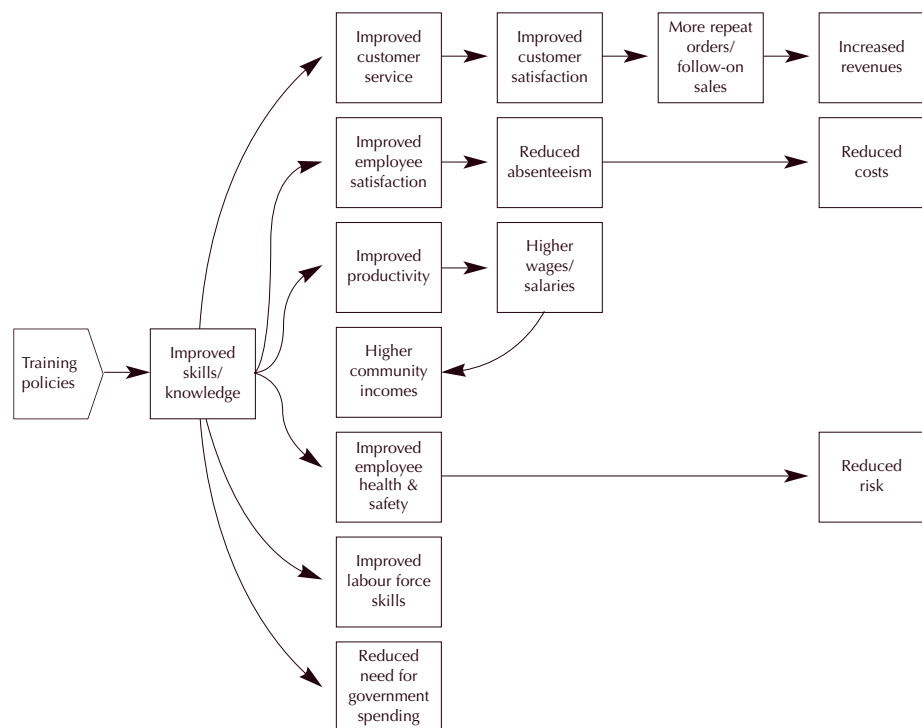


Box 3 illustrates the challenges associated with understanding and measuring the links between businesses' people policies, stakeholder interests and business value by reference to training.

Box 3 Training – stakeholder impacts and potential value generation

Figure 5 summarises some of the key potential links between businesses' training policies and their key stakeholders. Whilst many of the impacts can be traced directly through to an effect on businesses' costs and revenues, they also have impacts on other stakeholders, some of which feedback indirectly into business value. The diagram illustrates the challenges businesses face when seeking to understand the impact of their people policies.

Figure 5 The impact of training policies on stakeholders



The significance of these challenges is apparent in the evidence from our Global Human Capital Survey. This shows that few businesses are engaged in meaningful measurement of the impact of their training policies: Figure 6 (opposite) shows that whilst the vast majority of businesses (92 per cent) measure employees' initial reactions to training programmes and most (60 per cent) measure their impact on skills, this gives little indication of the ultimate impact of training on business performance. Deeper analysis is required if training is to be linked to business value creation. The evidence from the survey, however, shows that relatively few firms use more sophisticated methods to measure the business impacts: only 11 per cent measure the return on investment.

Figure 6 Approaches to training evaluation

Approach	Frequency of use (%)
1 Reactions and satisfaction – measures initial reactions to training	92
2 Learning – measures skills, knowledge or attitude change	60
3 Application and implementation – measures changes in behaviour	43
4 Business impacts – measures business impact changes	26
5 Return on investment – measures monetary impact	11

Source: PricewaterhouseCoopers, Global Human Capital Survey (2002)

Identifying appropriate people measures

Besides the complexity of the potential impacts, other issues add to the challenge facing those businesses wishing to understand how their people policies affect value creation. In particular, the relationship between historic trends and future performance is not always well understood, in part because people – all stakeholders, not just employees – behave in different, sometimes unpredictable ways. Similarly, the methodologies and tools that can link people policies to business value require considerable amounts of data and are, therefore, seen as potentially expensive and difficult to apply rigorously. For example, the value of different skills is evolving as businesses' needs change and this makes their value more difficult to incorporate appropriately into the analysis.

Overall, therefore, the diverse effects of people policies on business value may be both complex and, in some cases, unexpected because of their indirect impacts on the multiple stakeholders. This means that they are frequently difficult to identify and measure in a comprehensive way with the result that very often firms do not understand as fully as they might how their people policies impact on business value.

One ramification of these difficulties is the frequent disconnect between what businesses measure and what is important to value creation. For example, our Global Human Capital Survey shows that internal HR reports in most organisations include data covering headcount, staff turnover and training expenditure (see Figure 7 overleaf). Whilst these indicators are relatively easy to measure, they say little about the impact of people policies on businesses' performance either historically or in the future. In contrast, more meaningful indicators such as employee satisfaction and productivity are less often captured in internal reports. Similarly, indicators of diversity and fair pay, which are important issues for employees, trade unions and other stakeholders, and can potentially impact business revenues, costs, brand and reputation, are only rarely captured. Only 33 per cent of businesses measure fair pay in their organisations and even fewer report data on diversity (26 per cent). This disconnect is illustrated further by the example of training (see Box 3, p.8).

"The first step is to measure whatever can be easily measured. That is OK as far as it goes.

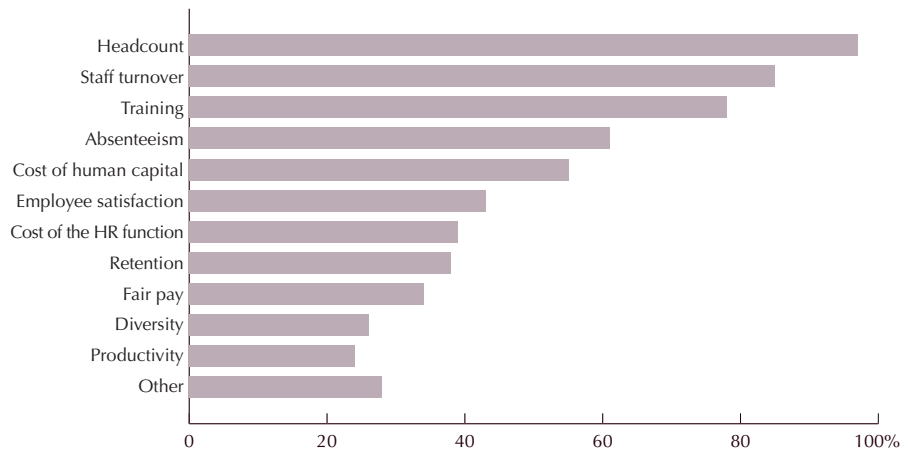
The second step is to disregard that which can't be easily measured or to give it an arbitrary value. This is artificial and misleading.

The third step is to presume that what can't be measured easily really isn't important. This is blindness.

The fourth step is to say that what can't be easily measured doesn't really exist. This is suicide."

Source: Robert McNamara, US Secretary of State for Defense

Figure 7 Categories of information covered by HR reports



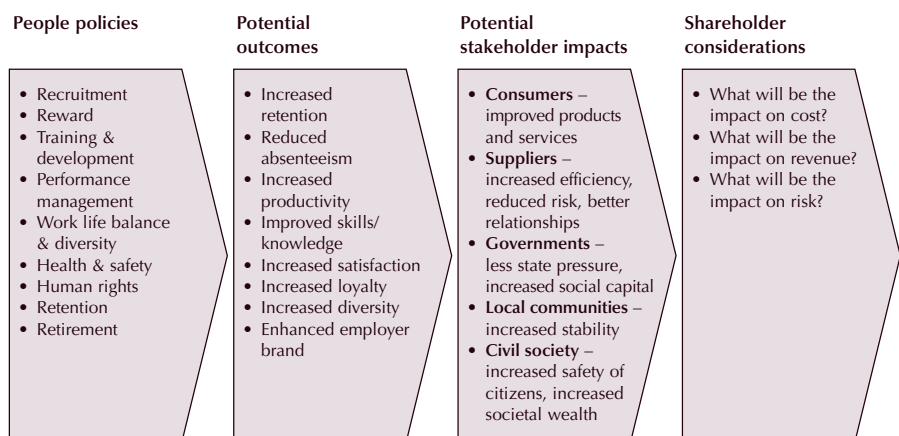
Source: PricewaterhouseCoopers, Global Human Capital Survey (2002)

The inevitable consequence is that many businesses will develop and implement inappropriate people policies and, further, take business decisions that are less likely to unlock the full value that good people policies and processes can deliver.

In practice, these challenges can be overcome by focusing on those elements of people policies that link most strongly to businesses' key value drivers. Identifying these elements requires businesses to be able to assess systematically how each policy will affect its stakeholders and, ultimately, its shareholder value. This involves the four stages illustrated in Figure 8:

- What are the key people policies?
- What are the expected/potential outcomes from each policy?
- How, if at all, do these outcomes impact significantly on the firm's stakeholders (besides its shareholders)?
- What are the direct and indirect impacts of each people policy on shareholder interests in terms of cost, revenue and risk?

Figure 8 Aspects of people policies and potential impacts on shareholders and stakeholders



What should businesses be doing?

If people policies are to be a source of value, businesses need to address each of the six key challenges shown in Figure 9.

Figure 9 How to achieve business success through people



1 CHALLENGE #1 Engage effectively with stakeholders

If a business is to develop a people strategy and policies that can deliver long-term sustainable business value, it needs to engage effectively with its stakeholders to understand how their perceptions, attitudes and behaviours affect it. In particular, it needs to gain insight into all the means by which people policies create or diminish value for the business. It can only do this by working closely with its key stakeholders, including its employees as well as its investors/shareholders (see ABB case study, p.13). Without the understanding that such a close relationship can bring, a business risks being surprised by the unexpected impact of its policies or missing the opportunity to develop people policies that support its overall strategy and enhance the value of its business.

Different stakeholders are likely to be interested in different aspects of a business' people policies. Figure 10 overleaf provides a framework that can be used to structure the identification of different stakeholders' key interests in aspects of a business' people policies. The challenge for each business is to fill the framework by determining those aspects that are most relevant to them since circumstances will vary from country to country, industry to industry and business to business. In practice, this requires all the potential connections between each element of a business' people policies and its stakeholders to be established and then an assessment to be made of their potential importance to the business.

Experience suggests that different stakeholders are likely to be interested in different aspects of a business' people policies, sometimes in less obvious and unexpected ways. For example:

- Employees themselves tend to be interested in all aspects of people policies although the weight attached to each element is likely to vary from business to business depending on circumstances

Figure 10 Stakeholder interests in information about businesses' people policies

		<i>Stakeholder group</i>				
		Employees	Customers/ suppliers	Local communities	Civil society	Governments
<i>Element of people policies</i>	Recruitment					
	Reward					
	Training & development					
	Diversity & equality					
	Work-life balance					
	Health & safety					
	Human rights					

Source: PricewaterhouseCoopers

- Governments' interests are also generally wide-ranging: in some cases, they reflect regulatory responsibilities (e.g. health & safety and diversity) and, in other cases, economic or social interests are the driver (e.g. reward, minimum wage rates)
- Customers often have an indirect interest in business' training policies since this can affect the quality of products and services provided
- Both customers and suppliers are increasingly interested in diversity policies: for instance, in the public sector, the procurement process often requires bidders to demonstrate that they have an acceptable approach to diversity whilst the example of Ford (see p.17) illustrates how consumers' attitudes can be affected by diversity issues
- Civil society has an interest in a business' approach to recruitment: the increasing globalisation of business has led to concerns being expressed at the way in which healthcare, IT and other professional and public service workers are recruited from developing countries and brought to work in developed economies sometimes with adverse impacts on the developing economies
- Local communities may take an interest in the recruitment and training policies of business since they affect the number and quality of jobs and the skills of the local workforce: in some cases, particularly in fragile economies and industries, a business' approach can have an important bearing on the local community through its contribution to employment and the development of workforce skills through training and lifelong learning (see Volkswagen case study, p.15)

Effective stakeholder engagement is a continuous process. Stakeholders' interests will evolve over time for a variety of reasons. The challenge for any business is to keep abreast of these changes, if not anticipate them.

Engage effectively with stakeholders – *checklist of actions*

- ✓ Identify and consult with key stakeholders mapped to policy areas to understand their expectations
- ✓ Identify gaps between current business practice and performance and stakeholder expectations
- ✓ Develop and implement appropriate responses to gaps
- ✓ Engage with stakeholders to report as appropriate on current position and direction of travel

ABB – consulting stakeholders

The ABB Group of companies is a leader in power and automation technologies serving both utility and industry customers. It operates in more than 100 countries and employs around 135,000 people.

“Our experience affirms that stakeholder dialogue is a vital part of a company’s social policy. By addressing the concerns of stakeholders, it confers and strengthens the social license to operate – a crucial factor in achieving sustainability.” *ABB Sustainability Report 2001*

In 2001 ABB published the first version of its corporate social policy based around 13 key principles. Simultaneously, the company launched an ambitious programme of stakeholder consultation reflecting the first principle of the policy. ABB sites in 43 countries were invited to participate in the dialogues of which 34 were able to do so by the end of the year with the remaining countries joining the following year. There followed several months of focused debate involving ABB’s managers and workers and other stakeholders including non-governmental organisations, trade unions, governments, the media and business partners. Often, these took the form of round table discussions with an independent facilitator. The first round of discussions was focused on whether or not the social policy covered the right issues whilst the second round focused on identifying the most important issues, putting social policy into practice and measuring compliance and progress.

“Some tricky moral dilemmas emerged as the moral certainties of ABB’s new policy came up against some of the grey areas of the real world.” *ABB Sustainability Report 2001*

The most frequently discussed principle in the first round was community involvement, followed by health and safety and equal opportunities. Working hours and reward drew the least comment. In the second stage, stakeholders were asked which principles should receive the highest priority in implementation and which were the ones on which ABB was most vulnerable to criticism. Almost all dialogues revealed the need for a clearly defined and planned implementation process. Other issues to emerge were the importance attached to support from the top and the integration of the principles into organisational structures and business processes. Inability to measure performance was the most frequently raised concern: stakeholders expected quantifiable indicators to be defined to gauge performance and year on year improvement. Any lack of such indicators was perceived as a policy weakness. The need for objectives and targets for each principle in the policy was also cited along with the importance of annual reports and external audits. As a result of the comments received, several projects are now under way to tackle the issues raised. For example, specialised teams are developing implementation guidelines and relevant indicators to measure continuous performance improvement. In addition, ABB’s positive experience has encouraged it to engage in further stakeholder consultation on a broad range of company policies with the result that the process has developed into an on-going stakeholder dialogue to address concerns of mutual interest and importance to ABB and its stakeholders.

Stakeholder consultation is conducted at least once a year at both group level and country – the most recent group level consultation was June 2003. Feedback reports have been produced for all participating countries to enable learning and performance improvement. Whereas stakeholder dialogues have in the last two years focused on ABB’s social policy, the agenda for future dialogues will be set by stakeholder participants to address local concerns.

CHALLENGE #2 Integrate people strategy and business strategies: understand what type of employer you need to be

Besides engaging with its stakeholders, the key challenge for a business as an employer is to develop a clear view of its overall vision, values and strategic goals. From this emerges an important question – what type of employer does the business need to be if it is to live up to this vision and these values and goals?

- **Vision:** where is the business going and how does it see itself in the future? The people agenda should figure strongly in this. In practice, this requires the business to be able to describe a snapshot of how it is addressing its future people agenda, for example in terms of its employees, local communities and wider corporate responsibility
- **Values:** the real values – which may not necessarily be the stated values – of a business set the tone for the way in which it operates. They permeate much of what it does. How should the business interact with its stakeholders around the people agenda? What does this mean for leadership behaviours, operational style, employment policies, fundamental attitudes to other stakeholders and the business' brand in the employment market? Safematic has been able to demonstrate this in its approach to employee well-being (see p.18)
- **Strategy:** a business' strategic goals have important implications for its people agenda. A business needs to have an effective approach to strategic planning which looks far enough into the future and considers the unexpected, for example through scenario planning, and which is effectively validated, including with stakeholders. The BT example (see p.15) illustrates how employee and customer needs can help drive strategy with successful business outcomes

Unless these issues are properly addressed, a business' organisational controls are weakened because they are subverted and leaders and managers make daily decisions based on the wrong premises. For the business, the risk is that stated brand values may be perceived to diverge from reality and this will have a detrimental impact on the employment brand, investor confidence and external stakeholder pressure.

The challenge for business leaders in all of this is to identify the real values that should define the organisation. Effective stakeholder engagement can be a powerful tool since the feedback it generates can provide important insights into any emerging divergence between the business' aspirations and the reality. This gives management the information it needs in order to know when to close the gap.

Integrate people and business strategies – *checklist of actions*

- ✓ Validate the ability of the overall business strategy to deliver sustainable business value (i.e. reflecting the interests of key stakeholders)
- ✓ Determine the implications for the key aims and objectives of the people strategy
- ✓ Test the alignment of existing people policies with this implied strategy to identify the gaps which need to be bridged
- ✓ Analyse the most important ways in which people can contribute further to the realisation of the overall business strategy

Volkswagen Auto 5000x5000 – enhancing competitiveness and creating jobs

Volkswagen's Auto 5000x5000 was given its name because the initiative will create a total of 5,000 jobs in Germany and employees earn DM 5,000 per month (€2,556). The project has already enabled 3,500 job seekers to find jobs in Wolfsburg working on the production of a new multi-purpose vehicle and a further 1,500 workers will be employed in Hannover in to work on a new VW microbus. The initiative aimed to help reverse the movement of core manufacturing processes from Germany by demonstrating that top-quality vehicles could still be produced at a competitive cost within Germany. The objectives were to create and secure new, long-term jobs that guaranteed an income sufficient to support a family and generate a reasonable profit margin.

Workers are employed in Wolfsburg under the aegis of a newly founded company Auto 5000 GmbH. The company is based upon an innovative labour model founded on a new agreement negotiated with the social partners. In the model, employees assume responsibility for the scheduled production volumes and agreed quality goals within their field. They are also responsible for adapting their hours of work to meet these requirements. The regular hours of work amount to an average of 35 hours per week. Depending on factory capacity utilisation, working time may increase to 42 hours per week. All overtime is credited to the employee's time account and is generally balanced out with leisure time. In addition, the agreement provides for three hours of training per week; of these, 1.5 hours are remunerated and 1.5 hours are 'donated' by the employee. The initiative has also contributed to the development of workforce skills. Employees are able to enhance their qualifications in two ways: by learning the basic prerequisites in order to enable them to fulfill tasks within Auto 5000 and through lifelong learning within the manufacturing process, for example by gaining qualifications through modules offered during the manufacturing process.

BT plc – benefiting from an engaged workforce

The opportunity to create superior customer service and to have motivated employees is an important win-win. With over 100,000 employees, BT has an established record of tackling this issue head-on by developing a range of attractive life friendly policies and practices.

For example, in 1998, BT's pilot 'freedom to work' initiative allowed around 600 employees to design their own working patterns. The scheme was so successful that it was integrated into mainstream policy on the basis that employees were happier to work in a way that suited their needs. The initiative produced £36 million in real estate cost savings, a reduction in the rate of absenteeism to 8.5 per cent and a maternity return rate of 98 per cent. In total, the company no longer needed to recruit or train 500 people a year, giving a further estimated saving of £30 million. In addition, society has benefited from a £10 million reduction in fuel consumption as a result of 6,000 homeworkers.

More recently, in 2002, BT has looked into new ways of engaging employees and has introduced 'Self Motivated Teams' in its Customer Service unit. The scheme introduces people to a new way of working, which gives them a greater personal stake in how they do their jobs, and a fairer share of the benefits that derive from improved team working and their individual contribution.

The initiative was introduced because it had become clear that the way customer service engineers were paid did not encourage effective working. Historically, their salary was based on the hours worked and not the level of contribution to the business. Within Self Motivated Teams, basic salary is protected but any additional pay is based on a points system, where points can be accumulated on an individual and a team basis. The benefits to the company are a re-energised and committed workforce, improved teamwork and more effective methods of working. As a result, customer targets and expectations are regularly being exceeded.

CHALLENGE #3 Align policies with people strategy

Once a business understands the gaps between the requirements of its strategy, the expectations of its key stakeholders and its current performance, it is in a position to identify and then implement those people policies that will generate the greatest long-term sustainable business value. The critical issue is to ensure that all people policies fit coherently within the overall people strategy: this implies that a business needs to understand how its people policies contribute to the employer brand and, hence, to achieving the objectives of the people strategy and ultimately, the overall business strategy.

Identifying the most appropriate combination of people policies is a challenge in itself. Many dimensions of a business' people policies are potentially relevant and each requires important choices to be made.

In principle, all of these choices need to be informed by an understanding of the likely impacts of each policy, and the interactions between different policies, on the business' value over both the short-term and, in particular, the longer-term.

In practice, however, this may be difficult since the effects will often be indirect, through their impact on all stakeholders (not just on the businesses and their investors/shareholders), as well as direct. Furthermore, it may be difficult to establish ways in which different elements of businesses' people policies interact with each other.

The solution is to focus attention and effort in those areas where employees have the greatest scope for affecting the business' value and then to map as many of the potential impacts and interactions as possible. In this way, a business can make informed choices about the most appropriate people policies.

Alignment of policies – *checklist of actions*

- ✓ Identify key people policy options for achieving an enhanced contribution to the people strategy and long-term business performance
- ✓ Assess potential costs, benefits and risks (both direct and indirect) associated with each key policy option based on stakeholder feedback
- ✓ Determine preferred option(s) and develop policies

Ford Motor Company – managing diversity

Ford Motor Company, one of the world's leading vehicle manufacturers is widely recognised as having a progressive approach to diversity. Ford was named as one of the 100 Best Workplaces in the EU in March 2003 and, in May 2003, was ranked number one among American corporations on DiversityInc's list of 'Top 50 Companies for Diversity 2003.'

Ford's approach to diversity is motivated by the belief that it can be a source of competitive advantage in its global markets. It is seen as broadening the range of talents available, adding to the appeal of its products, especially in new and emerging markets, and enabling Ford to serve its customers better.

"We find that well-managed, diverse work teams can outperform homogeneous teams in quantity, creativity and quality; that complex problems can best be solved by crossfunctional teams typical of matrix organisations; and that people who work, live and learn in integrated settings develop stronger interpersonal communications and negotiating skills." *Ford Annual Report, 2002*

The Executive Council on Diversity leads Ford's wide-ranging diversity policy. It embraces education, experience and religion as well as race, ethnicity, gender and age. It also covers work-life balance. Two examples illustrate the approach being taken in Europe:

- As part of its commitment to developing a more inclusive culture, Ford UK has conducted a baseline equality audit of the company on behalf of the Commission for Racial Equality, and the National Diversity Council and its local counterparts are developing and implementing action plans in response to the results of the audit. This process is now being replicated at other Ford plants across Europe.
- Ford Europe supports several ongoing training initiatives including a project to support approximately 50 juvenile offenders per year in Cologne, Germany, and support for the retraining of many unemployed German workers and a skilled trades apprenticeship.

In part, Ford's commitment to diversity reflects the unwanted publicity received as a result of an advertising campaign in Europe in which Ford's agency used a photograph of workers at Dagenham, UK that originally included five members of ethnic minorities. When the photograph was used elsewhere in Europe the faces of the ethnic employees had been replaced with white faces on the grounds that it 'did not portray the ethnic mix in Europe'. Although Ford management apologised to four of the five employees that were still working at Dagenham and gave each of them £1,500 in compensation, the union was not satisfied and staged a controversial walkout that cost the company an estimated £2.8 million in lost production. There were also indications that certain groups of consumers were boycotting Ford products.

CHALLENGE #4 Develop targets and indicators

Once the aims and objectives of a business' people policies have been determined, taking into account the interests of its stakeholders, a business needs to develop appropriate targets for each policy. These targets need to be supplemented by relevant performance indicators.

The complexity of the potential impacts of people policies means that measures of their contribution to a business' value are potentially hard to define and resource intensive to collect. For example, the importance of stakeholders' interests means that a business needs to go beyond the information provided in traditional financial reports to measures that are more consistent with the view of sustainable business value. This means identifying a set of indicators that captures the most important 'invisible' links between people policies and business value. This is about better, not necessarily more, information. Every business, therefore, needs to develop a set of indicators that can trace the link between the impacts of its people policies and the resulting business outcomes. (See Novo Nordisk case study, p.19.) In practice, this will mean balancing the need for relevance, reliability, understandability, comparability, timeliness and verifiability.

Develop targets and indicators – *checklist of actions*

- ✓ Determine internal information needs in relation to people and people policies
- ✓ Determine stakeholder information needs in relation to people and people policies – identify potential information gaps
- ✓ Identify a set of meaningful indicators/metrics linked to business impact/value based on an assessment of their strengths and weaknesses
- ✓ Set targets in the context of external benchmarks that are relative to strategy and trends
- ✓ Deliver on business principles

CASE STUDY 5

Safematic Oy – enhancing employees' well-being

Safematic Oy, a Finnish company that is part of Smiths Group's Specialty Engineering business group, is a leading manufacturer of lubrication and sealing systems for the pulp and paper industry.

In 1990, the company established an occupational healthcare station and programme to improve employees' working capacity and well-being. The scheme was introduced because one quarter of the company's employees were over 45, an age group seen as more susceptible to illness from ageing and lack of exercise. The company believed that if its workers were mentally and physically well, their working capacity would improve to the benefit of the customer and, ultimately, the company. As a result of the scheme, none of Safematic's employees sought early retirement and the rate of sickness absenteeism fell to just 2 per cent. Safematic's public profile as a caring employer was also enhanced.

Novo Nordisk – developing employee indicators

Novo Nordisk is a focused healthcare company with over 18,000 employees worldwide, of whom almost two thirds are based in Denmark. In 2001, the company developed key performance indicators to measure its people management. Four key indicators were defined and the impact of each indicator upon both employees and the company were also identified (see Figure 11). The indicators cover health and safety in the workplace, the number of people leaving the company and employees' perceptions of their training and development and the company's approach to equal opportunities. The company reports its performance on each indicator and sets targets.

Figure 11 Employee performance indicators

Indicator	Impact	Performance			Medium-range target
		2000	2001	2002	
Frequency of occupational injuries (per million working hours)	<ul style="list-style-type: none"> Increased quality of life for employees Improved work flow and productivity Saved sick leave 	8.4	8.2	8.9	Frequency of occupational injuries (per million working hours)
Employee turnover rate (%)	<ul style="list-style-type: none"> Inflow and outflow of knowledge 	10.6	7.7	6.4	Reduction of unwanted turnover
% of employees who agree or strongly agree that their work gives them an opportunity to use and develop their competencies/skills	<ul style="list-style-type: none"> Increased competence level for employees Increased competency capital 		65%	Not yet available	Follow-up through mandatory surveys
% of employees who agree or strongly agree that men and women have equal opportunities at Novo Nordisk	<ul style="list-style-type: none"> Increased gender diversity in the workplace 		M: 73% F: 60%	Not yet available	Follow-up through mandatory surveys

Source: Novo Nordisk

Employee development is a key priority for Novo Nordisk and is one of five focus areas in its People Strategy along with customer relations, attraction and retention, equal opportunities and a winning culture. These areas are all defined as critical to long-term performance. To measure performance on employee development, all employees participate in a web-based survey "eVoice" which seeks their views on six aspects of employee development:

- "My manager ensures that I have a development and training plan based on my needs and wishes"
- "It is possible for me to keep up with the latest developments in my field of work"
- "My development/training plan contributes to my ability to solve new tasks"
- "In my work unit we have identified the competencies/skills we will need in 2-3 years"
- "My manager follows up to ensure most of the activities in my plan are carried out as planned"
- "My work gives me the opportunity of using and developing my competencies/skills"

Employees are asked to assess how far they agree with each statement using a scale of 1-5 (where 1= least positive and 5= most positive). Average scores are reported both internally and externally. In business units where average scores are below 3, the management of the department is asked to prepare an action plan to tackle the issues by the end of the year.

CHALLENGE #5 Implement through leadership

A business will not derive full value from its people unless it has real commitment and leadership from senior management. Those businesses that are seen as being at the forefront of corporate social responsibility are differentiated by their strong and focused leadership.

Complex and increasing stakeholder demands require some re-thinking of certain aspects of leadership. In particular, leaders must:

- Display vision, strategy and direction: the real values of a business drive its behaviour (see Challenge #1, p.11). Leadership behaviours define the way others behave. If a business' leaders get it wrong, the impacts will be seen elsewhere in the organisation
- Drive adaptability and innovation: the business environment places pressure on a business to develop, for example, new products and services and new markets. Arguably, the characteristics that underpin an organisation's ability to adapt and innovate are conditioned by individuals' behaviours and a business' overall culture. The extent of engagement with stakeholders can affect how far a business can realise the benefits of adaptability and innovation. For example, a product development or marketing department may struggle to reach a diverse customer population if it does not itself reflect the diversity of its customers
- Be able to detect patterns, make connections and act quickly: businesses are finding that the world is changing more rapidly and that the interconnections that exist, for example between stakeholders are much more complex than they were say ten years ago. In addition, information is more readily available and can be more quickly disseminated in the public domain. In this environment, leaders need to be able to tune into emerging issues well before they reach mainstream consciousness and to define appropriate organisational responses. These could range from the unforeseen social implications of technological developments to previously inactive stakeholder pressure damaging the employment brand
- Demonstrate a commitment to transparency to build credibility: stakeholders are demanding greater transparency in order to assess management performance and credibility. Whilst the business impact of people policies is often difficult to quantify and report (see Challenge #6, p.21), there is a point at which lack of information will create doubt. For example, a poor reputation in the employment market can erode investor confidence and, potentially, detract from a business' value
- Work co-operatively and build a consensus: whilst a business' ability to compete successfully is vital to meeting many shareholders' interests, broader social and political developments mean that other stakeholders are sometimes keen to exert more influence over a business' leaders in other directions. In the area of people policies, this could mean responding to NGOs' concerns about employment conditions far down the supply chain, addressing issues about employee representation on boards and meeting shareholders' pressure on executive pay. For a business' leaders, the challenge is to respond to these stakeholders in a way that supports, rather than erodes, the underlying business vision, values and strategy

Implementation and leadership – *checklist of actions*

- ✓ Allocate responsibility for integrating people issues into strategy to the highest level
- ✓ Ensure that senior management understands and recognises the importance of people policies and is also committed to them
- ✓ Introduce a set of processes – from governance arrangements through policies and procedures to management systems – that support the overall strategy
- ✓ Connect the strategy to stakeholders through effective communication and involvement
- ✓ Connect to performance appraisal and reward systems
- ✓ Lead by example and aim to change hearts and minds

6 CHALLENGE #6 Measurement and reporting

To meet transparency concerns as well as to derive maximum value, a business needs to measure and report the impacts of its people policies and, in particular, the value that it derives from them.

Three overlapping groups of indicators are relevant:

- Those which reflect statutory obligations: for risk management reasons, a business needs to monitor compliance with its statutory obligations, for example on diversity and health and safety. Businesses need to think carefully about appropriate measurement and controls internally and how best to communicate these externally to address stakeholder concerns
- Those focusing on performance: stakeholders, especially shareholders, want to see indicators that link a business' people policies and practices to its performance. Whilst existing research has not produced a consensus on the most important aspects, indicators such as employee turnover and absenteeism are the most common, in part because they are also the most accessible. Other indicators, such as revenue or profit per employee, provide some insight into performance, especially when benchmarked against peer businesses externally. Furthermore, our Global Human Capital Survey shows that higher performing organisations have low(er) rates of absenteeism and a greater depth and breadth of performance management. In addition, analysis by Guest (2000)⁴ suggests that people practices affect performance through their influence on employee behaviour, increasing employee skills and abilities, promoting positive attitudes that result in a committed workforce and providing expanded responsibilities that make full use of employees' skills and abilities. Whilst these may be more difficult to measure, insights may be provided by the results of employee engagement surveys, graduate perceptions and investment in management training and development
- Those which are of broader interest: the increasing convergence of shareholder and stakeholder value means that reporting on items of broader importance, for example social factors, is as important as those focused on financial performance. If a business is out of tune with the broader expectations of its stakeholders, it risks being shocked, or even embarrassed, by how stakeholders view its performance even if direct links

⁴ Guest, D., et al (2000), *Effective People Management*.

to financial performance are difficult to show. Such risks might arise in areas such as diversity (e.g. race, gender and age), reward (e.g. around equal pay), health and safety measures (e.g. accidents), training and development and community involvement. Even if a direct link to financial performance is difficult to show, a business' relative performance against its competitors can paint a useful part of the picture of the business

A business needs to consider carefully whether and how it communicates its people policies and their diverse impacts, internally as well as externally. In so doing, it needs to build on its engagement with stakeholders so that it reflects their information needs (see Challenge #2, p.14).

The starting point is to ensure that it has appropriate and effective systems in place to collect the data that are needed to measure the impact of people policies and performance against agreed targets. Without such information, the business is not in a position to manage the policies let alone communicate their impact internally. This requires the development of a robust measurement framework that demonstrates the value to different stakeholders of its people policies (see Royal Bank of Scotland case study, p.23).

In terms of its internal reporting to employees, a business has to address three key questions:

- How should information about its people policies and their impacts be presented?
- What quality and frequency of reporting is appropriate?
- Which channels should be used for internal reporting?

For the other, external stakeholders there are some additional questions to be addressed:

- What should be the format and scope of a business' external report covering its people policies and their impacts?
- Would the reporting be consistent with the business' other external communications, including its marketing and other brand building activities?
- Should a business' external reporting on its people policies and their impacts be assured? How might this add to the value of reporting?
- What are the long-term implications (including risks) of external communication? Once a business starts to communicate externally, it is difficult to reverse

Measuring is managing – *checklist of actions*

- ✓ Define the measurement programme in the context of the strategy, management requirements and stakeholder interests
- ✓ Establish reliable data collection and analysis processes
- ✓ Develop appropriate internal and external reporting formats
- ✓ Measure, monitor and communicate performance to internal and external stakeholders
- ✓ Review data on a regular basis, against trend, external benchmarks and in the context of the strategy
- ✓ Develop and implement effective feedback mechanisms with stakeholders

Royal Bank of Scotland – assessing the business impact of employee policies

The Royal Bank of Scotland Group is one of Europe's leading financial services groups. It is the world's fifth largest bank and employs 111,000 people worldwide.

"With staff costs in 2002 of £3.9bn, measuring the effectiveness of our investment in human capital is a strategic imperative. Maximising this investment delivers a superior employee proposition to attract and retain the best people." *Greig Aitken, Manager, HR Strategy & Planning*

Driven by a desire to better understand the effectiveness of its employment offering in attracting, engaging and retaining staff, the Royal Bank of Scotland Group has developed an engagement model that links people information across the Bank with performance measures such as productivity and employee turnover.

The Bank has identified clear links between increasing levels of employee engagement and increased retention and business productivity as well as reducing employee turnover.

People data (including survey responses) have been aligned to the model and are mapped to eight 'drivers' of engagement including leadership, work-life balance, total reward and non-financial recognition. This allows the group to gain a detailed understanding of what aspects of the Bank's employee proposition strengthen employee engagement levels and, consequently, increase (for example) retention rates. The engagement analysis also helps business leaders develop targeted action plans to improve the engagement levels of their staff.

The work is based on extensive research into other organisations' experiences and, following a validation across 6,000 employees, the model has been embedded in the Group's Employee Opinion Survey (which is completed by over 93,000 staff each year) as well as surveys such as the joiner and leaver surveys.

This provides managers with a comprehensive picture of why employees decide to join, stay and leave the organisation.

Conclusions

The evidence from our analysis shows that smart people policies do add value for business. There is, however, no magic formula that defines the key success factors. What we can say with confidence is that those businesses in which the people strategy is aligned with the business strategy perform better.

These days a much wider group of stakeholders can have an impact (directly or indirectly) on business performance. This means that business needs to manage all its stakeholders and their varying needs although this will inevitably be fraught with important challenges. Our experience shows that those organisations that really make the effort to understand their stakeholders and what is important to them are better able to develop people strategies that address stakeholders' interests and generate sustainable value.

Furthermore, by really understanding stakeholders' needs, business will be better able to decide how they should measure and report the impact of their people policies on business value. This will enable them to define the information that they will need to capture. Those organisations that fail to address the wider stakeholder group risk alienating them and this will potentially damage their business performance.

Many businesses, however, struggle to understand and measure these relationships. This is, in part, because there is still too much focus on narrow financial information rather than other potentially more meaningful measures. As a result, important business decisions about people policies are often made without access to adequate information.

Implementing a framework for measuring, reporting and then (most importantly) communicating the outcome of business' people policies can help to lessen conflict among stakeholder groups. Moreover, greater transparency will inspire loyalty, strengthen the brand and ultimately create value for shareholders and other stakeholders alike.

With the continued development of the knowledge-based economy, the framework for business accounting needs to shift towards one which better reflects the diverse value drivers. Given that people add significantly to value, business needs to start accounting fully for its people. If it does this, the interests of shareholders will converge further over time with those of stakeholder interests as businesses become more transparent.

The research in this report was conducted by PricewaterhouseCoopers' Human Resource Services, Sustainable Business Solutions, **VALUEREPORTING**[®] and New Europe.

About Human Resource Services

PricewaterhouseCoopers Human Resource Services works with clients who aim to make their people a sustainable source of competitive advantage. Working closely with clients we offer practical, multi-disciplinary approaches to increasingly complex challenges facing businesses. With the ability to take fresh perspectives and think differently we develop and implement new, value-adding solutions. HRS brings together PwC professionals in the HR services arena, including retirement, tax and legal experts, affording clients unmatched breadth and depth of expertise.

About Sustainable Business Solutions

PricewaterhouseCoopers Sustainable Business Solutions has around 400 experts worldwide working in the field of sustainability and corporate responsibility helping clients improve their social, environmental and economic performance and create long-term shareholder value by developing strategy, governance, performance management and reporting solutions. These solutions take into account the need to respond to the expectations of stakeholders while grasping opportunities, stimulating innovation, improving productivity, managing risks, and strengthening market trust and credibility.

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VALUEREPORTING[®] is PricewaterhouseCoopers' innovative approach to performance measurement and corporate reporting designed to meet investors' needs for more and better information. **VALUEREPORTING**[®] supplements traditional financial reporting by helping companies provide a more detailed, transparent picture of their performance – market opportunities, strategy, risks, intangible assets, and other important nonfinancial value drivers. Research across a range of industries involving corporate executives, investors, and analysts worldwide has enabled PricewaterhouseCoopers to develop a suite of practical, proven **VALUEREPORTING**[®] services to help companies improve their corporate reporting and achieve greater transparency.

About New Europe

The New Europe Programme was established in May 1999 against a backdrop of unprecedented change across Europe. Since then, through its thought leadership activities, the programme has continued to examine the implications of important business issues including the introduction of the Euro, capital market integration, pension and savings reform, labour mobility and enlargement of the European Union.

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