

## SECTION I

# UNDERSTANDING AND MANAGING PEOPLE

**M**ost of the emphasis in this book is proactive and directed to the future. We wanted to avoid what happens when we do not adequately search for clues of change. Within every management function, the failure to accurately anticipate the future causes incomplete planning or errors in execution that can seriously harm the organization. For instance, if engineering designs something incorrectly, it is back to the drawing board for corrections—and life goes on.

If manufacturing cannot meet cost, delivery, or quality requirements, they will quickly correct the problem—and life goes on.

If marketing and sales fail to meet objectives, they will soon create a new program to meet those objectives—and life goes on.

If finance misses earnings projections, or accounting has debited something that should have been a credit, entries are reversed—and life goes on.

If human resource managers do not accurately anticipate the future and do not plan appropriately—we affect more than mere designs, machines, sales, and numbers—we touch people's lives. Almost never can we undo our mistakes.

There are many examples of failures by administratively focused HR professionals to accurately anticipate the future. And of these examples, none was more serious and delayed progress more than the failure to see and fully gauge the impact of the civil rights movement:

- In 1941, A. Philip Randolph, president of the Brotherhood of Sleeping Car Porters, convinced President Franklin D. Roosevelt to sign an executive order that called for an end to discrimination in

defense plant jobs. Many view this action as marking the start of “fair employment practices” and affirmative action. But how many in HR—practitioners, consultants, or academics—paused to consider what this action would mean not only for those who so unfairly bore the brunt of discriminatory practices but for the future requirements of their profession? Not many.

- In 1948, additional efforts by Randolph encouraged another president, Harry S. Truman, to issue an order integrating the U.S. military as well as all federal civil service jobs. Again, how many HR leaders saw this change within the largest employer in the nation as a precursor to what would almost assuredly become, for social as well as legislative requirements, a major issue in the workplace? Again, not many.
- The 1954 U.S. Supreme Court decision in *Brown v. the Topeka, Kan., Board of Education* was yet another major leading indicator of probable changes in the workforce. If black and white children went to school together, would they not also expect to work together?
- A 24-hour filibuster led by the late Senator Strom Thurmond of South Carolina narrowly defeated the 1957 Civil Rights Act. But this proposed legislation outlined many unattended civil rights abuses and was a preview of the Civil Rights Act of 1964. Once again, most HR and other business leaders did not see the need for meaningful, voluntary, and affirmative change.

This example illustrates how any failure to accurately anticipate the demands of demographic, social, economic, ethnic, and global changes can cost organizations dearly. Worse, such delinquencies touch many lives and can do great harm to ordinary people. This is a burden that no profession should bear, and that no one associated with the profession should ever permit.

The chapters in Section I deal with major issues that can touch people’s lives as well as the employer’s interest.

For instance, Anne Tsui and Joshua Wu’s article addresses the “new employment relationship.” Can improved employee commitment be obtained by trading job security (loyalty) for a challenging job with a fixed compensation package and the possibility of gaining new skills? Or does the traditional mutual loyalty approach produce the most productive, loyal and committed employees as well as the best company performance?

James Clawson and Douglas Newburg (Chapter 2) discuss the degree of a person's engagement at work or what they call "managing energy." Some research suggests that most companies have only moderately engaged workers and that great potential exists in managing people differently.

Cole Peterson, Wal-Mart retired senior vice president, outlines how the world's largest employer gets, keeps, and grows people (Chapter 4). He emphasizes how to use simple strategies that incorporate the organization's culture and overall operating philosophy.

Also included in this section are two articles on the same subject but with different conclusions. Peter Cappelli offers facts and a conclusion that there will not be a United States long-term labor shortage. Mike Losey suggests exactly the opposite.

We intentionally invited these two individuals to report their opinions on this subject. We did this to highlight that when we search for clues to the future it is not important when experts differ in their appraisals. The key benefit is knowing that such a difference of opinion exists.

Rather than rendering a planning process undecided or inconclusive we know now what to watch and what to continue to test. Of course, only one theory will ultimately prevail. But the alert strategic HR planner will be looking for the confirmation of one strategy over the other. This will allow them to check what assumptions and projections are coming true. And the benefit is they will see the final result and will be able to react much sooner than if they did not know the alternate theories existed.



# CHAPTER 1

## WILL THERE REALLY BE A LABOR SHORTAGE?

PETER CAPPELLI

**R**ecent studies warn that the U.S. economy will experience widespread job vacancies that cannot be filled because of a shortfall of workers. It is true that employers will face new and more difficult challenges in recruiting and hiring than previous generations faced, but the challenges have to do with changes in the employment relationship, not a shortfall of workers caused by demographic changes. These developments have important and positive implications for older workers. More generally, the solutions to these recruiting and hiring challenges focus back on employers and their own human resource strategies.

### RECENT DEMOGRAPHIC DEVELOPMENTS

The dominant demographic event of the past century, the baby boom's entry into the labor market, preceded what became a long period of economic stagnation and slow growth in the economy. It was hard for many workers to find jobs in this period, and unemployment rates remained relatively high. Chronic unemployment of young workers in particular was common as was widespread overqualification of workers for jobs. Evidence suggests that the rapid expansion of the workforce associated with the entry of the baby boom workers depressed their wages and lifetime earning opportunities.

---

This chapter is drawn from a larger study, "Will There *Really* Be a Labor Shortage?" in *Organizational Dynamics*, vol.3, 2003.

In contrast, the years from 1998 to the recession year of 2001 saw very tight labor markets; finding workers was a challenge and wages began to rise sharply. The studies that envision a future labor shortage assert that this period represents the beginning of a fundamental shift in labor markets, in some ways the reverse of the slack labor markets during the 1970s. They foresee circumstances that will be even more difficult for employers than the tight labor markets from 1998 to 2001.

Behind the predictions of a coming labor shortage is a demographic event called the “baby bust” generation. This cohort is just behind the baby boomers and is roughly 16 percent smaller. Those predicting a coming labor shortage assert that this smaller cohort will be unable to staff all the jobs currently filled by the much larger baby boom cohort. A frequent assumption is that this baby bust cohort is now just entering the labor force, but in fact, they entered about a decade ago. Table 1.1 illustrates the population distribution of the United States in 1980, 1990, 2000, and the projections for 2010. The average age of the baby-bust cohort in 2004 was 31 years and represented 71 percent of the workforce.

## LABOR SUPPLY TRENDS

Taking the labor shortage arguments seriously begins with an assessment of the role of the baby bust cohort in the overall supply of labor. Just behind it in the population is another, larger cohort that some refer to as the “echo” of the baby boom, the children of boomers. This larger cohort is just now coming into the labor force. The baby bust cohort therefore did not cause the population or even the labor force of the United States to stop growing. The echo cohort and immigration enabled the labor force to grow roughly 1 percent per year throughout the 1990s; and government projections suggest that, through 2014, growth will actually increase at a slightly faster rate than occurred during the 1990s. The rate of increase will then begin to slow, although the labor force will still be growing over the following decades.<sup>1</sup> illustrate the labor force, as opposed to the population. One can see that the projected labor force in 2010 is older but not smaller.

But the biggest demographic development in the future will continue to be the baby boom and the increasing number of older individuals as the

**Table 1.1**  
**Civilian Labor Force by Sex, Age, Race, and Hispanic Origin, 1980, 1990, 2000, and Projected 2010 (Numbers in Thousands)**

Group	Level			Change			Percent Change			Percent Distribution			Annual Growth Rate (percent)				
	1980	1990	2000	2010	1980-1990	1990-2000	2000-2010	1980-1990	1990-2000	2000-2010	1980	1990	2000	2010	1980-1990	1990-2000	2000-2010
Total, 16 years and older	106,940	125,840	140,863	157,721	18,900	15,023	16,858	17.7	11.9	12.0	100.0	100.0	100.0	100.0	1.6	1.1	1.1
16 to 24	25,300	22,492	22,715	26,081	-2,808	223	3,366	-11.1	1.0	14.8	23.7	17.9	16.1	16.5	-1.2	.1	1.4
24 to 54	66,600	88,322	99,974	104,994	21,722	11,652	5,020	32.6	13.2	5.0	62.3	70.2	71.0	66.6	2.9	1.2	.5
55 and older	15,039	15,026	18,175	26,646	-13	3,149	8,471	-0.1	21.0	46.6	14.1	11.9	12.9	16.9	.0	1.9	.9
Men	61,453	69,011	75,247	82,221	7,558	6,236	6,974	12.3	9.0	9.3	57.5	54.8	53.4	52.1	1.2	.9	.9
Women	45,487	56,829	65,616	75,500	11,342	8,787	9,884	24.9	15.5	15.1	42.5	45.2	46.6	47.9	2.3	1.4	1.4
White	93,600	107,447	117,574	128,043	13,847	10,127	10,470	14.8	9.4	8.9	87.5	85.4	83.5	81.2	1.4	.9	.9
Black	10,865	13,740	16,603	20,041	2,875	2,863	3,439	26.5	20.8	20.7	10.2	10.9	11.8	12.7	2.4	1.9	1.9
Asian and other <sup>a</sup>	2,476	4,653	6,687	9,636	2,177	2,034	2,950	87.9	43.7	44.1	2.3	3.7	4.7	6.1	6.5	3.7	3.7
Hispanic origin	6,146	10,720	15,368	20,947	4,574	4,648	5,579	74.4	43.4	36.3	5.7	8.5	10.9	13.3	5.7	3.7	3.1
Other than Hispanic origin	100,794	115,120	125,495	136,774	14,326	10,375	11,279	14.2	9.0	9.0	94.3	91.5	89.1	86.7	1.3	.9	.9
White non-Hispanic	87,633	97,818	102,963	109,118	10,185	5,144	6,155	11.6	5.3	6.0	81.9	77.7	73.1	69.2	1.1	.5	.6

<sup>a</sup>The "Asian and other" group includes (1) Asians and Pacific Islanders and (2) American Indians and Alaska Natives. The historical data are derived by subtracting Black and White from the total; projections are made directly, not by subtraction.

Source: Howard Fullerton Jr. and Mitra Toossi, "Labor Force Projections to 2010: Steady Growth and Changing Composition," *Monthly Labor Review*, November 2001, 124(11), p. 21 (AN 5785627).

baby boomers age. Those over age 65 account for roughly 13 percent of the population at present, a figure that will grow to 20 percent by 2050. The baby boomers are expected to live longer and be more active than any previous cohorts, which raises interesting and important questions for society, such as how we will pay for their retirements. It also raises important questions about the future supply of labor, the topic here. Life expectancy is roughly 15 years higher now than when the retirement age of 65 was established in the United States through the Social Security program, and all indications are that it will continue to rise. Many of the studies that foresee labor shortages in the future assume that retirement patterns will be unchanged, and that people will retire at the same age even as life expectancy and the ability to work longer go up. Surely this is unrealistic if for no other reason than financial resources for retirement may not allow it. There are many indications that the baby boom generation expects to keep working longer. Even a small increase in the retirement age (to 67 by 2027) of baby boomers will increase labor supply substantially because this cohort is so large.<sup>2</sup>

The first conclusion, therefore, is that the population and the potential labor force will still be growing at typical rates for the foreseeable future. If older workers decide or can be persuaded to work longer, the labor force may grow even faster, and since older workers are already experienced and trained, the average quality of the labor force may improve over time.

A second point is that the size of the entry-level cohort of workers may be less relevant now. In the 1960s, large employers primarily hired from the population of school-leavers and then promoted from within. Now, they increasingly hire laterally, filling positions at all levels from the outside. Further, even though the entry-level cohorts may be smaller in the future than they were in the baby boom, the overall number of college graduates in the period since the baby bust cohort left high school has risen, and U.S. Department of Education projections suggest slow but steady growth in all degrees through the foreseeable future. If any group within the baby bust cohort is noticeably smaller, therefore, it is likely to be those with high school or less education, a group that is not particularly in demand.

## LABOR SUPPLY AND ECONOMIC GROWTH

Does the labor force have to grow for the economy to grow? No, because productivity growth can allow each worker to contribute more to the economy. Productivity rises when employers invest in equipment and systems that help workers do their job or when workers receive more training and skills that improve their performance. A comparison of the U.S. economy now with its status at the end of World War II shows that it is roughly eight times larger, but the workforce is only twice as large. Each employee is roughly four times as productive now compared with employees in the late 1940s. If there had been no productivity growth, the U.S. economy would need four times as many workers as we currently have to sustain its current level. Productivity growth has been fastest when labor markets are tight, because wages are rising then. So if the labor market should tighten for a sustained period, efforts to increase labor productivity should help offset that tightness.

The more sophisticated labor shortage arguments put forth by experts agree that the growth rate of the economy as a whole depends on productivity growth—output per worker. They argue, however, that it also depends on growth in the number of workers: Output per worker multiplied by the number of workers equals total output in the economy. And so, the argument goes, if the growth rate of the labor force is falling, other influences being equal, then the growth rate of the economy has to fall as well. But this argument applies only if the economy is operating at absolutely full employment, and it almost never is.

If labor markets become tight and wages rise, human resource managers have an increasingly simple alternative to offer, and that is to *off-shore* the work by sending it to contractors or even their own operations in countries where labor is less expensive. Indeed, many observers believe that the opportunities to off-shore work have essentially expanded the available labor force for U.S. employers to such an extent that the logical consequence is a sharply declining labor market for workers. Offshoring is a far easier option than expanding immigration as the former can be done unilaterally, whereas the latter requires government intervention.

Some proponents of a coming labor shortage argument use evidence from the 2001 recession and the fact that the number of unemployed and

available workers following 2001 was at the lowest level among modern recessions. They contend this indicates that a labor shortage is imminent when the economy rebounds and that we have moved into a new era of tight labor markets. But all recessions are not the same. Recessions are defined by relative, not absolute, measures—a decline in the economy, not an absolute level of economic activity. And the 2001 recession, which followed the longest economic expansion in modern times, was among the shortest and weakest.

Finally, there is an argument that increasing the labor supply would help the economy by holding down wage growth, which would encourage hiring. The complication is that stagnant real wages also hold back consumer demand. Although adding workers faster than productivity growth might help expand Gross National Product, standards of living would fall, and it is not obvious that such a goal would be desirable.

Surveys indicating that employers have job openings that they have not filled are sometimes used to suggest that there is a labor shortage. These surveys do not indicate what wages and benefits the employers are offering, however. From the perspective of an individual employer, it is a real problem for them if they cannot find workers with the skills they feel they need at the wage they can afford to pay, even if that wage is below the market level. But it is not a labor shortage or even necessarily a problem for public policy if employers cannot pay the market price for what they need.

## AN OVERALL ASSESSMENT OF THE LABOR SITUATION

For the economy as a whole, then, there will be no decline in labor supply. Indeed, it will continue to grow, and the growth will likely increase (e.g., through delayed retirements) if labor markets tighten and wages and job opportunities improve. There is absolutely nothing about the changing demographics of the U.S. labor market that guarantees tight labor markets. As long as there is unemployment, it is next to impossible to argue that the labor force is holding back economic growth or that expanding the labor force would help to create new jobs. To see that demographics are not destiny and that labor supply does not dictate the state of the economy, it is useful to look at the experience of Europe where many countries have sharply

falling birth rates and true declines in labor supply. Yet virtually all these countries still suffer from high unemployment.

What causes tight labor markets is sustained periods of economic growth that exceed productivity increases. That growth then begins to draw down the additional pool of workers who will be added to the labor force every year. (It is worth remembering that the 1999/2001 tight labor markets resulted from the longest sustained period of economic growth in U.S. history.)

Does it matter if the arguments about long-term shortages of labor are wrong, especially for individual employers? If there is a long-term shortage of workers, then human resource managers will find that any policies designed to get work done—offshoring, substituting capital for labor to automate lower-skill jobs, raising wages and other terms and conditions of employment to attract more applicants, and so on—become perfectly sensible. If there is no long-term shortage, then these options do not necessarily make sense, and other approaches make more sense.

## WHAT IS DIFFERENT NOW

Although the demographic picture in the 1990s was not that different, many human resources managers have a gut feeling that the labor market situation they experienced then was a sea change. Part of the explanation may be just that few managers now have memories long enough to recall that tight markets were the norm in the 1950s and especially the 1960s. The period between 1998 and 2001 offered up new challenges in addition to tight labor markets, however, and it is these new challenges to which employers are reacting. The first is increased employee turnover, which forces human resource departments to be in a continuous hiring mode. The second is the pressure to hire new skills and expertise from the outside for jobs at all levels of the organization in order to restructure quickly. This is in contrast to previous generations where recruiting was almost entirely limited to entry-level positions filled by newly minted college graduates.

At the same level of labor market tightness, then, contemporary employers face considerably greater recruiting and hiring challenges compared with earlier periods. The underlying problem for most employers was in not recognizing this change in the underlying employment relationship.

Hiring could not meet their labor force challenges, hence the conclusion was easy to reach that the problem was beyond their control and must be due to an overall shortage of workers. But the problem was that many human resource departments relied solely on recruiting to respond to these developments, when in fact, retention management should have been at least as important a mechanism for addressing this new environment. Performance management also became crucial. Recruiting and selection to find the best workers became a potential source of competitive advantage, although few employers adjusted fast enough to do anything strategic in this area.

The economy had turned down by the time many human resource departments began to develop more sophisticated recruiting and selection systems, retention management programs, and performance management competencies. By the middle of 2001, retention problems virtually evaporated for most employers as new jobs dried up. Hiring demands fell drastically when voluntary turnover declined and even faster once company growth slowed. (Note that the demographic picture was basically the same in the boom year of 1999 as in 2001, a bust year.)

When the economy rebounds, problems will resurface, and they will be the same ones that employers faced before. And if employers rely solely on hiring to address them, they will have the same sense that there are not enough workers to go around. Instead, human resource departments need to invest in a range of responses beginning with performance management to identify which workers are crucial to retain. Even in the height of the 1999 boom, most employers conceded that their problem was retaining their *best* workers, not workers per se.

Companies have to get better at recruiting as well, but simply attracting more applicants is unlikely to be cost effective because of the effort required to sort through to find the best ones. Employers need to invest in programs that help them target appropriate recruits and identify where their recruiting investments are most effective.

## IMPLICATIONS FOR OLDER WORKERS

Overall, then, what can we conclude about the future from this quick summary of the past? From the 1970s until the late 1990s, most employers enjoyed an abundant supply of labor that made it possible to offset and

overlook the gradual decay of their human resource competencies and practices. Employers did not have to be good at recruiting or selection when overqualified applicants were queuing up at their door. They did not have to worry about retention policies when no one was quitting. They did not have to develop employees when corporate hierarchies were shrinking and any talent that was needed could easily be hired from outside. And when companies were downsizing and restructuring, human resource capabilities were the first thing cut. When labor markets tightened, surplus labor was no longer available to camouflage the problems caused by not having these competencies. The recruiting function, which had eroded into the role of simply taking and filling job requisitions, could not solve all the problems caused by the breakdown of these other systems.

It would be as much a mistake to believe that the slack labor markets of the 2001 recession have eliminated the challenges facing employers as it would be to believe that we are facing an inevitable shortage of workers. No one knows whether future labor markets will be tight or slack—it depends almost entirely on growth and productivity prospects for the economy. It is fair to say, however, that the persistent worker surpluses associated with the baby boom that made it possible for employers to ignore virtually all human resource challenges through the mid-1990s may not be back any time soon. As the interest in performance management has increased, it has become easier for employers to recognize how valuable the best employees are. One consequence of this is an understanding that there are never enough “good” employees. To respond to this challenge, employers will have to develop competencies in recruiting and selection, performance management, retention policies, and other practices that support finding and keeping quality workers even if labor markets remain slack.

An important new competency that should be part of the future for human resources is managing the older workforce. In many organizations, the human capital “pipeline” began with inexpensive, inexperienced workers, who then advanced through the ranks with seniority-based pay to become experienced and expensive workers. Efforts to restructure costs, therefore, often meant—at least implicitly—getting rid of older workers and replacing them with younger ones. When employers thought about retaining older workers, they saw problems because the pay for those workers—tied to seniority—was high.

The days of lifetime employment and seniority-based systems are largely over now as companies move toward models of contingent work, independent contracting, and more free-market arrangements. At the same time, a very large group of experienced, often highly skilled, workers are leaving their current employers, and increasing numbers of them would like to be doing *something* in the labor market even if it does not resemble what they did before. As the baby boom ages, this pool of retirement age individuals looking for alternative working arrangements will grow every year. A tremendous opportunity awaits companies that can adopt policies and practices to accommodate the interests of this enormous group of reentrants. It requires going somewhat further down the path to flexibility than many employers may find suitable: Older workers do not necessarily want to work the long schedules of their younger counterparts, and they may not be as willing to manifest the commitment and “rah-rah” spirit that some organizations require even of their contractors. But these workers also offer skills and competence and are often willing to work for much less money than their younger, career-minded counterparts. It is a big challenge for human resource managers to develop these alternative policies and possibly an even bigger challenge to persuade the rest of the organization of the need to do so. Employers that cannot adapt to embrace this new workforce will miss a significant source of competitive advantage.

## NOTES

1. Howard Fullerton Jr. and Mitra Toossi, “Labor Force Projections to 2010: Steady Growth and Changing Composition,” *Monthly Labor Review*, November 2001, 124(11) pp. 21–28.
2. See Alan L. Gustman and Thoman L. Steinmeier, “Retirement Effects of Proposals by the President’s Commission to Strengthen Social Security” Cambridge, MA: NBER Working Paper w10030, October 2003, for projections about retirement trends.