Aon Hewitt

Consulting
Talent and Rewards

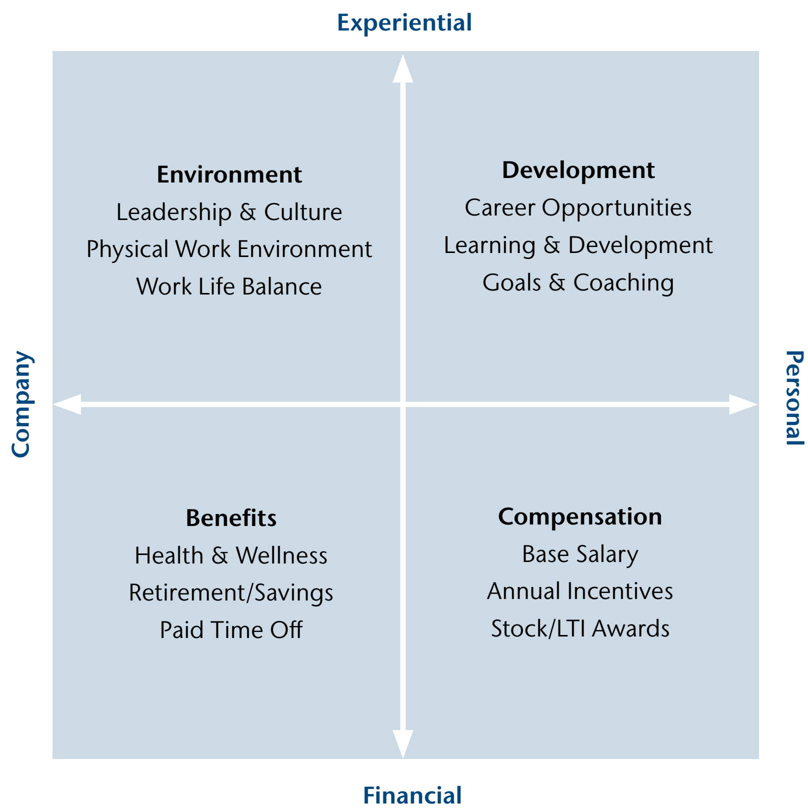
2012

Total Rewards Survey

Transforming Potential Into Value

Aon Hewitt's Total Rewards Framework

The Aon Hewitt 2012 Total Rewards Survey defines total rewards as "everything an employee gets from the employer that they find rewarding" (i.e., compensation, benefits, learning, development, etc.). This concept is depicted below:



At Aon Hewitt, we use this four-quadrant model to illustrate the concept of total rewards. Everything an employee receives from an employer (i.e., not just those elements listed above as examples) can be positioned within this framework, depending on whether the reward element is:

- Financial or Experiential—Financial elements have a clearly defined value or cost, while experiential elements are those the employee experiences through inter action with the company, leadership, management, colleagues, and customers.
- Personal or Company—Some rewards are tailored to the individual (e.g., salary, bonus, personal goals, development plan, etc.), while others are provided in more or less the same way to all employees (e.g., benefits, culture, work environment).

While virtually every organization provides rewards in each of the four quadrants, many leading companies are keenly interested in finding ways to shift more of the total rewards elements up and to the right. This is because we know that more personal and experiential rewards create a stronger emotional bond between employees and the company.

2012

Total Rewards Survey

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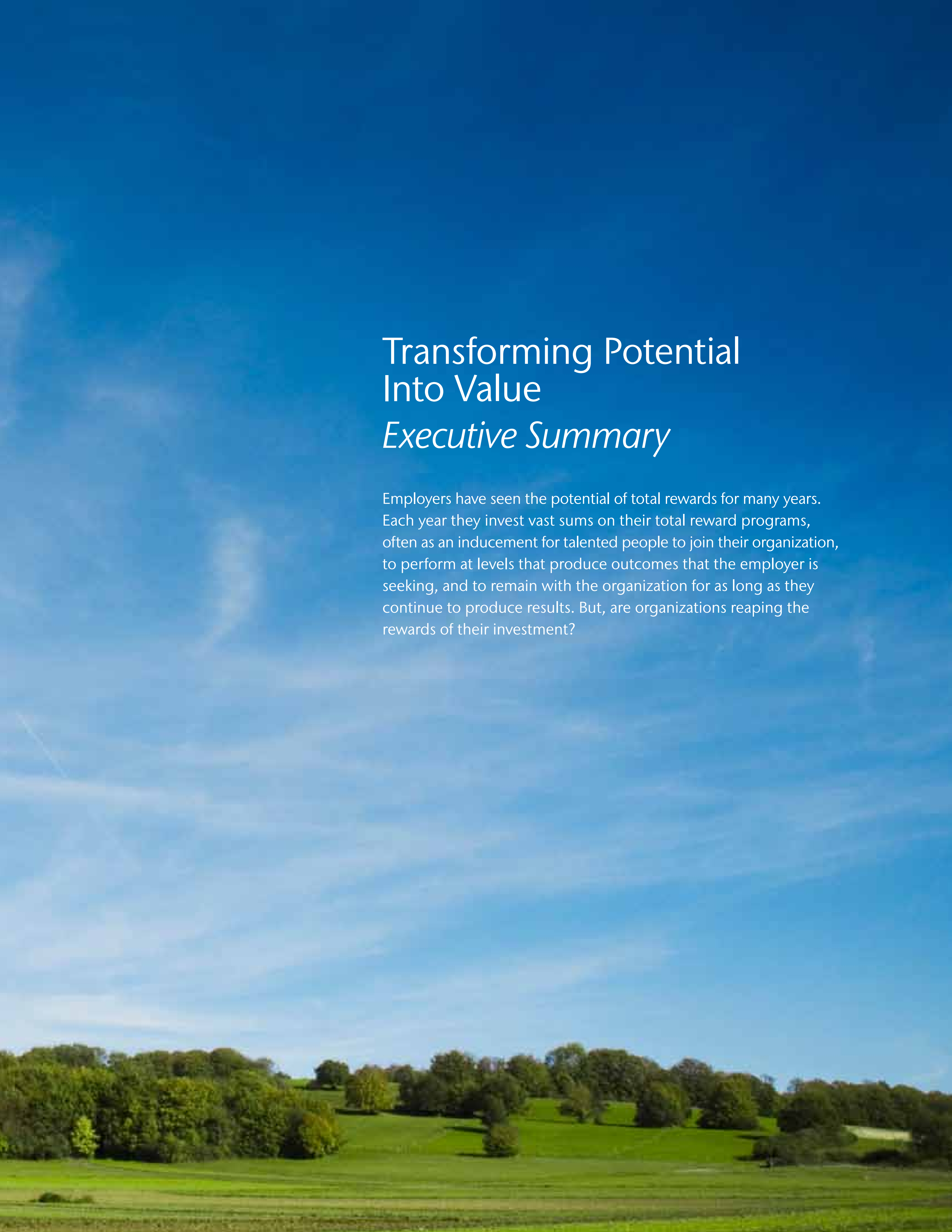


Transforming Potential Into Value

Executive Summary

Employers have seen the potential of total rewards for many years. Each year they invest vast sums on their total reward programs, often as an inducement for talented people to join their organization, to perform at levels that produce outcomes that the employer is seeking, and to remain with the organization for as long as they continue to produce results. But, are organizations reaping the rewards of their investment?

Aon Hewitt's Total Rewards Survey

In the fall of 2011, Aon Hewitt conducted a survey to gather data about organizational priorities including current and future direction of total rewards programs and to identify areas that require additional focus. This report presents the survey findings and Aon Hewitt's analysis and recommendations for employers seeking to more fully realize the potential of their total rewards programs. Interest in the survey was high, with nearly 750 organizations participating.

Overall, the survey results suggest there is much room for improvement in how employers are managing their total rewards program. The responses also point to a number of areas where employers who want to improve can do so. Practices of high-performing organizations point the way toward some of the initial steps and even some of the more advanced actions that employers can take to improve the value they are getting on their total rewards spend.

High Aspirations

The scope and breadth of total rewards leads to high expectations and aspirations. Survey results show that many business leaders and HR practitioners believe that when total rewards are properly aligned, designed, and delivered, the impact on individual engagement and organizational performance can be significant. Consequently, there is great interest in finding ways to transform the potential that total rewards offers as a management tool. Many organizations, however, struggle to find the right combination:

- Forty-one percent of participants say they want to be managing total rewards as a portfolio or package; slightly less than 10% are doing this today.
- One-third of companies surveyed want to see their total rewards as a differentiator; only 10% say they are there today.
- One-quarter of survey respondents want to be early adopters and innovators in total rewards; only 10% say they are there today.

Mediocre Execution

Total rewards often represent one of the largest investments that an organization makes. But what return do organizations get on that investment? Consider that 60% of companies surveyed described their engagement levels as low and two-thirds indicated that the trend in engagement is holding steady or trending downward. Other research confirms that engagement is critically low, and that churn, even amongst top performers, is high.

So, how does such a promising concept like total rewards produce such abysmal results? The survey results shed some light on that question. The answer seems to lie in how companies execute—or fail to execute—on their approach to total rewards:

- No clear link to business strategy or desired outcomes—Eighty-seven percent of survey respondents indicate that it is critical to align total rewards strategy with business strategy; only 56% are doing so and 74% of companies do not have a strategy for managing total rewards.
- Failure to rely on hard data and metrics—Only 46% of companies feel it is critical to gather facts to drive decisions on total rewards, and only 37% are doing so.
- Not listening to employees or asking leaders—While 37% of survey respondents say it is critical to gather data from employees to manage total rewards, only 28% are doing so.

Are High-Performance Organizations Doing Anything Differently?

Who Are the High Performers?

For this study, "high performing" or "The Best" organizations are defined as those that achieve the highest levels of:

- **Revenue against objectives**
- **Innovation**
- **High employee engagement**

Using this definition, we found 150 organizations in our study sample, representing approximately 20% of the total number of participating organizations. Those that did not meet all three criteria are defined as "The Rest."

If we dig a little deeper, we find that some organizations are getting better results. The question is: Are they doing anything differently when it comes to their approach to total rewards that we can learn from?

The survey results do show two major similarities between "The Best" and "The Rest."

1. High-performing companies and the rest identified the same programs are most important for attracting and retaining talent, including base pay, challenging work, culture, health care benefits, etc.
2. All companies identified similar planned investment allocations in human resource programs, from retirement to pay.

Survey results show that high-performing organizations do five things differently from "The Rest."

Articulate strategies and goals

Balance more inputs for decision-making

Connect to the business and employees

Define effectiveness differently

Earn better outcomes

Consequences Are Costly

The survey results identified three major consequences for companies that do not manage total rewards effectively:

1. Missing valuable input from employees, which may lead to lower engagement and higher turnover.
2. Missing opportunities to manage total rewards as a portfolio, which may lead to higher costs and lower effectiveness.
3. Introducing unnecessary risk into their total rewards approach.

Failure to identify and properly manage rewards can ultimately lead to damage to an organization's brand, loss of customers, and a reduced ability to attract and retain employees. Expanding the evaluation of total rewards programs to include efficiency, effectiveness, and exposure alongside competitiveness, cost and compliance, is one way companies can begin to find ways to improve the return on their total rewards investment.

The survey results show that these high aspirations and poor execution combine to produce a situation where much change is desired. Among survey respondents, 55% say they believe some change will be required and an additional 38% indicate that they believe significant change will be needed in their total rewards in order to meet their business and workforce needs.

Change is Desired

Survey results suggest that this change is likely to happen in three sequential phases:

1. Catching up–For many companies, the activity around total rewards is likely to involve addressing some basic needs, such as: putting a total rewards strategy in place, aligning leaders to the direction set for total rewards, addressing organizational structure and cultural issues.
2. Moving forward–Survey results suggest that many employers would like to make shifts in how they design and administer their total rewards programs.
3. Pulling ahead–A further testament to the perceived potential and high aspirations that respondents associate with total rewards is revealed in the following two facts:
   - While 10% of respondents currently see their total rewards as a differentiator for their organization, 33% want it to be a differentiator.
   - While 10% of respondents describe their organizations as an "early adopter" of leading-edge total rewards concepts, 25% want to be seen this way.

The Way Forward is Clear

Charting a course forward involves addressing what are seen as the main impediments to change. Survey results suggest several barriers need to be overcome with respect to the total rewards program: little or no awareness of total rewards objectives; leaders not being aligned; cultural barriers; organization structure changes; budget constraints; HR structure, governance and decision rights; HR resource constraints; global framework and local application.

Three key observations are drawn from the data:

1. HR owns most of the barriers, except for budget constraints–HR is in a leadership position to lead the total rewards agenda.
2. Setting direction and aligning leaders is a good place to start–High-performing organizations indicate that they have a better handle on these two initiatives.
3. Implementation challenges should not be underestimated–Likely challenges to the successful execution of a total rewards program include: leadership development, manager effectiveness, culture, challenging work, and learning.

Map, Compass, Radar, and Telescope

Successfully managing total rewards will require more than a sense-and-respond approach to program effectiveness and the internal and external standards of the day. It will require foresight—the ability to accurately forecast workforce trends, emerging competitive practices, potential regulatory changes, and the future wants and needs of talented workers. It also requires careful consideration of today's changes and their future impact. Indeed, the challenges of today often relate to the unintended consequences of actions taken yesterday. The survey data provides some interesting information on the actions that employers are planning for today and the areas in which employers are expecting to make reduction—all which will lead to the unintended consequences of tomorrow.

High Aspirations

Employers have seen the potential of total rewards for many years. Each year they invest vast sums on their total rewards programs. But this money is not paid for purely altruistic reasons. Total rewards generally are provided as an incentive for talented people to join an organization, to perform at levels that produce outcomes the employer is seeking, and to remain with the organization for as long as they continue to produce results; in short—to link employee behavior with business goals, creating an engaged and productive workforce.

A Brief History of Total Rewards—From Maslow to Pink

Research from over the years and across many disciplines tells us that the combination of rewards offered by an employer represents a system of inducements, where different reward elements drive different behaviors and outcomes. Some rewards are strong attractors, while others play a more important role in motivating or engaging employees. This research insight is reinforced by personal experience and common sense.

The scope and breadth of total rewards leads to high expectations and aspirations. Many business leaders and HR practitioners believe that when total rewards are properly aligned, designed, and delivered, the impact on individual engagement and organizational performance can be significant. Consequently, there is great interest in finding ways to unlock the potential that total rewards offers as a management tool. However, many organizations struggle to find the right combination. In a way, this is surprising given how long we have been working with the idea of total rewards.

In fact, while the ***term*** "total rewards" may have come into vogue only in the last several years, the ***concept*** has been with us for decades.

In the 1950s, psychologist Abraham Maslow first published *Motivation and Personality*, which introduced his theory about how people satisfy various personal needs in the context of their work. He postulated that there is a pattern of needs recognition and satisfaction people follow in generally the same sequence. He also theorized that a person could not recognize or pursue the next higher need in the hierarchy until her or his currently recognized need was substantially or completely satisfied.

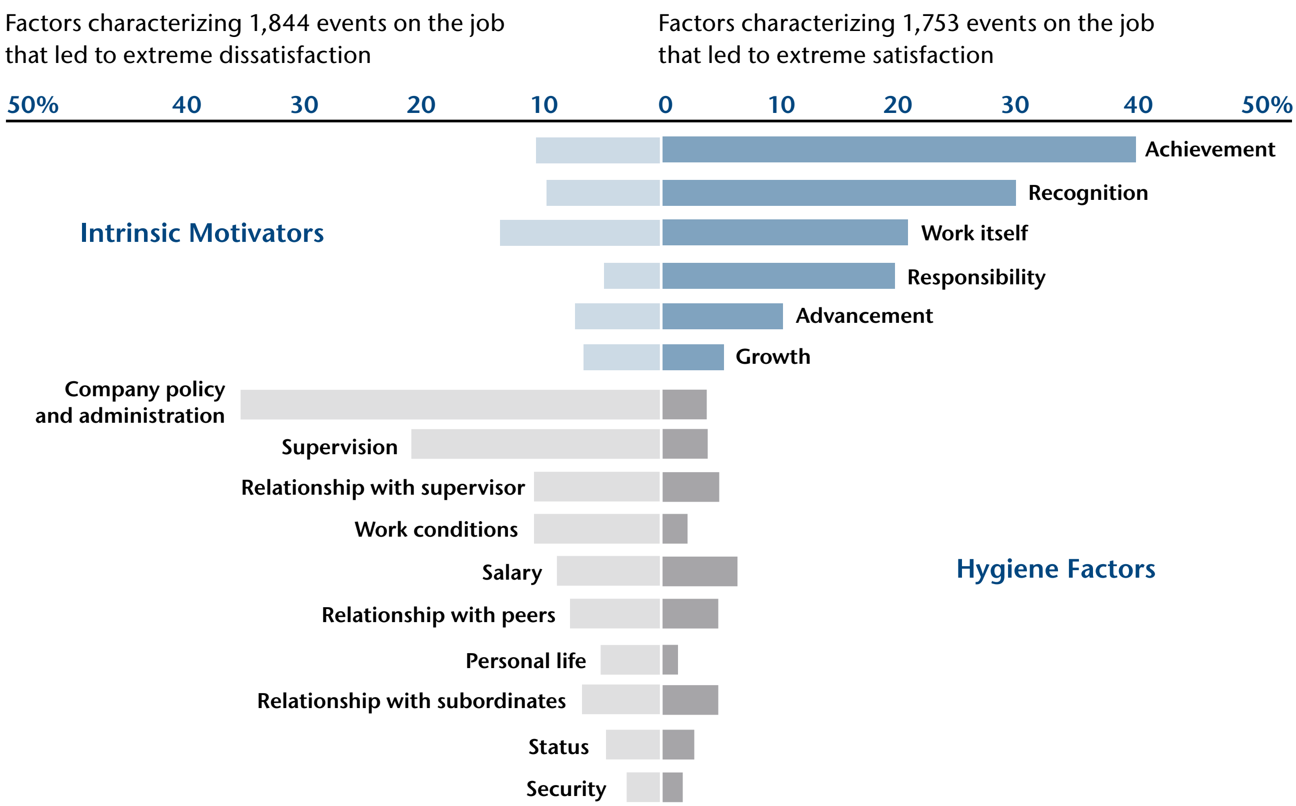
Maslow’s hierarchy of needs is often illustrated as a pyramid with the survival need at the broad-based bottom and the self-actualization need at the narrow top. His hierarchy is depicted below, alongside the main components of total rewards, which we have listed in a parallel structure to illustrate the connection.

Maslow’s Hierarchy	Total Rewards
Self-Actualization	Advancement/Growth Opportunities
Aesthetic Needs	Interesting, Challenging Work
Cognitive Needs	Learning and Development
Esteem Needs	Recognition, Promotion Performance Feedback
Belonging and Love	Affiliation and Co-workers
Safety and Security Needs	Financial Security, Health & Welfare
Physiological Needs	Hourly Wage, Base Salary

In the 1960s, sociologist Frederick Herzberg constructed a two-dimensional paradigm of factors affecting people’s attitudes about work. He concluded that factors such as company policy, supervision, interpersonal relations, working conditions, and salary are “hygiene factors” rather than motivators. According to his theory, the absence of hygiene factors can create job dissatisfaction, but their presence does not motivate or create satisfaction.

In contrast, he determined from the data that motivators are the elements that enrich a person’s job; he found five factors in particular that were strong determiners of job satisfaction: achievement, recognition, the work itself, responsibility, and advancement. These motivators (satisfiers) were associated with long-term positive effects in job performance while the hygiene factors (dissatisfiers) consistently produced only short-term changes in job attitudes and performance, which quickly fell back to their previous levels. Thus, Herzberg’s paradigm essentially described an early framework for total rewards.

Factors Affecting Job Attitudes as Reported in 12 Investigations (Herzberg)



In the 1970s and 1980s, we saw further advancements in the concepts of total rewards. This ranged from comments by management and HR guru Ed Lawler to comments by Peter Drucker, who began advocating flexibility and choice-making[1]. Concurrently, Edward Demming advised that "joy in successful performance and recognition" are the most effective means of optimizing employee commitment and self-driven performance. Rewards are important, but should not be given in a manner that devalues the intrinsic reward natural to people[2].

[1] *Managing in Turbulent Times*, Peter Drucker, 1980.
[2] *Out of the Crisis*, Edward Demming, 1982.

It is worth noting that Maslow's theory, while widely cited due to intuitive appeal, has elements that have not been empirically validated (e.g., the pre-potency and order of the hierarchy). Nonetheless, the theory and concept that people are motivated by a variety of elements from basic life needs to realizing personal potential has served as an important catalyst for researchers and practitioners alike to better understand motivation in the workplace. Total rewards addresses many motivational theories that have emerged over the decades, including operant conditioning/rewards and punishment (Skinner); need for achievement, power, and affiliation (McLelland); goal theory (Locke, et al); expectancy and instrumentality (Vroom); and intrinsic motivation (Deci and Ryan).

In recent years, we have seen a range of commentators—from management consultants like Jon Katzenbach[3] to *New York Times* best-selling author Daniel Pink[4]—present compelling arguments for taking a "total rewards view" of the world that balances financial rewards with experiential or intrinsic motivators in order to increase motivation and improve organizational performance.

Have employees, too, been saying the same thing all along?

Perhaps most important, during all this time employees have been telling us the importance of total rewards—or at least they have been trying to tell us. Employee research shows that the combination of various program elements most crucial in attracting talent often differ from the elements that engage—which, in turn, differ from those that retain[5].

[3] See, for example, *Why Pride Matters More than Money: The Power of the World's Greatest Motivational Force,* Jon R. Katzenbach, 2003.
[4] See, for example, *Drive: The Surprising Truth About What Motivates Us*, Daniel Pink, 2009.
[5] Aon Hewitt, "Engagement 2.0 Survey of US Employers and Employees," March 2010.

Attraction, Retention, and Engagement Drivers Are Different

Top Attraction Drivers	Top Retention Drivers	Top Engagement Drivers
Competitive base pay	**Senior leadership making right decisions for the future**	**Clear career path**
Competitive health care benefits	**Necessary tools**	**Involved in decisions that affect my work**
Financial stability of company	**Competitive health care benefits**	**Necessary resources**
Flexible work schedule	**Necessary resources**	**Career development**
Competitive retirement benefits	**Reliable workgroup**	**Teamwork**
Competitive vacation/time off	Career development	Co-workers make personal sacrifices to drive success
Reputation as a great place to work	Clear career path	Co-workers make personal sacrifices to improve their skills needed to contribute
Opportunity for advancement	Manager understands what motivates me	Manager understands what motivates me
Challenging work	People-oriented culture	Appropriate decision-making authority
Company culture	Stress management	Good understanding of how health care benefits work

The data in the chart above reflects responses across a range of companies. Individual company responses may vary significantly, so employers should be careful about drawing inferences. What is important to note is that the factors affecting attraction differ from those most affecting retention, which differ again from those that influence engagement. We have a tendency to talk about "attract, retain, and motivate" in one breath and treat it almost as one concept. Clearly, total rewards has an impact on all three objectives. However, employers would be wise to disaggregate this trinity—focusing on each objective separately when evaluating or designing total rewards programs.

Total Rewards Impact Evident

Finally, evidence for the potential impact of a well-designed total rewards program also exists at a much more basic, common-sense level. Think of what most employees do when considering leaving one job for another. What would you do? If you are like most people, you might take out a sheet of paper and draw a vertical line down the middle to produce two columns, one labeled "Stay" and the other "Take the Offer." You might then proceed to list the various aspects of the job you currently have and the one you are considering. Often this process starts with financial elements like salary, bonus, and stock awards. Frequently, the bottom of the page is where experiential elements like "opportunity to grow" and "challenge" are listed.

So, if psychologists, sociologists, management gurus, business writers, employees, and our own common sense have been advocating a total rewards approach for decades, there are two obvious questions:

- For organizations that have **not** adopted total rewards as a way of thinking about attracting, motivating, and retaining workers, why not?
- For organizations that **have** adopted a total rewards framework, what kind of results are they getting?

The first question is a real conundrum that is beyond the scope of this discussion, but we might hypothesize that these companies are not aware of this framework or are not aware of or convinced of its value, which leads us to the second question—one we hope to shed some light on here.

Aon Hewitt's Total Rewards Survey

In the fall of 2011, Aon Hewitt conducted a survey of employers to gather data about organizational priorities. Our goal was to assess the current and future direction of total rewards programs and to identify areas that require additional focus if the full potential of total rewards is to be realized. This report presents our findings, analysis, and recommendations for employers seeking to more fully realize the potential of their total rewards programs. Interest in the survey was high, with nearly 750 organizations participating.

Survey Reveals High Aspirations for Total Rewards

Aon Hewitt's ***2012 Total Rewards Survey*** confirmed that aspirations for total rewards are high, even if few organizations are fully realizing them. Consider the table below, which shows survey respondents' top priorities for total rewards in 2012.

Total Rewards Priorities for 2012

Priorities	Percent of Companies
Improve employee engagement	**58%**
Improve alignment with business objectives	**52%**
Improve ability to retain talent	**48%**
Improve ability to attract talent	**44%**
Take a more holistic view of rewards	**40%**
Reduce benefit costs	**39%**
Improve alignment to individual performance	**37%**
Create a roadmap to manage total rewards for 3 to 5 years	**35%**
Improve the return on total rewards investments	**25%**
Create or improve programs targeted to top performers	**22%**
Introduce new/innovative programs	**22%**
Redesign programs around major internal/external factors (e.g., health care reform, retirement eligibility, etc.)	**18%**
Reduce reward program cost	**10%**
Introduce more choice	**8%**
Segment rewards by employee groups	**6%**

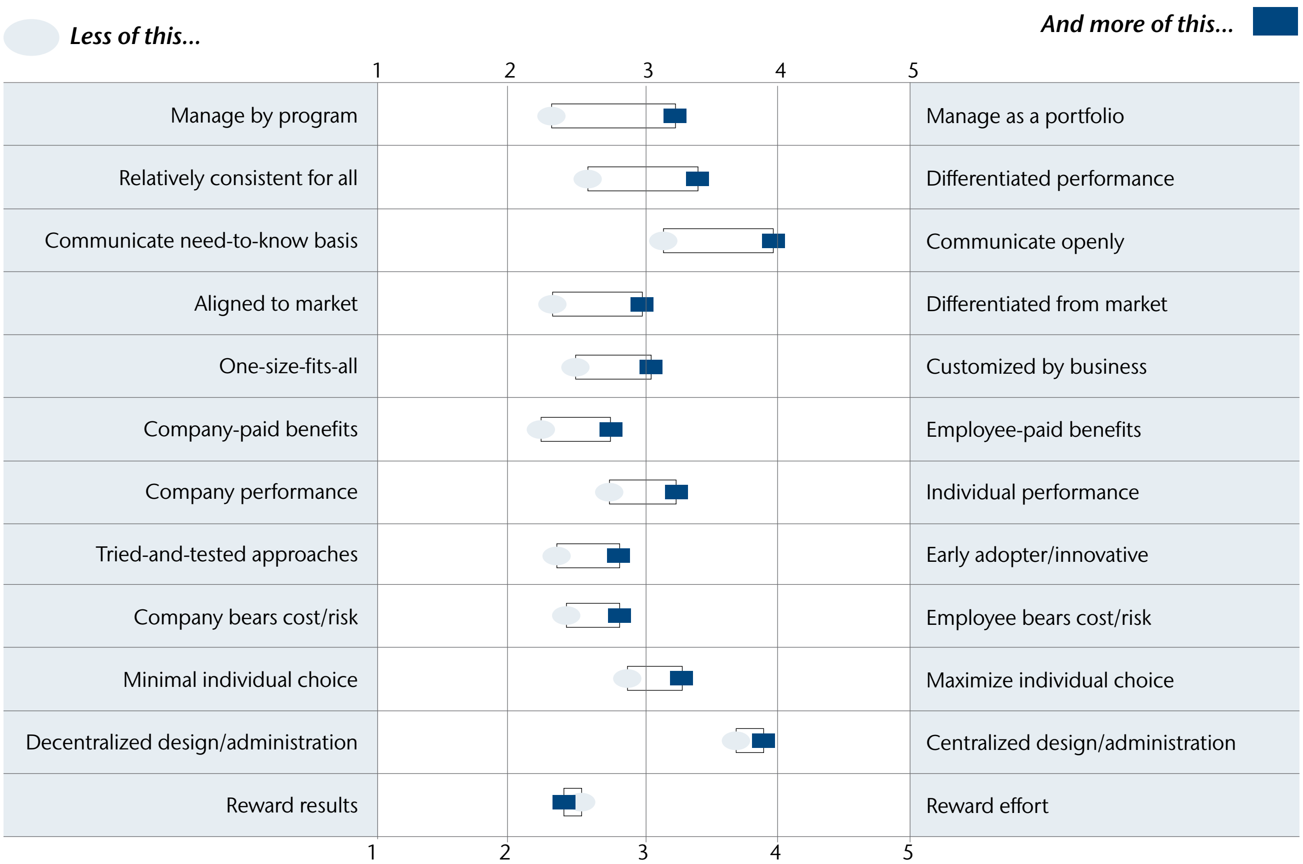
Note that the four most often cited priorities relate to crucial talent and business objectives. The remainder of the priorities reflects a list of tactics that companies intend to deploy to achieve the talent and business objectives. About one-half of companies are expecting total rewards to help them improve their ability to engage, retain, and attract talent, while a similar percentage see total rewards as a key lever to help drive improved business results. Virtually all companies are looking for total rewards to help with at least two of these four objectives. The results indicate a clear understanding of the connection between engaging and motivating employees and achieving business goals.

Aspirations Versus Actions

But there is more. Take a look at how companies say they would like to manage their total rewards programs, and how that compares with what they are actually doing:

- 41% of participants say they want to be managing total rewards as a portfolio or package—they realize that much of the power in a total rewards approach is implied by the concept's first name, "total," which suggests that a better managed whole can produce something greater than the sum of the parts. In reality, however, slightly less than 10% are doing this today.
- One-third of companies surveyed want to see their total rewards as a differentiator—something that helps them win the war for talent, but only 10% say they are there today.
- One-quarter of survey respondents want to be early adopters and innovators in total rewards—positioning themselves on the leading edge of new ideas in order to gain first-mover advantage, thereby putting distance between themselves and the competition. But once again, only 10% say they are there today.

Leaders Considering Significant Changes in Total Rewards Approach



Are Organizations Realizing a Total Rewards Return on Investment?

Total rewards often represents one of the largest investments an organization makes. But what return do organizations get on that investment? Consider that 60% of companies surveyed described their engagement levels as average or low, and two-thirds indicated the trend in engagement is holding steady or trending downward. We live in a world where roughly one-half of workers are disengaged and roughly one out of every eight workers are *actively* disengaged[6].

[6]Aon Hewitt, "Engagement 2.0 Survey of US Employers and Employees," March 2010.

We know from other research that:

- One out of every five or six employees chooses to leave their employer each year.
- More than one out of every 10 high performers has left their employer *since the downturn.*
- 42% of employees are not energized by their work.
- 40% are stressed to the point of feeling “burned out.”
- 64% are physically exhausted when they get home from work.
- Workplace stress is a significant issue and one main reason for the stress is “not knowing what is expected from me in my job.”
- Only 43% of employees trust their senior leadership.
- More than half of employees do not know how their pay is determined.
- Satisfaction with health benefits continues to decline, yet 23% of employees do not consider themselves to be in good health and 27% do not feel motivated to be healthy.
- Nearly half (45%) of employees do not feel financially secure for retirement.
- Approximately one half of employees does not see long-term career opportunities at their current employer.
- Fully 43% of employees believe they must leave their current employer to advance to a higher-level job.
- More than half of organizations report that employees do not have a clear picture of the skills that they should build to support business growth.

The obvious question is: How does a promising concept like total rewards produce such abysmal results?

Mediocre Execution

The survey results shed some light on why the total rewards concept has failed to produce better results. The answer seems to lie in how companies execute—or fail to execute—total rewards delivery. Survey responses point to three common, problematic practices:

1. Navigating without a map (no clear link to business strategy)
2. Navigating without a compass (not relying on hard data and metrics)
3. Navigating without radar or sonar (not hearing the voice of the employee)

These three ideas are explored in more detail.

Navigating Without a Map (No Clear Link to Business Strategy or Desired Outcomes)

Eighty-seven percent of survey respondents indicate that it is critical to align total rewards strategy with business strategy. There are three issues here:

1. Why aren't 100% of respondents saying it is critical to align total rewards strategy to business strategy?
2. Why are only 56% actually doing so?
3. If 87% believe it is critical to align total rewards strategy with business strategy, how can it be that almost 75% of companies do not have a strategy for managing total rewards?

A total rewards strategy is the map that guides the management of rewards programs. Yet, it seems as though most firms have chosen a destination but are navigating without a map. It has long been argued that "total rewards strategy should ensure that the rewards framework matches the strategic needs of the business, and that the mechanics of the total rewards structure reinforce the desired culture and management style. Total rewards strategy also drives the components of the total rewards programs to influence and motivate employee behavior in the right direction[7]." For example, we see some employers making investments in health care to drive better cost outcomes and foster employees who are better able to come to work, work more productively, and produce better results.

Navigating Without a Compass (Failure to Rely on Hard Data and Metrics)

Hard facts and reliable data serve as a compass in the sense that they help keep total rewards programs on course.

The survey reveals that 46% of companies feel it is critical to gather facts to drive decisions on total rewards. This number strikes us as remarkably low. Indeed, the lack of sound, fact-based decision-making in total rewards likely represents a root cause for the low return on investment in this area. Further, while 46% of companies said it is critical to gather facts, only 37% say they are actually doing so. More than half the survey respondents indicated that they do not measure the effectiveness of total rewards annually and use the results to plan next year's initiatives. Our experience suggests that companies may be over-relying on data measuring competitiveness, cost, and compliance—while not paying sufficient attention to metrics that help describe efficiency, effectiveness, and exposure to risk.

[7] Kantor and Kao, "Total Rewards: From Clarity to Action," *World at Work Journal*, Q4 2004.

Navigating Without Radar or Sonar (Not Listening to Employees or Asking Leaders)

One way to navigate in the dark (or underwater) is to listen for the blip on a radar screen or the ping of a sonar system. Perhaps the most obvious audible guidance system to listen for when managing total rewards is the voice of employees and leadership. And, while 37% of survey respondents say it is critical to gather data from employees to manage total rewards, only 28% are doing so. This explains why roughly half of survey respondents report that they do not have reliable data on the rewards preferences of their high-performing and high-value employees, and they do not understand how employee preferences differ in key geographies.

Employee Voice Vital

The employee voice is a vital sound to listen for when evaluating or crafting reward programs. Indeed, we are finding increasing numbers of employers interested in understanding the wants, needs, and preferences of current and prospective employees. Leading employers are finding ways to gather reliable data from people who do not yet work for them, but who one day might.

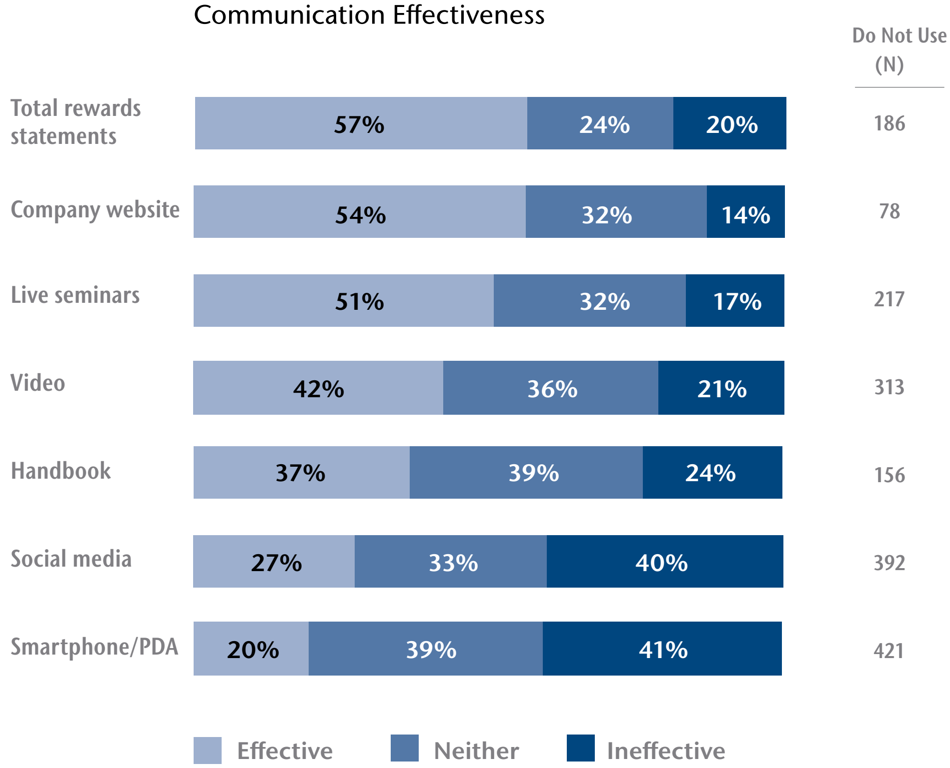
Leader Voice Faint

While the employee voice is not as resounding as it should be, what is perhaps more startling is the extent to which the voice of leadership has grown faint on total rewards. Most companies surveyed do not have a total rewards strategy. This represents an astounding missed opportunity for leaders to bring their voice to the total rewards discussion. A key role for leadership in the creation of total rewards strategy and programs is to define how the organizational approach to total rewards should reinforce the desired management style and culture. Organizations that are serious about driving results through total rewards will be wise to find ways to bring this input into the mix, and to do so in a structured, quantifiable way.

Communication Lacking

A final note on communication: It is often said that communication is a two-way street. While the survey results indicate most companies are not distinguishing themselves in the extent to which they are listening to the employee voice, it also suggests that execution is poor as well when sending messages to employees.

Communication Effectiveness



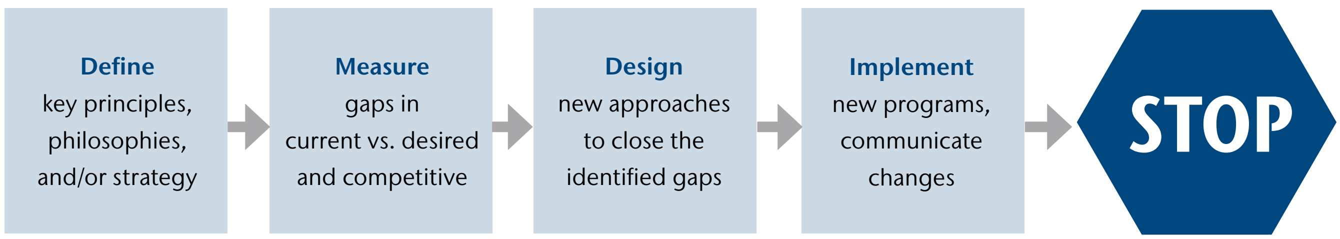
If hard data, facts, current effectiveness of total rewards, and the employee voice are not driving the design and operation of total rewards programs, what is?

It seems the answer to that question more often than not is **cost** and **competitiveness**. Clearly, costs must be managed, but 21st century thinking involves **optimizing** costs rather than simply reducing them. How many employers have gotten themselves into more trouble by trimming past the fat and cutting to the bone? Competitiveness also needs to be managed carefully. Trying to gain competitive advantage by mimicking what everyone else is doing is inherently nonsensical, yet it remains the focus of many organizations when it comes to developing their reward programs.

Aon Hewitt Point of View: Total Rewards Should Be Managed as a Process

In many organizations, there exists a gap between what employees and prospective employees are told about a company's total rewards and what they experience every day. Indeed, this gap between the rhetoric and the reality is one of the primary disengagers in many companies. One of the reasons for this is that total rewards all too often are managed as a project within an organization, following a series of steps something like this.

Total Rewards Often Managed as a Project



This kind of approach leads to the development of static reward programs that are not sufficiently responsive to changing organizational or economic conditions. Rewards are often designed with a "get them in the door" mentality, and insufficient attention is paid to the changing needs of an ever-evolving workforce. These changing needs then create pressure for modifications which, more often than not, are undertaken on a large scale only after significant pressure has accumulated. This produces step changes in total rewards that employees often perceive as a rewriting of the employment deal. This erodes trust. Finally, changes frequently are made without regard to how they will impact other areas of the total rewards package and the actual or perceived value provided to employees. This usually produces unintended consequences, which then create a whole string of issues that need to be managed in order to avoid or resolve disruption.

Human Resource Functions Not Structured for Total Rewards

Because total rewards are so often managed as a project, organizations fail to adjust their human resource structures to reflect the concept of total rewards. By and large, human resource functions are not structured to support systemic thinking and holistic decision-making across a wide range of total rewards elements. Long-standing, firmly entrenched silos preclude consideration of "radical" ideas that may produce significant, positive organizational impact. Consider, for example, how most organizations would go about evaluating a proposal to reduce retirement plan contributions in order to provide more funding for leadership development. Or, think of the leading technology firm that had an espoused strategy to make physical space a central component of the employment experience and total rewards offering, but, nonetheless, had the head of facilities reporting up through finance rather than human resources.

These kinds of problems would be mitigated if we were to think of total rewards as a closed-loop system, and manage it accordingly.

The question is how to do that.

Aon Hewitt Total Rewards Process

At Aon Hewitt, we view total rewards as a process, along the lines of Six Sigma. Managing it as such can help address many of the problems that arise when an organization's total rewards program is handled as a project, such as:

- Development of static reward programs not sufficiently responsive to changing organizational or economic conditions
- Failure to anticipate the unintended consequences arising from program change
- HR structures are not adjusted to reflect and support the adoption of the total rewards concept

Taking a systemic view of total rewards is an important step toward improving the return on investment. One way to do this is by viewing the total rewards process as a Six Sigma closed-loop system.

The diagram below shows how the Six Sigma five-phase DMAIC methodology can be applied to an organization's total rewards process.

Six Sigma Methodology Applied to Total Rewards

Interestingly, the survey findings suggest that—whether consciously or subconsciously—high-performing companies are managing their total rewards using this kind of Six Sigma thinking.

Read on to see how.

High-Performing Companies Take a Different Approach

The survey data point to widely shared high aspirations for total rewards and widespread mediocre execution leading to generally poor outcomes and results. However, if we dig a little deeper, we find that some organizations are getting better results. The question is: What are they doing differently in their approach to total rewards that we can learn from?

With outcomes and performance in mind, we sought to examine how high-performing organizations approach total rewards. Are they doing anything differently from what the others are doing?

Who Are These High-Performing Companies?

For this study, we identified "high-performing" organizations ("The Best") as those that achieve the highest levels of:

- Revenue against objectives
- Innovation
- Employee engagement

Using this definition, we identified 150 organizations in our study sample, representing approximately 20% of the total number of participating organizations. Those organizations that did not meet all three of these criteria are identified as "The Rest."

What Do Most Organizations Have in Common?

Our study shows some similarities across companies that are worth noting. First, both high-performing companies and The Rest identified the same programs as most important for attracting and retaining talent. The lists were practically identical.

Top Talent Attraction and Retention Programs

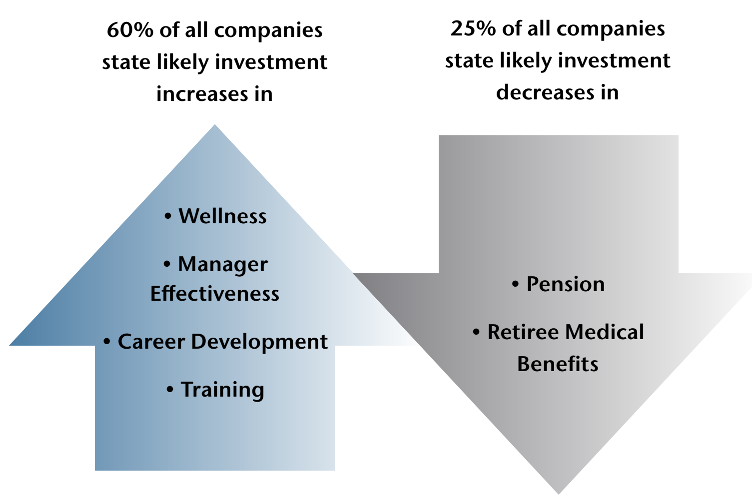
Programs	Percent of all Companies
Base pay	72%
Challenging work	70%
Culture	66%
Health care benefits	66%
Career development	61%
Short-term incentives	61%
401(k) defined contribution	60%
Manager effectiveness/Support/Coaching	58%
Training/Learning	56%
Paid time off	54%
Long-term incentives/Stock options/Restricted stock	48%
Flexible work arrangements/Workplace flexibility	45%

The list validates the notion that companies recognize that programs across all four total rewards quadrants are critical to attracting and retaining talent. We see elements of pay, benefits, learning and development, and work environment evenly distributed. Further, it is important to note that work environment areas of culture and challenging work take the number 2 and 3 spots. These elements are increasingly high on the minds of business leaders relative to critical talent objectives.

The second similarity across all companies has to do with planned investment allocations. When asked what types of investment changes companies anticipate (increase, decrease, or stay the same), we saw a similar pattern across all participants. Companies plan to decrease investment in traditional retirement vehicles such as pension and retiree medical, and increase investments in other areas. Investment plans indicate a strong reallocation toward upper-quadrant areas of manager effectiveness and learning and development.

There is a strong interest in wellness programs and expanding the culture to support wellness initiatives. Wellness is the only likely benefits investment increase for most organizations (although one could argue that wellness programs, too, impact the work environment). However, few companies have funding available to spend on wellness. Most chose to take the funding from other programs, or add to the cost as part of benefits, and then offer incentives to lower the cost.

A Similar Pattern of Investment Reallocation Across All Companies



Survey results indicate relatively little change in investment levels for pay and other areas of benefits. Further, these data validate that rewards should be (and in many cases, are) viewed as a portfolio across which investments should be allocated or reallocated. From our consulting with clients, we know some employers are considering defined contribution health care models to replace their defined benefit health care plans. This can have significant implications to a total rewards model and can fuel the drive to a portfolio approach.

The question remains, however, whether all organizations make such total rewards reallocations independent of one another or in a holistic, purposeful fashion.

What Are the High-Performing Companies Doing Differently?

As seen in the data above, many companies are focusing on common reward programs. However, our study aims to identify the greatest differentiators between high-performing companies and everyone else ("The Rest") regarding how they plan, develop, and implement total rewards. **It appears that the differentiating performance factor is not the programs offered. It is how they are executed.** We found that when it comes to total rewards, high-performing organizations do five things differently:

Articulate strategies and goals

Balance more inputs for decision-making

Connect to the business and to employees

Define effectiveness differently

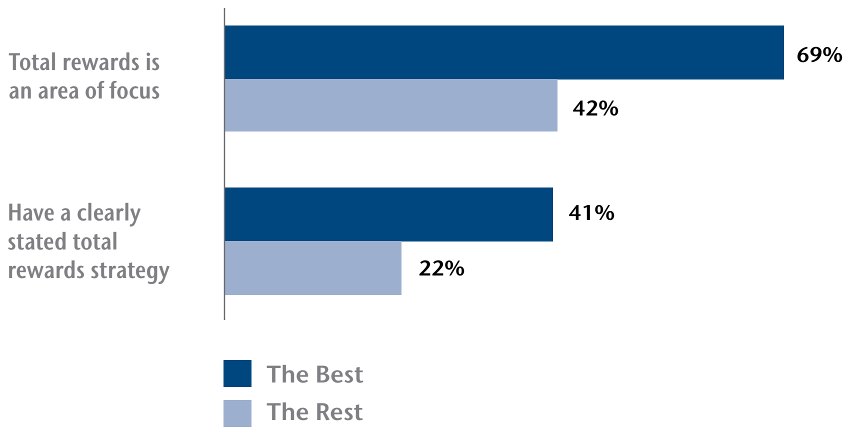
Earn better outcomes

In the balance of this section, we will examine each of these five elements.

High-Performing Companies Articulate Clearer Strategies and Different Goals for Total Rewards

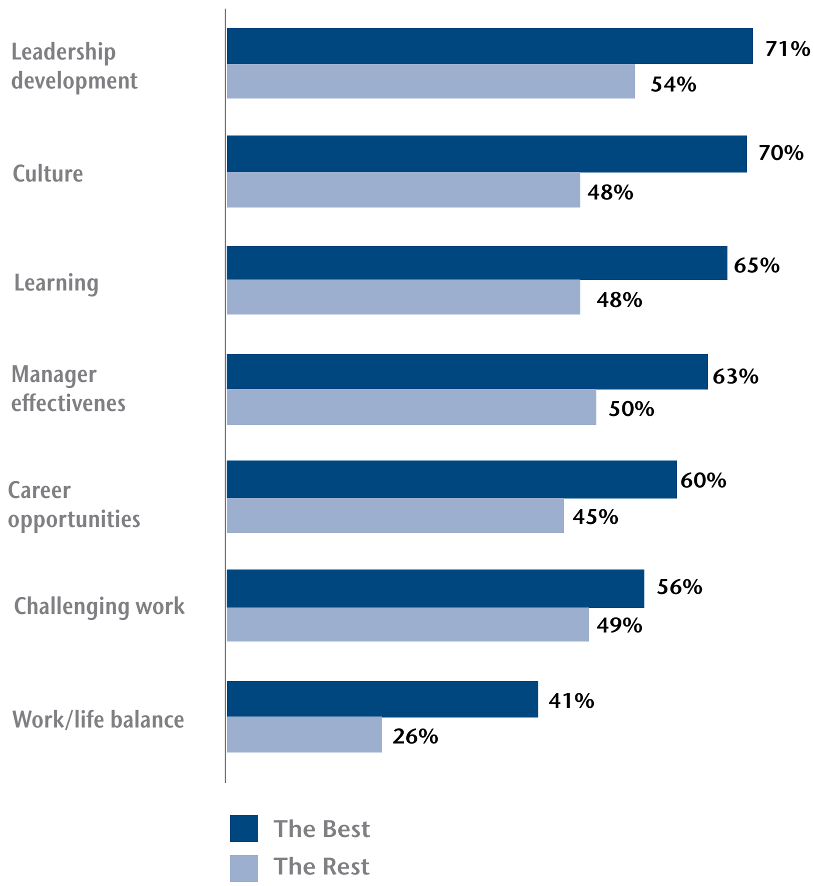
Whereas the data indicate consistency across companies in terms of program importance and likely reallocations, the first key differentiator of high performers is strategy and focus. High-performing companies declare total rewards an area of focus and clearly articulate a total rewards strategy at almost twice the rate of other sampled organizations.

Percent of Companies with Total Rewards and Articulated Strategy



The data also indicate that high-performing companies have clearer goals regarding the focus and targeted position of programs. The data displayed in the next chart indicate that high-performing companies are purposefully differentiating in the areas that are hard to replicate: culture, leadership, learning and development, and work/life balance. This finding shows an important contrast: Average companies state there will likely be investment in these areas, but are operating without a holistic focus, strategy, or declaration of competitive position. Articulation of a total rewards strategy is perhaps the prerequisite to success.

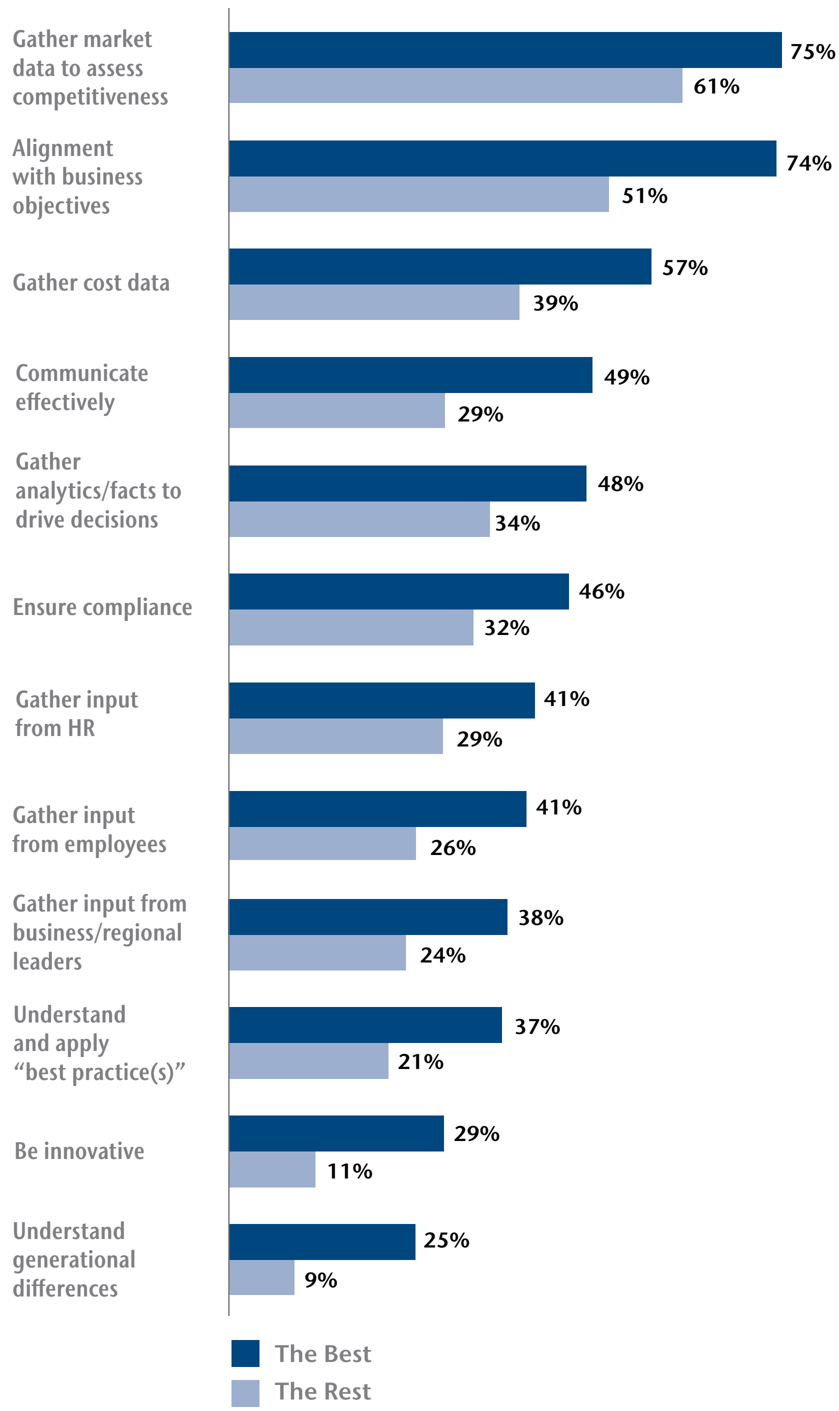
Percent of Companies Declaring Focus and Competitive Goal for Specific Programs



High-Performing Companies Balance More Inputs for Total Rewards Decision-Making

We also see a difference in how high-performing organizations inform their total rewards decisions once they have a strategy. Across the board, high performers are using more data inputs. They balance multiple inputs that include business alignment, competitive position, cost, and compliance. Further, attention to program alignment with business performance is the dominant differentiator between high-performing companies and The Rest. We also see high performers consider innovative programs at a much higher rate than The Rest, which drives an even greater opportunity to differentiate. The average company places more weight on competitiveness and cost relative to other critical inputs. Clearly, the lens used to make decisions will drive the decisions that are made. Decisions made to reach competitiveness and cost objectives as a priority will yield different designs and different outcomes than decisions made prioritizing alignment with the business.

Percent of Companies Using Various Inputs to Total Rewards Strategy and Design



It is noteworthy that customer and constituent input into total rewards strategy and design is relatively low across the board. High-performing organizations are still gathering data from employees, leaders, and HR colleagues at a higher rate than average companies, but this finding would indicate an opportunity to drive further success—for all organizations—through involving more key stakeholders in the process.

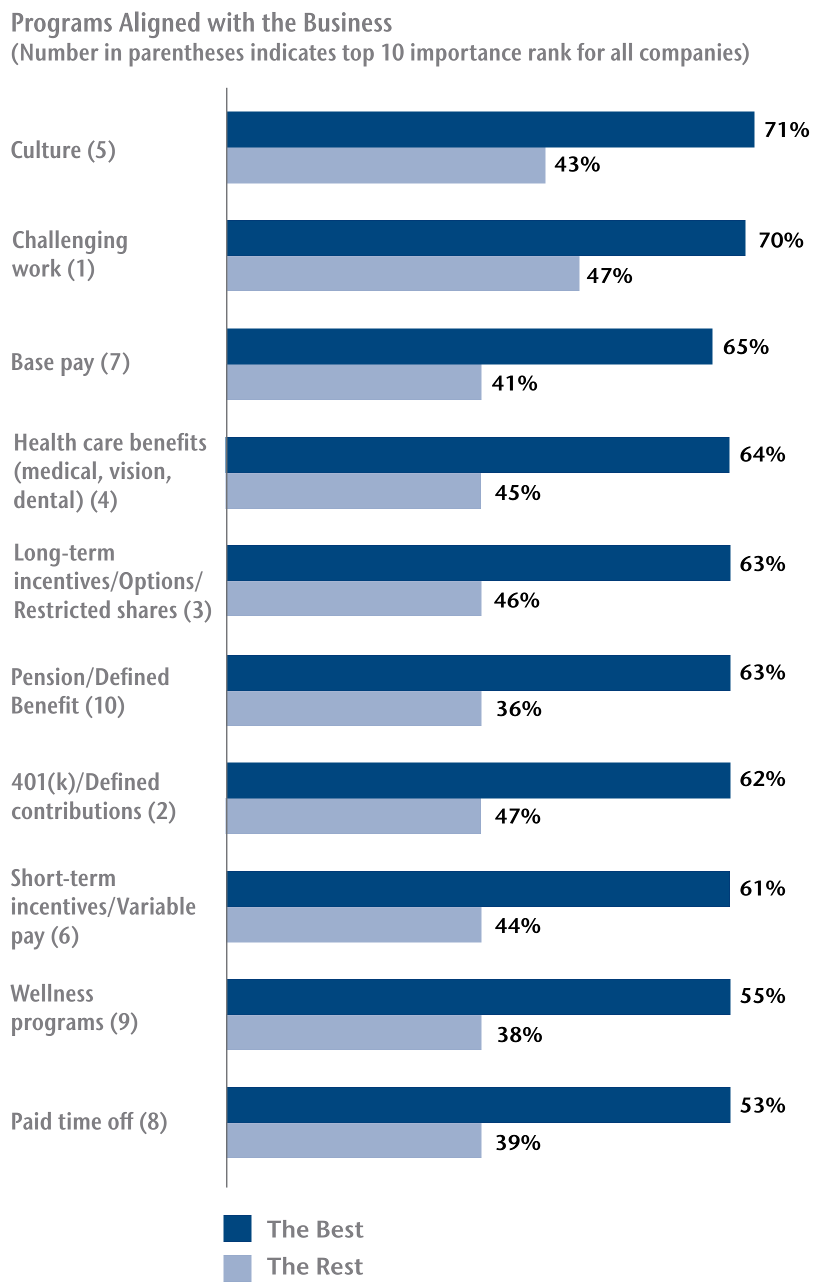
High-Performing Companies Connect More to the Business and to Employees

While most companies seem to be declaring similar directions in planned investments, the high performers are simply executing better. There are three areas of focus when it comes to execution: aligning programs with business objectives, being innovative and flexible, and communicating effectively.

Connect to the Business

A key differentiator for high-performing companies is that they use business alignment as input into total rewards strategy and decisions. Logically, one would hope that high performers, in fact, **achieve** better alignment between total rewards programs and the business relative to other companies. Indeed, this is what we found.

Percent of Companies Aligning Most Important Rewards with Business Objectives



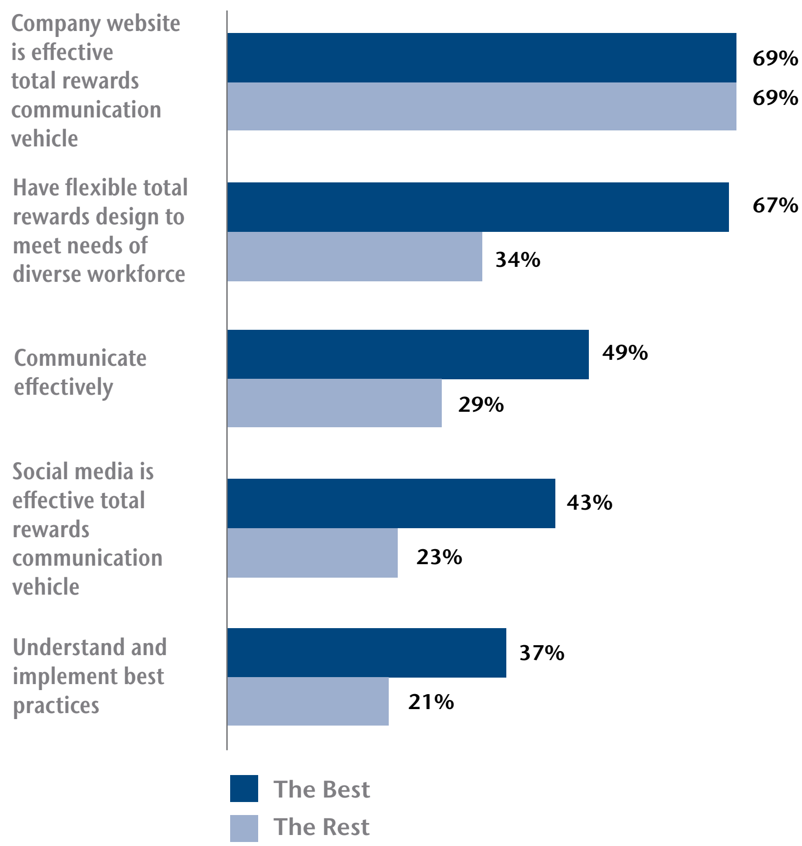
High-performing company program designs are generally more aligned with the business. Further, the programs that are more aligned relative to other companies, are the ones The Best seek to differentiate on (culture, manager effectiveness, training/learning, and career development). High-performing companies are achieving what they have articulated in their total rewards strategy. In contrast, other companies have the highest business alignment with defined contribution plans, long-term incentives, and short-term incentives (and still at a lower rate than high performers). While these pay and benefit programs are essential foundational elements of rewards that must be delivered correctly, perhaps the average company is not focusing enough energy on aligning the differentiating programs with business objectives.

Connect to Employee Value

High-performing companies connect to employee value at a higher rate than other companies—they do it through flexibility, first-mover advantage, and follow-through communication. First, our data show that the biggest employee connection difference is providing flexibility for diverse workforce needs. This requires not only that the employer understand what the diverse segments are, but also knows what its diverse employee base wants (and we know that high performers also use employee input in strategy and design at a higher rate).

Second, high performers are using first-mover advantage in implementing next-practice programs that include innovative ways to reach employees, such as social media applications. Finally, high-performing companies have better follow-through in terms of communicating value to employees across the board and through frequently used channels such as the company website.

Connecting Total Rewards to Employee Value

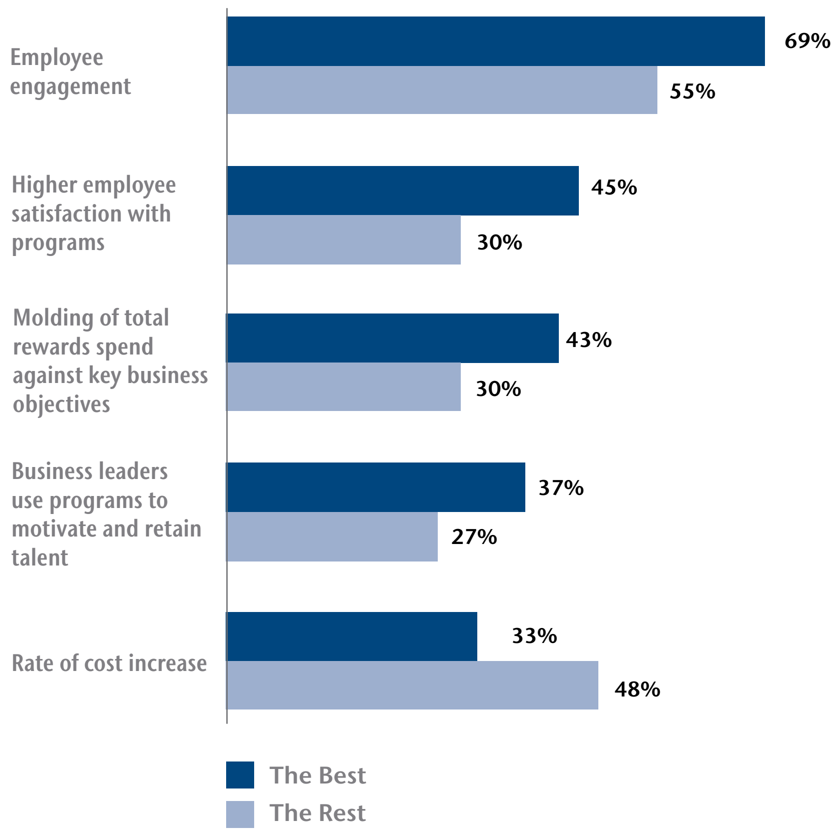


High-Performing Companies Define Total Rewards Effectiveness Differently

Most organizations typically define success through the cost lens. This is the most frequently selected success metric by the average company in our study, and they examine cost and budget outcomes at a higher rate than high-performing companies. So, how do high-performing companies define and measure their success?

Quite simply, high performers are much more likely to define and measure success through a balance of employee value and ROI—in addition to, but at a higher rate than, budget and cost management.

Percent of Companies Using the Following to Measure the Success of Total Rewards Programs

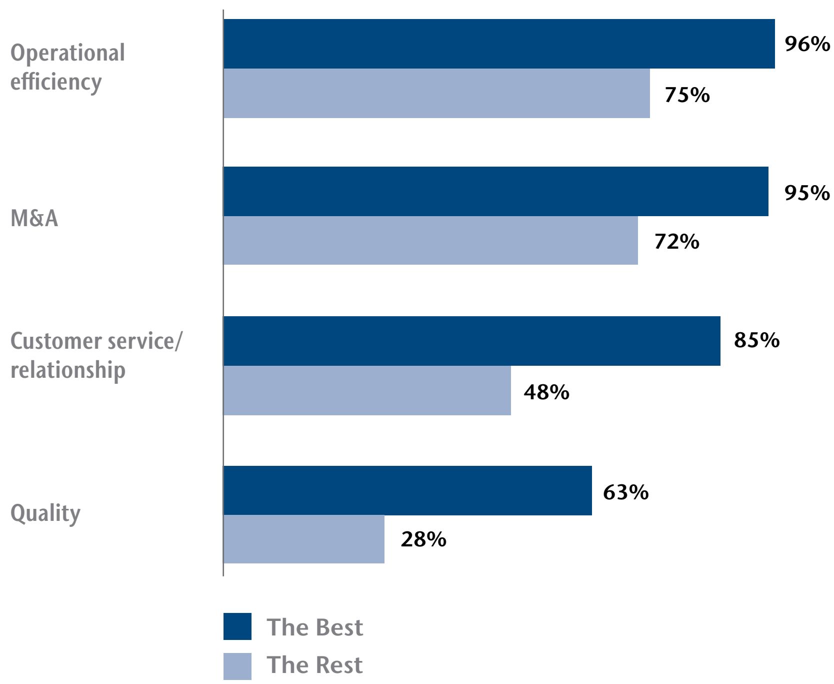


High-Performing Companies Earn Better Outcomes

We find that high-performing organizations outperform "The Rest" of survey respondents on important business and human capital outcomes.

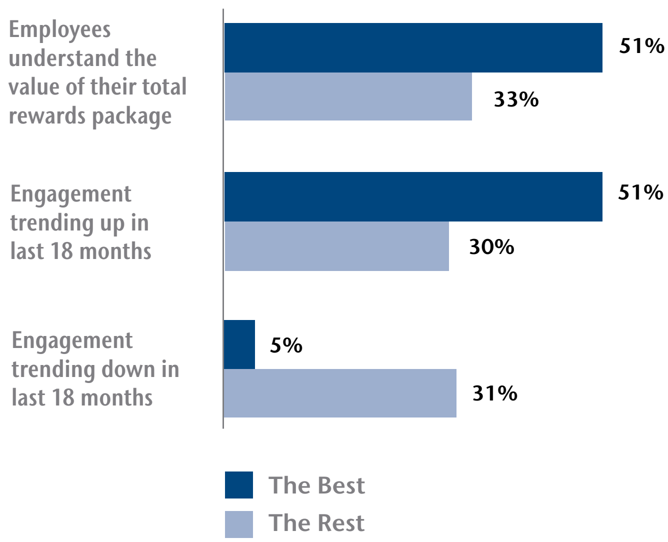
High-performing organizations achieve better operational efficiency, M&A success, customer service, and delivery of quality products/services than other organizations. There are many reasons why this may be the case (including correlation of these outcomes with our high-performing criteria), but in our sample of high-performing companies, we see strong patterns in how they articulate a total rewards strategy, gather input, deliver programs, and measure success relative to alignment with the business. It stands to reason that companies that focus on business alignment in total rewards design would see better business outcomes.

Better Business Outcomes



We know from our other research and client experience that most companies have been seeing a downward trend in employee engagement in the last few years. This study shows that the average company is likely to change investments without a strategy, use cost as the primary guidepost for design, not align their business goals with the programs they say are most important, and measure success through cost. The average company is also likely to have seen a downward trend in employee engagement in the last 18 months.

Percent of Companies Indicating Various Employee Engagement Outcomes

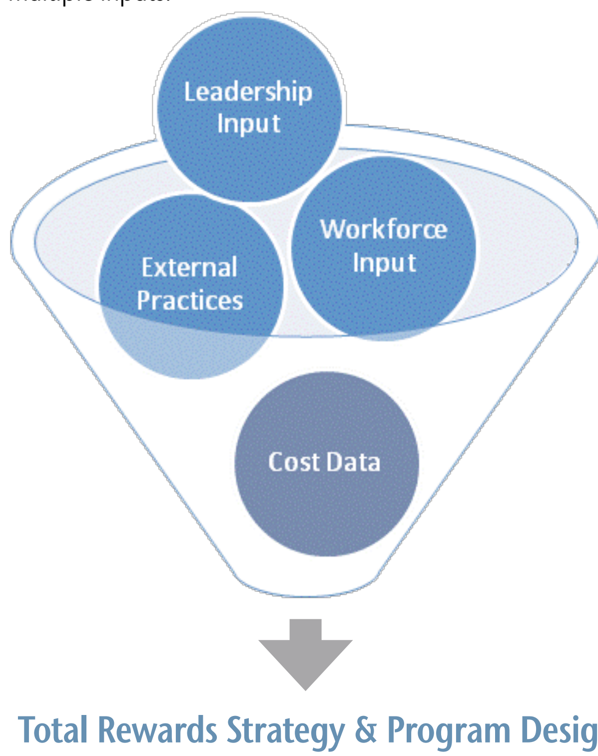


In contrast, a high-performing company articulates a strategy to differentiate on upper-quadrant rewards, balances multiple inputs in design, connects programs to the business and to people, and defines success through a balance of employee value and ROI. A high-performing company, in turn, is also likely to have employees who see the value of their total rewards and an upward trend in employee engagement.

The few elite companies that accomplish successful alignment of their total rewards will achieve the best business and people outcomes because they have achieved significant, sustainable competitive advantage with the total rewards they offer. This should be the goal (and the challenge) of the organizations who comprise "The Rest."

Aon Hewitt Point of View: Four Critical Inputs to Total Rewards Strategy

This study affirms the Aon Hewitt point of view that total rewards strategy requires multiple inputs.



Leadership input includes input on business objectives, value drivers, operating style, reward philosophy, and change readiness. Workforce input relates to preference data from employees (and prospective employees), the impact of demographics, and dynamic modeling of measures like engagement and retention in response to potential reward changes. External input refers to competitor practice on level and format of rewards, reward trends, and legislative changes. Cost data should include current spend and cost trends as well as cost impacts associated with potential reward changes.

Too often, companies proceed to set reward strategies before gathering all the necessary input. In the absence of hard data, key decisions can be based on untested, flawed, or plainly incorrect assumptions. We know this because we have seen such assumptions quickly debunked once the right data is brought to the table. It only makes sense to do the due diligence and assemble the data before crafting the strategy that guides the allocation of money—in what, for many organizations, is their single largest expense item.

Gathering the right input is as important to inform the strategy as it is to inform execution, implementation, and communication of the total rewards strategy.

Consequences Are Costly

The survey revealed that high-performing organizations are much more likely to have a map, a compass, and radar. They take a different approach to measuring results, and include different items in their total rewards plan. What are the consequences for “The Rest,” the companies that do not manage total rewards in this fashion?

Three key consequences identified by the survey are:

1. Missing valuable input from employees, which may lead to lower engagement and higher turnover.

2. Missing opportunities to manage total rewards as a portfolio, which may lead to higher costs and lower effectiveness.

3. Introducing unnecessary risk into their total rewards approach.

Each of these consequences is explored in more detail.

The Employee Voice Is Being Overshadowed

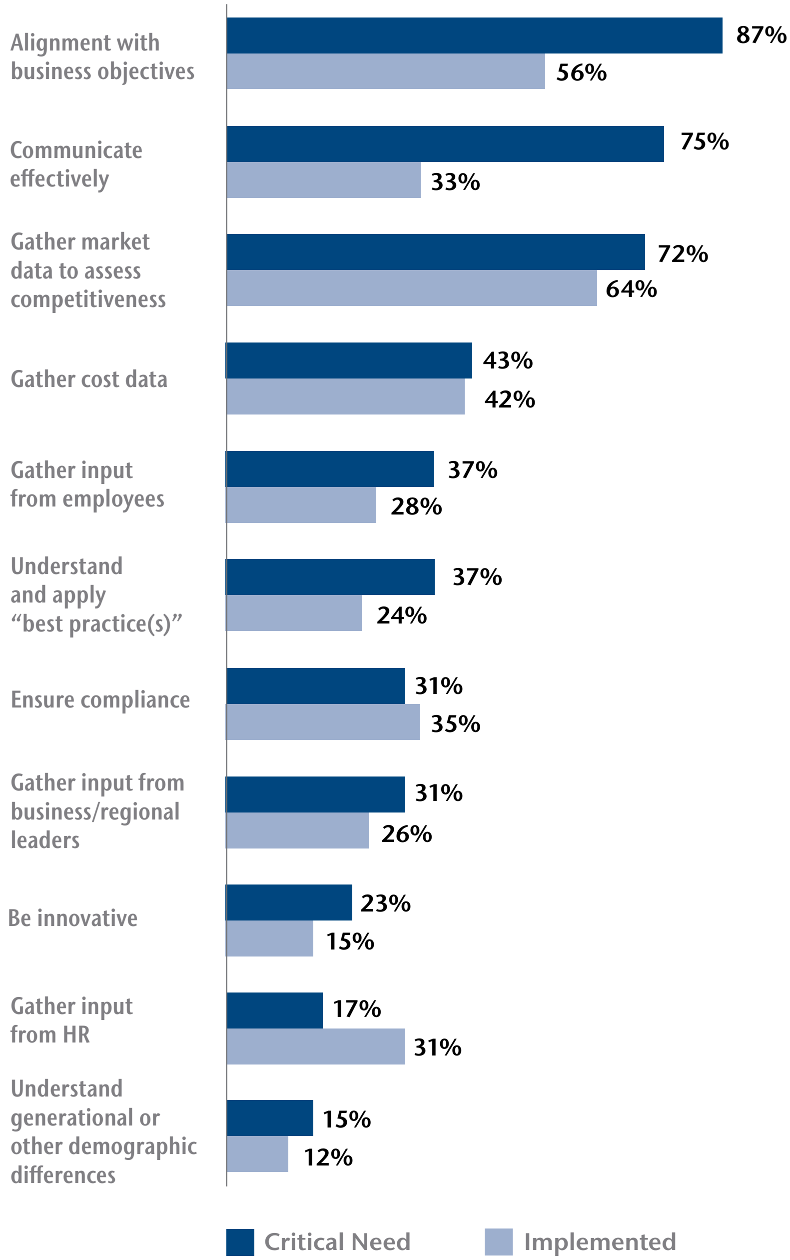
According to survey respondents, three of the top four priorities for 2012 are to improve engagement (58%), improve retention (48%), and improve attraction (44%). The other is to improve alignment with business objectives (52%). These three objectives are all about improving the perception of total rewards in the eyes of employees and prospective employees. This is not surprising—in our experience, it is rare to find guiding principles for total rewards that do not include "attract, retain, and motivate" as a central purpose of total rewards. It is hard to imagine how total rewards can accomplish this aim if the reward programs are not understood or appreciated by employees and prospective employees.

Total Rewards Priorities for 2011 and 2012

Priorities	Percent Selected
Improve employee engagement	**58%**
Improve alignment with business objectives	**52%**
Improve ability to retain talent	**48%**
Improve ability to attract talent	**44%**
Take a more holistic, integrated approach of all reward programs (compensation, benefits, work/life balance, career development/learning)	**40%**
Reduce benefit costs	**39%**
Improve alignment to individual performance (i.e., pay for performance)	**37%**
Create a roadmap to manage total rewards over the next 3-5 years	**35%**
Improve the return on our Total Rewards investments	**25%**
Introduce new/innovative rewards/programs	**22%**
Create or improve programs targeting top performers	**22%**
Redesign programs around major internal/external factors (e.g., health care reform)	**18%**
Reduce reward program costs	**10%**
Introduce more choice	**7%**
Segment rewards by employee groups	**6%**

Still, the survey results tell us that only 37% of companies say it is critical to gather data from employees, and only 28% are actually doing so.

Elements Critical to Building and Executing a Successful Total Rewards Strategy



Further, we find that 20% more survey respondents disagree than agree with the statements, “We understand how employee preferences differ in key geographies” and “We have reliable data on the preferences of high potentials and high-value employees.” This is shocking. How can we ensure that total rewards are helping to attract, retain, and motivate top talent if we are not actively working to understand what it is that top talent actually want?

Agreement with Total Rewards Objectives

Objective	Agree	Neither	Disagree
Rewards need to be redesigned to better support our business strategy	46%	23%	31%
Employees understand the value of their total rewards package	36%	19%	45%
Our total rewards design is flexible to meet the needs of a diverse workforce	40%	31%	29%
Our total rewards program is based on assumptions that have been well tested and confirmed as factual	35%	34%	30%
We have a good sense of our return on total rewards expenditures based on quantitative measures	32%	25%	43%
We have reliable data on the rewards preferences of our high-performing and high-value employees	29%	21%	50%
We have a strong, reliable global governance model in place for total rewards	29%	31%	40%
We excel at managing changes to our total rewards programs	28%	39%	33%
We measure the effectiveness of our total rewards annually and use the measures to plan next year's initiatives	27%	22%	51%
We have reliable data on how reward preferences differ for employees in our key geographies	26%	27%	48%
We are actively modeling reward preferences of both our current and future workforce	26%	25%	50%

The survey results clearly demonstrate that **program cost is twice as important as employee preference when managing total rewards**. On one hand, both cost and preference rank high on the list of factors to consider **when setting a total rewards strategy**. Cost ranks fourth and employee preference ranks fifth.

Most Important Elements when Making HR Program Decisions

Most Important Element	Percent Selected
Cost	**86%**
Competitive position	**70%**
Alignment with the business performance	**66%**
Legal/regulatory compliance	**52%**
Leadership's rewards philosophy	**40%**
Risk to the enterprise	**25%**
Employee wants/needs	**43%**

However, when it comes to decision-making, we see a sharply delineated difference. Consider, for example, what gets measured. The most common measure for evaluating program success is cost. Program cost is reported by 66% of companies as being among the most important measures of program success. This is in stark contrast to other measures like employee satisfaction (33%), employee participation in programs (27%), and employee understanding (23%). Note that cost is used twice as frequently as any of these employee-centric measures.

Success Measures of Total Rewards Programs

Measures	Percent Selected
Evaluation of cost vs. budget	**66%**
Employee engagement	**58%**
Employee turnover	**54%**
Rate of cost increase	**45%**
Modeling of total rewards spend against key business objectives	**33%**
Higher employee satisfaction with programs	**33%**
Business leaders use programs to motivate and retain talent	**29%**
Compliance	**28%**
Higher participation in programs	**27%**
Higher understanding of programs	**23%**
Modeling of total rewards spend against key workforce objectives	**11%**
Risk	**10%**
HR is nimble enough to support business leaders through total rewards	**9%**
Unfilled positions	**8%**

We see similar findings when we look at how decisions are made. Here, again, the most common factor is cost. Survey results show that 86% of respondents view cost as a critical factor when making decisions, while only 43% indicate that employee wants are critical when making decisions. Once again, cost is twice as important as the employee view.

It may be tempting to argue that these data are merely a reflection of the times in which we live. During an economic downturn, there is certainly more pressure to economize and manage costs carefully. However, looking ahead, there is virtually no interest reported among survey respondents in exploring ways to better meet employee needs through actions like offering choice (7%) or segmenting rewards among employee groups (6%). These responses represent missed opportunities, and lead us to the next finding.

We know from our work with clients that managing total rewards as a portfolio creates more opportunities to find creative solutions. Rather than simply cutting costs, a portfolio approach opens the door to solutions that rebalance the elements, where costs in one program are mitigated by investments in other programs. This is more than mere semantics. When the portfolio approach is combined with quantitative data on employee preferences and a holistic measurement of the value of total compensation and rewards relative to peers, it can lead to solution sets that have lower overall cost but higher perceived value. To the extent these solutions are also better aligned with business objectives, competitive norms, and organizational attitudes toward managing risk, they are even more attractive solutions.

Missed Opportunities to Find Optimal Solutions

The portfolio approach to total rewards may offer the most untapped potential in the realm of employer responses to the challenges presented by the changing health care landscape. Fully 78% of survey respondents indicated that health care tops their list of priorities in 2012. This was followed by pay (75%), total benefits (60%), and learning and development (51%). However, only one out of every two respondents is viewing health care as an opportunity to rebalance the overall total rewards portfolio. This is unfortunate.

Survey findings show that many companies plan to increase spending in the following areas:

- Wellness (67%)
- Manager effectiveness/support/coaching (62%)
- Training/learning (57%)
- Career development (55%)
- Recognition (41%)
- Culture (41%)
- Challenging work (40%)

Planned Investment Changes

Investment Changes	Increase	Stay the same	Decrease
Wellness programs	67%	32%	1%
Manager effectiveness/support/coaching	62%	37%	1%
Training/learning	57%	41%	2%
Career development	55%	43%	1%
Recognition programs	41%	57%	3%
Culture	41%	57%	1%
Challenging work	40%	60%	1%
Financial planning/education	35%	61%	4%
Base pay	32%	67%	2%
Short-term incentives/variable pay	32%	65%	4%
Flexible work arrangements/workplace flexibility	30%	67%	2%
Long-term incentives/options/restricted shares	27%	66%	7%
401(k)/defined contribution	17%	79%	4%
Health care benefits (medical, vision, dental)	22%	64%	14%
Paid time off for volunteerism	13%	82%	4%
Tuition assistance	10%	87%	3%
Paid time off	8%	87%	5%
Child care	6%	89%	4%
Charitable matching contribution	8%	86%	6%
Concierge services	8%	82%	10%
Paid leave for maternity/paternity/adoption	7%	91%	2%
Post-retirement medical	5%	66%	29%
Adoption assistance	5%	91%	4%
Pension/defined benefits	4%	76%	19%
Retiree medical	4%	72%	24%

If the increased investments in these areas correlate strongly to employee wants and needs, an opportunity exists to couple these changes with the planned cuts in retiree medical, pension, and health care (the three top areas where companies are indicating plans to reduce costs) and to manage the decision-making, design, and communication in such a way as to maintain or reduce the overall spend—while enhancing program effectiveness in the eyes of employees, business leaders, and even shareholders.

However, survey results reveal that only one out of every two respondents sees the opportunity to rebalance, and among those who see the opportunity, nearly two-thirds (64%) see the opportunity as existing only within the health care benefits area. This probably says more about how companies are organized than it does about where the opportunities actually exist, since most of the increase in spending is taking place in elements outside the health benefits package.

Taking Unnecessary Risk in Rewards

Numerous studies and articles have argued that HR professionals need to become more actively involved in risk management; understanding organizational risks arising from how HR policies work in practice and how employees respond. Total rewards is an important area to consider when assessing broader human capital risks.

In the current social and political climate, the reputational damage that poorly conceived or executed total rewards can confer on an organization may be significant. The risk that reward practices may be seen in an unfavorable light by organizational stakeholders such as employees, customers, media, regulators, and politicians can have far-reaching impact on the business.

The governance focus on reward practices—particularly as it relates to executive compensation—remains acute. Given (all) this, it is reasonable to suggest that total rewards risk management should be high on the agenda for most organizations. The survey results show, however, that in most cases it is not—at least not in any systematic way. Survey results show that 75% (or more) of companies have not clearly identified the financial, execution, alignment, or regulatory risks associated with their reward programs.

Furthermore, the vast majority do not have processes in place to measure and assess the risks and do not regularly monitor and report on the risks; even fewer have mitigation strategies in place to manage reward-related risks. The failure to identify and properly manage a reward risk can lead to damage to an organization’s brand, loss of customers, and a reduced ability to attract and retain employees.

Interestingly, while the high-performing companies are less likely to say they have identified specific categories of risk, they are more likely to indicate that they monitor and report on the risks and that they have mitigation strategies in place.

Aon Hewitt Point of View: Managing Risk in Total Rewards

A first step in managing risk as it relates to total rewards is to gain familiarity with key concepts relating to risk management:

- Risk is generally understood to refer to the combination of the probability of an event occurring and the impact such an occurrence would have.
- Risk management refers to coordinated activities aimed at directing or controlling an organization with respect to risk.
- Three phases to risk management are widely recognized: identification, assessment, mitigation.

Total Rewards Risk Assessment

Any total rewards risk assessment model should cover at least four main dimensions:

- Alignment Risk—This is about how the organization has **designed** its total rewards programs. The key question here is: To what extent is there a risk that our reward system is not well aligned with other key elements? Assessing this risk involves addressing questions such as:
  - To what extent do total rewards support our business aims?
  - To what extent are total rewards congruent with other HR programs?
  - To what extent do our programs drive the desired/appropriate behaviors?
  - To what extent are there any big discontinuities in our rewards relative to other companies that might pursue our employees?
- Execution Risk—This is about how the organization **delivers** total rewards. The key question here is: To what extent are our total rewards programs being used in the manner intended? Questions to consider include:
  - To what extent were total rewards programs (and subsequent changes) effectively put into place initially?
  - To what extent do we utilize our total rewards programs as intended?
  - To what extent do reward programs operate as intended, with appropriate service levels?
  - To what extent is there ongoing, effective two-way communication using a mix of high-tech and high-touch approaches regarding total rewards?

- Financial Risk—This is about how much total rewards **cost** or are forecast to cost. The key question here is: To what extent are we appropriately managing the cost of total rewards?
  - To what extent are our total rewards cash and accounting expenses appropriate?
  - To what extent are we deriving a sufficient ROI on total rewards costs?
  - To what extent can we anticipate and continue to support our total rewards costs for the foreseeable future?
  - Do the rewards programs have volatile levels of expense?
  - Will the costs move in line with business performance?
- Regulatory Risk—This is about how we **monitor** total rewards. The key question here is: To what extent do we have proper controls in place with respect to our total rewards programs? This risk area is concerned with these kinds of questions:
  - To what extent are we monitoring adherence to legal requirements?
  - To what extent do we have proper governance and oversight in place?
  - To what extent are we ensuring our total rewards programs are consistent with relevant organizational and societal values?

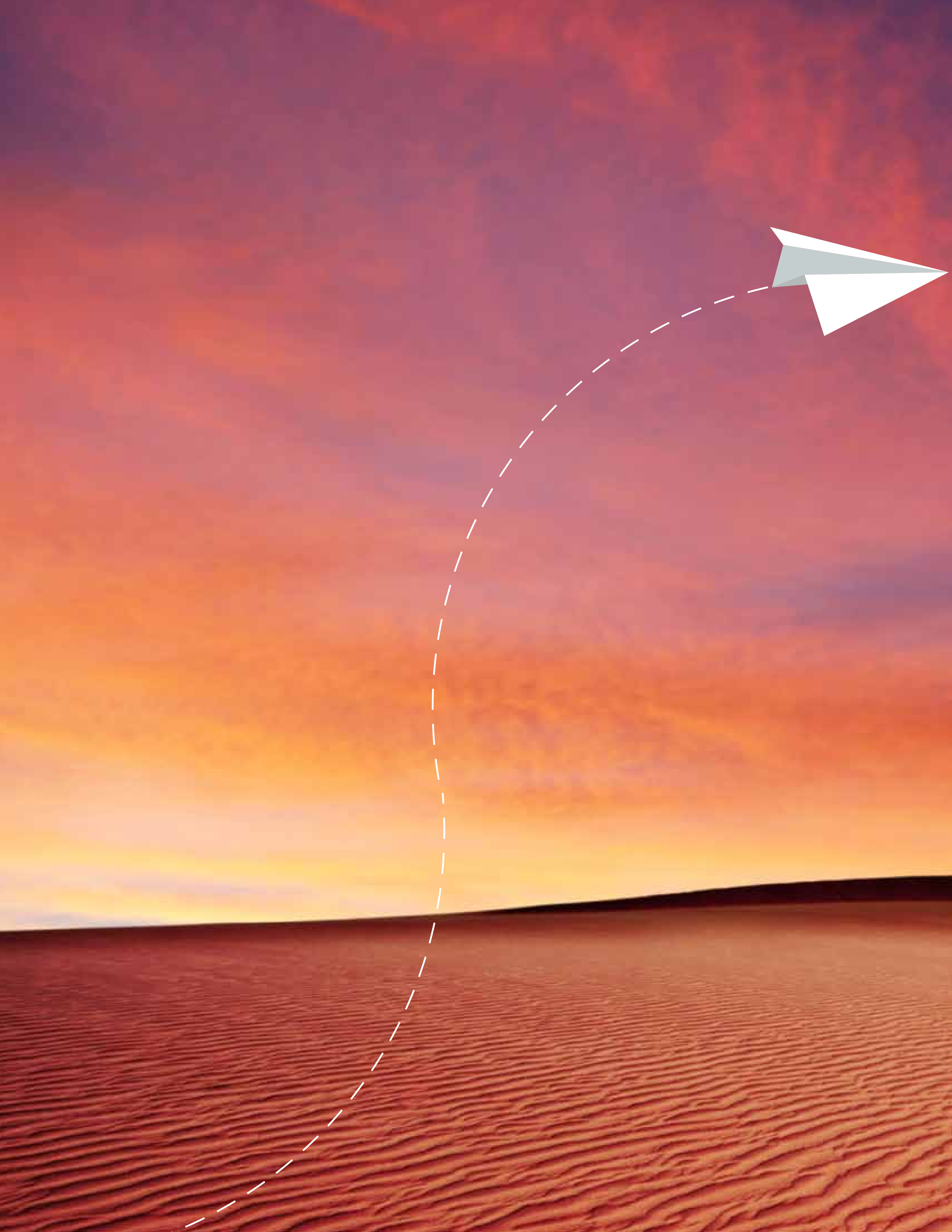
Risk Mitigation

Having identified and assessed the total rewards risks, the next step would be to discuss, agree upon, and implement mitigation strategies. There are four possible responses to managing risk once it has been identified, and all can be applied in various forms to different reward programs.

1. Treat
2. Terminate
3. Tolerate
4. Transfer

Expanding the evaluation of total rewards programs to include efficiency, effectiveness, and exposure to risk alongside competitiveness, cost, and compliance is one way companies can begin to find ways to improve the return on their total rewards investment.

How is your organization assessing total rewards risk? What are the implications of not doing so?



Change is Desired

It should not come as a surprise that high aspirations and poor execution combine to produce a situation where a lot of change is desired. Among survey respondents, 55% say they believe some change will be required and an additional 38% indicate they believe significant change will be needed in their total rewards in order to meet their business and workforce needs. Survey results suggest that this change is likely to happen in three sequential phases:

- Catching up
- Moving forward
- Pulling ahead

Company responses to survey questions seem to vary based on where they currently see themselves in these three phases.

Phase I: Catching Up

For many companies, the activity around total rewards involves addressing some basic needs, such as:

1. **Creating a total rewards strategy**. For employers who do not already have a total rewards strategy—which includes a significant number of survey respondents—the work begins with putting a strategy in place. A strategy is useful in that it helps to articulate a specific value proposition for current and prospective employees; one that helps to attract, motivate, and retain the workers who have the skills and values the employer needs. It also helps provide a framework to evaluate, design, and administer the total rewards programs to ensure maximum motivational impact on desired behaviors.

2. **Aligning leaders to the direction set for total rewards**. Having a clear direction is not helpful unless leaders are aligned to it. This is a key step in enhancing total rewards effectiveness and an area where high-performing companies outperform others. The right approach to create buy-in and consensus will vary from organization to organization. More and more, we are seeing that this process includes an increasingly sophisticated approach: testing total rewards against key workforce expectations and business performance scenarios. Testing "what-if" outcome scenarios with leaders again is a proven way to test hypotheses and align around the appropriate course of action.

3. **Addressing organizational structure and cultural issues**. Often, this involves building a total rewards mindset within the HR function and among senior leaders. One constituency already has a total rewards mindset: the employees. They choose every day to join, stay, and perform (or not) based on the combination of reward elements they experience. Effectively creating a culture of total rewards starts with a leadership discussion, followed by devising an HR structure and governance process that can support total rewards portfolio decisions.

Phase II: Moving Forward

Survey results suggest that many employers would like to make shifts in how they design and administer their total rewards programs. The table below describes the overall direction of these shifts, based on survey responses.

Shifts in Design of Total Rewards Program

Respondents Expect to See LESS…	Respondents Expect to See MORE…
Decentralized approaches to rewards	Centralized approaches to rewards
One-size-fits-all approaches to rewards	Customized reward programs
Rewards being managed element by element	Rewards being managed as a portfolio
No choice offered	Individual choice
Same rewards for all	Differentiated rewards based on performance
Rewards linked to company-wide results	Rewards tied to individual performance
Rewards based on results and effort	Rewards based on results only
Company bearing cost and risk in reward programs	Employee bearing cost and risk in reward programs
"Need to know" mentality driving communication	Open communication about rewards

These data, coupled with the conversations we have on a regular basis with our clients around the world, suggest the following broad market trends:

1. **Companies are centralizing responsibility for defining reward strategy and developing programs**. This is being done for a variety of reasons: to better control cost, realize economies of scale, ensure better alignment with broader business aims, and leverage the development of programs that have applicability across business units and/or geographies. In many instances, companies also want to make better use of the specialized knowledge required to develop and implement reward programs. Often, it also is an attempt to seize control and/or drive more accountability.

2. **Companies are pushing for more tailored approaches**. The move to centralize typically is not an attempt to force a one-size-fits-all approach on diverse parts of the business. On the contrary, we see that centralizing often is a means to ensure that the appropriate expertise inside the organization (or provided by outside experts) is properly applied to the development of solutions that are appropriately tailored to meet the unique needs of various business units and geographies. (A concurrent goal is to reduce or eliminate meaningless distinctions in programs where tailoring is not justified or appropriate.) Introducing individual choice is, perhaps, the ultimate way to tailor approaches to rewards. This continues to be an area of great interest. Most employers quickly shy away from a-la-carte approaches where employees have a vast array of options across anumber of reward programs. However, there is increasing interest in exploring a set menu approach where a few different predefined packages are assembled and offered to employees. Employers increasingly see this approach as a logical outcome after using conjoint analysis and employee segmentation to discover how best to optimize their total rewards expenditure.

3. **Companies are pursuing increased performance orientation and differentiation**. While employees may or may not be offered more choice in their total rewards, it seems clear that they will be held accountable for producing better results if they want to maximize the value of their individual total rewards package. Employers are continuing in their efforts to deliver rewards differentiated by performance. This goes beyond pay and is being extended in a much more rigorous way to work opportunities, learning and development programs, advancement opportunities, and so on. Survey results suggest that the performance that matters will increasingly be individual performance as opposed to company performance. Furthermore, they suggest that employers will be rewarding results and not simply effort.

4. **Companies are shifting cost and risk to employees while aiming to provide better communication**. Not only are employees going to find their total rewards more tightly linked to their own performance, they will also find that employers will be looking for ways to shift the cost and risk of reward programs onto employees. Examples of this abound in the health care and wellness arena, but are also evident in retirement and savings programs.

   These changes (along with movement to more choice) are driving changes in total rewards communications. It is no longer sufficient to explain the basics of how reward programs operate. Leading employers are working to provide communications that help employees make better decisions to make better choices and better manage the risk that is being shifted to them. For leading employers, the aim of total rewards communications is no longer simply to create awareness, understanding, and acceptance of programs; it is to aid decision-making, build commitment, and create advocates.

To a great extent, these themes represent a continuation of market trends we have been observing for years. Still, as employers struggle with execution, these are the steps many of them are working on to move their reward programs forward. A select few are working to get ahead of the curve.

Phase III: Pulling Ahead

A further testament to the perceived potential and high aspirations that respondents associate with total rewards is revealed in the following two survey findings:

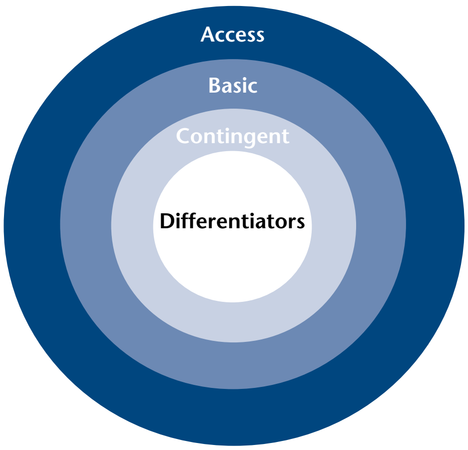
- Only 10% of respondents currently see their total rewards as a differentiator for their organization, but 33% want it to be a differentiator.
- Only 10% of respondents describe their organizations as "early adopters" of leading-edge total rewards concepts, but 25% want to be seen this way.

These data point to a desire by many organizations to pull ahead of the pack when it comes to their total rewards programs. These employers will not be satisfied with simply replicating typical practice or perhaps even best practice. They want to be on the leading edge, out in front, early adopters who are—as a result of good decision-making on total rewards—creating competitive advantage for their organizations.

Furthermore, survey data suggest that the employers who are able to achieve these aspirations are more likely to achieve better revenue growth, higher employee engagement, and more innovation.

The question is: How best to do that? Fortunately, the survey results point us to some answers.

Aon Hewitt Point of View: A Bold New Total Rewards Framework



High aspirations and mediocre execution are combining to produce a lot of pressure for change. This is a time for breakthrough thinking that may require bold new ideas, including new ways of looking at the issues. To help our clients meet some of the challenges highlighted in this report, we have been presenting a new framework for total rewards.

This new model complements the four-quadrant model presented earlier. The four-quadrant model is still useful, but because it provides a "home" to any reward element, it can contribute to an ever-expanding list of rewards, each of which is then given equal importance by the model. Our new approach is intended to serve as a catalytic mechanism and to stimulate new thinking around where to focus energy, effort, and expense in total rewards.

The model divides rewards into four types, each of which occupies a place in a set of concentric circles:

- "Access" refers to those rewards to which the organization provides access only—the rewards themselves are paid for by the employee or (in some cases) perhaps a third party. The organization provides access because by doing so it can either make the rewards more convenient (for example, by pre-screening a provider), more efficient (by securing a volume discount), or both.
- "Basic" rewards are those "table stakes" reward elements that the organization feels it must provide to be in the game. The aim with respect to these rewards is to meet the defined competitive benchmark, and that is it. The organization sees little or no advantage to overinvesting in these rewards.
- "Contingent" rewards are those elements of the package that are delivered based on some level of performance or behavior by the employee. Incentive compensation often comes to mind first. But other rewards such as work tasks, promotions, learning opportunities, and wellness credits also fit the definition.
- "Differentiators" are the one, two, or—at most—three reward elements that are going to set your company apart. These are your signature programs; the elements for which you are most famous. Your program design and delivery for these elements is world-class.

The Way Forward is Clear

Charting a course forward involves addressing what are seen as the main impediments to change. Survey results suggest several barriers need to be overcome.

- Little or no awareness of total rewards objectives
- Leaders not aligned
- Cultural barrier (fear of change)
- Organizational structure changes
- Budget constraints

Setting a Course for Change

When asked about barriers to change, responses show that both "The Best" and "The Rest" of organizations are struggling equally with budget constraints. Beyond that, three key observations can be drawn from the data.

1. HR owns most of the barriers.
2. Setting direction and aligning leaders is a good place to start.
3. Implementation challenges should not be underestimated.

Each of these points is discussed further in this chapter.

Barriers to Change: "The Best" versus "The Rest"

Barrier	Percent of "The Best" Companies Citing	Percent of "The Rest" Companies Citing	Difference
Little or no awareness of total rewards objectives	32%	45%	-13%
Leaders not aligned	23%	34%	-11%
Cultural barriers (fear of change)	29%	33%	-4%
Organization structure changes	23%	27%	-4%
Budget constraints	71%	72%	-1%
HR structure, governance and decision rights	15%	13%	2%
HR resource constraints	41%	34%	7%
Global framework and local application	26%	18%	8%

HR Owns Most of the Barriers

It is interesting to note that all but one of the main barriers to achieving total rewards objectives are owned by HR—“budget constraints” is the sole exception. Some might argue that this is a condemnation of HR, but we see it as empowering. When it comes to total rewards, HR is clearly sitting at the head of the table. This is a time to lead. Whether the required work relates to setting or clarifying the direction of total rewards and getting leaders aligned to the total rewards strategy, or addressing matters relating to structure and governance, these are all issues HR can firmly own.

What needs to be done is fairly clear, but that does not mean it will be easy. Total rewards is a broad concept, by definition, and it cuts across myriad organizational lines within HR and around the larger organization. Often we see well-intentioned professionals trying to drive total rewards initiatives from within a specialty area in HR (usually compensation or benefits) or from within a business group or division. But the nature of total rewards suggests that—to be effectively managed—it needs to be directed by someone having a broad purview within HR and within the wider organization. Typically, this means direct involvement of the top HR executive, at least through the initial stages of setting the direction and building leadership alignment to the strategy. Of course, leadership can also come from the CEO. Indeed, some of the most effective total rewards programs we have encountered were developed under the strong guidance of the CEO.

When the top HR executive (or CEO) does not seize the reins, total rewards initiatives often sputter or devolve into activities that occur within HR silos and, no matter how well intentioned, rarely deliver the same impact that an integrated, coordinated suite of initiatives spanning the full spectrum of rewards can produce. The data from high-performing companies bears this out.

Setting Direction and Aligning Leaders is a Good Place to Start

High-performing companies indicate they have a better handle on setting overall strategy and aligning leaders to the strategy. It strikes us that for an organization seeking to improve the effectiveness of its total rewards programs, this is a sensible place to start.

The key here is to get beyond a short set of guiding principles of five to eight bullet points on a single PowerPoint slide. This may be a good place to start in setting direction, but this step alone does not provide sufficient depth or clarity to ensure consistent understanding and appropriate design and execution of total rewards throughout a large, complex organization.

A written total rewards strategy generally is crafted to meet three primary aims:

- To articulate a distinctive value proposition for current and prospective employees that attracts and retains people with the capabilities and values that the employer needs to succeed.
- To provide a framework within which the employer designs, administers, and evaluates effective reward programs, delivering the maximum motivational impact to drive desired behaviors and results.
- To align leaders on purpose and actions relating to total rewards.

In essence, the total rewards strategy helps establish the employer's "brand."

Managing the Brand

Reward systems affect organizational performance and individual behavior largely through the impact they have on people's beliefs and expectations about how they are and will be rewarded. Expectations are particularly important in influencing motivation, and they also have an important influence on organizational culture and the organization's ability to attract and retain talented employees. In order to be effective, a reward system must impact perceptions and beliefs in ways that produce desired organizational behaviors.

The perceptions and beliefs that individuals develop are partly a product of the practices and behaviors of the organization, but they are also influenced by statements that the organization makes—or fails to make—about its values and intentions. Regardless of what an organization says or does not say about its reward practices, individuals will form beliefs about how rewards are administered. These beliefs represent the employer's "brand" in the market for talent.

Employees and prospective employees develop their beliefs based on their experiences with the organization, what they are told by others, and what they are told by their leaders. Personal experience and cultural orientation become the filters through which individuals interpret this information as they make plans for developing a satisfying and rewarding situation for themselves.

If the organization is silent in terms of what it is doing, it may cause individuals to develop a lesser impression of the brand than they would have if the organization had stated principles that effectively guided individual beliefs. The key issue for the organization is how to influence the beliefs that individuals develop. Drafting a written statement of total rewards philosophy can help achieve appropriate "brand positioning."

Once the total rewards strategy is developed, it should drive and guide the organization's reward system and be a relatively permanent piece of the organization's culture, history, and policies. Core principles should not change, except in those extraordinary circumstances where major strategic changes need to occur in the way the organization is managed and run. Once the reward strategy has been established, it should be communicated frequently and reinforced publicly by the organization's leadership.

Issues Typically Addressed by a Total Rewards Strategy

A well-conceived total rewards strategy should address the following elements:

- **Strategic perspective**–A total rewards statement begins with an articulation of the organization's values and strategy. A well-crafted reward strategy is clearly linked to the aims of the business. The written statement of total rewards philosophy is the place to be clear about where, when, and how links between business goals and rewards are made.
- **Statement of overall objectives**–The reward philosophy should include statements that describe how the reward system will support the needs of the business and the company's customers, employees, shareholders, and other key stakeholders. This typically includes a delineation of the role of each reward element.
- **Prominence**–The statement of total rewards philosophy describes the overall importance of pay relative to other tools that can focus and affect actions and decisions (e.g., shared values, job design, promotions, clear strategies, feedback, etc.). In addition, a well-crafted reward strategy will describe the degree to which rewards are expected to drive employee actions and decisions through variability, influence over outcomes (controllability), and the explicitness of the pay-for-performance link.
- **Performance measures**–A total rewards strategy should clearly identify the performance criteria to be rewarded, the appropriate level of measurement (e.g., corporate, business unit, geographic region, workgroup, individual, etc.) for each and through which reward elements each will be recognized.
- **Competitive market reference points**–The total rewards strategy should describe the types of companies, industries, or other reference points that will be used as the basis for determining the competitiveness of the reward package.
- **Competitive positioning**–The strategy should also clearly describe the desired competitive position relative to the competitive reference points in the labor market. Ideally, the strategy also will define how the competitive positioning is expected to vary with performance or other criteria.
- **Degree of internal equity and consistency**–The statement should address the extent to which the total rewards strategy will be applied uniformly throughout the company (i.e., to each function, team, geography, etc.), both horizontally and vertically.

- **Communication and involvement**–The strategy should define how much information about the reward programs will be disclosed and explained to employees. It also should outline the degree of participation that employees will have in the design and ongoing administration of the reward programs. This should include a clear delineation of where human resources' responsibility for designing and managing rewards ends and management's accountability begins. The strategy also might define the organization's policy toward employee unions and works councils.
- **Governance**–If it hasn't already been defined elsewhere, the total rewards strategy should define the roles and responsibilities that various constituents within the organization will have in the ongoing administration and evolution of the reward programs.

Implementation Challenges Should Not Be Underestimated

We have seen that high-performing companies are better than others at executing. And we have seen (from the table at the beginning of this section) that they are more preoccupied with execution looking forward. So, what are likely challenges to the successful execution of a total rewards program?

The top five areas companies would like to move to an "above competitive" position are:

1. Leadership development
2. Manage effectiveness
3. Culture
4. Challenging work
5. Learning

At the same time, the results identified two areas where respondents would like to reduce the extent to which they are above competitive:

1. Health care
2. Retirement

It is interesting to note how, in a separate question, respondents evaluated which programs are easiest and hardest to change. The results are shown in the table.

Total Rewards Elements: Ease of Change

Total Rewards Element	Easy to Change	RANK	Total Rewards Element	Hard to Change
Wellness programs	37%	1	Pension/Defined benefit	57%
Recognition programs	36%	2	Long-term incentives	54%
Financial planning/Education	34%	3	Short-term incentives	53%
Training/Learning	28%	4	Retiree medical	53%
Career development	22%	5	Culture	50%
Paid time off for volunteerism	21%	6	Base pay	49%
Charitable matching contribution	21%	7	Child care	44%
Concierge services	20%	8	Health care benefits	43%
Manager effectiveness/Coaching	20%	9	401(k)/Defined contribution	42%
Tuition assistance	20%	10	Paid time off	42%
Flexible work arrangements	18%	11	Concierge services	39%
Health care benefits	17%	12	Flexible work arrangements	35%
Challenging work	17%	13	Paid time off for volunteerism	34%
401(k)/Defined Contribution	16%	14	Charitable matching contribution	33%
Adoption assistance	15%	15	Adoption assistance	33%
Paid leave for maternity/paternity	15%	16	Paid leave for maternity/paternity	30%
Short-term incentives	12%	17	Manager effectiveness/Coaching	29%
Base pay	12%	18	Career development	22%
Pension/Defined benefit	11%	19	Tuition assistance	22%
Retiree medical	11%	20	Challenging work	22%
Child care	11%	21	Wellness programs	21%
Paid time off	11%	22	Recognition programs	18%
Long-term incentives	10%	23	Training/Learning	18%
Culture	9%	24	Financial planning/Education	15%

Taken together, these data suggest that companies will:

1. Enhance their competitive position on four reward elements that are seen as relatively easy to change–leadership development, manager effectiveness, challenging work and learning.
2. Reduce their competitiveness on two reward elements among the eight most difficult to change–retirement and health care.
3. Change their culture, which is rated as the least easy to change, and fifth most difficult to change.

This situation may help to explain why 41% of companies want to be managing total rewards as a portfolio rather than as discrete elements (even though only 9% of companies are doing so today). It only makes sense to use the enhancements in the "easy to change" programs as a way to mitigate the planned reductions in the "hard to change" reward elements. Not only will leading employers be taking this kind of portfolio approach, they will be doing it armed with lots of good data on cost, competitiveness, employee preference, and expected impact on the human resources and business outcomes that have been identified as strategically most important.

Of course, this must be done while maintaining or strengthening core elements and improving communication to enhance understanding and appreciation of reward elements.

Aon Hewitt Point of View: Total Rewards Governance

The mismanagement of total rewards is a significant governance issue. Governance is all about well-conceived, cohesive policies and processes for a given area of responsibility. When those processes produce outcomes not in line with expectations or common sense, various alarms start to sound and responsible parties are held to account.

We need look no further than executive compensation to see how this can happen. Just as "pay for performance" has been a lightning rod for attention from regulators and governance advocates, the woeful return on total rewards investment may be lurking as the iceberg that is about to do major damage below the waterline. In many companies, executive pay is the "flea on the tail of the dog" when compared to the full cost of total rewards programs organization-wide.

The Independent Directors' Executive Compensation Project provided a framework for evaluating executive compensation. That framework has been adapted here to address total rewards. How would your company score on this six-point assessment?

1. **Alignment**–Does the total rewards program reflect and reinforce company culture, values, purpose, strategy, and objectives, and does it reward behavior consistent with these strategies and objectives? Is the total rewards program creating competitive advantage?

2. **Accountability**–Does the total rewards program reflect and reinforce the company's business and economic environment? Does the company monitor execution of total rewards programs, and take corrective action where application and/or results are not up to expectations? Are total rewards costs consistent with desired results? Does the company measure and report on total rewards cost, compliance, competitiveness, efficiency, effectiveness, and risk? Who is responsible for total rewards budget effectiveness and how do we ensure appropriate allocation?

3. **Engagement**–Does the total rewards program foster the desired level of urgency, focus on goals, teamwork, and appropriate risk-taking? Do employees appreciate and value all elements of the rewards programs? Does the total rewards program enable the company to attract, motivate, and retain the talent that it needs? Are its provisions consistent with reasons people typically want to work for the company?

4. **Fairness**–Are total rewards programs/features/values competitive with those of peer companies regarding, size, complexity, business model, industry, and performance? Is eligibility and participation in total rewards programs defined in a manner that is clear, consistent with company values, and well understood by employees? Is the return on total rewards investment producing acceptable results in the eyes of shareholders?

5. **Objectivity**–Does a board-level committee receive thorough, objective advice from knowledgeable, completely independent sources on a regular basis regarding total rewards? Does the committee make all assessments and decisions on a well-informed basis without undue management influence or bias?

6. **Transparency**–Do employees and board members understand all elements of the company's total rewards program? Does the company fully and clearly inform the public about relevant elements of the program?

While some organizations might pass this test, most would likely receive a fair or poor rating. Given the vast sums involved and the potential impact on business results, it makes sense to fix this. If employers don't, they risk having someone else fix it.

Map, Compass, Radar and Telescope

Successfully managing total rewards will require more than a sense-and-respond approach to program effectiveness and the internal and external standards of the day. It will require foresight—the ability to accurately forecast workforce trends, emerging competitive practices, potential regulatory changes, and the future wants and needs of talented workers. It also requires careful consideration of today's changes and their future impact. Indeed, the challenges of today often relate to the unintended consequences of actions taken yesterday.

Planning for Today

The survey data provide some interesting information on the actions that employers are planning for today, which may lead to the unintended consequences of tomorrow. The top areas where employers plan to increase spending are:

1. Wellness programs
2. Manager coaching
3. Training
4. Career development

At the same time, the areas where most employers are expecting to make reductions in spending are:

1. Retiree medical
2. Pension
3. Health care
4. Concierge services

These are particularly interesting directions to consider, especially in the context of earlier findings regarding more performance-oriented rewards in the future and employees bearing more of the cost.

These data suggest that tail-end baby boomers and Gen-Xers may be facing big disappointments in coming years. Many employers may take steps to protect workers who retire in the near future from some of the changes that are being contemplated, anticipated, and executed with retiree medical and pension plans today. This means that near-term retirees may still be able to benefit—to some extent—from the programs and rules that have been in place for much of their careers. Those retiring 5 or 10 years from now, however, may be facing a very different situation, forced to confront financial security and health care issues that many of them did not anticipate during much of their working careers.

For those who are further away from retirement, the issues may be muted by two key factors. First, they are thinking about retirement less than their colleagues of more advanced years. Second, many of them joined the workforce with a different set of expectations regarding retirement savings and health care. Many never experienced a pension plan and have been educated to understand the three-pillar model of retirement savings (i.e., personal, company, and government contributions to retirement savings).

Before late-stage boomers and the beginning Gen-X even reach retirement, they will likely find that their experience at work changes dramatically. Companies are raising the bar on performance expectations, and are placing heavy emphasis on managers and leaders to show the way, set an appropriate tone, and manage the business and the workforce more effectively. Survey results indicate that additional training will be provided and, while many will see this as an opportunity to grow and improve their own effectiveness, some may also see it as an additional requirement to perform in a time when performance hurdles are being raised.

To top it all off, the data suggest employers are going to be more focused on wellness programs, which for many may mean that not only will employees be required to participate in an annual health screening, but they will be required to act on the results and eventually show improvement.

At the same time, convenience benefits like concierge services are going to be reduced, so employees may be more challenged to find ways to balance work/life integration. Work/life balance actually scored lowest on the areas where employers expect to be placing more focus moving forward. This is a somewhat troubling finding.

While “traditional” work/life program areas may be receiving less attention, work/life is an ever-evolving area and leading employers are focusing their efforts differently. Employers have begun to realize that “work” and “life” are no longer mutually exclusive but rather more integrated for most employees—resulting in the need for different types of work/life solutions. With much demographic diversity in the workplace, continual advances in technology, and a workforce that is continuing to work harder than ever before, employers are focusing work/life programs more in the areas of time off and flexibility. So while child care centers may not be increasing in popularity, flexible work arrangements, virtual work, and PTO banks are the new face of work/life for many employers.

Among employers in Aon Hewitt's Benefit SpecSelect database, for example, flexible work arrangements have nearly doubled in prevalence in the past five years. And the percentage of employers offering PTO banks (combining vacation, holiday, sick, and personal time into one bank of time off to be used for any purpose) has increased from 16% to 28% since 2004. This is an important part of building a health culture and allowing for workout time during the day. As employee needs for work/life integration continue to change and become more diverse, the face of work/life solutions will continue to mirror this change.

On other fronts, too, leading employers will find ways to help employees manage the changes and challenges that present themselves as we move deeper into the 21st century. They will find ways to help employees see the opportunities and rise to the challenges. They also will find ways to see over the horizon in order to better forecast what is coming, so they can manage their employee communications more effectively and provide more advance notice on changes. They will develop all sorts of "telescopes" that help them see further up the road than their competitors so they can develop appropriate contingency plans to seize opportunities more quickly and avert potential catastrophes. These "telescopes" will include tools such as dynamic workforce models, robust data on employee engagement, and deep data on reward preferences covering current and prospective employees that can be analyzed by segment. Leading employers are taking steps to put these capabilities in place.

Aon Hewitt Point of View: Employee Segmentation Analysis

Employee segmentation has become a hot topic, and one for which there is no end of differing opinions, approaches, and uses. Yet not all approaches produce actionable information. Broadly speaking, segmentation is the process of breaking down large populations into similar "groups" of employees to understand what is important to them and how they might behave in certain circumstances.

There is no single right way to segment your employees. Consider the range of options available:

- Demographics: for instance, male vs. female; young vs. old
- Opinions and attitudes: for instance, those satisfied with rewards vs. those who are not satisfied
- Usage, employee characteristics or behavior: for example, those who are high performers vs. those who are not, or those who are high users of health care services vs. those who are not
- Employee need or preference: for instance, those employees who value tuition reimbursement vs. those who don't, or those who have a strong need to minimize out-of-pocket medical expenses vs. those who do not

Yet, not all of these segmentation approaches are useful or practical. To be effective, a segmentation approach requires two things:

1. There must be differences across segmentation groups, but consistency within segments.
2. The segments identified must be actionable—you need to be able to identify those in the segment so you can target, communicate, or position a product appropriately.

Demographics can certainly identify different groups of people, but just because an employee is a male, he may not have different needs, usage, behaviors, or attitudes than a female. Someone working in a marketing function may have similar needs, values, and opinions as someone working in finance. So, while we can easily identify and segment people, demographics often are not all that useful. Exceptions here are differences based on age (especially generational categories), salary, and sometimes race/ethnicity. We often do see differences in needs, attitudes, and behaviors across these characteristics.

Consider the following example. Demographically speaking, most Americans resemble their immediate neighbors. Generally, you are likely to have the same age, education level, family status, race, income, and so on as those living in your immediate neighborhood. Demographically, you are likely to be very similar. Yet, parked in every driveway will be a different car. You read different books. You take different vacations. Demographics, therefore, may not be a very good predictor of purchase behavior.

Similarly, segments derived from attitudes, opinions, or satisfaction levels produce fascinating differences (just think of all the differences between liberal-minded employees and conservative-minded employees), but the problem becomes trying to do something with these results. Unless you can identify which employee shares a particular attitude, it becomes difficult to adjust your employee value proposition in a way that increases receptivity and acceptance.

Perhaps the most powerful way to use segmentation is to combine these elements (demographic, attitudinal, behavioral, and preference-based) to create a holistic view of the employee population and from which to identify appropriate targets and effective actions.

Segmentation is a powerful tool to help understand the different needs of your diverse employee popultion. Embracing its importance can help you design and communicate rewards appropriately.

Closing

These survey results suggest there is opportunity to enhance how employers are managing their total rewards programs. The responses also point to a number of areas where employers who want to raise their game can do so. Practices at high-performing organizations point the way toward some of the initial steps and even some of the more advanced actions employers can take to improve the return they are getting on their total rewards spend.

Given where things seem to be heading in terms of companies generally raising the bar on performance expectations, it strikes us that leadership in HR, finance, and the business—along with others responsible for total rewards in their organizations—are wise to double down on their efforts to understand best practices and leading thinking on the topic, and to work aggressively to put these in place within their own organizations.

There is a risk that improved execution will only serve to raise the bar further. This will be the price of success for those who manage total rewards successfully. The price of failure for those who do not surely will be more difficult to bear. Which price will your organization pay?

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Aon Hewitt is the global leader in human resource solutions. The company partners with organizations to solve their most complex benefits, talent and related financial challenges, and improve business performance. Aon Hewitt designs, implements, communicates and administers a wide range of human capital, retirement, investment management, health care, compensation and talent management strategies. With more than 29,000 professionals in 90 countries, Aon Hewitt makes the world a better place to work for clients and their employees.

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