Tough Times
Demand Focus—
Total Rewards Strategy

by Andy Hiles

A total rewards strategy is a focused game plan that allocates resources and tailors activities to achieve a target performance level within a prescribed timetable. It must be unique to the organization that develops it and, when done effectively, will help drive sustainable, competitive advantage in the ever-tightening market for key talent by carefully considering the full list of potential sources of value to employees. This article resolves common areas of confusion over total rewards strategies and provides some potential value drivers for consideration.

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DOES AN ORGANIZATION NEED A COMPREHENSIVE TOTAL REWARDS STRATEGY?

While covered extensively in other articles, it is worth restating that over the last several years we have seen seismic changes in the landscape for talent and the people programs that organizations develop to attract and retain employees. Compensation programs are increasingly under stress to differentiate base salaries—rewarding high performers—in the context of dwindling merit budgets. Emphasis continues to shift from internal equity to market data comparisons. Short-term incentive plans are moving away from subjective measures, and more recently long-term incentive plans are packed with underwater options that no longer hold any retention power.

At the same time, benefit plan costs are a large and growing portion of reward programs, and employers are responding to the recession with cutbacks in all nonessential areas. Sharpening the pencil around employee benefit plan costs is, for most organizations, a logical and necessary step.

A colleague of mine recently said, “The plan is the plan until we get a new plan.” I like her statement very much in that it gets to an essential element of strategy—a plan of action around which everything will be aligned. What she did not say (but would have if asked) is that, when done correctly, a strategy is a template for allocating resources to drive competitive advantage. Unfortunately, in the world of employee rewards programs, some confusion exists about exactly what a robust total rewards strategy is (and is not).

Even more troubling is the sometimes lack of appreciation for the full scope of reward plan value drivers. Understanding these value drivers can help differentiate an organization from the competition and/or allow for cost-reduction steps that save needed dollars but do not have a commensurate negative impact on employee appreciation and engagement.
In addition to the added cost pressure brought about by the recession, market volatility can make it nearly impossible for the chief financial officer to predict next year’s benefit plan costs. Employers, aided by recent legislative changes and emboldened by the clear mandate to reduce costs, are pushing greater responsibility for making good decisions to employees—who show signs of being unprepared (and possibly uninterested) to meet the challenge. And to complicate matters, the workforce is diversifying rapidly while employer-sponsored benefit plans show disparities in savings and health results across workforce segments. Organizations that do not have an explicit plan to address these new benefit plan realities run the risk of overspending for benefits, cutting costs in the wrong areas or simply failing to garner sufficient employee appreciation for the dollars invested.

**WHAT IS A TOTAL REWARDS STRATEGY?**

A total rewards strategy is a focused game plan that allocates resources and tailors activities to achieve a target performance level within a prescribed timetable. Strategy is future focused and is typically a response to a new development in the market (economists call this a *nonlinear* or *discontinuous* change). In employee reward programs, examples of nonlinear/discontinuous change include the recession-induced free fall of stock values. In benefits, nonlinear changes include the transformation in the *consumer* (the diversifying workforce), the shift in risk/decision-making responsibility from employers to employees, and the growth in importance of benefit plan costs (level and volatility) in achieving overall organizational goals.

Noted strategy consultant Vijay Govindarajan of the Tuck School of Business at Dartmouth says that managers spend most of their time managing the present—doing a better job at the same activities. While this is important, he stresses that in times of discontinuous change, managers must do two things well at the same time: manage the present (*operational efficiency*) while creating the future (*strategy*).

According to the excellent *Harvard Business Review* article entitled “Can You Say What Your Strategy Is?” by David J. Collis and Michael G. Rukstad (April 2008), strategy has three core elements:

1. **Objective**
2. **Scope**
3. **Advantage**

Let’s consider how these apply to employee reward plans.

The total rewards objective is the very specific “what” an organization is trying to achieve. It should be highly measurable as well as time bound. The organization should stick to reward plan goals that can be measured, like differentiation in base pay, cost per employee, plan participant behaviors (savings rates, condition management compliance, etc.) and/or employee satisfaction with reward plan offerings, etc.

The scope aspect of the strategy statement adds clarity to who and what is included. Often, total rewards strategy projects include on the compensation side job evaluation, base salary, salary increase, recognition, short- and long-term incentives and, sometimes, performance management. The benefit program includes health and welfare, financial security, paid time off and work/life programs.

Finally, the most important part of the strategy statement—the advantage—outlines the means an organization will employ to achieve its objective. This is all about differentiation, finding the aspects of the total rewards program that will be emphasized to drive better results for the same or less cost. Organizations can drive differentiation using any of the value drivers in the supply chain of total reward activities: plan design, communication, administration/enrollment and decision support.

**HOW IS A TOTAL REWARDS STRATEGY DIFFERENT THAN A MISSION, VISION OR PHILOSOPHY?**

The total rewards strategy will specifically define next steps for the organization while providing a consistent template for future decision making. It must be unique to the organization that develops it and (when done effectively) will help drive sustainable, competitive advantage in the ever-tightening market for key talent.

Sometimes organizations confuse strategy with a

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Employees have no insight into these calculations. As the consumers of the product (reward programs), employees and their families assign value in many different ways. And this is important: If employees assign a high value to this product (reward plans), the employer commands a higher “price” and greater return on investment, measured as attraction and retention impact for a lower cost.

Of course, employee reward programs are not exactly like other consumer products. First, employees dissatisfied with reward plan offerings cannot easily go elsewhere for pay or to buy their health care, time off or retirement benefits. The stress of job change, benefit tax laws and availability of individual coverages are such that employees will “buy” these products from their employer almost regardless of how they feel about them (with the return on investment to the organization being the variable).

The second critical difference between reward programs and other consumer products is that it is very important to the maker of the product (the organization) that the products work well. This is true for compensation plans (retaining employees and having them focus on the right activities) and benefit plans like retirement savings, as employers want their employees to be able to afford to retire. Recently, focus has shifted to health care. In years past, health care was just an expense to be managed. However, employers now realize that a well-designed health plan will do more than just manage cost and trend—it can help employees stay on the job and be productive.

In developing a total rewards strategy, we recommend that the employer go beyond just economic or actuarial value and carefully consider the full list of potential sources of value to their employees. Note that employee preferences can be difficult to determine without quantitative research into the covered population. However, some potential value drivers to consider in addition to pay level relative to benchmarks and richness of benefit plan design include

- **Ease of understanding**—“I know what is most important and how I will be rewarded for doing it well.”
- **Knowledge of the value of the total rewards package**—“I can now see all of the sources of my rewards, and they add up to more than I thought.”
- **Well-designed defaults**—“I didn’t have to do a thing and I am saving and investing for retirement in a way that really fits my situation.”
- **Timely information about programs and access to services**—“It really helps to know these services are available to me and that my employer has prescreened them ... so I know I am getting...
Also keep in mind that just like the customers for a company’s services, employee groups differ significantly in what matters most. Age groups, concentration in certain roles and pay levels, turnover, opportunity for promotion, career development opportunities, culture, competitiveness of local labor markets, geography (critical mass in some places versus wide dispersion) and racial/ethnic diversity all vary by organization. The total rewards strategy a company develops should consider all these differences and be unique to that organization. Having the total reward programs be the same, or even a little better than other organizations is acceptable—but it is intense focus on what’s unique to the organization and workforce that will drive optimal efficiency and real competitive advantage.

Endnote
1. For example, see “Building a Culture of Personal Benefits Responsibility” (Benefits Quarterly, Second Quarter 2007); “It’s Time to Rethink Employee Benefits” (Benefits Quarterly, Fourth Quarter 2006); and “Release Hidden Value: Maximize Your ROI in People” in Executive Excellence Magazine.