HARVARD BUSINESS

Flexible Compensation and Benefits

Why Variety Will Rule and How to Leverage It

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How to Beat the Coming Shortage of Skills and Talent

By

Ken Dychtwald, Tamara J. Erickson, Robert Morison

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Why Variety Will Rule and How to Leverage It

THE WORLD'S LARGEST privately held software company, SAS, Inc., provides data warehousing, business intelligence software, and industry-specific systems to large companies, with forty thousand customers in more than one hundred ten countries. Based in Cary, North Carolina, SAS is renowned for its rapid growth, minimal turnover, and peerless product quality and customer satisfaction.

SAS is also widely known for the benefits that it offers its employees, nearly ten thousand worldwide. The package includes free on-site full-service primary medical care; low-cost preschool child care and kindergarten; extensive on-site recreational, exercise, and massage facilities; on-site discounted automobile maintenance, dry cleaning, and hair salon services; subsidized cafeterias; three weeks of paid vacation plus a Christmas–to–New Year's shutdown; and domestic partner benefits. Unlike other high-tech companies, SAS does not trade on-site amenities for sixty-hour workweeks. Managers encourage SAS employees to spend their evenings and weekends with families or neighbors. Salaries are competitive but not extravagant.

Meanwhile, SAS does demand productivity and results. Founder and CEO James Goodnight explains, "I like to be around happy people, but if they don't get that next release out, they're not going to be very happy."[1] He simply believes that stressed-out workers produce bad software. "It turns out that doing the right thing, treating people right, is also the right thing for the company."[2] One employee sums up the success of SAS's approach: "You're given the freedom, the flexibility, and the resources to do your job. Because you're treated well, you treat the company well."[3]

The approach works: SAS maintains 98 percent annual customer retention and consistent growth in revenue and profits, and its annual staff turnover rate has been consistently below 5 percent, even during the 1990s technology bubble, when the industry's was 20 percent.

That's the lesson of this chapter: compensation and benefits should work for employees and for the business—as levers with which the company can meet employee needs, enable their productivity, and improve their performance.

A Changing Scene for HR Professionals

HR veterans know that, not long ago, benefits were similar for all employees and often based on a union contract. Levels of certain benefits linked to tenure, and perks escalated as employees climbed the corporate ladder, but choice was limited. Compensation was primarily market based, consisting predominantly of wages, salaries, or commissions. People might jump to a new employer for a large raise, but many would stay to protect their pensions and retiree health-care benefits, generally generous and seemingly guaranteed.

Today's situation differs dramatically for several now-familiar reasons.

- Increasing workforce *diversity* in ethnicity, gender, age, and background means more variety in workers' needs and preferences for compensation and benefits.

- Increasing workforce *mobility* and weakening worker loyalty because of downsizing and poor governance means a greater desire for portable benefits, and so portability in the employment deal becomes a valuable recruiting and retention tool.

- Increasing employee *consumerism*, especially among talented workers, means that employers must provide specific (and increasingly lifestyle-dependent) combinations of benefits.
- Flatter organizations mean fewer hierarchical promotions. Organizations must find ways to recognize employees and meet their needs for status through expansions of role and responsibility rather than rank.
- A higher proportion of mature workers means more people transitioning to less intense roles. As organizations turn to mature workers, many of them partially retired, to meet labor and skills needs, they must adjust pay, role, and rank in accordance with career downshifting. We must break the expectation of steady advancement and make it okay in the minds of workers and organizations for careers to have ebb as well as flow.
- Virtual organizations and telework mean no offices, corner or otherwise. With flexible work arrangements and dispersed workers, the physical signs of status, such as a fancy office, lose much of their power. We need more reliance on other forms of employee recognition.

As a result, today's worker-consumer looks at the compensation and benefits "package" in two new ways. First, it is one part of the overall employment deal, which also encompasses the often dominant variables of the work itself, work arrangements, learning opportunities, and the organization's mission, culture, and management style. Second, workers look for very specific elements of the employee deal and combinations of benefits—for example, flexible hours together with child-care or elder-care support, or the option of making "trades" between pay and time off. To underscore how compensation and benefits are in transition today, table 11-1 lists the fundamental changes.

To attract and retain talent today—and to compete tomorrow as slow workforce growth tightens labor markets—organizations must handle the variety of employee needs, accommodate employee mobility, customize more employees' deals, and get all facets of the deal "right." Most organizations have taken large steps in these directions: cafeteria-style benefits, portable defined-contribution pensions, and compensation plans with long-term components like stock grants. But there's much more work to be done as workforce composition changes and competition for skilled people intensifies.

TABLE 11-1

Trends in compensation and benefits

Element	From	To
Pay	Tenure based, mainly cash	Performance based, more equity
Pension	Defined benefit	Defined contribution, cash balance
Health benefits	Employer managed and provided	Cofunded and comanaged
Other benefits	Standard	Many choices, cafeteria-style, customized
Recognition and reward	Formal, periodic	Formal and informal, on the spot

A “Perfect Storm” of Market Conditions?

Organizations feel the pressure of increasing complexity—handling growing variety in employee preferences and increasing customization of the employment deal demands unprecedented flexibility in management processes, information systems, and HR staff. The lines of delineation among compensation, benefits, and other facets of the employment deal are blurring. Start with the growing list of benefits-related payroll deductions, not just for government and employer pensions and health-care premiums, but also for insurance, stock purchase, and (in the United States) before-tax self-funding of additional medical and educational accounts. Employees must make constant trade-offs between money and benefits. Then overlay the complications of a variety of flexible work arrangements, including the fact that many employees consider control of their time or extra time off as the most important “benefit.” What, for example, is the definition and measurement of *vacation time* for someone who takes time off, but clears e-mail, voice mail, and important matters, and even conducts meetings via teleconference, almost every day during “vacation”? Thus, benefits categories—and the management responsibilities for them—increasingly overlap, and more people, processes, and information systems must work together flexibly to shape and administer employment deals.

Are these the ingredients for a “perfect storm,” when all the unfavorable conditions converge at once? Competition for talent intensifies as labor markets tighten. The most talented workers are the most sophisticated consumers, looking for the best-tailored employee deals. Costs spiral as the workforce ages, health-care costs march upward, government mandates increase, and employers face the added effort and cost of handling complicated benefits options and customizing employee deals. In this whirlwind, employers and employees both face an unpleasant trade-off: each dollar spent on employee and retiree health care doesn't go to staff, equipment, or profits, and the more received in health benefits, the less received in wages, pensions, and vacation.[4]

The enormous retiree health-care liabilities of major corporations like the automobile makers have been in the news lately, and examples like Bethlehem Steel are fresh in CEOs' minds. At the time of Bethlehem's initial bankruptcy, its production costs were competitive, but the costs associated with a retiree-to-employee ratio of 5:1 proved unsustainable. The company has now liquidated, with retiree benefits much curtailed.[5] Companies in mature industries must choose between "changing the rules" for employee and retiree benefits and collapsing under untenable cost structures.

Facing this storm, employers must act now, when most labor markets still favor them, to reduce both long-term and short-term cost structures, especially around health-care costs. Many companies are, for example, abandoning defined-benefit pensions and raising employees' health-care contributions and out-of-pocket expenses. Of course, eliminating too much can compromise the role of compensation and benefits in recruiting and retention.

Overwhelming as the imperative to cut health-care and other benefits costs may seem, we recommend caution. Don't rush headlong into cutting benefits. Instead, adjust the deal to fit your business and workforce strategy. Organizations like SAS enjoy extraordinary employee loyalty and performance and attendant business results, because they buck the trend in benefits reduction and focus on enabling work/life balance for all employees.

What should an organization caught between cost pressure and employee demands do? Before you make tactical improvements in employer efficiency or employee accountability, we recommend looking at the big picture.

Start with business objectives. One objective is *enabling* employees to work productively, live their lives, and achieve work/life balance. This support comes mainly through base compensation, benefits, and work arrangements. Another objective is *motivating* employees to perform at the highest possible levels; to strive constantly to improve themselves, their organizations and processes, and their contributions; and to commit themselves to the success of the enterprise. This motivation comes mainly through variable compensation, learning and development opportunities, an organization's culture and leadership, and the stimulation of the work itself.

If you want to maximize the impact of compensation and benefits, you must recognize their limitations. Designing a new compensation option or adding a benefit of growing popularity (e.g., elder care) will have marginal effect when most employees view the deal in broader terms. Compensation and benefits enable employees to work and live, and are essential to employee satisfaction. But they usually don't necessarily motivate employees or secure their commitment. Thus, we recommend managing compensation and benefits in two larger contexts: the complete employment deal and the organization's performance management system—the set of methods for identifying, assessing, motivating, and rewarding employee performance. Employees are looking at the big picture, so employers must as well.

What Do Employees Want in Compensation and Benefits?

Our nationwide survey showed, first of all, how essential compensation and benefits are to employees.[6] Two-thirds report dealing with financial issues, from trying to reduce debt to saving for purchase of a home or for children's education expenses. Over half are married, and over half have one or more children living at home. Twenty-seven percent report dealing with health issues for themselves or close family members. Ten percent have caregiving responsibility for an elder relative or adult dependent. So it's no surprise that direct compensation and the security of a benefits package rank extremely high among employee priorities. Employees still place high value on a traditional benefits package and—no surprise, given trends in health-care costs—especially the health coverage component.

When we polled employees on their relative preferences among ten basic elements of the employment deal, comprehensive benefits and retirement packages consistently topped the list, as table 11-2 shows.[7]

We described a *comprehensive benefits package* as "health care, dental, prescription drugs, disability, maternity, child care, elder care, wellness coverage funded primarily by employer." *Comprehensive retirement package* was "employer-funded pension and health-care benefits." These two basic elements of the deal rank a consistent one-two across many categories, including gender, race, and income level. There are, however, some exceptions. Among younger workers (ages eighteen to thirty-four), for whom retirement

TABLE 11-2

Overall preferences

Element	Relative weight
Comprehensive benefits package	18.5
Comprehensive retirement package	14.4
Work that enables me to learn and grow	11.7
Workplace that is enjoyable	11.5
Work that is personally stimulating	10.0
Flexible work schedule	9.0
10 percent more in total compensation	7.2
Two weeks' additional paid vacation	6.3
Work that is worthwhile to society	5.9
Flexible workplace	5.5
	Relative weights add to 100

Source: *The New Employee/Employer Equation* survey

seems a distant prospect, today's benefits package ranks first, but a retirement package is down the list, below an enjoyable workplace, stimulating work, and work that enables learning and growth. Among mature workers (ages fifty-five and up), with retirement on the closer horizon, the retirement package ranks first, the immediate benefits package second. Among workers over age sixty-five, many of whom have pensions and benefits established, both elements move down the list. Finally, as we saw in the chapter on flexible learning, there is a cadre of employees—many of them high performers—for whom work that enables learning and growth is simply paramount, outranking even the security elements.

We surveyed preferences for more specific deal elements within the categories of financial compensation, health and wellness, and time off. In financial compensation (see Table 11-3), the theme seems to be "show me the money." Overall, employees showed the strongest preference for bonus compensation, above an annual pay raise, even though only 30 percent say their employers currently offer bonuses. The shorter-term payouts of bonus, raise, and stock outrank the longer-term payouts of pensions and life insurance. We suspect, however, that if we'd included just one pension option in the survey, it would have scored significantly higher.

TABLE 11-3

Financial compensation preferences

Element	Relative weight
Bonus compensation	26
Annual pay raise	19
Stock options or grants	18
Employer-funded defined-benefit pension	17
Employer-sponsored retirement savings plan	16
Life insurance policy	4
	Relative weights add to 100

Source: *The New Employee/Employer Equation* survey

The breakdown of the health and wellness category (see Table 11-4) underscores how highly employees value—and worry about inadequacies in—health-care coverage, which carries three times the preference weight of the second-place element, retiree health-care coverage. The results for other elements may be deceptive—basic health care carries so much weight that there isn't much score left to go around. Still, wellness programs, elder care, and child care, while important or even essential for some employees, rank low. The message from employees seems to be, "Provide the basics first—and health coverage is most basic of all."

In the category of time off from the job, paid vacation understandably ranked first. People most crave more time off. It carried double the preference weight of the second element, paid maternity/paternity leave. Employees expressed quite low preference for the other two elements, unpaid leaves of absence and paid sabbaticals, even though both have proved invaluable at crucial points in individual careers.

We were also able to compare all of these specific deal elements as a group, apart from their categories. The results of that analysis reinforce what we've said. Health-care coverage ranks first, with half again the weight of the second element, paid vacation. The financial compensation elements, including pensions, come next, followed by the remaining health and wellness and time-off elements.

Our survey included having employees report on whether each of these compensation and benefits elements is available to them through their

TABLE 11-4

Health and wellness preferences

Element	Relative weight
Health-care coverage	47
Retiree health-care coverage	16
Prescription drug coverage	15
Short- and long-term disability coverage	10
Wellness program or fitness club membership	5
Elder care	4
Child care	3
	Relative weights add to 100

Source: *The New Employee/Employer Equation* survey

employers. Note that we're tracking perceived availability, not whether employers claim the elements are offered, and not whether employees actually partake of them. Table 11-5 lists the elements by category in order of overall employee preference, and highlights the greater availability in large organizations (over five thousand employees), especially in comparison with small employers (under fifty employees).

This list reveals some apparent mismatches: items of high preference, such as bonus compensation, not generally available; and items of low preference (shortsightedly, some might argue), such as life insurance, regularly available. We note the low availability of some of the benefits—for example, child care and wellness programs—that get a lot of attention in the "best places to work" listings. We can see the transition under way from defined-benefit pensions to employer-sponsored savings plans like 401(k)s. Most striking of all is the contrast between large organizations and small. Large companies, with greater numbers and variety of employees to address, are more likely to offer every element on the list, often by wide margins. But that doesn't necessarily pay off in terms of employee engagement, of employee willingness to put forth extra effort to help the organization succeed. On our 100-point engagement scale, employees of small companies score 7 points above average and 11 points above their counterparts in large companies. Small organizations manage to connect with employees by means other than compensation and benefits.

TABLE 11-5

Perceived availability of compensation and benefits elements

	% overall	% large organizations	% small organizations
Financial compensation elements			
Bonus compensation	30	44	24
Annual pay raise	55	74	34
Stock options or grants	19	50	7
Employer-funded defined-benefit pension	33	50	17
Employer-sponsored retirement savings plan	56	83	29
Life insurance policy	58	80	31
Health and wellness elements			
Health-care coverage	73	90	48
Retiree health-care coverage	25	36	11
Prescription drug coverage	63	82	38
Short- and long-term disability coverage	50	78	21
Wellness program or fitness club membership	18	31	7
Elder care	5	10	2
Child care	7	14	2
Time-off elements			
Paid vacation	76	92	53
Paid maternity/paternity leave	29	45	13
Unpaid leaves of absence	50	64	33
Paid sabbaticals	5	6	4

Source: *The New Employee/Employer Equation* survey

We conclude that adequate pay and benefits are necessary to employee satisfaction, but not sufficient for genuine employee engagement. Especially as job markets tighten, an attractive benefits package is a prerequisite for attracting and retaining employees. The perception that pay or benefits are inadequate or unfair can cause an exodus. So compensation and benefits may top the list, but they are increasingly table stakes. To engage employees' discretionary energy and deep commitment, however, you also must look elsewhere in the employment deal—in particular at work that is stimulating, work that enables learning and growth, and an enjoyable workplace.

Keep in mind that averages are deceiving. Workforce diversity is growing, and few people have "average" sets of needs and preferences. On the contrary, the employer's challenge is to recognize differences and individualize offerings to the extent practical within a set of (preferably modular) compensation and benefits options. A majority of employees may still be driven to seek the security elements. But significant minorities are driven by money, focused on flexibility in work arrangements, or connected with the work itself far more than with the employer.

Six Challenges in Managing Compensation and Benefits

In the course of our research into the management issues of a changing workforce, we have identified six major and interrelated challenges associated with compensation and benefits management: customization, segmentation, combination, integration, fairness, and accessibility. We discuss them in turn and offer recommendations on how to view and face each challenge.

Customization

Our study of the three workforce cohorts shows how their preferences for benefits and other facets of the employee deal vary based on a combination of age, generational attributes, and where they tend to be in their careers:

- ***Young workers*** often want and highly value time off for other pursuits. They prefer rewards that are instantaneous—if not literally, at least perceptually—and show little interest in the "old deal" (seniority-based pay, ritualized performance review, standard pension and benefits plan). As young workers marry and start families, child-care and family health-care benefits take on instant importance.

- ***Midcareer workers*** often focus on health-care, financial management, and wealth accumulation benefits. Some still (or again) need child care, some need elder care, and some need both. According to a Society for Human Resource Management survey, 25 percent of employees have some responsibility for caring for parents or other elderly family members, and another 25 percent anticipate having such responsibility in the future.[8] Midcareer workers also want time off for family and other pursuits, and relish sabbaticals, often for "the things they never got to do."

- ***Mature workers*** want affordable, age-relevant health-care and insurance benefits, as well as ample free time for personal pursuits. Many want to downshift their responsibilities, phase into retirement, or work in a flexible arrangement that satisfies their desire to contribute to an enterprise, to the community, and to family.

No fixed set of benefits options will affordably satisfy all three groups, and these worker cohorts represent just one possible workforce segmentation. With so much variety among employees and their needs, the employee deal in general—and benefits in particular—must be highly customizable. Perhaps the number-one challenge in benefits today is providing the set of options most meaningful and valuable to each employee while managing the overall program in a way that is cost-effective for the employer. In a sense, we're taking "cafeteria benefits" to the extreme and making that the norm. But customization has practical limits. The workforce may show infinite variety, but benefits can't. Crafting from scratch an individual deal for each employee in a large organization would be unmanageable and unaffordable. The compromise position is "mass customization," long familiar in manufacturing (where companies can produce seemingly endless variations of an item) and banking (where each customer's combination of services and terms seems uniquely tailored). Mass customization happens not because each item or service is built from scratch, but because it is rapidly assembled from a set of well-defined, modular, connectable components.

For benefits management, mass customization means that individual options must be well defined, with the legitimate connections and combinations known, and the underlying information systems must have the flexibility to represent options in modules. In assessing your organization's ability to customize benefits and other facets of the employee deal, be specific. How easily can people—both employees and HR staff—craft combinations? How do the information systems facilitate or impede this process? The goal is to *simplify* offerings, processes, procedures, and systems—and thus control costs—even while handling more variety in compensation and benefits packages.

Offering a valuable individual benefit to a significant number of employees is good. Anticipating employees' needs with new benefits is better. Providing flexibility to add, change, and phase out benefits options quickly and seamlessly is better still. Providing customization of benefits to maximize value for each employee is best of all.

Segmentation

One way to overcome the limits of customization is through better employee segmentation. The challenge is to identify meaningful and useful employee segments around which benefits options and combinations can be crafted. The traditional ways of looking at employees—by rank, function, skills, or tenure—are of declining usefulness for purposes of understanding needs and providing benefits.

Given the growing diversity in the workforce, and the growing challenge of work/life balance for so many workers, organizations need new forms of segmentation more in tune with people's needs both on the job and at home. We call this the "next frontier" in employee surveys and segmentation. The goal is to understand and appreciate employees' needs, expectations, and aspirations both on the job and off. The new variables in segmentation include age, generational cohort, life stage, lifestyle, and work stage.

Combination

In pursuit of work/life balance, employees look not just at individual benefits offered, and not just at the value and fit of the benefits package, but at specific *combinations* of benefits. A young worker might want extra time off for educational pursuits plus tuition assistance. A midcareer worker might want flexible hours that dovetail with child-care services. A mature worker might want part-time work plus help with financial management. These combinations usually draw from different "columns"—financial, health care, family support, time off.

The employer can increase the value of the benefits package to employees by making such combinations apparent and accessible. Using better segmentation, the employer might point out or package sets of benefits options as the "starter set" to satisfy a given life stage or lifestyle. The employer can also simplify the process for employees to find the right combinations on their own, as discussed later.

Integration

Compensation and benefits are just two components of the complete employee deal. As employees become more sophisticated and demanding consumers, they look at employee deals in their entirety. Employers must be able to view and manage deals the same way. That means the people and processes associated with compensation, benefits, work arrangements, learning opportunities, and overall performance management must work together as never before. It takes a cross-functional effort—and the active everyday involvement of line managers—to craft, adjust, and manage deals for key individual employees. It also takes cross-functional effort to outline and articulate the overall deal offered by the employer.

To understand the need for and process of integration, ask a simple series of questions: Who works with employees in crafting their deals? Who works behind the scenes? What does the employee do on his or her own? How do information systems support the process? What can we do to simplify, streamline, and coordinate the cross-functional process called *deal making*? If you have an employer branding initiative under way, its work likely provides a head start in understanding your level of and need for integration across the elements of the employee deal. But the branding team is likely to focus on the external market and articulate what you offer as an employer. Perhaps a counterpart group should focus on the inside—bringing together the organizational pieces needed to craft employee deals and live up to the brand.

Fairness

This issue applies most visibly to compensation but also affects benefits and other facets of the employee deal. Many countries' laws mandate equitable treatment of workers, especially regarding benefits. Besides abiding by legal definitions of fairness, an employer must maintain the *perception* of fairness among employees—which is tough if executive compensation and perquisites appear excessive—because commitment, morale, performance, and retention can suffer, sometimes dramatically. People are generally happy with a pay system that seems fair across roles, ranks, responsibilities, and organizational units; that approximates "market rates" for the work performed and responsibility held; that depends on performance, including individual, group, and enterprise; and that values skills, experience, and productive behaviors.

With today's workforce, managers face potentially tricky issues of fairness at both ends of the age and experience spectrum. Young workers rightly want payment for performance and results. Since they don't expect a "job for life," they object when colleagues earn significantly more because of tenure, not performance. They have a valid point. When an employer shies away from rewarding an outstanding contributor—sometimes an outstanding innovator—because the person is new to the organization, then it is likely to lose that talent. If the employee has yet to demonstrate all the needed skills and traits but has produced outstandingly valuable results in an assignment or a project, then a flexible compensation scheme can finesse the situation by paying for that performance with a one-time bonus rather than the recurring benefit of a large raise in base pay.

At the other end, mature workers want payment for their experience, if not tenure. Whenever the enterprise can actively apply and share that experience—functional, organizational, marketplace—then the experienced employee should be rewarded. Mature workers also want to adopt various forms of flex retirement, but not suffer financially or in status. That entails compatible adjustments to pay, benefits, and pension calculations as they downshift to less intensive roles. Thus, the criteria for performance measurement and compensation calculation must cover results achieved, responsibility handled, skills and experience applied, and traits and behaviors demonstrated. The employer should pay youth for innovation, age for experience, and many employees for both—clearly and fairly to everyone.

Accessibility

We highly recommend providing employees with the "benefit of accessible benefits." Indeed, many employees will value assistance in understanding and maximizing the potential of their benefits package. Streamline and simplify the process for understanding what's available, choosing the best combination of benefits, and managing the consumption of those benefits. At the same time, educate (and maybe provide incentives for) employees to consume their benefits wisely and frugally, thereby curbing their own costs as well as the employer's. Making benefits more clear, accessible, and manageable also makes them more valuable to employees and increases their commitment to the organization.

Making the benefits offerings more valuable to employees while still closely managing the costs—sounds like a win-win and an obvious thing to do. It should not entail a lot of additional investment, since the employer is packaging and communicating what's already available. Unfortunately, we've found few organizations that really do this with purpose and excellence.

The challenge of accessible benefits is greatest, in the United States at least, with respect to the seemingly endless options and complications of health-care coverage. Highly capable and intelligent people get caught up in the funding options (premiums, MSAs, FSAs, etc.), provider variations (in-network versus out), coverages (various percentages usually less than 100), and co-payments (different for physician, pharmacy, etc.). Coping with health emergencies can drain an employee on the job and off. During such crises, employees need an advocate or agent to cut through the clutter and make the system work for them. Absent such employer assistance, a cottage industry has grown of consultant-facilitators who help people deal with their medical "benefits."

This need for accessibility extends beyond benefits to all facets of the employee deal. But benefits may be your company's place to start, especially if utilization and value to employees, and corresponding yield and value to the employer, seem low. Two pioneers are Saint Thomas Health Services and Humana, Inc.

Accessible Benefits at Saint Thomas Health Services

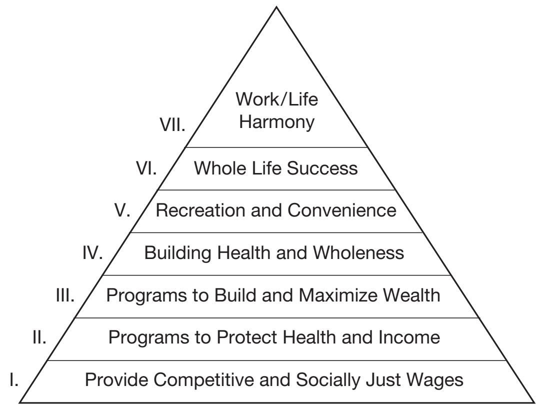
Saint Thomas Health Services (STHS) is part of Ascension Health, Inc., a national Catholic health ministry with a large network of hospitals and health-care facilities. Ascension Health is the largest not-for-profit health-care system in the United States. The STHS organization focuses on packaging and articulating employee benefits in ways that its ten thousand associates in the Nashville area can understand, appreciate, and fully use.[9] STHS found that its traditional benefits program, though thoughtfully designed, was not really being utilized, either by the employees for their own advantage or by the organization as a way to encourage loyalty, commitment, and performance. When Saint Thomas Hospital integrated an acquisition in 2001, it took the opportunity to update its HR practices and redefine its benefits to enhance associate value, while reducing areas of waste and abuse.

The result is a broad and rich program called LifeWorks! In STHS's view, too often benefits and other HR programs have centered on the offerings themselves, not on why they exist or how employees view them. The result is that people cannot understand them, don't use them, and don't value them. The fifty-five-page LifeWorks! Guide starts with the following mission statement: "LifeWorks! is a framework for developing and communicating a comprehensive partnership between Saint Thomas Health Services (STHS) and our associates. Our goal is simple: to empower you with the resources needed to help you achieve a healthy work/life balance through a wide variety of employee benefits and support programs."[10]

Perhaps as important as the details of the program is that it has been constructed to be understood and used by STHS staff. The LifeWorks! components and philosophy are communicated visually as a pyramid (see figure 11-1) containing "seven levels of support," beginning with basic life needs (fair and competitive pay) and evolving to higher-level wants and desires,

FIGURE 11-1

LifeWorks! pyramid



Source: Saint Thomas Health Services

such as health and recreation nearer the peak of the pyramid. The pyramid makes it easy for associates to grasp the entire program while also seeing all the parts and how they relate to one another to form a comprehensive package of "wholeness and healing" for the entire STHS community.

STHS has attempted to integrate—from the associate perspective—what had been discrete programs. LifeWorks! offers benefits and options for its staff at virtually any life stage, and the guide provides detailed descriptions of the rationale for each support level. For each level, the guide describes benefits, eligibility information, costs, and contact information. While offering the disclaimer that the guide is "not intended to serve as a Summary Plan Description" as defined by ERISA, it nevertheless delivers, in one publication, detailed information about every benefit available to associates in a clear, easy-to-read format, and that achievement alone probably makes it a most valuable communication from STHS.

The benefits redesign for STHS was done by a small team that used worker preferences as its data source. The goal was to expand the health and well-being aspects of LifeWorks! and make the financial components more relevant and useful to all participants. Work is ongoing to enhance financial well-being offerings and further associates' abilities to access and utilize the many parts of LifeWorks!

STHS's goal is to demonstrate its profound and tangible commitment to its workforce to create the environment needed to attract talent despite changing demographics. This means making benefits meaningful and accessible to associates at different life stages and with different needs. This includes appealing to younger workers, who tend to be focused on the here and now, and yet respond to opportunities for wealth accumulation and other benefits. A strong and easily understood benefits program should build loyalty and commitment among all workforce generations—and the expectation is that LifeWorks! will.

Accessible Benefits at Humana

Humana, Inc., headquartered in Louisville, Kentucky, is one of the nation's largest publicly traded health benefits companies, with approximately 6.6 million medical members located primarily in eighteen states and Puerto Rico. Humana offers coordinated health insurance coverage and related services—through traditional and Internet-based plans—to employer groups, government-sponsored plans, and individuals.

Humana test-drives new plans, new options, and new tools with its employees before it rolls them out to customers. Because Humana employees are engaged in both the business of the company and their own benefits plans and decisions, they are an ideal test base: they are knowledgeable and sophisticated about the company's business, products, and mission, and consumers of the company's products. In 2001, Humana launched a pilot "consumer-driven" health benefits program called SmartSuite for its five thousand employees in the Louisville area. The intent was to give employees more control over their health benefits choices and spending. In the pilot year, SmartSuite grouped six different health benefits plans into a single bundle for employees; options included traditional PPO and HMO, as well as CoverageFirst, Humana's first consumer-choice health plan offering. Following the pilot and extensive feedback from employees, Humana rolled out SmartSuite to its customers six months later.

In June 2002, the end of the pilot year with its own employees, Humana reported a savings of $2 million and an increase in medical claims costs of just 4.9 percent—versus a projected 19.2 percent increase and actual average claims increase experience of about 19 percent for other companies in the region. The savings are the result of three factors:

- ***Communication and education efforts.*** For example, Humana put a lot of effort into a campaign to demonstrate that double coverage (both wage earners in a family signing on for health-care benefits from their employers) did not produce double value. Almost all employees who had double coverage dropped the secondary coverage, which produced savings when the second plan was Humana's.
- ***Plan design changes.*** Humana modified personal physician and specialist visit co-pays, added a hospital co-pay for some plans, and added deductibles as an option to help employees lower payroll deduction costs.
- ***Behavior modification.*** The vast majority of the savings are the result of employees simply changing the way they use their health benefits plans. The company has found, for example, that while visits to personal physicians were up in the pilot year, hospital visits (which are usually more expensive) were down. Employees were choosing to have procedures done on an outpatient basis at their doctors' offices rather than in the hospital. They also made different pharmacy choices, opting for less expensive drugs. In short, "Employees are accessing care differently."[11]

At the same time that it introduced SmartSuite to help employees make choices of health benefits that best fit their life stage, family needs, and budgets, Humana also automated the process with the Wizard, an online benefits information and selection service available to employees through the corporate intranet or over the Internet. Many employees are becoming increasingly comfortable using online tools, so introducing the Wizard was a natural evolution in the company's use of online resources for employee communication. Using the Wizard, employees can narrow their plan choices by selecting variables such as hospital co-pay, deductible, plan coinsurance, pharmacy plan, and type of benefits—to customize a plan that closely meets their health-care needs and finances. The parameters for the Wizard are not infinite (employees cannot specify, for example, a specific dollar amount for a premium), but there are plenty of choices. They can balance out-of-pocket expenses against a monthly premium, for example. They can also view their actual usage information to help them decide how to adjust their benefits packages. Once employees have made their choices, they can compare various choice options, enroll, or start over to see new options compared.

Over the last three years, Humana has expanded the options in its employee benefits packages and the associated decision-making tools based in large part on employee feedback. Within two weeks of the enrollment period in June, Humana surveys employees about their experience in signing up for benefits and conducts focus groups among employees to drill down about their overall enrollment experience. In the first two years of SmartSuite, ending in June 2003, Humana received some seventy-five hundred lines of comments from employees (some just one word, others detailed critiques of the experience).

Following successful implementation of the Wizard for its own employees, Humana has rolled out the service to its corporate customers, along with training programs to teach customers and their employees how to get the maximum benefit from it. Humana also offers an online help desk for both its own associates and customers' employees who have health benefits questions, and delivers an online newsletter to all associates.

Performance Management Should Guide Changes in the Deal

Compensation and benefits work best—for both an organization and its employees—as part of a complete and coherent performance management system that enables and motivates people to perform well. The deal has got to be clear, and that's part of what performance management does. If the rewards and benefits of working are clearly tied to measurable performance, then employees perceive the system as fair, and the business can adjust the system for optimal results.

Performance management is a system of identifying, assessing, motivating, and rewarding employee performance, with a natural emphasis on serving and motivating top performers. It includes the process of individual and group performance appraisal, as well as orchestration—usually by the immediate manager—of compensation, benefits, other forms of recognition and reward, and other elements of the deal, such as work arrangements and learning opportunities that support and motivate employees. Performance management must be structured and consistently applied, but also flexible and responsive to the needs and styles of employees and employee segments. Every organization has a de facto performance management system, even if it is not explicitly designed and its motivational effects are inconsistent and ineffective.

Designing performance systems is never easy; changing them may be harder, if for no other reason than employees are used to the ones they have, like them or not. But it is the employees, especially high performers, whom you should listen to. They have the answers to your questions about what to include in a performance and reward system to attract, retain, and consistently motivate them. You will find that a foundation principle in any new organizational performance system is choice—informed choice—for employees, both in their deals and in how they relate to the performance system.

Put these trends together, and now may be a good (or overdue) time to revisit the design and operation of your performance management system. The following are hallmarks of the most effective recognition and reward systems. They describe how a successful performance management system operates:

- ***Individuals receive continuous, personalized reinforcement and feedback throughout the year.*** Managers and other feedback providers take the time to monitor, assess, and discuss an individual's performance regularly. Employees make the process work by turning feedback into improvement. Complaints such as "My supervisor is too busy to review my performance" and "The only feedback I get is when I've done something wrong" are sure signs of a performance management system that is neither functional nor respected.

- ***Financial and nonfinancial factors determine incentives and rewards.*** Even in the presence of clear financial indicators (e.g., revenue or profit), each employee is measured on a mix of factors, including behaviors that enable others to succeed (e.g., sharing experience).

- ***Learning and innovation are rewarded, with both recognition and financial incentives.*** Prominent in the measurement and reward mix must be an individual's learning on behalf of the organization (which implies sharing and acting upon what is learned) and innovating to improve the organization's performance.

- ***Judicious risk taking is rewarded.*** Failure upon taking a considered risk is tolerated (few organizations can bring themselves to reward such failure). The performance management system should note not just day-to-day production or results, but also the often bold, thoughtful, and creative attempts that fail.

- ***Recognition is public.*** The organization creates visible forms of acknowledgment, praise, and award that are held in high regard by employees, and that foster performance. Some forms of recognition are regular, others very ad hoc. For example, one international company had senior HR executives present their best practices at a corporatewide HR meeting, and the top three were recognized. The executive whose best practice was voted number one was then asked to go to any market in the world to implement that winning practice.
- ***The reward system reinforces the corporate values, and vice versa.*** If the organization claims to place value on learning and innovation, but there are no rewards or recognition for learning or innovation in the performance system, employees quickly see the disconnect. The performance system must "live" the organization's values—and motivate associated behaviors.
- ***The bonus or incentive is at risk.*** Incentives are linked to performance and are not automatic. They may be based on combinations of results (e.g., individual, team, businesswide) not entirely under the individual's control. But they must not be automatic, and money must be at risk, or the incentives lose their motivational power.
- ***Executives' incentives are tied to the long-term success of the business and are consistent with the interests of shareholders.*** Executive compensation can set the tone for a performance management system. Employees are well aware of the differences between their compensation packages and those of top executives. If executive compensation is out of alignment with the performance or interests of the organization, then people have reason for discontent, and the performance management system is automatically suspect.

Employee Recognition at CalPERS

California Public Employees' Retirement System (CalPERS) is putting many of our performance management principles into operation in a six-year-old employee recognition program, one of the most pervasive in any large U.S. organization. Only a handful of companies (Southwest Airlines, The Container Store) and governments (City of Seattle, State of Arizona) have institutionalized informal, day-to-day employee recognition the way CalPERS does. They recently received a national award as the Best Overall Recognition Program from the National Association for Employee Recognition.[12]

According to various studies, as many as 85 percent of employees leave their jobs because of the relationship with the immediate supervisor. This is one reason CalPERS has identified everyday employee communication and recognition as core competencies for its management team. It holds them accountable for making and maintaining connections with employees, and trains them to do so. The expectation is that supervisors will be attentive to employees and that all employees will support one another by giving recognition that is sincere, specific, timely, and personalized.

Recognition happens at three levels:

- Day-to-day recognition, the base or foundation of the program, consists of verbal or written feedback. "Rocks" (as in "your work is solid as a rock") in the form of a note card or an electronic "e-rock" serve as a means for employees and management to recognize one another.
- Informal recognition involves management-delivered, performance-based recognition for individuals and teams. Specific accomplishments or behaviors critical to business success are celebrated in a wide variety of ways, such as a management-catered barbecue or a personalized memento.
- APEX (Achieving Performance Excellence) is the organization's formal peer-driven recognition award. APEX awards, given annually to 1–3 percent of the organization, include a crystal trophy, a professionally taken photo of each recipient that is hung in the lobby until the next award cycle, lunch with top management, a public presentation, and $500. Receiving the APEX award is considered a major milestone in one's career, in large part because the program is peer driven—employees developed it and nominate and select each year's recipients.

CalPERS has turned its position as a governmental "low-cost" organization to its advantage through the recognition program. With little money for cash awards, the organization must excel at day-to-day and informal recognition, which is creative and delivered with sincerity. CalPERS tries to say regularly, "Here's what you did that made a difference, we value you, our customers value you, and here's how your work contributes to our success."

Employee satisfaction surveys are anonymous but broken down by unit, so the organization can see where there are supervisory strengths and weaknesses. Some supervisors are uncomfortable with giving and receiving recognition (e.g., if they haven't received much, if any, recognition throughout their personal careers), but CalPERS encourages them to work through their discomfort by finding ways to give recognition that best fit their personal communication styles (e.g., if note writing doesn't come easy, then drop by an employee's desk for a face-to-face thank-you). Through a 360-degree feedback process as part of their professional development, managers and supervisors receive the coaching and guidance needed to improve.

CalPERS worked for more than two years with cross-functional teams of staff, including union representatives and an outside consultant, on developing and rolling out the employee recognition program. The bottom-line results include improved employee and customer satisfaction, increased productivity, and a low turnover rate, compared with other California state agencies. Recognition has become a highly valued aspect of working at CalPERS, and helped make it an employer of choice in the state of California.

Is Your Performance Management System Working Well?

There are several litmus tests to gauge how well your performance management system is working. For starters, the performance system must motivate the best performers. Of course, performance management is for all employees, and general excellence in performance management means greater overall productivity. But it's especially important that the system work well for the employees who contribute the most.

The system must also accurately reflect business objectives. Employees should understand that their rewards derive from doing what the business values most. For example, a business cannot insist upon superior customer service but reward call center employees for call volume instead of customer satisfaction and retention. Employees must feel that their work matters toward business performance.

The performance system must also be transparent and understandable, especially to those at lower levels in the organization. If employees say, "I don't really understand how things work; I just get my automatic once-a-year raise," then they're not being influenced or motivated by the system. They must understand the performance management process to participate in it.

In particular, the system must be explicit about the baseline of performance that everyone must meet, and the consequences for failing to meet it. Finally, employees understand and fully appreciate the value of their total reward packages. They must know what benefits and choices are available, be able to make and manage their selections, and value their compensation and benefits packages.

We recommend periodically "taking the pulse" of the performance management system. Talk with a selection of managers, top performers, and representative employees about how and how well the performance management system meets its objectives. Then discuss ways to improve the performance, perception, and results of your system. Keep in mind that assessing and meeting people's needs and influencing their performance are not exact sciences. When designing or revising a performance management system, keep in mind these four underlying realities.

First, people have a wide range of needs and values when it comes to work and benefits. As we have seen throughout this book, these preferences and responses differ by career cohort, as well as by life stage, lifestyle, and work stage. Second, employees may not be able or willing to tell you what they value. This can be a major obstacle in developing the data needed to craft a performance system. Unaware of the possibilities, they may not know how to express what work arrangements, benefits, or learning opportunities might mean the most to them. Alternatively, if they do not sufficiently trust the organization, or sense that the organization does not trust its employees, they will withhold information about their preferences, suspicious of what the organization intends to do with it.

Third, employees' expectations condition their motivation. If people's expectations regarding the job and workplace are not being met, specific attempts at motivation—including monetary—have little effect. This factor can be especially important with young workers who do not yet know the ropes. That's one reason why rapid incorporation into both organization and job are so important. Finally, job satisfaction leads to "membership" in the organization. Membership is a choice. Some people work but never become real members of the employer organization. Others become not just members but leaders in the organization's operational and social structure. Commitment comes when employees are satisfied in all facets of their jobs—the work they do, the deal they have, the respect they enjoy. A performance management system encourages membership by helping an employee appreciate how all these pieces fit together.

ACTIONS TO TAKE

In Adjusting Compensation and Benefits

To maximize the effectiveness of compensation and benefits programs in the twin contexts of the employment deal and performance management, we recommend these four basic actions:

- ☐ ***Probe with purpose.*** First, gain real insight into the compensation and benefits most valued by employees now and in the future. Ask them, perhaps through surveys and focus groups, and research what other companies have discovered, particularly companies in your industry or competing for the same kinds of employees and skills. Second, evaluate the effectiveness of your overall compensation and benefits programs in meeting business needs. Find and eliminate the instances where compensation, benefits, and reward systems send mixed signals about performance expectations and organizational values.

- ☐ ***Customize deals.*** Now is the time to develop and deploy a sustainable and cost-effective plan for individualizing compensation and benefits. Within a few years, you will need the information systems, technology infrastructure, and business processes to implement individual deals broadly in your workforce. In the meantime, all progress in this direction adds to your employer-of-choice credentials.

- ☐ ***Educate employees and retirees.*** When surveyed, many employees will underestimate both the value and range of their benefits. Prepare them to manage the components of their benefits packages and make the trade-offs that are important to them and their futures. They must understand why and how they can help control costs, both out-of-pocket and the employer's costs.

- ☐ ***Engage in the debate.*** U.S. businesses must muster the political will and form the coalitions to enter and change the political debate around pension and health-care issues. They have a duty to shareholders and employees to address these issues for the long term. For a legislative agenda specifically around enabling flexible retirement, see chapter 4.

Notes

Chapter Eleven

1. Gary H. Anthes, "Pillar of the community," *Computerworld*, November 24, 1997.

2. Charles Fishman, "Moving Toward a Balanced Worklife" *Workforce*, March 2000, 38–42.

3. Charles Fishman, "Sanity, Inc.," *Fast Company*, January 1999, 84

4. Howard Gleckman, "Welcome to the Health-Care Economy," *BusinessWeek*, August 26, 2002.

5. Robert Guy Matthews, "A Retired Steelworker Struggles with a Health-Insurance Crisis," *Wall Street Journal*, May 12, 2003.

6. Unless otherwise cited, all statistics in this section are drawn from *The New Employee/Employer Equation* survey. This research project included a nationwide survey of over seventy-seven hundred employees conducted in June 2004 by Harris Interactive for the Concours Group and Age Wave.

7. For purposes of this ranking, we assume base salary and vacation time as given, and offer for comparison increments of each. Preferences within the categories of compensation and time off are discussed in the following paragraphs.

8. SHRM/SHRM Foundation, "2002 Benefits Survey."

9. Interview with Glenn Carnathan, April 2003.
10. Saint Thomas Health Services LifeWorks! Guide.
11. Interview with Deborah Triplett and LaQuesha Dillingham-Spivey, June 2003.
12. Interview with Heidi Evans, May 2003.