



Will the looming war for talent impact your business?

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Labor and the Production Process

The three factors or inputs of production are land (including natural resources), capital, and labor. The American economy is reliant on resources (both natural and human) to drive production. Through the production process these factors are transformed into outputs (good and services) that people will want to consume.

The issue of resource availability and rate of resource utilization are factors that economists examine to determine if growth levels can be sustained without adverse price (inflation) consequences. One such barometer are labor indicators including the unemployment rate, pool of available workers, and wage rates and compensation costs.

Many economists are concerned that the unemployment rate which has recently fallen to 4.7% is too low. Other signs that the labor demand market may be outstripping supply include first time claims for unemployment which incidentally are at their lowest levels since the dotcom era.

While no one would argue that employment is better than unemployment, policy makers worry about an unhealthy imbalance. Specific concerns center on the unemployment rate reflecting competition for workers resulting in higher wages, rising production costs and inflationary pressure. The potential for inflation is evident in the numbers. Average hourly wages have risen 3.3% over the last year and are well ahead of their 4 year average. The last time this happened was during the mid 1990's but new technologies also emerged pushing up productivity and keeping costs per unit in check. Companies were able to absorb the extra costs because it resulted in more production and more earnings.

Today consumers have a global economy to thank for keeping prices in check. The rapid growth of globalization and the associated competitive marketplace has limited companies abilities to pass on costs to consumers. Companies have responded

by limiting benefit costs and other ancillary compensation expenses.

Unlike the low unemployment rates in the late 1990's brought on by rapid business growth, conditions in 2006 seem to be the beginning of a long term trend brought on by the changes in worker demographics. It is my opinion that companies must invest in new, progressive Human Resource practices to win the emerging battle for talent. Progressive organizations must retool their Human Resource systems (employee recruitment, development, compensation and rewards) to align with the shifting demographics and cultural attributes of the next generation of workers. It is those companies that will realize a significant return on their labor investment, insulate themselves from worker defect, and position themselves to develop and exploit their collective intellectual property in the knowledge economy.

This paper will examine that issue along with the challenges, opportunities and tough decisions modern business leaders will need to make over the next two decades as they endeavor to make themselves more attractive to a changing workforce.

Diminished resources. Diminished loyalties.

Consider this: In 15 years about 77 million Baby Boomers will be retiring but only 44 million Generation Xers are in the pipeline to take their place. At the same time, the United States economy is likely to grow at a rate of 3% to 4% per year. Even if organizations successfully retain the majority of their talented Generation Xers, and increase productivity thru new technologies and innovative work platforms, significant labor shortages are likely to occur, restricting opportunities for growth and expanding corporate costs. Some economists and Human Capital experts feel the current buyers' job market is about to turn. If the job market takes off it is not illogical to expect that frustrated, over-worked, under-appreciated employees will look to leave.



Companies that haven't taken time to build loyalty and foster a level of employee engagement will be left with diminishing and shrinking options especially for highly touted managers and skilled workers.

Employee engagement is the state of emotional and intellectual commitment to an organization or group. It is a by-product of an organizational climate that promotes shared assumptions, values, visions and beliefs about an enterprise and its function in the marketplace. It produces behavior that will help fulfill an organization's promises to customers, and in so doing, improves business results. It is related, but not equal to, employee satisfaction and commitment to stay.

With the prospect looming for an all out war for talent many organizations are now focusing in on practices, platforms, tools and techniques that promote and sustain an otherwise elusive level of job loyalty and commitment that is otherwise missing from this new generation of workers.

Generation Xers

Generation Xers (born between 1964-1977) started their careers in the early 1990s, amidst those first waves of downsizing, restructuring, and reengineering. They have seen draconian changes and have lived through economic revolutions, booms, busts, bubbles, consolidations and corrections. Generation X came of age during the mythic new economy and are the first generation to reach mature adulthood in the real new economy of highly interconnected, rapidly changing, fiercely competitive, knowledge-driven global markets. They are self-sustaining survivors, who are extremely mobile. They know no loyalty (job security is not a concept they have ever experienced) and will change professional occupations at a whim. Generation X is sometimes referred to as the "opt-out revolution" where a career is simply "a job that one has had too long." This generation has experienced or at least witnessed (and perhaps even orchestrated) offshoring of jobs, reduced benefits, and defaults on pension plans. As a result, Generation X workers have been conditioned to watch out for themselves. This breed of workers is more likely to think of themselves as a "free agent" loyal only to him/herself and his/her family.

What does this group want from the work environment? Positive working relationships, interesting and challenging assignments, and opportunities to learn and grow. When these conditions are absent in the workplace, Generation Xers defect.

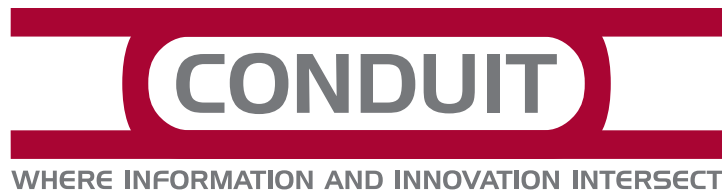
Generation Xers are independent thinkers. Many Generation Xers are becoming entrepreneurs. By a margin of two-to-one, this generation is more likely to start their own company than be a senior executive in a large firm. One-fifth of all small business owners in the United States are Gen Xers, and the Gen X start-up rate is three times that of older age groups. Entrepreneurship is especially attractive to Gen X moms who may want to parent their children on a full-time basis while also earning an income.

That's OK; offshoring will make up for the slack. Won't it?

The subject of off shoring generates extreme differences of opinion among policy makers, business executives, and thought leaders. Some have argued that nearly all service jobs will eventually move from developed economies to low-wage ones. Others say that it is impractical to for service driven companies to stay competitive offshoring key positions that require extensive interaction and co-development with colleagues.

Broadly speaking, today's technology has made it possible for a suitably qualified person anywhere in the world could undertake any task that requires neither substantial local knowledge nor physical or complex interaction between an employee and customers or colleagues. While firms have successfully offshored engineering, accounting, and customer care positions, rising wages in key cities in India and Eastern Europe indicate that the supply of offshore talent addressing these disciplines is already running thin.

Some multinationals are hesitant about making investments in countries without proven track records, favorable tax conditions, rigorous patent protections, and/or infrastructure improvements. As a consequence there is a lemming effect. Companies that hire offshore talent tend to follow one another to locations with a track record of success instead of choosing places that meet each



and every need.

It will be interesting to observe if individual governments will enact policy to make their countries more attractive to multi-nationals by reducing the level of bureaucratic interference, improving the local infrastructure, increasing the competitiveness of tax regimes, and strengthening intellectual-property laws.

In practice, just a small fraction of the jobs that could go offshore actually will. Today, around 565,000 service jobs have been offshored to low-wage countries. By 2008, that number will grow to 1,200,000. Projecting these numbers to the entire global economy, total offshore employment could grow to about 4,000,000 in 2008—just 1 % of the total number of service jobs in developed countries.

Off shoring will probably continue to create cheaper labor alternatives for some firms addressing select positions, but it not likely materialize as a long-term solution for companies looking to close productivity gaps.

Is the Government likely to intervene?

Not likely thru monetary policy. Monetary policy produces tradeoffs. The policy makers have not shown a strong desire to significantly curb growth in exchange for slight higher unemployment. Federal intervention through monetary policy is difficult to forecast but at this point is unlikely. Ben Bernanke, in his first public speech as Federal Reserve chairman, laid the case that keeping inflation low will foster economic growth and sustain job creation. Bernake reinforced the notion that price stability is the central issue and contributes importantly to the economy's growth. When prices are stable, businesses, consumers and investors don't have to worry that inflation will eat away at their investments and paychecks. They also can feel more confident about longer-term financial planning.

With that said, however, Bernanke also noted he would like to see the Fed spell out acceptable bounds for inflation. Former chairman Alan Greenspan, who retired Jan. 31, didn't like that approach, contending it could crimp the Fed's flexibility.

Of course not all economists believe that we are at full employment and beyond our capacity to support economic expansion. In addition to unemployment totals and unemployment rates, The Fed will continue to monitor wage and productivity data to assess the possibility of inflation. Data that is tracked includes; Civilian Labor Force (defined as the sum of employed and unemployed persons), Average Weekly Hours, Average Hourly Earnings, Employment Cost Index, and Productivity.

The Employment Cost Index (ECI) is a measure of the change in the cost of labor, free from the influence of employment shifts among occupations and industries. It includes changes in wages and salaries and employer costs for employee benefits. Many consider the Employment Cost Index as the most comprehensive measure of labor costs and related growth rates. As such, it can signal wage inflation and is closely watched by the Fed. Unlike the Average Hourly Earnings measure of wage inflation, the ECI is not affected by shifts in the composition of employment between high-wage and low-wage industries or between high- and low-wage occupations within industries. Thus, the ECI represents labor costs for the same jobs over time.

Should the ECI continue to trend upward the Fed may continue to raise interest if rises are in excess of productivity growth and are deemed to be a driver of inflation. A large rate of growth in the ECI may make it more likely that the Fed will increase the Fed Funds rate. While this might prove beneficial to the bond market perhaps, but higher wage inflation is not good for the stock market because high wage growth may reduce profits and of course higher interest rates will make borrowing money more difficult.

While many believe that we are carefully close to the unemployment rate actually fueling inflation and are worried about the propensity for wage inflation, Bernanke hinted that "accepting higher inflation, policy-makers could bring about a permanently lower rate of unemployment."

The political pressures brought about by some of the recent pension defaults and the chronic escalation in medical benefits may bring about fiscal policy changes.



Lawmakers and economists are increasingly concerned that the overall health of the pension system is being strained by corporate troubles, an aging work force and complex funding rules that allow plans to quickly fall behind.

Implicit liabilities involve a moral obligation or expected responsibility of the government that is not established by law or contract but instead is based on public expectations, political pressures, and the overall role of the state as society understands it.

The Pension Benefit Guaranty Corp (PBGC) is funded by insurance premiums paid by employers who sponsor insured pension plans, plus any money earned from investments and any funds from pension plans they acquire.

Even though the PBGC is not funded by general tax revenues, the American taxpayer in the end could be footing the bill as a result of inadvisable government policy. More and more companies in recent years have defaulted on their pension plans, transferring a great deal of under-funded pension liabilities to the federal government. According to the Wall Street Journal, the agency has taken on obligations exceeding its assets by \$23.3 billion -- including the United Airlines bailout.

Reports indicate that 1,108 pension plans were under funded by \$354 billion at the end of 2004, up from just 221 such plans in 2000. Reasons include financial troubles that squeeze cash, low returns on pension fund investments and waves of early retirements that boost payouts.

The issue gained national attention when United Airlines' moved to dump its pension plans in bankruptcy court — the largest pension default ever.

The Bush administration and rattled legislators want to tighten pension funding rules and increase annual payments. Congress is considering bills to stem a rising tide of under funded pension plans and make sure defaults don't swamp the federal agency that insures payments to workers. Rising Healthcare costs also pose challenges for fiscal policy makers. Clobbered by annual double-digit price increases for employee health benefits, many

businesses have passed on the costs of health care to workers or dropped coverage altogether.

Health coverage is increasing difficult to afford. 43.4 million people in the United States were without health insurance coverage. A national survey of small businesses by the National Blue Cross and Blue Shield Association and the Employee Benefits Research Institute found that one in seven companies with fewer than 100 employees said they plan to drop health insurance due to its costs.

Healthcare expenditures in general, and spending on prescription drugs in particular, have grown significantly over the years as a percentage of the Gross Domestic Product (GDP). In 2006 Healthcare expenditures will account for 15.1% of the GDP and are expected to rise to 15.9% by 2010.

At some point The Federal Government may be forced to cover the uninsured or mandate that companies do it. Either way the healthcare crises in the United States will add to the cost of doing business either through increased taxes or direct premiums. As the growing ranks of "employed and uninsured" who may often forgo care until they need to go to the emergency room, the government is forced to pick up the tab for the uninsured anyway. This issue is liable to prompt increasingly passionate political debate.

How do these economic conditions change the contract between employer and employee?

Being a prestigious employer means little to this generation. If companies want Xers to come to work for them (and stay) they will have to retool their Human Resource systems, create a classless and cooperative culture, encourage and facilitate open communication, offer frequent feedback, engage them in decision-making, make work interesting and fun and provide ample opportunity for personal growth and learning. In short they will need to focus on recruiting those employees that already work for them, building and fostering a strong sense of employee engagement.

While investment in work force tools and processes that build a cooperative culture, create role identity, and foster a common vision thru communication



and reward systems will cost more per employee, the business case for engagement is compelling. Engagement is highly correlated with key business metrics including; employee productivity, retention, sales growth, customer satisfaction, and total shareholder return. Improving engagement has direct, positive impacts on business metrics.

How will employers do it?

Gen Xers look for tangible results on a daily basis. They grew up in a fast-paced, high tech world and want instant results. Companies will need to redesign compensation and assessment tools to give them more frequent feedback. Xers respond positively to feedback that's more frequent than what companies are used to. Industry research indicates that the vast majority of job-seekers are looking for career opportunities in cooperative, supportive workplaces. Manager-to-employee along with peer-to-peer recognition programs administered at the local level close the feedback gap that annual reviews and/or quarterly assessment fail to satisfy.

Non-cash will play an increasingly important role.

As wage pressures loom, organizations have realized that non-cash incentives (tangible rewards in lieu of cash compensation) are often more effective in driving incremental productivity and sustaining employee engagement. For decades a debate has raged over the pros and cons of non-cash versus cash awards. At the heart of the debate is the premise that one is better and thus more effective than the other, creating an "either-or" situation. Enlightened organizations now realize that both have merit and, when properly utilized, non-cash can create a dynamic, flexible, highly motivational, cost-effective compensation component.

So are you well positioned?

While the importance of productivity has never been greater, HR's strategic connection to corporate growth by attracting, developing and retaining a

talent pool is only beginning to be understood and appreciated by "C" level colloques.

Up until the 1990s the percentage of shareholder value could almost be completely attributed to the financial performance and capital assets of the firm. This proposition has dropped in the last decade and now a larger percentage of market valuation (as high as 80%) is made up of intangible assets.

"The triple bottom line" is a relatively new business expression that explains this new focus. Market value calculation has morphed from simply a numbers issue to an integrated analysis that measures a company's ability to generate wealth in conjunction with available environmental and human resources. It has become a way to value a firm's ability to carry on into the future.

In the capital markets, the triple bottom line concept calculates not only a firm's ability to generate wealth, but its ability to do so over time thru the constructive exploitation of available resources. Highly valued firms are proactively managing their natural and human resources.

The growing importance of intangible assets in determining the value of a business' value is the main reason many business leaders outside the Human Resource profession are starting to better understand the strategic worth and relevance of Human Capital Management.

The opportunity for Human Resource executives to play a driving role in sustaining organizational success and contributing to market valuation has never been greater. Addressing barriers to productivity is one of the key ways HR professionals will be able to make a major difference in the productivity rates of organizations they work for.

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