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Feature: *What Were They Thinking?*

What Were They Thinking?

Chapter 8: Let Workers Work: The Downsides of Having People Manage Their Own Benefits

What Were They Thinking?: Unconventional Wisdom About Management

Facing growing competition and financial pressure, many companies have responded by cutting employee benefits to maintain their profits. A 2005 survey by Deloitte found that 90 percent of the responding companies planned to rein in costs during 2006 by changing their active employees' health plans. Companies are also cutting back pension benefits, either freezing or canceling defined benefit plans—those programs that pay retired employees a fixed sum depending on their final wage and years of service—and either eliminating retirement programs completely or substituting defined contribution plans where employees manage their own accounts and assume more of the risk of ensuring they have the financial resources to permit them to retire.

So, a 2004 Deloitte survey discovered that only 10 percent of corporate executives would offer a traditional defined benefit retirement plan if they were able to create their companies' retirement benefit programs from scratch. Many people predict a similar movement in health care plans, with programs migrating from defined benefit to defined contribution plans. In these types of plans, employers put up some money and employees are then largely responsible for using that money to purchase insurance and manage their own health care. The advantage to employers is that their financial obligations are known—they are determined by the money to be allocated to the plans—and more controllable. In each of these changes in both pensions and health care, the trend is clear—companies are shifting risk and liability, and also decision-making responsibility, to their employees; indeed, such a shift is an explicit objective of many of these changes. But companies, in their haste to cut short term, visible costs and transfer decision making to their workforce, haven't thought very carefully about the implications of these actions for their profitability and productivity. If they did, they would see that many of the changes will have feedback effects that can either limit or even eliminate the supposed benefits. For one thing, such changes ignore the time and expertise required to manage benefits. Moreover, the emphasis on employee responsibility for their own benefits management (1) ignores the advantages of specialization and the division of labor, (2) causes employees to spend time on issues that are far removed from their primary jobs, diverting effort from their work, and (3) removes an important way in which companies have traditionally competed to attract talent, at the very moment that talent is going to become increasingly scarce.

The move toward giving employees responsibility for benefits is striking and huge. Many companies are experimenting with insurance plans that make their people more "cost conscious" by taking an active role in health care decision making. For example, Definity Health, now part of United Healthcare, and one of the vendors of consumer-driven insurance programs, boasts on its Web site that "you, the consumer of health care services, are given direct access to your health care dollars and the freedom to make choices." The shift to defined contribution retirement plans, already well under way, does the same thing for retirement—people are responsible for deciding whether or not to participate in an employer's program, how much to contribute, and where and how to invest their retirement assets.

There are three big problems with these changes in who makes the decisions. First of all, remember Adam Smith and the famous pin-manufacturing factory, which illustrated the efficiency gains from specialization and a division of labor? The whole premise of specialization is that people who only have to learn about a subset of decisions and activities can become more expert than those who have to cover a broader range of issues. Specialization permits people to delve more deeply into a subject. And specialization gives people practice and experience and the proficiency that comes from that practice and experience. In other words, specialization promotes efficiency. Michael Jordan may have

been a great professional basketball player, but his career as a baseball player was short and undistinguished. In every field of endeavor, outstanding achievement and great performance come from years of experience and hours of practice.

Making everyone—and I mean everyone, including people with limited education, limited resources, and possibly even limited reading and English language skills—responsible for managing their health care and retirement decisions violates the most basic ideas of specialization and expertise. It is important to recognize that decisions about health care and retirement are decisions with substantially more complexity, financial importance, and risk than the typical consumer purchase decisions so often used in the misguided analogies I see. Confronted with too many choices that they don't necessarily want to make, many employees literally don't do anything. There is convincing evidence, in the case of retirement benefits, that the more choices employees face, the less likely they are to sign up for any plan, thereby forgoing employer matching dollars. And the more investment options they have, the more likely they are to leave their assets in money market accounts that don't provide sufficient returns to ensure a decent prospect of retirement.

Second, when do employers think people are going to make these benefits decisions and gain the expertise to do so? Clearly some of this learning and decision making will occur on the job. My employer, Stanford University, occasionally runs retirement seminars during the workday and provides calculators on its Web site to help people navigate the myriad choices and complexities of benefit management; and once a year we also have a series of benefits fairs that people can take time off to attend. This is all nice, and maybe even pleasurable for some—for example, a young Texans Credit Union employee remarked, "Co-pays, 401(k)s, flexible spending accounts—it was fun figuring out what everything meant." But I wonder if anyone actually bothers to calculate how much time is diverted from people's principal work activities to the task of managing their benefits.

Of course, every action provokes a counteraction, and employers' decisions to force people to make time-consuming decisions that tax their abilities has stimulated the development of an industry to—surprise!—do for a fee what companies themselves used to do for their workforce in simpler times. So, Health Advocate, a firm founded in 2001 by five former Aetna U.S. Healthcare employees, charges companies a monthly fee of \$1.25 to \$3.95 per employee to help people deal with their health insurance decisions. Another company, in Assist, markets claims assistance to employers as an employee benefit, also charging a per-employee per-month fee. Medical claims assistance is a growing business because dealing with insurance companies and coverage can tax even the most skilled and educated workers. But how about this for an idea: instead of offering assistance and advice as an added benefit, or hoping that somehow employees can cope on their own and not spend too much company time doing so, why not offer benefits that don't require a PhD to figure out?

It is also important to note that much of the shifting of risk from companies to their employees is economically inefficient. That's because companies can spread risk—for instance, of incurring a catastrophic medical expense—across their entire employee base while individual employees have much more difficulty in diversifying their risk. Moreover, economists argue, for risk-diversification among other reasons, individual employees are going to be more risk averse than companies; in the case of medical insurance, for example, many employees are reluctant to retire or even change jobs for fear of losing health insurance. One survey found that more Americans were afraid of rising health care costs than terrorism or even losing their jobs.

If something like insurance is more valuable to an individual than it costs a company to provide, the obvious course is for the company to purchase that product or service and provide it to the employee—precisely the opposite of what is occurring. The current trend of off-loading of risk to employees is contrary to much of conventional economic theory, which argues for the assumption of risk by those entities—in this instance companies—that have a comparative advantage in doing so.

Finally, when companies shift decision-making tasks and risks onto their workforce, they make themselves less desirable as employers, compared with companies that offer more generous employee assistance. Here a little historical perspective helps us understand the likely consequences of such moves. Companies began offering benefits such as retirement and health care coverage in the early part of the twentieth century for several, quite self-interested, reasons. First of all, these efforts, sometimes referred to as "welfare capitalism," helped to forestall unionization drives. Second, companies offered these benefits to attract and retain employees. Ford Motor Company, for instance, experienced such high turnover that it could scarcely operate its assembly lines. Raising wages and providing employee assistance represented an effort to build a workforce that would provide competitive advantage. Similarly, Eastman Kodak's pension efforts arose from its enlightened self-interest in attracting an experienced, educated, and loyal labor force.

There has been much commentary on the coming shortage of labor throughout the industrialized

world, a consequence of declining birth rates. In the United States, the passing from the workforce of the baby-boom generation is expected to create numerous job openings and labor shortages in vital industries such as oil and gas, air traffic control, and government, as well as throughout the economy more generally. If there is one thing that is clear from looking at Fortune's best places to work lists, it is that most of those companies offer benefits that are more generous than standard for their industry or for the economy as a whole. Thus, it seems ironic that companies are cutting one of the ways that they have traditionally attempted to achieve an advantage in attracting employees just at the moment that the competition for labor is about to increase.

Shifting decision making and the risk for funding retirement and health care, as well as other benefits, onto the workforce at first glance looks like a shrewd way to take costs out of the system. But many of these gains are ephemeral. Individual employees do not have a comparative advantage in decision making about retirement and certainly not about medical care, and the time required to manage their various accounts is often going to come out of time spent on other work. Moreover, worrying about retirement and health care can distract people's focus and make concentration and effort more difficult. Perhaps that's why the best employers offer more generous benefits and use the idea of specialization and comparative advantage to have decisions made by those most qualified to make them, in partnership with their people.

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