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The Employee as Customer

Using Market Research to Manage Compensation and Benefits

QUICKLOOK

- ⇒ Companies can apply market research to measure employees' benefits preferences.
- ⇒ Multiple techniques have been developed to collect employee preference information.
- ⇒ Win-win situations result when the perceived value of the benefit to the employee outweighs the cost to the company.

By Lynn Gaughan and Jorg Kasparek, NCR Corp., and
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NCR has identified program changes that will increase the value of its employee benefits package without increasing costs to the organization.

What benefits programs do employees really value? What program should a company introduce next? What programs should be changed to enhance their value?

NCR, an Ohio-based computer-maker, teamed up with International Planning and Research (IPR), a management consulting company, to better understand employee preferences. By applying proven market research solutions to measure employee preferences, NCR now is better able to structure its compensation and benefits to realize optimal value.

The Need for Market Research

Anyone who has been through a master's of business administration (MBA) program understands the importance of conducting market research to determine the features and functions customers would like in a product or service *and* what they are willing to pay for them. In the same way that companies compete for customers by offering the optimal mix of features at the right price, organizations also compete for employees by offering the optimal mix of salary, benefits and working conditions. Only by viewing employees as customers and doing the necessary market research to understand their preferences can a company design the kind of compensation and benefits package that will enable it to gain a competitive edge in attracting and retaining talent in today's highly competitive labor market.

The traditional approach to managing compensation and benefits involves competitive benchmarking studies of the compensation and benefits offered by other companies – particularly those competing for the same scarce talent. The intent of such studies typically is to identify and adopt best practices used in compensation and benefits programs.

While necessary, these studies alone

are insufficient. Companies that rely solely upon them are merely “following” rather than “leading.” In fact, this type of approach is akin to searching for troubles in the road ahead by using the rearview mirror. It ignores the fact that human capital is a competitive advantage of the firm, and that merely keeping up with the competition is not enough. In contrast, a compensation and benefits offering that creates unique value for employees – one that is difficult for competitors to replicate or involves significant switching costs to employees – will provide a sustainable strategic advantage to the employer.

Applying Market Research Techniques to Compensation and Benefits

Though the potential benefits are great, the challenge of identifying the optimal tradeoffs in compensation and benefits offerings is non-trivial. Despite the importance of these offerings, most methods for evaluating their impact are inadequate for the following reasons:

- The value of compensation and benefits programs to the employee often is unclear, as is their impact on recruitment and turnover. The end result often is an expensive program that has unknown value to employees and unknown return on investment for the company.
- The sheer volume of choices offered under the typical cafeteria-style program results in a level of complexity and lack of flexibility that limits their usefulness. To ensure employee satisfaction, it is necessary to understand the specific preferences of employees as they attempt to assemble their particular package of benefits.
- Management runs the risk of creating expectations that it cannot fulfill when it uses traditional methods for

analyzing options in compensation and benefits programs that do not require employees to make tradeoffs among the various benefits under consideration.

Unfortunately, research of this nature is extremely complex, given the challenges noted earlier. Sophisticated customer preference revelation techniques are required to gather the amount of detail necessary to provide actionable information. A series of advanced analytical techniques is needed to interpret and analyze the data, and specialized software is required to facilitate manipulation of the vast amount of multidimensional information generated by this research.

There are multiple techniques that have been developed to collect this kind of preference information. While each technique has its own strengths and weaknesses, the one chosen by NCR and IPR requires the employee to choose simultaneously between various benefits options within the context of his or her total compensation dollars. Compared with other techniques such as conjoint or discrete choice, this technique is ideally suited to the type of data collection that is required for compensation and benefits preference revelation because it allows for multiple simulations involving a large number of attributes. It achieves this by presenting choices in a realistic true-to-life decision-making mode. This ensures more accurate results by increasing respondent interest and minimizing respondent fatigue, which facilitates the development of a more robust decision/simulation model.

What's Valuable to Employees?

A primary goal of the NCR study was to identify compensation and benefits program changes that would provide greater value to employees without increased cost to NCR. These changes are characterized as “win-wins.” This was accomplished with the employee preference survey that provided a disciplined means of determining the value NCR employees place on various new and existing benefits.

The “value” information NCR obtained from the survey is contained in a data-

base that is now being used for cost-benefit analysis of possible changes to NCR's compensation/benefits programs. For example, the NCR study had respondents evaluate four alternative fitness programs, ranging from a low-cost option that offered discounts at local fitness centers to a high-cost option that included an onsite fitness center. The resulting tradeoff survey database gave NCR estimates of the values employees placed on the different fitness program alternatives and indicated the alternative with the highest payoff (value relative to cost). NCR believes the information obtained from the survey will produce significantly enhanced success rates for new benefits programs.

NCR's study consisted of a series of discrete steps:

- Compile a list of benefits (features) and options (alternative benefits levels). Like other companies, NCR maintains an extensive list of possible new benefits employees have suggested through employee focus groups, e-mail, exit interviews, suggestion boxes, new hire orientations, rejection letters and phone calls.
- Develop cost estimates for alternative

benefits levels. (See Figure 1 for an example of a benefits feature tradeoff sheet.)

- Segment employees into demographic groups to be surveyed and set sample quotas for each group.
- Develop educational materials to support the survey.
- Conduct the trade-off survey.
- Compile and analyze survey results.
- Develop executive summary and recommendations.
- Utilize tradeoff survey database for ongoing cost/benefit analysis of alternative compensation and benefits changes.

Building a Benefits Package

During the NCR tradeoff survey, each respondent was asked to build the benefits package that best met his/her needs and was consistent with his/her compensation budget. During this process, he/she was able to choose reductions or increases in cash pay in exchange for richer or less generous benefits packages.

The survey was similar to a cafeteria-style or flexible benefits selection process. With these programs, employees are given benefits dollars, or take

payroll deductions, to spread across alternative benefits/options that cost different amounts. This was the essence of the NCR survey, but with two key distinctions.

First, the survey allowed NCR to test market a new benefit or set of benefits to a small group of employees to determine interest and buy rates. It projected a reasonably reliable measure of the volume and total cost of the new benefit before deciding to incorporate it into its benefits programs.

Second, the sampled NCR employees were asked to undertake multiple cafeteria selection processes, making benefits choices under different cost scenarios (for example, mid, lower, and higher costs). These cost scenarios were used to identify those benefits that are highly valuable to employees as well as those that, while nice to have, are not so highly valued. The cost scenarios were most useful in estimating employees' willingness to pay for each level of benefits. When the benefits value estimates are combined with benefits cost information, win-win changes in employee benefits can be identified. Figure 2, page 36, illustrates a simplified hypothetical example of a win-win change.

FIGURE 1: BENEFITS FEATURE TRADEOFF SHEET

A Costs. Please modify this "base" benefit package into another which you would most prefer, bearing in mind that selecting different levels will impact your cash pay (see box to right). The base package is highlighted in blue. You can make a change by clicking another box.

	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Base Benefit Package</td> <td style="text-align: right;">\$11,460</td> </tr> <tr> <td>Chosen Benefit Package</td> <td style="text-align: right;">\$11,460</td> </tr> <tr> <td>Change in cash pay</td> <td style="text-align: right; background-color: #fff9c4;">\$0</td> </tr> </table>	Base Benefit Package	\$11,460	Chosen Benefit Package	\$11,460	Change in cash pay	\$0
Base Benefit Package	\$11,460						
Chosen Benefit Package	\$11,460						
Change in cash pay	\$0						

FEATURE	ALTERNATIVE LEVELS				
Medical Plan	Opt Out -\$4,800 <input type="checkbox"/>	Traditional – Basic Current A Base <input checked="" type="checkbox"/>	HMO -\$800 <input type="checkbox"/>	Traditional – Enhanced +\$1,000 <input type="checkbox"/>	PPO +\$1,300 <input type="checkbox"/>
Long-term Disability Plan	Opt Out -\$840 <input type="checkbox"/>	50% of Your Salary Current A Base <input checked="" type="checkbox"/>	60% of Your Salary +\$240 <input type="checkbox"/>	70% of Your Salary +\$480 <input type="checkbox"/>	
Life Insurance	None A Base <input checked="" type="checkbox"/>	1 Times Your Salary +\$240 <input type="checkbox"/>	2 Times Your Salary Current +\$480 <input type="checkbox"/>	3 Times Your Salary +\$720 <input type="checkbox"/>	4 Times Your Salary +\$960 <input type="checkbox"/>
401K Plan	None -\$1,800 <input type="checkbox"/>	3% Match 5-Year Vesting +\$1,200 <input type="checkbox"/>	6% Match 5-Year Vesting Current A Base <input checked="" type="checkbox"/>	6% Match 1-Year Vesting +\$900 <input type="checkbox"/>	10% Match No Vesting +\$2,400 <input type="checkbox"/>
Paid Parental/Family Leave	None Current -\$180 <input type="checkbox"/>	3-Day Leave A Base <input checked="" type="checkbox"/>	12-Week Leave 1/2 Salary +\$540 <input type="checkbox"/>	12-Week Leave Full Salary +\$1,800 <input type="checkbox"/>	

**FIGURE 2: WIN-WIN:
THE KEY IS COST VS. VALUE**

	Traditional Premium	HMO System
Health Insurance		
Cost to Company	\$6,000	\$4,000
Value to Employee	\$6,500	\$5,000
Vacation Allowance	3 Weeks per Year	4 Weeks per Year
Cost to Company	\$3,500	\$5,000
Value to Employee	\$4,000	\$6,000
Total		
Cost to Company	\$9,500	\$9,000
Value to Employee	\$10,500	\$11,000

The NCR Case Study

The NCR study was designed to deliver two benefits:

- Respond to employees' desires to have a meaningful role in designing future compensation and benefits changes. This desire was registered in recent companywide associate satisfaction surveys.
- Identify compensation and benefits changes that would lead to higher perceived value for NCR employees without increasing the company's compensation and benefits costs. The latter result would improve associates' satisfaction with the company's compensation and benefits package.

The NCR compensation and benefits team identified the program categories and study options, developed associated costs for each option and provided descriptive material for the survey for each category. Five broad benefits categories were included:

- Health benefits (medical care, dental care, vision, and long term care)
- Work/life programs (pre-school day care, school age day care, elder care, wellness benefits, concierge services)
- Retirement benefits (401[k] savings plan, pension plan, financial planning)
- Vacation benefits
- Alternative forms of fixed vs. variable compensation (additional incentive bonus, stock options).

The study was conducted in January and February 2000 among 423 NCR employees in New Jersey, Georgia, Ohio and California. Small group sessions maximized interaction with employees throughout the survey process.

Computerized interviewing was necessary because the costs of several benefits options are a function of respon-

dent characteristics (age, salary, bonus target) and the survey employs sophisticated "branching techniques" in which the questions asked are determined by respondent answers to previous questions and combinations of choices selected. Computerized interviewing can be administered using stand-alone PCs or via the Internet.

Establishing Parameters for the A-B-C Choices

Respondents were shown a grid of various benefits categories with corresponding levels or options for each category and were asked to select their most preferred option for each benefits category. Prices were shown for each option and, as the respondent made a selection, a corresponding cumulative payroll deduction was displayed. Hence, respondents were forced to evaluate the value of an option against its costs in terms of foregone cash pay. The respondent completed this choice process under three sets of option prices:

- The "A cost" scenario – prices were set to reflect NCR's cost of providing the option to the employee.
- The "B cost" scenario – prices were 25 percent lower across the board.
- The "C cost" scenario – prices were 25 percent higher.

The purpose of the three cost scenarios was to test the price sensitivity of the features and options and to provide information on the respondent's willingness to pay for an option, which was used later for the analysis of win-win benefit changes. Fifteen benefits categories (with three to six options per benefit) were evaluated in this study.

Identifying Win-Win Opportunities

A key objective of this study was to identify changes in NCR's compensation and benefits package that would produce win-win outcomes. These outcomes result when employees are provided a superior package or set of choices with no cost increase to NCR. As noted earlier, the process is not unlike the one a company faces when it needs to determine which of all the possible new features and enhancements it should add to an existing product.

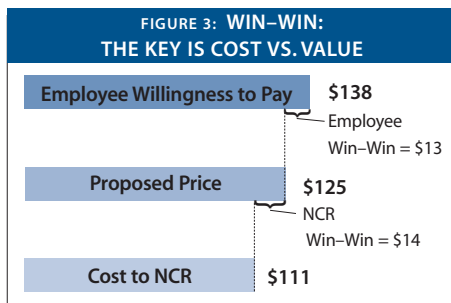
Quite simply, the approach is to add those enhancements that have a greater value to the consumers of the product than they cost the company to include. For example, if consumers value and are willing to pay \$100 for a new feature that costs the manufacturer \$50 to add, there is a surplus of \$50 (value less cost) that can be used to produce a win-win outcome. If the manufacturer prices the new feature at \$75, it makes a profit of \$25 (\$75 - \$50) and consumers enjoy a \$25 gain (\$100 - \$75). Thus, the key to achieving win-win is for NCR to identify enhancements to its compensation and benefits package that are worth more to employees than it costs NCR to provide them.

The study tested several new benefits categories in terms of employee interest and willingness to pay, including a vision plan, a long-term care plan, child and elder care, a wellness benefit, concierge services, changes to the 401(k) savings plan, financial planning and alternatives for more variable pay. It was estimated that the total value of the win-win opportunity that could be generated by these new benefits was approximately \$600 per employee. Five of the benefits categories represented about 85 percent of the opportunity for win-wins. Two forms of variable pay, stock options and additional annual incentive bonuses provided the greatest opportunity for employee and company gains.

The level of win-win dollars for any specific benefits category was computed by observing the selections of the respondents under the baseline "A" cost scenario. The "A" costs were set to be approximately the true cost to NCR of providing the benefits option. By selecting an option, an employee indicates that the option is worth at least as much to him/her as it costs the company to provide the option. By subsequently presenting the employee with alternative cost scenarios, it is possible to estimate for each respondent a dollar measure of value or willingness to pay for the chosen option. If the price of the option is set between the "A" cost and the estimated willingness to pay for each respondent, a win-win outcome is achieved. The "volume of sales" for each

option was extrapolated from the respondent sample to the entire NCR population.

For example, consider the vision plan. The respondent sample suggested that approximately three-quarters of NCR employees would select one of the five options listed under “A” costs. The options range in cost to NCR from \$30 (discount only) to \$195 (family plan, high option), averaging about \$111. The employee willingness-to-pay estimates for vision options range from \$39 to \$240, averaging \$138. The proposed average price for vision is about \$125 (ranging from \$34 to \$218). The average win for employees is \$13 (the difference between the proposed price of \$125 and employee willingness to pay of \$138). The average cost saving per employee for NCR is \$14 (proposed price of \$125 less NCR cost of \$111). With 10,000 employees, the company saving would be \$140,000. The additional value to employees would be \$130,000. (See Figure 3.)



Understanding Employee Preferences

By viewing employees as customers of its HR programs, NCR has taken the logical step of using a customer survey research technique to understand employee preferences more completely. As a result, NCR has been able identify program changes that will increase the value of the benefits package it offers to employees without increasing its costs. Working with IPR’s analytic and modeling tools, NCR has been able to quantify precisely these economic gains. Aside from competitive compensation and benefits costs, companies who consult their employees in a systematic way before they “re-engineer” their programs are more likely to find “win-win” changes. As a result, they stand to reap gains through reduced attrition and increased yield on acceptance of job offers. The advantages offered by this alternate “employee as customer” approach towards compensation and benefits management represents a significant – and sustainable – competitive advantage. MS

ABOUT THE AUTHORS

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FOOTNOTES

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