Why Total Rewards are More Important than Ever

September 2009

This is a critical time to be proactive and avoid the question “Why did you not act?”

- Many organizations have shifted their focus from growth to carefully managing their balance sheets and taking necessary steps to remain competitive, or in some cases viable.

- Employers are taking steps to free up capital and cut costs while struggling to keep their workforce engaged and productive.

- Organizations must make the most of investments in compensation, retirement and benefit plans to help create a more efficient organization, while minimizing the impact to employee loyalty, productivity and turnover.

- Crisis conditions create opportunities to foster and embrace innovation.

- You can send a very positive signal to your employees
  “We are going to survive and we value you!”
Immediate intervention and a well thought out approach drives:

- An integrated response to the crisis ✓
- Immediate cost savings to your organization ✓
- Employee engagement in the process ✓
- Scaleable foundation for future plan changes ✓
- Open communication ✓
- A “steady hand” and strategic leadership ✓

Point of view: Total Rewards are part of an integrated set of solutions that should align with desired business objectives

<table>
<thead>
<tr>
<th>Business Objectives/Outcomes</th>
<th>Revenue Growth</th>
<th>Cost Efficiency</th>
<th>Risk Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Value Drivers</td>
<td>Customer Value</td>
<td>Operations / Process</td>
<td>Deal / Transaction</td>
</tr>
<tr>
<td>Human Capital Outcomes</td>
<td>Attraction / Selection</td>
<td>Engagement / Performance</td>
<td>Retention</td>
</tr>
<tr>
<td>Integrated Human Capital Solutions</td>
<td>Leadership Development</td>
<td>Selection &amp; Assessment</td>
<td>Recruitment &amp; Staffing</td>
</tr>
<tr>
<td></td>
<td>Organization Structure &amp; Governance</td>
<td>Total Rewards</td>
<td>Performance Metrics</td>
</tr>
<tr>
<td></td>
<td>Research/Analytics</td>
<td>Communication</td>
<td>Technology / New Media</td>
</tr>
<tr>
<td></td>
<td>HR Function Effectiveness</td>
<td>Change Management / Project Management</td>
<td></td>
</tr>
</tbody>
</table>
Total Rewards: Balancing multiple inputs is necessary to determine the right rewards designs

Leadership input:
- Business objectives/value drivers
- Rewards philosophy
- Rewards objectives
- Change readiness

Workforce input:
- Employee preferences
- Demographics
- Engagement/Retention forecasts associated with rewards changes
- Change readiness

External input:
- Capital markets
- Legislation
- Rewards trends
- Rewards prevalence
- Rewards competitiveness

Optimized Total Rewards Designs

Rewards Cost:
- Current rewards spend
- Cost trends
- Cost/savings forecasts associated with rewards changes

Total Rewards strategy: Articulate the total rewards philosophy that aligns with business objectives

<table>
<thead>
<tr>
<th>One size fits all design</th>
<th>Customized reward packages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Linked to company performance</td>
<td>Linked to individual performance</td>
</tr>
<tr>
<td>Low variability based on performance</td>
<td>High variability based on performance</td>
</tr>
<tr>
<td>Service/Level oriented</td>
<td>Performance/Value oriented</td>
</tr>
<tr>
<td>Fixed costs</td>
<td>Variable costs</td>
</tr>
<tr>
<td>Company bears the cost</td>
<td>Employee bears the cost</td>
</tr>
<tr>
<td>Company bears the risk</td>
<td>Employee bears the risk</td>
</tr>
<tr>
<td>Base compensation below market median</td>
<td>Base compensation above market median</td>
</tr>
<tr>
<td>Incentive compensation below market median</td>
<td>Incentive compensation above market median</td>
</tr>
<tr>
<td>Benefits below market median</td>
<td>Benefits above market median</td>
</tr>
</tbody>
</table>

Current position Required position to align with business objectives
Rewards Optimization: Maximize workforce ROI for targeted levels of rewards investments

Rewards Optimization balances cost and employee value

Rewards Optimization: Decision-support for rewards designs under consideration

- Rewards Optimization combines two time-tested analytic techniques:
  - Conjoint analysis (employee preferences regarding reward trade-offs)
  - Cost/Benefit optimization analysis

- Decision-support regarding the following questions:
  - What is the best total rewards investment in employees to maximize outcomes like attraction, retention, engagement, perceived value?
  - What is the best way to allocate total rewards investments across programs?
  - What are the employee relations risks associated with specific rewards changes?
  - What is the forecasted cost and employee impact for a rewards redesign under consideration?
  - Do the answers to these questions differ by important demographics like age, tenure, job family, level, geography?
Rewards Optimization: Sample preference survey

If these plans were identical in all other ways, which would you prefer?

- Employer contribution to DC Pension: None
  - Long Term Disability: Company provided - 10% of current pay
  - Long Term Disability: No Coverage

Please type a number between 0 and 100 where 0 means "Definitely would NOT accept" and 100 means "Definitely WOULD accept".

How likely would you be to be to accept this Employee benefits package?

Rewards Optimization: Sample cost/benefit analysis

<table>
<thead>
<tr>
<th>Change in Employee Engagement</th>
<th>Cost/Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>2X Merit increase</td>
<td>$18,000</td>
</tr>
<tr>
<td>Manager increases career coaching discussions</td>
<td>$450</td>
</tr>
<tr>
<td>100% 401(k) match up to 6% of pay</td>
<td>$15,000</td>
</tr>
<tr>
<td>Healthcare contributions decrease 5% in exchange for healthy behavior programs (screening, weight loss, etc.)</td>
<td>$2,000</td>
</tr>
<tr>
<td>Ability to buy up to 5 days time off</td>
<td>$0</td>
</tr>
<tr>
<td>2X bonus target opportunity</td>
<td>$28,000</td>
</tr>
<tr>
<td>Half bonus target opportunity</td>
<td>($14,000)</td>
</tr>
<tr>
<td>Healthcare contributions increase 15%</td>
<td>($3,000)</td>
</tr>
<tr>
<td>Half annual merit increase</td>
<td>($9,000)</td>
</tr>
<tr>
<td>50% 401(k) match up to 6%</td>
<td>($12,000)</td>
</tr>
<tr>
<td>No merit increase next year</td>
<td>($18,000)</td>
</tr>
<tr>
<td>Freeze pension plan</td>
<td>($8,000)</td>
</tr>
</tbody>
</table>
Rewards Optimization: Sample Efficient frontier of program spend

ILLUSTRATION
Rewards Optimization Graph

- More Engagement / Current Cost
- Same Engagement / Less Cost
- Lowest Cost / Lowest Engagement

Incremental Cost/(Savings) in Thousands

Alternate reward mix A
Alternate reward mix B
Alternate reward mix C

Rewards Optimization: Sample rewards redesigns with cost and engagement impact

<table>
<thead>
<tr>
<th>Program</th>
<th>Current Mix</th>
<th>Alternate Mix A</th>
<th>Alternate Mix B</th>
<th>Alternate Mix C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merit increase</td>
<td>No change</td>
<td>No merit increase next year</td>
<td>No merit increase next year</td>
<td>No merit increase next year</td>
</tr>
<tr>
<td>Bonus pay</td>
<td>No change</td>
<td>1.25X current target</td>
<td>More weight placed on individual performance</td>
<td>1.5X current target</td>
</tr>
<tr>
<td>Long term incentive</td>
<td>No change</td>
<td>No change</td>
<td>Up to 5% of pay in deferred performance bonus/shares</td>
<td>Up to 15% of pay in deferred performance bonus/shares</td>
</tr>
<tr>
<td>Paid time off</td>
<td>No change</td>
<td>No change</td>
<td>Ability to buy up to 3 days</td>
<td>Ability to buy up to 3 days</td>
</tr>
<tr>
<td>DC match</td>
<td>100% match up to 4%</td>
<td>100% match up to 4%</td>
<td>100% match up to 5%</td>
<td>100% match up to 6%</td>
</tr>
<tr>
<td>Pension</td>
<td>DB pension – no change</td>
<td>Freeze pension</td>
<td>Freeze pension</td>
<td>Cash balance</td>
</tr>
<tr>
<td>Active medical</td>
<td>No change to contributions</td>
<td>20% increase in contributions</td>
<td>No change in contributions</td>
<td>10% increase in contributions</td>
</tr>
<tr>
<td>Retiree medical</td>
<td>No change</td>
<td>Access only</td>
<td>50/50 cost share</td>
<td>Access only</td>
</tr>
<tr>
<td>Engagement</td>
<td>74%</td>
<td>61%</td>
<td>80%</td>
<td>85%</td>
</tr>
</tbody>
</table>
| Change in Cost         | $0          | -$94mm          | -$115mm         | +$85mm
Total Rewards Strategy process: Rewards optimization is an integral part of a rewards strategy process

**STRAW-MODEL PROCESS**

<table>
<thead>
<tr>
<th>Phase I: Planning</th>
<th>Phase II: Diagnostics</th>
<th>Phase III: Rewards Strategy</th>
<th>Phase IV: Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Conduct kickoff meeting</td>
<td>• Conduct demographic analysis and workforce planning forecasts</td>
<td>• Conduct rewards optimization analysis</td>
<td>• Create phased reward change implementation plan</td>
</tr>
<tr>
<td>• Create workplan</td>
<td>• Conduct change readiness and risk assessment</td>
<td>• Create integrated data report with optimization analysis and cost/value impact of various rewards redesigns</td>
<td>• Conduct stakeholder analysis and create communication strategy</td>
</tr>
<tr>
<td>• Collect data from initial data request</td>
<td>• Create change strategy</td>
<td>• Conduct employee preference (conjoint) survey</td>
<td>• Feedback results</td>
</tr>
<tr>
<td>• Conduct leadership interviews (or optional survey)</td>
<td>• Conduct employee change readiness and risk assessment</td>
<td>• Conduct cost analysis regarding current rewards spend and forecasted cost/savings associated with rewards changes</td>
<td>• Create initial rewards blueprints</td>
</tr>
<tr>
<td>• Articulate rewards philosophy and objectives</td>
<td>• Conduct employee preference (conjoint) survey</td>
<td>• Conduct employee preference (conjoint) survey</td>
<td>• Conduct rewards optimization analysis</td>
</tr>
<tr>
<td>• Conduct employee focus groups (optional)</td>
<td>• Conduct cost analysis regarding current rewards spend and forecasted cost/savings associated with rewards changes</td>
<td>• Conduct rewards optimization analysis</td>
<td>• Create phased reward change implementation plan</td>
</tr>
</tbody>
</table>

Rewards optimization steps highlighted in bold text

---

**Total Rewards Optimization**

The key is investing finite employee reward dollars across a workforce in a way that best balances organizational and employee interests, generating the highest possible perceived value for employees at the most economical level for the enterprise.

- Total investment in employee
- Best allocation of that investment
- Employee segments
How Does it Work?

Use TRO framework to help your company:

- Decide which strategy produces the optimal combination of financial cost to the organization and perceived value to employees
- Ask employees to evaluate and make trade-offs across their full portfolio of programs, as opposed to looking at each program separately
- Make decisions that ensure your organization manages people more effectively to improve performance

Example: For a health care system incurring turnover costs of more than $7.5 million annually, TRO analysis showed that spending money on an improved work environment, learning and development opportunities, and benefits – not pay – was the best to reduce turnover among clinical staff
Studies show that the more employees know about their company’s rewards system, the more satisfied they were with the company and greater commitment and engagement at work.

Engaged employees provide a competitive business advantage. Research shows a significant link between employee engagement, customer loyalty and profitability.

Communicating Total Rewards Best Practices – Highlight Value

- Make more information about the total rewards system available to employees, especially details about how the system operates.
- Personalize total rewards by creating a statement for each employee detailing the rewards he or she has received.
- Minimize the use of traditional communication vehicles, such as policy statements, to announce or explain rewards.
- Encourage one-on-one conversations between supervisors and employees about total rewards.
- Measure outcomes over time—see whether any outside forces have affected those outcomes.
- Communicate the value stock options and restricted stock.
- Show what courses an employee has taken or can take.
ABC Company's Changing Workforce

<table>
<thead>
<tr>
<th>Generation</th>
<th>%</th>
<th>%</th>
<th>%</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baby-Boomers (1947-1966)</td>
<td>45</td>
<td>36</td>
<td>19</td>
<td>-</td>
</tr>
<tr>
<td>Generation X (1966-1978)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Generation Y (1978-1988)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Future Gen (1988-???)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Today 45% 36% 19% - %

Tomorrow* 18% 32% 31% 18%

As the composition of ABC Company's workforce changes, emerging gaps in skills and competencies will need closing.

*Based on preliminary analysis without review of termination and retirement behavior. Projection for discussion purposes only.

Type of Outcomes

- **Internal Branding Campaign for a Global Manufacturer**
  - 64% of associates have a better understanding of their total rewards and how to take advantage of them
  - Associate understanding of their total rewards package increased 20 points
  - More than half of our associates say offering is above average compared to competitors

- **Personalized Total Rewards Communication for an International Security Company**
  - 90% say it is the most important/important benefits communication they receive
  - 58% feel a stronger sense of allegiance to the company
  - 71% said they're more likely to stay with the company now that they've seen the value of their total rewards package
  - 81% more likely to recommend company as a good place to work

- **International Communication Campaign for Global Leader in Convenient Snacks, Foods and Beverages**
  - 96% said they had a better understanding of their total rewards
  - 88% are better prepared to make smarter choices about their benefits and programs
  - 83% feel better about the company as an employer
Examples of Total Rewards Communication

Define: What's the Employment Experience?

Organizational Culture
Supervision
Leadership
Diversity & Inclusion
Pay & Benefits
Work/Life

Corporate Citizenship

Define
What Are Our Aspirations?
What's the Employment Experience?
Why Nationwide?
What’s the Employment Experience?

- What are the attributes that drive attraction and retention at your company?

- Which of these are priorities for your company?
  - Low, Medium, High

- What are the programs, policies or practices that reinforce the importance?
**Define: Why Choose Your Company?**

- How does our external brand align with the internal employment experience?
  - What does it mean to associates? Recruits?
  - How is this reflected and reinforced within the organization?

---

**Differentiate**
Differentiate:

How is working at your Firm different?
- What's unique about the culture?
- What's missing?

How can we reinforce and differentiate the employment experience?

CONSIDER
- Role/Career Path
- Diversity
- Generations

Integrate
Integrate: Communication and Implementation

- Year At-a-Glance:
  - How will effective communication begin to integrate the aspects of the employment experience at your Company?
  - What channels will we use?
  - What will require associate action?
  - What’s important to our associates?

Getting Rewards from a Total Rewards Website

- Finding a way to clearly and concisely explain benefits to its highly diverse, scattered workforce
- Portal with up-to-the-minute reports on the total value of their compensation and benefits package
- Access the information anytime from employees’ desks or from any computer with web access, kiosks
- Continuous flow of information
- Choice between housing the site yourself—which requires extra-secure firewall protection—or having a vendor host it for you
### Rethinking Everything – A Checklist of Key Ideas

*This is a critical time to be proactive and avoid the question “Why did you not act?”*

<table>
<thead>
<tr>
<th>Actions for Workforce Management</th>
<th>Actions for Enhancing Leadership</th>
<th>Actions for Your Health and Benefits Programs</th>
<th>Actions for Your Compensation Strategy</th>
<th>Actions for Your Defined Contribution Plans</th>
<th>Actions for Your Defined Benefit Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify who in your leadership ranks can drive successful change</td>
<td>Systematically assess leadership talent</td>
<td>Review the terms of your Rx contract</td>
<td>Talent Re-Pricing Total compensation Management</td>
<td>Communicate openly and continuously</td>
<td>Invest in longer maturity bonds</td>
</tr>
<tr>
<td>Determine what are your biggest risks?</td>
<td>Make informed decisions about people.</td>
<td>Be diligent about your Health Plan Financial Management</td>
<td>Relocate Incentive Pay</td>
<td>Available fiduciary oversight and governance processes</td>
<td>Increase bond and lower stock allocation</td>
</tr>
<tr>
<td>Discuss how to change the culture as we change the organization</td>
<td>Let valuable know they are valued</td>
<td>Dropout at large case life and disability audit</td>
<td>Identify job families that must directly contribute to strengthening and executing strategy</td>
<td>Emphasize the importance of asset allocation and diversification</td>
<td>Change plan design or freeze plan</td>
</tr>
<tr>
<td>Examine how you will manage the transformation while keeping your business going</td>
<td>Clearly and regularly communicate changes to employees</td>
<td>Examine joining Rx Coalition</td>
<td>Determine reductions based on position role</td>
<td>Emphasize impact of potential recent health and investment manager failures</td>
<td>Annuitize or cash out liabilities</td>
</tr>
<tr>
<td>Outline what communications are critical internally and externally within your timeframe</td>
<td>Identify key risks such as losing outstanding employees and leaders who the organization wishes to retain</td>
<td>Conduct audits to remove extra expense</td>
<td>Liquidate any deferred compensation COLI policies to free up cash for pension contributions</td>
<td>Change pension investment policy to leverage future upside returns and limit further downside erosion (might also support higher EROA assumption)</td>
<td>Ready, 2012</td>
</tr>
<tr>
<td>Systematically assess leadership talent</td>
<td>Communicate openly and continuously</td>
<td>Reduce or eliminate company contributions to 401(k)/defined contribution plans</td>
<td>Communicate openly and continuously</td>
<td>Reduce or eliminate company contributions to 401(k)/defined contribution plans</td>
<td>Reduce or eliminate company contributions to 401(k)/defined contribution plans</td>
</tr>
</tbody>
</table>

---

AON CONSULTING