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Global Asset Management

When work doesn't work

Why investing in people is good for business

The RBC Global Equity team

"It would appear that Covid-19 has acted as a catalyst for individuals to re-evaluate their priorities, and their relationship towards employment and the labour market as a whole."

Human capital and corporate culture are among the greatest contingent assets a company enjoys. And in times of changing socio-economic trends, staying focused on extra-financial sources of capital is key to generating shareholder value. As long-term investors, we believe that now is the time – more than ever, in fact – to pay attention to great businesses displaying a competitive advantage through these extra-financial forms of capital. It is these intangibles that will ensure a company is able to remain relevant in today's environment.

Covid-19: a catalyst for change

When listening to earnings calls over the last couple of quarters, references to "The Great Resignation"[1] have become increasingly prevalent. A phenomenon that began in the U.S., businesses across the UK and Europe are now facing similar challenges:

- During the last year, a record number of Americans voluntarily quit their jobs, totalling over 47 million[2], a figure which equates to almost one-third of the total nonfarm workforce.
- Resignation levels continued to soar during the first half of 2022.
- The number of job openings reached the highest level in American history at the end of March this year, with employers posting more than 11.4 million jobs in aggregate.

These statistics suggest that there has been a mass exodus from the workforce, and apparent staff shortages within the hospitality and travel industries, for example, seem to prove this thesis. It would appear that Covid-19 has acted as a catalyst for individuals to re-evaluate their priorities, and their relationship towards employment and the labour market as a whole.

[1] The term was first used by Anthony Klotz, a professor of management at University College London's School of Management, in May 2021.
[2] U.S. Bureau of Labor Statistics

Going back to the beginning

Interestingly, if we dig a little deeper into the data, it appears that the Great Resignation is essentially a continuation of a trend which started after the world emerged from the recession caused by the Great Financial Crisis (GFC). When applying a linear forecast from September 2009, which marked the first quarter of economic expansion following the GFC, to February 2020, it seems that resignation rates are just marginally higher than a trend continuation of an annual increase of 0.11% would suggest (Figure 1).

A certain level of quitting is consistent with a healthy and functioning labour market. This seemed to be 2-2.5% of the workforce prior to the GFC. Quitting had been stable but fell as a result of the GFC when workers were less likely to voluntarily leave their jobs, probably because they felt less confident about finding another.

It took a long time for that confidence to rebuild. The legacy of the GFC lasted years and it was not until 2016 that quitting returned to pre-GFC levels. Interestingly it has now exceeded that. In the way that the GFC had a psychological effect on quitting behaviour that took years to normalise, could the pandemic have had a similar behavioural effect?

The dramatic surge in resignation rates after the pandemic, which is in stark contrast to the gradual normalisation after the recession in 2008/2009, suggests a revaluation of priorities and favouring a healthy work-life balance over income security, a trend that can be increasingly observed between Millennials and Generation Z, who account for the largest share of the U.S. workforce. As an example, research has shown that 75% of Generation Z would prefer working patterns where they either split their time between remote and on-site work or work entirely from home[3].

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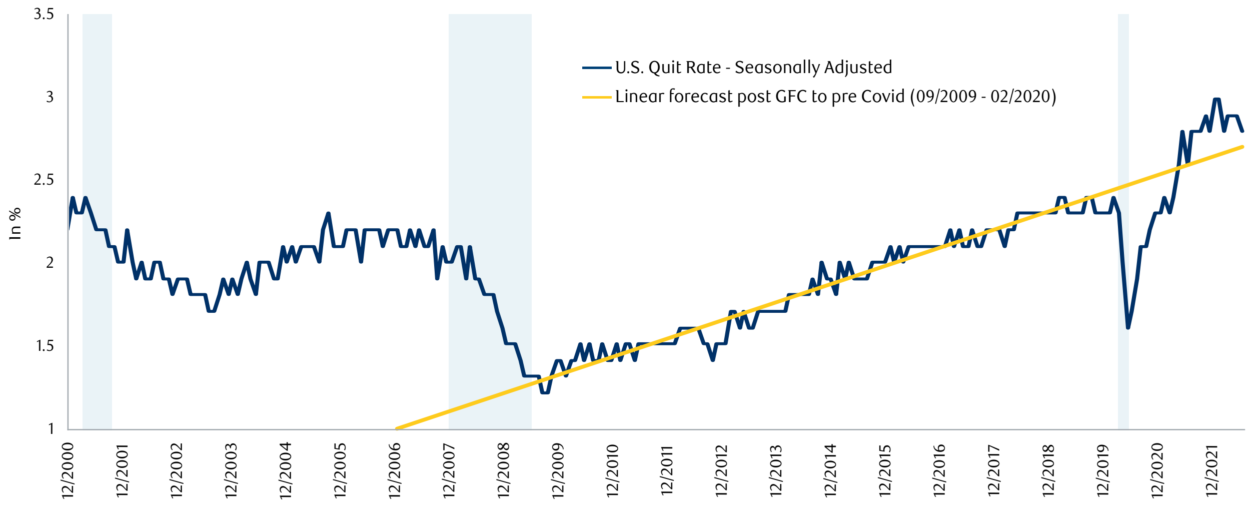
[3] https://www2.deloitte.com/content/dam/Deloitte/global/Documents/deloitte-2022-genz-millennial-survey.pdf

Figure 1: U.S. quit rates (SA) since 2000



Source: Bloomberg, U.S. Bureau of Labor Statistics, RBC

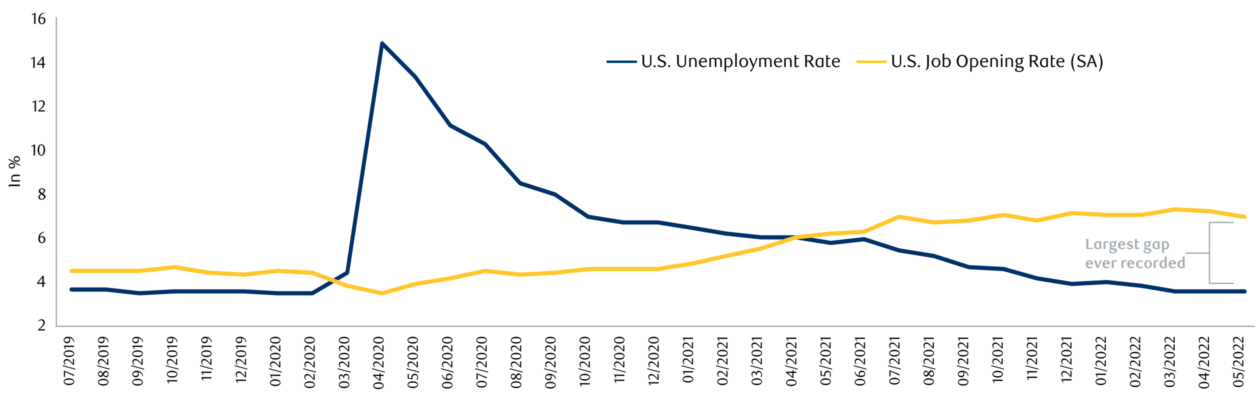
Time to quit

With the arrival of the pandemic, the contraction of the economy and the associated widespread uncertainty, the number of voluntarily-resigning employees dramatically decreased by 46%. As this uncertainty began to wane at the start of 2021 and optimism once again started to dominate the narrative, we saw a reversal as a record numbers of employees took the opportunity to resign, thus sparking the phenomenon of the Great Resignation.

It is worth noting here that the increase in resignations captures those employees who would have otherwise resigned in 2020 had the pandemic not occurred, and hence quit rates are broadly in-line with their long-term trend, as illustrated in Figure 1.

Looking at the U.S. unemployment rate reveals another interesting development; the rate decreased back to the pre-pandemic level of 3.6% in June of this year, matching the 50-year low initially achieved in December 2019 (Figure 2). This suggests that employees are not resigning from their jobs to permanently exit the labour market, but rather signals a strong job market with ample opportunities for workers. However, it raises the question of where the historic anomaly of job openings and unemployment originated from?

Figure 2: U.S. unemployment versus job opening rate



Source: Bloomberg, U.S. Bureau of Labor Statistics, RBC

The Great Resignation...or the Great Reshuffle?

On this point, it would appear that many employees chose to retire over the past two years due to a reconsideration of their work-life balance, coupled with the opportunity to benefit from elevated asset price valuation and stock markets which surged to all-time highs during 2021. Another fallout from the pandemic seems to have been in the hiring efforts of companies, with a visible reduction in this area being seen across several industries. Lastly, the uncertainty of 2020 coupled with years of stagnating wage growth seems to have evolved into a new boldness among workers who are now demanding better deals from their employers.

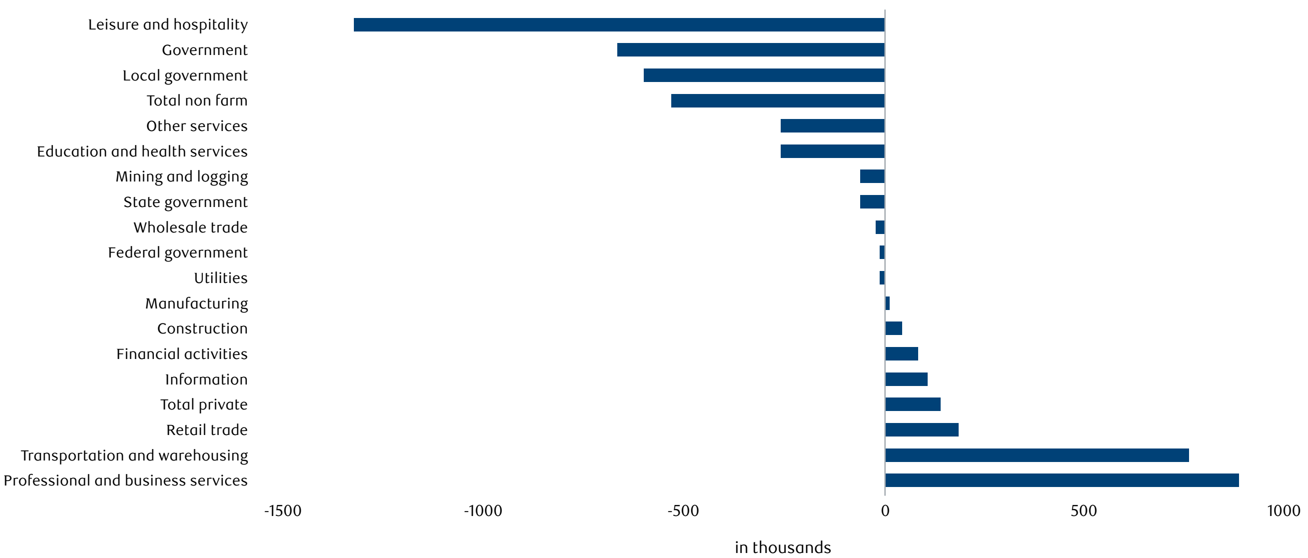
Employees are seeking better opportunities due to dissatisfaction surrounding salary, benefits or working conditions, rather than exiting the labour market completely. Indeed, the greatest spike in quit rates can be observed in the lower-paid industries such as hospitality and leisure, non-durable goods manufacturing and the retail trade.

On the other hand, employees on nonfarm payrolls increased in traditionally higher paying industries such as professional and business services, as well as in the information sector. It is interesting to observe that resignation rates within the retail trade sector are at an all-time high while the total workface in this industry has actually increased since the pandemic. While this seems counterintuitive, it does underline the new bargaining power of employees which forces companies to offer higher wages, more competitive benefits, and more flexible work arrangements to new employees. Additionally, companies have to provide their employees with more autonomy and a greater sense of purpose.

LinkedIn CEO, Ryan Roslansky, referred to the current situation as the 'Great Reshuffle' rather than the Great Resignation (Figure 3). This seems to be the right observation, as illustrated by data as of June 2022, which showed that the total number of nonfarm payrolls decreased only by -0.3% compared to pre-pandemic levels, indicating an almost equivalent level of employees participating in the labour market.

Moreover, hiring rates exceeded resignation rates by 1.5% in April and are geographically aligned, meaning that the reshuffling is taking place between industries rather than locations. It would appear that the frequently-cited relocation as one of the causes of the Great Resignation does not play a material part.

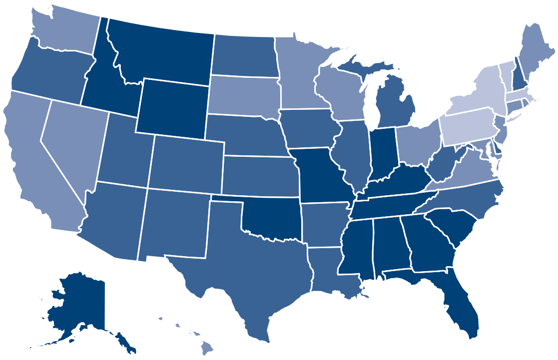
Figure 3: Employment change by industry (SA) since February 2020



Source: U.S. Bureau of Labor Statistics, RBC

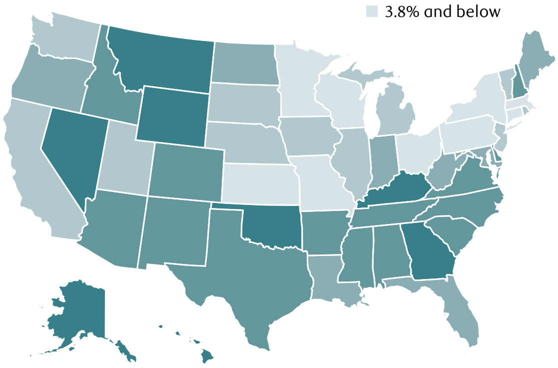
Figure 4: State quit rates, April 2022, seasonally adjusted

Total U.S. quits rate: 2.9%



State hire rates, April 2022, seasonally adjusted

Total U.S. hires rate: 4.4%



Source: U.S. Bureau of Labor Statistics

Retain, adapt, evolve...

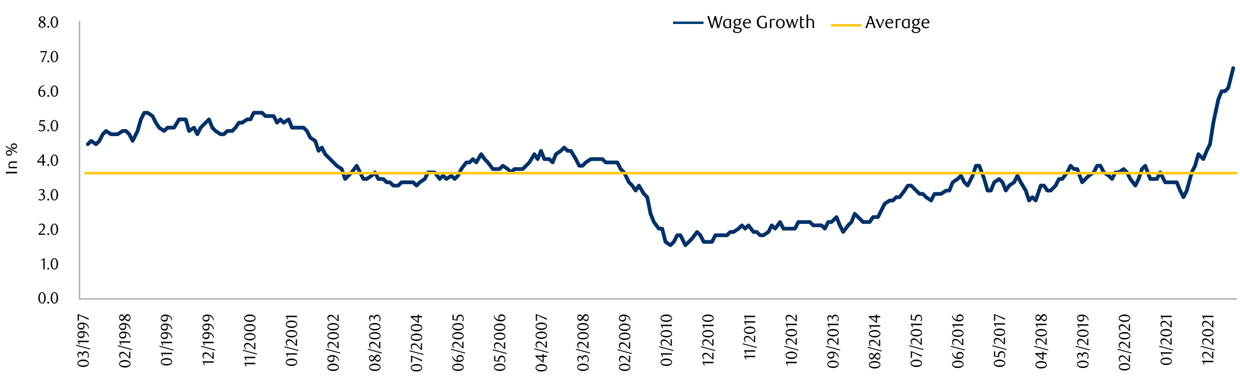
The process of sourcing, recruiting and onboarding a new recruit can be a costly and resource-intensive process, so it is vital for any successful business to be aware of the true cost for replacing an employee, and to understand how to retain talent.

In the current economic environment, the cost of replacing staff is likely to be on the increase and companies are recognising the need to take action. Amazon, for example, has recently increased its minimum wage across the U.S. from USD 15 to USD 18 per hour, which is significantly higher than the legal minimum wage. Looking at the Federal Reserve Bank of Atlanta wage growth tracker, we have seen the steepest increase in wage growth in 25 years, mainly driven by non-college degree employees and "job switchers" as opposed to "job stayers".

Furthermore, it would seem that quit rates are disproportionally driven by Generation Z where the turnover rate is almost three times the national average according to data from ADP, one of the leading processors for payrolls. This also corresponds with data from LinkedIn, which tracked the percentage of members with recent job changes and saw an increase of 134% among Generation Z compared with pre-pandemic levels, far exceeding that of Millennials which rose by 24%.

Additionally, according to a study conducted by Jefferies, only 20% of survey participants strongly support office working, as opposed to remote working, and 75% of respondents showed a significant interest in a four-day working week. As Generation Z will account for roughly 40% of the global workforce by 2030, employers will need to adapt to changing work patterns in order to compete within a tight labour market.

Figure 5: Atlanta Fed's Wage Growth Tracker



Source: Bloomberg, Federal Reserve Bank of Atlanta, RBC

A specialist's perspective

We recently hosted a roundtable where an economist and thought leader, with decades of experience in working practices, shared his views on how businesses can combat the Great Resignation.

We discussed the impact of the pandemic on recent changes in the labour market and how employers are responding.

It was acknowledged that for knowledge workers the pandemic had generally provided them with more choice and flexibility. However, for others, especially those in essential roles, it had taken agency away from them. The unequal consequence of the pandemic is now expressing itself in greater staff turnover, creating challenges for employers.

The discussion identified two likely approaches employers may take: a constructive approach which internalises some of the new ways of working in order to attract and retain staff or a more conventional approach that seeks to return to the pre-pandemic status quo with only token efforts when it comes to areas such as hybrid working.

Good management leads the way

Management plays a key role within firms, acting as an enabler of talent when it functions well. But management can also inhibit value creation with employees increasingly less likely to be tolerant of poor management practices. Poor employee satisfaction can lead to increased staff turnover and this feeds through to corporate results in time. However, by then it is invariably too late.

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The world of work has changed dramatically in the wake of the pandemic and there is an opportunity for companies that are willing to optimise new ways of working, improve leadership and respond to employee needs. Ultimately, this should lead to satisfied employees, effective organisations, improved performance and happier societies – a solid investment for any company to make.

Conclusion

In a time of changing trends, organisation and senior management leaders will have to rethink how to preserve and steward their most important assets in responsible and sustainable ways.

Companies willing to optimise new methods of working, which have strong, effective management and respond to employee needs will have the ability to create contingent assets in the form of engaged, motivated human capital. Such assets may not be available in financial statements, but they have the power to determine the path of a company's long-term financial performance.

Ultimately, investing in these great businesses reduces risk and uncovers differentiated alpha sources, therefore generating value for shareholders that significantly exceeds the return on the average company or the market.

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