

MERCER



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WORKPLACE

2012

Workplace 2012

Beyond the Global Financial Crisis

Consulting. Outsourcing. Investments.

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Executive summary

In April 2008, Mercer launched a report outlining research that profiled the Australian workforce over the next four years. The report—*Workplace 2012: What does it mean for employers?*—discussed how employers can mitigate the risk of pending demographic shifts threatening Australian businesses.

Based on the research findings, demographic shifts and an ageing labour force were identified as some of the most significant issues shaping the future of the Australian workforce and Australia's productivity in coming years. These shifts will threaten the sustainability and profitability of Australian businesses.

The global financial crisis that hit in mid-2008, and continues to unfold, has brought these issues into sharper focus. As employers wait with apprehension for the next development in these unprecedented times, they should not lose sight of long-term workforce trends. Those that do may find themselves without the skills and workers necessary to survive and grow in the medium- to long-term future.

In October 2008, Mercer commissioned economic consultancy, Econtech, to provide an updated profile of the workplace in 2012 in terms of the demand for, and supply of, labour. This report takes into account economic data and events from February to October 2008, and includes updated demographic projections.

Mercer's commentary on the implications for employers of this updated report makes the following conclusions:

- **There will be only short-term relief for employers.** The economic downturn will provide only short-term relief for employers from an ongoing skills shortage and ageing workforce. Ongoing demographic shifts in the workforce will continue and employers should not make short-term decisions without also considering their medium- to long-term workforce requirements.
- **Employers have to plan now for an economic recovery.** We acknowledge that attraction of new staff may not be a high priority for many employers in the current economic environment. However, in times of economic turmoil, the issue of talent management can become more critical than ever.

Employers should re-shape their workforce now to cope with the demands of tomorrow. It's important to identify: what skills your organisation will need; what skills are in short supply; what skills you are potentially losing from your workforce; and how you plan to retain or transfer the skills of your older workers.
- **Re-defining the workplace to drive productivity remains critical.** Reinventing key elements of the workplace will be essential for employers to meet changing business conditions and priorities in these volatile economic times. Successful businesses will increase the productivity of their (smaller) workforces. They will also retain the experience and knowledge of older workers by being creative and flexible in their work practices.

Background—What did initial forecasts say about Australia's workplace in 2012?

Overall, Mercer's first Workplace 2012 report concluded that as the age profile of Australia's labour force changes dramatically over the next four years, mature-aged workers will become a more significant part of the labour force and in turn will seriously influence the Australian workplace and work practices. To remain viable, employers need to take action today to ensure necessary workplace strategies are developed and implemented for future success.

- Australia's labour force was forecast to rise from 11 million to 11.7 million between 2007/08 and 2012/13—a 6 per cent increase.
- By 2012 the number of workers aged 55 or older in the labour force was forecast to increase by 14 per cent—close to an extra two million people, to make up 17 per cent of the total labour force.
- Demand for labour was forecast to continue to grow strongly—meaning wage pressures were expected to continue and vacant positions were expected to take some time to fill due to the skills shortage.
- Superannuation legislative changes ('Better Super') that aimed to simplify tax rules to encourage older workers to remain in the workforce past the age of 55, were forecast to boost labour force participation for those aged 55 and over by a minimal 0.1 per cent (or 7,500 people) by 2012/13.
- A sensitivity analysis of an interest rate rise and fall to 7.5 per cent and 6 per cent respectively was included in the initial research. By 2012/13 the impact of the interest rate rise was expected to have largely dissipated with the participation rate only 0.1 per cent lower than the baseline. Conversely, an interest rate fall was expected to have the opposite effect.

What's changed in the Australian economy?

- In September, October and November 2008, international financial markets deteriorated, with large-scale financial failures in several major countries, including the USA. Consequently, growth in the global economy is forecast to be weak during 2009. This expected easing in global growth, together with more difficult market conditions for borrowers, presents the risk of weaker demand and output in Australia.
- In November 2007, the official cash rate was 6.75 per cent. The cash rate was raised 0.25 percentage points in both February and March 2008, leaving the cash rate at 7.25 per cent. In the months that followed, the higher interest rate and tougher credit conditions (caused by the global financial crisis) dampened demand faster than expected. As a result, the Reserve Bank of Australia (RBA) reduced the cash rate by 0.25 percentage points to 7 per cent in September 2008. The weak outlook for domestic demand as a result of continuing global financial crisis led the RBA to cut the cash rate by a further 1.00 percentage points in October, 0.75 percentage points in November and a further 1.00 percentage points in early December to take it to 4.25 per cent.
- Lower interest rates are intended to accelerate the pace of the economy, which will impact the labour market. However, even with the interest rate cuts, the short-term outlook for the economy remains weak because the turmoil in global financial markets has shattered business and consumer confidence. Business investment and consumer spending will weaken over the short-term. The economic slowdown will lead to a moderation in employment growth and a fall in the participation rate.
- At the time the earlier report was published (February 2008), the unemployment rate was at its lowest in 30 years, at around 4 per cent. Since then, the unemployment rate has been rising — reaching 4.4 per cent in November 2008.
- The outlook for unemployment is now more pessimistic than at the time of the earlier report. Latest forecasts, finalised in November, indicate unemployment will rise above five per cent by the end of 2009 and reach approximately 5.21 per cent by 2012/13.
- The outlook for commodity prices has changed significantly since the initial report was written. At that time it was expected that prices had peaked in 2006/07 and were set to slowly ease back. In the following months the outlook was revised and prices were expected to peak in 2008/09. The more recent financial market turmoil and global economic slowdown has reduced the demand for commodities. The reduced demand has led to commodity prices falling faster and further than forecast in our first report in early 2008.

Workplace 2012: An updated profile

We have updated our research to test the conclusions of our first report in the context of recent economic developments. This new research profiles Australia's future workforce under two distinct scenarios:

1. **Updated economic indicators scenario** — to recalibrate our original results in light of new economic data, trends and forecasts.
2. **Immigration scenario** — to understand the impact of government plans to increase the number of skilled migrants in Australia.

Updated economic indicators scenario

The updated economic indicators scenario is based on existing policy, including changes to immigration policy announced in the May 2008 Federal Budget. It factors in the recent changes to interest rates and other key economic and financial variables, including the Government stimulus package that was announced on 14 October 2008. It also includes revised commodity price expectations.

A comparison of key findings from this updated research with our first report, concluded:

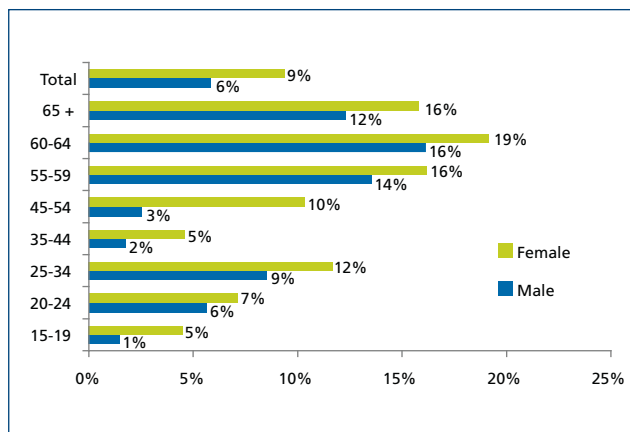
- Australia's labour force has grown at an average annual rate of 1.7 per cent over the last ten years. This will slow to 1.4 per cent between 2007/08 and 2012/13. Updated forecasts show the labour force will rise from 11.2 million to 12 million — a 7 per cent increase — by 2012/13. This is in line with initial forecasts of a 6 per cent increase. The faster pace of growth is largely due to the increase in migration.
- Labour force growth will continue to be strongest amongst those aged 55 or older. This is shown in Table 1.
- Labour force growth will be strongest particularly amongst females aged 55 or older. This is shown in Chart 1, which demonstrates the changing age and gender profiles of the Australian labour force.

Table 1—Growth Rates for Population, Labour Force and Participation Rates

Age	2002/03 to 2007/08	2007/08 to 2012/13
Population Growth		
15-54	6%	6%
55+	15%	14%
Total	8%	9%
Labour Force Growth		
15-54	8%	6%
55+	39%	15%
Total	11%	7%
Participation Rate Change		
15-54	1.3	-0.1
55+	5.6	0.3
Total	1.7	-0.7

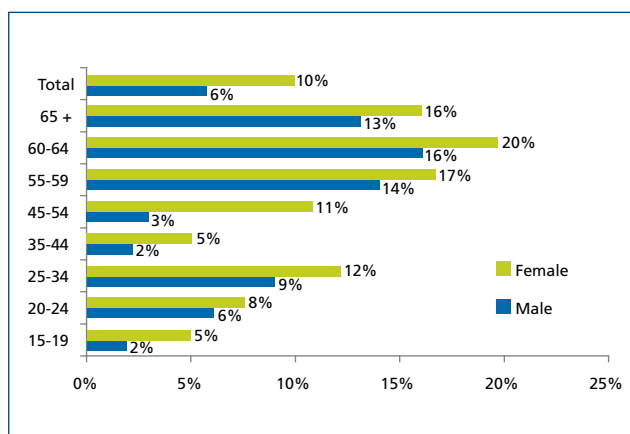
Source: LF model, Econtech

Chart 1—Change in Labour Force between 2007/08 and 2012/13



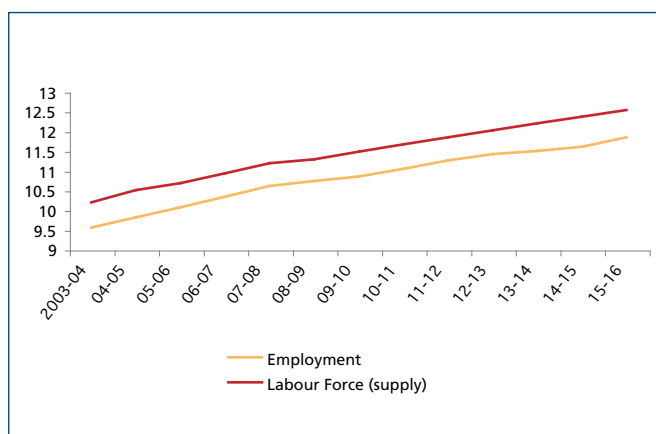
Source: LF model, Econtech

Chart 2—Change in Employment between 2007/08 and 2012/13



Source: LF model, Econtech

Chart 3—The Gap between Labour Supply and Demand ('000 People Employed and in the Labour Force)



Source: LF model and MM2, Econtech

- Employment growth is expected to be 50 per cent higher for females (10 per cent) compared to that of males (6 per cent) between now and 2012, as shown in Chart 2.
- Based on the concept that the number of people employed represents labour demand, Chart 2 also shows there will be a 20 per cent increase in the demand for females aged 60-64 in the Australian workplace by 2012 and a 17 per cent increase in the demand for women aged 55-59.
- Unemployment is forecast to rise from the current rate of 4.4 per cent to around 5 per cent by 2009/10 and will stay relatively stable until 2012/13 — closer to the sustainable NAIRU* rate of 5.25 per cent. This is consistent with forecasts in the first report.
- Gross Domestic Product (GDP) growth, which is driven by growth in labour force and productivity and drives demand for labour, is forecast to moderate from a strong 3.7 per cent in 2007/08 to a weak 1.8 per cent in 2008/09. Over the longer term, the economy is expected to recover with GDP expected to increase by over 4 per cent in 2012/13.
- The difference between GDP and employment growth is forecast to widen at a faster rate than forecast in the first report. Although Australia's labour force will decline as the population ages, GDP growth is expected to be sustained by labour productivity growth.
- Accelerated falls in commodity prices are, unsurprisingly, expected to weaken GDP and employment growth.
- The sharper decline in commodity prices is expected to lead to a quicker and greater easing in labour market conditions compared to the originally forecast gradual decline, which would have led to a tighter labour market in 2012/13.
- A more pessimistic outlook for commodity prices is expected to increase unemployment rates by 0.2 percentage points by 2012/13.
- Pressure on wages will reduce as the gap between labour demand and supply widens slightly.
- In the years from 2011/12, the economy and labour force will begin to adjust towards the long-run equilibrium.

* NAIRU stands for non-accelerating inflation rate of unemployment. The NAIRU is the rate of unemployment consistent with stable inflation.

Immigration scenario

The immigration scenario models the impact of the immigration policy changes announced in the May 2008 Federal budget. The policy changes are part of a series of measures designed to increase the availability of skills that employers need in order to continue economic growth. The changes include the Government adding 31,000 skilled migrants to the migration programme in 2008/09.

This scenario removes the increased immigrant numbers and compares back to the updated economic indicator scenario to show the difference between the two, and therefore the impact of the policy change on the economy and labour market.

Key findings

- The injection of additional skilled migrants will boost both GDP and employment growth for Australia. In 2012/13 real GDP is expected to be 0.11 per cent higher as a result of the migration increase. The higher GDP is driven by the increase in the population and productivity due to the additional skilled immigrants.
- Immigrants are generally younger and more skilled than the typical Australian resident because the skilled immigration program is designed to attract people with these qualities. Hence, with the additional skilled migrants in Australia's labour force, the biggest increase will be among people aged 25 to 34.
- Overall, the immigration policy changes are expected to contribute an additional 0.9 per cent (102,000 people) to the labour force by 2012/13.
- Both the supply and demand of labour will be higher as a result of the increase in overseas migration. Specifically, the labour force will be 0.9 per cent higher and employment will be 0.5 per cent higher than would otherwise be the case, as demonstrated in Table 2.
- The migration intake will boost the level of the national population; a larger population leads to a larger economy and hence higher demand for labour.
- By 2012/13, the changes to the immigration policy will increase the gap between the demand and supply of labour by 41,000 individuals, taking the gap to around 595,000 people.
- The increase in immigration will moderate wage growth by 1.5 per cent in 2012/13.

Table 2—Differences between Immigration Scenario and Updated Economic Indicators Scenario by 2012/13 ('000 persons)

	Population (15+)	Labour Force	Employment	Gap (LF—Emp)
Immigration scenario	18,581	11,918	11,364	554
Updated economic indicators scenario	18,714	12,020	11,425	595
Difference (number)	134	102	62	41
Difference (per cent)	0.7%	0.9%	0.5%	7.3%



What does it mean for employers?

The global financial crisis that continues to unfold, has brought the challenges of re-shaping the workforce into sharper focus. Employers cannot ignore longer-term issues such as significant demographic changes for the sake of reacting to immediate financial issues.

The financial crisis will only deliver limited respite, if at all, from the critical skills shortage and ageing workforce that Australian employers will continue to face. To be successful, employers have to make decisions that meet business needs and help drive business growth, today and in an economic recovery. Knee-jerk reactions to the immediate economic environment could be costly in four or five years time.

In other words, short-term actions and relief could lead to medium- and long-term pain — they could be the difference between short-term survival and maintaining a viable and productive workforce in the future.

Limited relief for employers

Despite recent global economic turmoil the conclusions of this updated report on Workplace 2012 are broadly similar to the conclusions of our first report. Australia's labour force is still ageing at a rapid pace and by 2012 employers will face a workforce where more than 1 in 6 workers will be aged 55 or older.

Current economic conditions including falling commodity prices, and an increase in skilled immigrants, will ease pressure on a tight labour market. However, they will not

be sufficient to mitigate the business risks associated with underlying demographic shifts in the make-up of the Australian workforce in the next four years.

Plan now for an economic recovery

Tougher economic times challenge organisations to manage costs while maintaining service standards and revenue growth. This can often mean a reduction in head count.

Tightness in the labour market has eased slightly. However, the gap between supply and demand is not wide enough for employers to become complacent. Cutting talent in the wrong place or just cutting too much, will affect your future growth.

We acknowledge that attraction of new staff may not be as high on the list of priorities for employers in the current economic environment as it has been in the recent past. However, in times of economic turmoil, the issue of talent management does not subside; in fact it becomes more critical than ever.

Having the right people in the right roles at the right time could be a determining factor in whether a business survives the economic downturn. At the very least, it will affect how quickly a business can recover.

Without effective talent management strategies, you will lose some of your workforce as people decide to move on. Any cuts should be made with a clear understanding of what critical capabilities and people are necessary to restore business growth and take advantage of opportunities as the impact of the current economic crisis recedes.

Baby Boomers: Impact and opportunities

Current economic turmoil, and its impact on superannuation savings, has meant more people are choosing to, or being forced to, stay in the workforce for longer. Recent reductions in superannuation savings balances have left many Australians uncertain when, or whether, they can afford to retire.

Retiring at the age of 60 or 65 is no longer an option for many, particularly for Baby Boomers. Mortgage repayment commitments beyond age 65 and responsibility for dependents later in life, whether children or grandchildren, a partner, or aged parents, are also factors that are keeping older workers in the workforce.

Older employees can be a very valuable resource, offering much needed experience and corporate memory, which may be critical to successfully re-building a business outside of the economic crisis.

With this in mind employers should note that workers aged 50 and over are the demographic most dissatisfied with the benefits offered by their employer¹. Older employees are looking to their employers to help them plan and prepare for retirement². By tailoring benefits and jobs to meet their preferences and life stage, employers have the opportunity to retain these employees for longer, but with the flexibility to suit business requirements in the current financial environment, such as that provided by part-time work.

In boom times organisations are able to create more opportunities for high potential employees so they can be moved around the organisation to get the experience needed in order to make it to the next level. In troubled times those opportunities may be less achievable, and promises can fail. The experience and guidance of older workers who have been in the organisation for some time can be invaluable in developing younger staff.

Re-defining the workplace to drive productivity remains critical

Downturns and periods of economic stagnation are of course inevitable. Economies endure these conditions, and innovation, positive change and fresh opportunities often result.

Over the next four years Australia's workforce will increasingly comprise workers aged 55 or older and employers will still be faced with a critical skills shortage. This is where employers have an opportunity—an opportunity to retain, engage, and leverage workers aged 55 or older as productivity drivers—by reinventing the 21st Century workplace.

Reinventing the workplace will require:

- Successful management of work and life transitions including successful transfer of knowledge within the workplace;
- Differentiating yourself as an employer by understanding and creating an Employment Market of One; and
- A willingness to redefine the job.

Capitalise on the transfer of knowledge

The ongoing skills shortage and more recent global financial crisis will require employers to increase productivity per person and/or to find workforce substitutions such as technology. In either case, business processes may need to be reviewed and re-developed. The corporate knowledge held by employees aged 55 or older may be critical in this process.

When experienced workers leave the workforce, a wealth of intellectual capital will often walk out the door with them. Intellectual capital and knowledge such as key client relationships, key suppliers, and key contacts can be lost and not easily replaced.

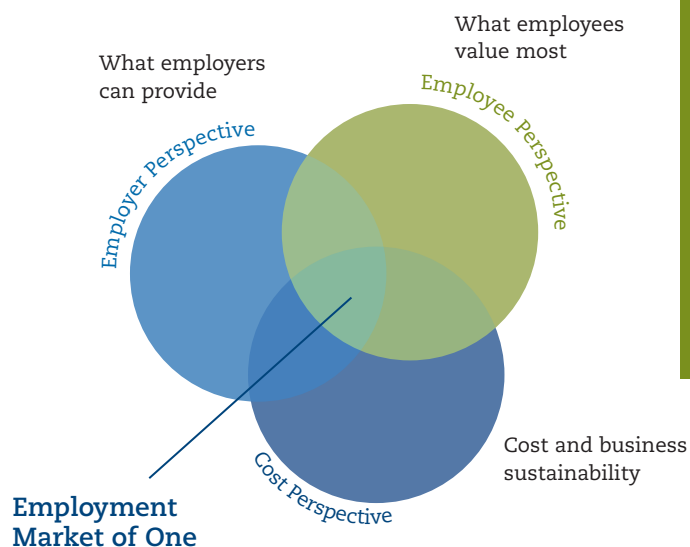
If organisations expect to cope with the increasing drain of experienced talent out of the workforce they should undertake analysis and research *now* to understand the demographics of their workforce. It's important to identify: what skills your organisation will need; what skills are in short supply; what skills you are potentially losing from the workforce; and how you plan to transfer the skills of your older workforce to remaining workers.

1. Mercer; *Benefits Outside the Square 2008*
2. Ibid

Employment Market of One

Employees, regardless of age, are turning to their employers for support in a range of areas, and in tough economic times benefits such as access to financial advice, insurance or even discounted internet plans are highly valued.

As noted in our initial Workplace 2012 report, the challenge for employers will be to cater for an 'Employment Market of One', as distinct from a one-size-fits-all approach to rewards and benefits. Organisations need to balance considerations of cost, practicality, and what employees value most. We believe that a deeper understanding of your employee market may help you to meet this challenge more effectively and efficiently.



Conclusion

The global financial crisis will not alleviate an ongoing critical skills shortage and the impact of an ageing workforce on Australian employers. Instead, it has shone the spotlight on these issues as organisations around the world are faced with a need to re-shape their workforces.

In times of economic turmoil, the issue of talent management does not subside — it becomes more critical than ever.

The demographic shifts in Australia's workforce and the implications for Australia's future productivity are long-term issues and employers cannot risk losing sight of these issues in the rush to survive the current volatile financial environment.

As we wait with apprehension for the recovery from these unprecedented times, smart employers will work to ensure they're in great shape to out-perform their competition when the economy rebounds.



Ensure you are ‘Workplace 2012 Ready’

Recommendations for managing workforce challenges in the current economic climate

CHALLENGE

Avoid knee-jerk staff reductions to control or reduce talent costs

Australia will continue to face a skills shortage and a relatively tight labour market with an increasing number of Baby Boomers nearing retirement age. Not having a plan for a sustainable workforce may jeopardise the future productivity of your business.

Consider the end game: the economy will turn around.

Avoid actions that will later undermine competitive positioning. Talent may be your only sustainable form of competitive advantage.

ACTION

- Understand the workforce you need for the future by taking a measured, analytical approach to workforce planning.
- Balance any action with long-term business strategy.
- Optimise HR functional efficiency while maintaining or reducing costs.
- Restructure the organisation to remove unnecessary management layers and improve line of sight and productivity.
- Consider opportunities to reduce costs in other areas through greater use of technology and outsourcing.

CHALLENGE

Retain key talent and knowledge—particularly of your older workers

Don't let short-term focus confuse or de-rail your medium- to long-term strategy. By 2012 the amount of workers in Australia's labour force aged 55 or older will increase by 15.4 per cent while the number of workers aged 25-54 will only increase by 6.3 per cent. More than one in five workers will be aged 55 or older.

ACTION

- Communicate often and honestly to employees to bolster flagging engagement and productivity and to counter de-motivating messages and rumours.
- Develop opportunistic initiatives to maintain or build the pipeline of high-value candidates while retaining high performers at all levels in the organisation.
- Identify and articulate the organisational and individual capabilities required to keep the business strategy on track.
- Establish capability development paths.

CHALLENGE

Build and encourage a performance culture

Effective performance management programmes, linked to career development and rewards, allow employers to foster employee engagement while keeping rewards costs affordable and sustainable. Such programmes can help retain high performers, who will be in even greater demand once the economy rebounds.

ACTION

- Segment the workforce to offer or emphasise different rewards for different employee groups — create an Employment Market of One.
- Develop new, or enhance existing, variable pay programmes to tie compensation more closely to improved marginal productivity and measurable financial goals.
- Adopt a holistic approach to rewards by considering all factors that appeal to employees and that can help keep costs in check (pay, benefits, career and other intrinsic work factors).
- Re-calibrate pay-for-performance measures and policies to enhance differentiation, drive growth and ensure you're paying for the right performance.

Employers who react to the current economic crisis with no long-term view, are at risk of destroying a viable and productive workforce.

About the research

To model the workforce in 2012, Econtech's Murphy Model (MM2) is used, as well as a custom-built model called the Labour Force (LF) model. An updated economic indicators scenario and alternative scenarios are modelled. Each scenario is generated using these models to test the sensitivity of different assumptions. MM2 is used to forecast the effects on the economy, while the LF model is used to estimate effects on the labour market.

Murphy Model 2

MM2 is a fully integrated macro-industry econometric model which can be used to fully capture both the direct and indirect impacts of labour market changes on the Australian economy over time.

MM2 is a macro Computable General Equilibrium (CGE) model that fully recognises the interrelationships between the supply and demand sides of the economy. For consistency with economic theory, MM2 has long-run properties of steady state growth, profit maximisation, external balance, fiscal balance, and equilibrium rates of inflation and unemployment.

The theory-related dynamic properties of MM2 include rational expectations in financial markets, and a hierarchical adjustment process featuring a

Keynesian short run, a classical medium run, and a neoclassical long run. The modelling of production fully integrates with the modelling of expenditure. GDP on the production side is disaggregated into the 18 broad Australian and New Zealand Standard Industry Classifications (ANZSIC) industries, linked together through an input-output table. MM2 is based on the common view that while demand shocks may affect economic activity in the short term, in the long term economic activity is supply driven. Specifically, in long-run equilibrium:

- The unemployment rate converges to a NAIRU (non-accelerating inflation rate of unemployment);
- Economic growth is steady and balanced; and
- The exchange rate appreciates/depreciates at a steady rate, allowing domestic inflation to be permanently below/above foreign inflation.

LF Model

- The LF model is used to project Australia's labour force. The LF model uses MM2-Demographic population projections which are developed into projections of the labour force by gender and by age group. The labour force forecasts that are generated in the LF Model take into account that baby boomers are retiring and the effect this has on lowering the labour force participation rate.

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