Original Article

Managing global employee benefits

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ABSTRACT Multinational companies operate in a diverse and dynamic environment in terms of geographies, operating units, customers and their employees around the world. Although companies often spend a material portion of total compensation costs to provide benefits to their employees, they struggle at the corporate level to know what benefits they offer to reflect local market practices, how much they cost and what types of risks they pose to the enterprise. They also struggle with why, to what extent, and how corporate leaders and functions should get involved in local benefits-related decisions. Data from the 2012 Corporate Governance of Global Employee Benefits study of 140 North American- and European-based multinationals conducted by Aon Hewitt and the American Benefits Institute suggests that the business and benefits issues faced by multinational companies vary significantly for mature and emerging economies.

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INTRODUCTION

Effective corporate governance is considered vital for a company to manage its risks. What if one were to consider company-sponsored employee benefits as a fully owned subsidiary with a separate balance sheet and income statement? What value would such a company create in its own right for the shareholders? What governance is needed to ensure such value creation?

Corporate governance of employee benefits appears to be an increasingly important consideration for companies – largely because financial costs and risks of benefits have grown significantly in relation to the value they potentially create for the company.

In this article, we explore:

- what business- and benefits-related challenges multinational companies face in developed and

emerging markets, and the actions they take in response;

- how they make design, financial and operational policy decisions;
- how they organise themselves around the world to execute these decisions;
- the execution challenges they face; and
- the actions they have taken or will take over the next 2 years to improve the corporate oversight and control of employee benefit policies worldwide.

SUMMARY

Multinational companies operate in a diverse and dynamic environment in terms of geographies, operating units, customers and their employees around the world. Although companies often spend a material portion of total compensation costs to provide benefits to their employees, they struggle at the corporate level to know what benefits they offer to reflect local market practices, how much they cost and what types of risks they pose to the enterprise.

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They also struggle with why, to what extent, and how corporate leaders and functions should get involved in local benefits-related decisions.

Data from the 2012 Corporate Governance of Global Employee Benefits study of 140 North American- and European-based multinationals conducted by Aon Hewitt and the American Benefits Institute suggests that the business and benefits issues faced by multinational companies vary significantly for mature and emerging economies (see Figure 1).

Regardless of this, companies provide benefits largely to be market competitive. However, the costs and risks of sponsoring employee benefit plans are rising disproportionately to the business value that employee benefits may deliver to companies.

In fact, the financial costs and risks due to employee benefits are driving corporate involvement in local country benefits decisions more than for any other reason (such as the desire for a centralised operating model). However, most companies are not confident that they are exercising sufficient corporate oversight to reduce financial and operational costs and risks of their global benefits.

So why do companies struggle with getting their arms around their global benefits? We found that there is a direct correlation between the effectiveness of managing global benefits and five key measures of global benefits governance: (i) ready access to reliable information on benefit programmes worldwide, (ii) routine evaluation of risks and opportunities to manage these risks,

(iii) global benefits design, financial and operational policies to guide local benefits decisions, (iv) allocation of roles and responsibilities between global, regional and local functions to make and execute policy decisions and (v) protocols to report and monitor risks on an ongoing basis.

Companies that manage their global benefits using the above five measures gain higher rates of satisfaction with governance of their global benefit programmes and demonstrate higher confidence in managing financial and operational costs and risks more effectively.

THE TREND TO CENTRALISATION

More and more companies have moved towards a centralised operating model – and this trend is likely to continue in the future. In the aggregate, almost two-thirds of companies that participated in Aon Hewitt's governance study said they operate in a somewhat centralised manner today. Within the next 5 years, more than four out of five multinational companies expect that they will centralise their operations. In comparison, 5 years ago, only one in four companies operated in a centralised manner (Figure 2).

MANAGING GLOBAL BENEFITS

The trend to centralisation in companies' operating models is also reflected in the management of global benefit programmes; although there does not appear to be any discernible correlation between the centralisation

Figure 1: Select from the list below business- and benefits-related issues that your company is currently facing in mature and emerging markets (as defined in your company).

Figure 2: How centralised are the operations within your company and how has the level of centralisation evolved over time?

in operating model and how companies manage benefits. Most companies will move towards a more centralised approach to manage their benefits, which leads us to believe that companies see business value in doing so. However, the level of centralisation that has happened to date is largely driven by concerns around financial costs and risks of benefit plans.

Corporate and business leaders are facing financial and operational consequences of benefit decisions made several years, if not decades, ago when their operating environment was very different than what it is today. In mature markets, rising costs are also attributable to factors outside employers' controls, such as longevity improvements driving costs of traditional pension arrangements and medical cost inflation driving costs of providing medical coverage. At the same time, social coverage in mature markets is waning rapidly for much the same reasons, thereby increasing employees' dependence on benefits provided by their employers.

Therefore, it is no surprise that the costs and risks of employee benefits are the single biggest driver of corporate involvement in local country benefits decisions. Boards and senior management of companies also appear to be increasingly concerned.

Companies place greater emphasis on corporate oversight of benefits sponsored around the world

by costs and size of benefits obligations. However, significantly fewer companies are satisfied by the current level of corporate involvement in managing benefits outside the country where corporate headquarters are located (see Figure 3).

This lack of satisfaction also translates into low confidence levels in achieving certain measurable outcomes. Multinational companies do not appear confident that current corporate controls over global benefits are sufficient to ensure alignment of benefits with corporate strategy and achieve reductions in costs or risks of employee benefit plans.

Many companies – particularly larger multinationals with more than 25 000 employees worldwide – have corporate benefit policies of sorts to guide local benefit decisions, which cover at least some types of benefits such as defined benefit pension plans or medical plans. However, most companies often do not know if local benefit practices in fact align with these policies established by corporate functions. Similarly, more than 90 per cent of the companies that participated in the study were *not* confident that they have instituted adequate corporate controls that would lead to reduced financial and operational costs and risks. The challenges are more pronounced for smaller companies.

Companies with less than 25 000 employees do not always know what benefits they offer around

Figure 3: Importance and satisfaction levels of corporate oversight in international locations.

the world, have not formally (or informally) established corporate benefit policies and struggle with corporate oversight of their benefit programmes – largely because they lack the necessary resources.

So why do companies feel less confident that current levels of corporate involvement in local benefits decisions will adequately reduce the costs and risks of their global benefit programmes? Not all companies have corporate guidelines that are specific enough. For example, cost and risk budgets may not be apportioned by country and by benefit plan, which may lead to decisions being made by local operations that are not in line with corporate budgets, but centred instead around common practices and local benchmarks.

We found that many companies do not have formal structures and protocols, such as committees, formal corporate guidelines and policies, clarity of roles and responsibilities for decision making, and reporting and approval protocols.

There is indeed a strong correlation between the existence of such formal structures/protocols, and their effectiveness for execution. In other words, companies with informal or *ad hoc* protocols tend to say that they are not effective in executing their global benefits strategy.

That said, the existence of a formal structure in itself is not sufficient for managing global benefits. In fact, what is more important is how a company uses such a structure to manage benefits-related risk.

FIVE MEASURES OF GLOBAL GOVERNANCE – IT'S ALL ABOUT RISK!

It is clear that having a global benefits strategy in place is seldom sufficient for companies to manage their global benefits at the corporate level if there are no mechanisms in place to execute such a strategy. A more fundamental question, however, is why should companies establish a global benefits strategy? As rising costs and risks of benefit programmes are the primary drivers of corporate involvement, companies tend to control some design and financial decisions. This is a good start because these controls may limit the financial exposure that companies have to their benefit programmes. However, there are other organisational risks, such as local operations providing above market benefits to their employees without having a proper business rationale to justify a higher cost structure. Understanding *all* risks under design, financial

and operational policies and defining corporate policies that are specifically targeted to manage such risks is likely to be next evolution in managing global benefit programmes (see Figure 4).

Data, data, data!

Knowledge management remains the single biggest challenge in managing global benefit programmes. This is hardly surprising given the complexity of the operating environment for a multinational company highlighted by the numbers alone – such as the number of: countries of operations, business entities, business lines, corporate transactions (acquisitions and demergers), types of benefits offered to employees, and local regulations and labour agreements that apply to benefit programmes – the list is endless! Collecting this information at the corporate level from multiple sources is not an easy challenge to overcome. A few companies that use a web-based common technology

platform to collect and manage this information on a global scale often say that beyond collecting such data, keeping it current is equally important and can be very challenging. Regardless, using technology and improving discipline around its use is the only way companies can get their arms around their global benefits.

Opportunities and risks

How the benefit information ought to be used is in fact a more important question that companies need to answer, which is no easy task given the sheer volumes of data. We believe that companies ought really to collect information *only to the extent* necessary to understand the risks benefit programmes pose to the enterprise, and to make strategic decisions to manage these risks. There is in fact precedent to this approach: when there are financial reporting requirements that necessitate the collection of such information (think reporting of pension financials under

Figure 4: For each of the following, rate your organisation's current position as being more like description A (on the left) or B (on the right) today, as well as expected position within next 3 years.

international accounting standards), companies seem to do a better job of understanding their risks and managing them – particularly in countries of large operations. However, many companies do little to assess opportunities (and related risks) to align designs with their workforce strategy and cost budgets, optimising financing arrangements via scale, and improvements in operating models and global purchasing to reduce costs of operations.

Corporate policies

As we said earlier, at present corporate policies tend to largely focus on controlling design and financial decisions. For example, many companies require their local management and human resource functions to seek corporate approval when making changes to their benefit plans or when establishing new benefit plans. Hardly surprising if rising costs of traditional pension benefits and rising costs of providing medical coverage are a big concern for many. Similarly, corporate treasury is often required to provide input in local financial decisions. These controls are indeed helping companies manage some risks better. However, when asked, most companies say that such controls do not always work as they ought to, and that they continue to find instances when local benefit decisions are made without sufficient involvement from corporate functions or that they are involved in a last minute dash to approve decisions without having sufficient information for such approvals or truly understanding the implications of such decisions.

Local operations, on the other hand, say that corporate policies are not always clear or specific enough in helping them make good design, financial and operational decisions. They also say that there is little strategic context to inform their decision making when the only requirement is of corporate approval without sufficient clarity on when and how to seek such approvals. Finally such controls can often be viewed by local operations as a barrier to the decision-making process and for successful implementation when corporate functions are not able to dedicate the resources to work with local teams.

Governance structure

At a corporate level, governing benefit programmes is not only needed to meet local country fiduciary requirements, but rather should occupy a distinct corporate governance role. This ensures that decisions in relation to the design, financial and operational management of benefits are prudent and supported by suitable business rationales. This in turn minimises the development of business risks that may be disproportionate to the corporate value of the benefits. Corporate policies that guide such decisions need some form of formal (or informal) structure to ensure successful implementation given the complexities of an operating environment for a multinational company. There is no single best practice for a governance structure – this is because what works for one organisation may not work for another. As an example, a holding company with a portfolio of businesses that are responsible for delivering their own financial results may need a governance model that is very different from a company with centralised operations and a formal matrix structure with corporate and regional leadership spanning multiple businesses.

An appropriate governance structure for a company is best informed by the following:

- Which risks and opportunities related to design, financial and operational decisions, are important for a company to manage?
- Where, at corporate, regional and local levels, are they best managed?
- Who are the people, with appropriate skill sets, best suited to manage such risks?

Monitoring

Clearly, governing global benefits is not a one-time process. So *what* do companies monitor? This varies given that ready access to data is quite challenging. Many companies certainly manage well the reporting of pension financials under international accounting standards. Leading companies – that have begun to manage pension risks for some of their large pension plans – monitor progress against their risk management policies. This approach in fact can be extended if

corporate policies are articulated with sufficient clarity and specificity to cover design, financial management and operational decisions. The goal of such a process then would simply be to monitor risks of misalignment with corporate positions on programme design, financial cost/risk budgets and operational policies.

CONCLUSIONS

Given the complexities involved, it is not at all surprising that few companies are satisfied with the corporate oversight of their employee benefits worldwide. We believe that the desire for corporate oversight and control over local benefits decisions has increased relatively recently as costs and risks of benefits offered to employees have grown in the last decade – often due to factors that are outside employers' control.

Although the way in which a company manages its employee benefits fundamentally depends on factors such as how the company is structured to operate, the types of benefits it offers its employees, how much they cost and the risks they pose in relation to their risk profiles and cost/risk budgets, we do indeed see great advantages for multinational companies from some level of corporate governance of global benefits regardless of the level of centralisation:

- From a design perspective, although local relevance is important to delivering, corporate oversight of such decisions ensures alignment with companies' overall strategy.
- From a financial perspective, taking a global view of costs and risks of benefits may allow companies to allocate costs more effectively based on their business and talent needs, and allocate risk budgets more efficiently.
- From an operational perspective, multinational companies can in fact improve operational efficiencies and reduce the costs of benefits operations by leveraging their global scale than purchasing services as smaller individual operations in many of their worldwide locations.

Establishing corporate policies that are specifically targeted to managing risks and opportunities only to the extent they are important from a corporate perspective (and can be better managed at the corporate level), and implementing a formal governance structure designed solely to execute such policies will allow companies to allocate their resources (both internal and external) optimally and ensure specific outcomes in terms of improved alignment of benefit designs and reduced costs and risks due to benefit plans.