

How Flexible is Total Reward?

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1. Introduction

Over the last decade, as the external environment has become more turbulent, organisations have sought initiatives to ensure the recruitment and retention of a high quality workforce. Faced with this problem, many organisations have attempted to remedy it by simply offering increased pay. However, whilst this may provide some respite in the form of a short-term solution, this approach may not be delivering the best results. Instead, some organisations have turned to wider reward mechanisms. Total reward, as we shall see, does this embracing a whole range of mechanisms that aim to attract, retain and motivate staff. Flexible benefits offer a narrower means of offering choice to employees, but can allow a degree of tailoring the reward to fit their needs. This latter point is especially important as the workforce becomes more diverse in nature. What might be attractive to a married, middle-aged, white male is unlikely to be the same as someone younger, of different ethnic origin and marital status. This is especially so as there is greater and greater interest in work/life balance issues. Again, childcare help may central for some groups, eldercare for others or concierge services for a different population.

So, total reward and flexible benefits are in the limelight because organisations have rightly calculated that having a better understanding of what turns their employees on will bring benefits in recruitment and retention. Making employees a priority for the future is more likely to offer competitive advantage.

This paper will, firstly, outline the nature of total reward and flexible benefits. It will then describe how common such schemes are in the UK. Next, it will set out the reasons for introducing these remuneration initiatives. Common problems and obstacles will then be reviewed before looking at some practical questions. The concluding section will address some broader issues and the implications for reward management.

1.1 Total reward

The concept of total reward is based on the assumption that people work for more than money. As Zingheim and Schuster (2001) report, it is rare to find an organisation within the FTSE 100

that pays its employees more than less well performing organisations. Instead, high performing organisations offer, what they refer to as a '*better workforce deal*':

'In the better workforce deal the organisation and the employees meet halfway. The organisation invests in people and the people meet it by learning new skills and competencies and performing to reach organisational goals. It is a positive deal, where both are winners.'

While money is obviously an important part of reward, it is increasingly evident that it takes more than just cash to recruit and retain high quality employees. There is debate about how specific one should be about the content of total reward. The CIPD and practitioners tend to see total reward as a practical matter. E-reward, by contrast, talks about a philosophy, a set of principles a 'mindset' rather than a set of particular reward practices (IDS, 2003). Zingheim and Schuster (2001), in rather similar vein, suggest that the concept of total reward comprises four components:

1. **Compelling future:** Employees want to be able to draw self-esteem and satisfaction from working for a particular organisation. They want to feel that the organisation has a positive vision of the future and a set of values that they can support.
2. **Individual growth:** Employees want to have opportunities for training and development and the chance to apply it. Organisations need to provide meaningful training that will prepare employees to fill the roles that the organisation requires. Consequently, this implies a need for appraisal and feedback.
3. **Positive workplace:** Employees want to work in a pleasant environment. Roles and workplaces should be designed around employees, with a focus on facilitating their development. Employees need to feel that what they do is important and to understand how their role relates to the organisation's goals. This requires open communication.
4. **Total Pay:** Total pay comprises basic pay, performance-related pay, benefits, and recognition or feedback. Employees want total pay that is designed around their role and their needs. Some of the options available are basic pay to reward the employees continuing value; performance-related pay to emphasise results; benefits to provide protection from life and health hazards, in addition to holidays, recognition and feedback. Of all the elements that comprise total pay, recognition and benefits are best positioned to address individual need and preference. Flexible benefits offer individual choice and help with the flexibility required by a diverse workforce.

An organisation's total reward strategy describes the basic principles and scope for designing rewards across the

organisation. Zingheim and Schuster (1998) contend that senior management needs to give consideration to the following six reward principles as they develop their total reward strategy.

Create a positive and natural reward experience. Senior management need to be aware at the start of the process, of the importance of communicating and educating employees on how rewards are changing, and the advantages to the workforce and the organisation. Employees need to be involved in the whole process.

Align rewards with business goals to create a win-win partnership. There needs to be a win-win situation for both the organisation and employees. As employees contribute to the organisation in achieving its goals, those same employees need to share in its success. To encourage this win-win situation, senior management needs to ensure that employees have a clear direction and that they feel valued by receiving appropriate rewards.

Extend employees' line of sight. Engage employees in understanding how what they do affects and influences bottom-line results.

Integrate rewards. Be aware that different reward tools have very different outcomes and use each reward tool for what it does best. Take an overall perspective of not only money but also total rewards.

Reward employees' ongoing value with basic pay. Use basic pay to reward the skills and competencies needed by the organisation, the employee's consistent performance over time, and the employee's value relative to the labour market.

Reward results with performance-related pay. By rewarding employees based on results, performance-related pay creates stakeholderhood and a win-win relationship between the organisation and its employees.

The principles and the components of total reward are important in aligning reward with organisational strategy. The better the fit between the approach to total reward and the business strategy, the more likely that the reward scheme will be effective. As mentioned previously, organisations that are able to address individual need and preference in terms of total pay are more likely to attract and retain key employees. This is certainly the thinking behind the likes of PwC, the Nationwide Building Society and Norwich Union, that have been quoted as being proponents of total reward (IDS, 2003). Norwich Union, for example, describes three components of their total reward approach – 'performance', 'development' and 'a career framework'. Through these means, the company hopes to give greater attention to non-financial aspects of reward (IDS, 2003). This then can become part of the employer 'brand' to be used in recruitment.

1.2 Flexible benefits

1.2.1 Issues and definitions

A reward policy that has become increasingly popular in the UK is to provide employees with flexible benefits, that is, giving employees scope to make their own decisions about how their remuneration package is comprised. Flexible benefits, also referred to as *'cafeteria benefits'* or *'flex,'* typically allow employees to choose from a menu of optional benefits to suit their specific preferences and lifestyle requirements. A useful definition provided by Stredwick and Ellis (1998) is that:

'It is a formalised system that permits individual employees to influence the make-up of their pay and benefits package, so that they may select certain items and reject others to match their personal requirements.'

As opposed to giving employees a salary and fixed additional benefits that can either be taken or left, the basic concept is that an employee is given a package value and is able to select their benefits within pre-defined limits.

'Too often, companies will offer their staff benefits that they do not want or value as highly as others. Employers need to find out what their employees want, and tailor the benefits they offer accordingly. Employees cannot be treated as one homogeneous group, and good employers are increasingly going to want to fit benefits around the requirements of each of their individual employees.' (Aldred, 2001)

AstraZeneca define flexible benefits as:

'... the means by which individual employees can tailor their individual salary and benefits package to meet their individual needs within an agreed compensation cost.'

According to some commentators, there are two different types of flexible benefit schemes that organisations can offer (Lewis, 2002). The first of these is referred to as *'true flexible benefits,'* which include goods and services that are paid for by the organisation. The second type are known as *'voluntary benefits,'* in which employees are presented with a variety of discounted goods or services for which they pay themselves, for example, holiday discounts and cheap CDs. This approach is often criticised for being a kind of half-way house for those organisations that are not yet ready to move to true flexible benefits, or even further, for being at the *'grotty end of the flex market'* (Lewis, 2002). Voluntary benefit schemes do not really offer flexibility at all, but they may sit alongside flexible benefit schemes as an additional offering.

Flexible benefit schemes should ideally cover a comprehensive range of benefits. These might include work-life benefits, especially various forms of leave or work breaks; convenience benefits, such as concierge services or shopping vouchers; lifestyle

benefits like gym membership; status related benefits, particularly company cars and more traditional protective benefits including, insurance and pension contributions. How one classifies the offer of free fruit is not obvious!

A popular option is for organisations to provide flexibility in terms of holiday, allowing employees to exchange annual leave for other benefits within the scheme. In the minimalist versions, this might only entail a salary 'sacrifice' of accepting a lower pay for more holiday, or vice versa. For the vast majority of organisations, employees are forced to preserve certain core benefits. These typically include minimum pension provision, life assurance, personal accident insurance, permanent health insurance and 20 days holiday. These basic benefits continue to apply to all employees to ensure that no employee reduces their benefits to below a safe level.

Another area that has become increasingly prominent is employee share ownership or profit-driven bonuses, though not necessarily as part of a flexible benefits' scheme.

'The linking of elements of employee' remuneration to their company's financial performance, through profit-related pay and share schemes, is gradually becoming more widespread and is increasing to the extent that people are now sharing their employer's risk.' (Hay Group, 2000)

Research by Hay Group (2000) reports that 53 per cent of the 136 UK organisations surveyed in its annual survey of employee benefits offered some kind of long-term incentive scheme. The UK government is introducing a highly tax-efficient 'All Employee Share Ownership Plan' to encourage employees to hold shares in the organisation. This is providing a great opportunity for organisations to overhaul existing reward strategies in order to promote and improve employee engagement. Although it also has to be said that companies interest in profit sharing and share ownership schemes has tended to wax and wane with the tax regime in place at the time (Reilly, Cummings and Bevan, 2001).

1.2.2 Flexible benefits and total reward

With reference to the four components of total reward suggested by Zingheim and Schuster (2001), the notion of flexible benefits falls mostly within the total pay component. In relation to this, many organisations typically think of reward only in terms of tangible benefits, such as those which comprise flexible benefit schemes. By comparison, the concept of total reward is much more comprehensive, it considers reward both in terms of tangible benefits and those which are much less evident.

For example, Alberton (2000) argues that although most large organisations have always offered training to employees (at considerable expense), the broad area of learning and development has not traditionally been considered a reward.

However, with organisations requiring a steady supply of new skills and employees wanting to ensure continuing employability, viewing development as a reward is becoming more important. In a related vein, Abbott (2003) cites findings from Watson Wyatt's 2002/2003 *Top Performing Employees Survey* that shows that employees consistently ranked career opportunities and work-life balance initiatives far ahead of tangible benefits.

Some would argue that the notion of total reward is also more concerned with the relationship between an organisation's reward strategy and its business objectives. In an empirical investigation by Towers Perrin (2000), managers were asked to rate the strength of association between various benefits and organisational strategy. Overall, it was found that there were strong relationships for learning and development/career opportunities (mentioned by 38 per cent of the managers), followed by leadership development (33 per cent), recognition (31 per cent), and work-life balance initiatives (16 per cent). In contrast, strong relationships between organisational strategy and healthcare benefits were mentioned by 60 per cent of managers, as was the relationship for savings plans, also 60 per cent. This suggests that many managers do not currently realise the importance of alignment. Alberton (2000) agrees, arguing that many organisations pay lip service to the notion of alignment. Only a handful take the necessary steps to ensure that their reward strategy is linked to organisational goals:

'Implementing a rewards strategy without considering its impact on the business may prove to be counterproductive and a waste of resources.' (Alberton, 2000)

Alignment not only has to be vertical in linking to the business strategy, it also has to be horizontal in connecting to other aspects of the HR strategy. In other words, the approach to remuneration has to be consistent with the approach to training and development, to resourcing, to employee relations, *etc.* The total reward concept sets out to make these links, especially to development, because its aim is to take a holistic view of employee recognition and motivation. Flexible benefits may relate to recruitment and retention objectives, yet it may be in reality positioned within the organisation as simply another pay device trying to get a *bigger bang for one's buck!* There may not be any broader attempt at greater employee engagement or participation.

Lynda Gratton (2003) has recently reminded us that there is a *third dimension* to alignment: implementation. It is all very well aligning HR policies with the business strategy or having an internally coherent programme of people management, but theory has to be translated into practice. If the delivery is good, the policy will be effective. However sophisticated the initiative, if it is not properly implemented, it will fail.

2. Prevalence of Flexible Benefits

There is no evidence on the take-up of the total reward concept. One suspects that the concept of total reward is still a long way off in practice for most organisations. They may address the different components that make up total reward, but not integrate them in an effective and systematic way. In particular, learning and development are not necessarily seen as a reward and valued as such (not least because of the difficulties of quantifying the benefits), especially as these will vary from individual to individual.

Earlier research done on the extent of the usage of flexible benefits tended to suggest that it was more talked about than done. Administrative complexity was always seen to be an obstacle to implementation. This was partly because of the cost of delivering choice to employees, but partly because of the time taken up by HR staff in managing the activity. Nowadays, technological innovation has facilitated flexible benefit schemes. A number of consultants now offer various packages that ease the process and which make good use of IT. Computer technology is now capable of handling the complex decision-making processes involved in flexible benefits and at a reasonable cost (Johnson, 1996). HR staff may be involved in scheme design, but the operation may be in the hands of employees themselves. The application of flexible benefits has been a key feature of employee self service. In addition, there are a number of outsource providers that are keen to remove the burden of both design and operation from HR departments – at a price!

Various surveys have been conducted to elicit the rate of uptake of flexible benefits by organisations. A summary of the most recent findings is given below. Although there is a variation in the figures presented here, there is a general consensus regarding two aspects. Firstly, organisations now have a heightened awareness of flexible benefits. Secondly, although the desire for such schemes continues to be high, the likelihood of the floodgates opening remains low. It appears that there will be a slow, but continuous, increase in the number of organisations implementing flexible benefit schemes in the immediate future. As Thompson and Milsome put it in their 2001 review of reward practice:

'Flex is still somewhat at the margins of mainstream benefit practice, although take-up appears to be gathering pace. But despite the hype, flexible benefits remain far from universal.'

Lewis (2002) argues that between five and ten per cent of organisations currently have formal schemes in place. However, the research suggests that between 50 and 60 per cent of UK organisations are actively looking at introducing flexible benefits over the next few years.

IRS Employment Review's annual *Pay Prospects Survey* (2002) indicates that for the past two years, flexible benefits has topped the agenda for organisations considering changes to their reward systems. The survey reports that 24 per cent of organisations surveyed reported that they have either already introduced, or are considering introducing flexible benefits over the next 12 months.

The *Employee Benefits Research Supplement* (2002) reports, in a survey of 282 UK organisations, that just nine per cent have adopted a flexible benefits scheme.

Take-up of flexible benefits is almost certainly biased towards the private sector and then towards financial services. Companies in this environment are more likely to offer a range of benefits that can be flexed. In the public sector, there are likely to be fewer benefits (eg private medical insurance is not available on principle in government departments) and ones of a more fixed nature (eg the defined benefit pension scheme). Moreover, the technological infrastructure that facilitates employee choice may be missing in a large number of organisations.

There is also the question of how many of the flexible benefit schemes are truly that. In 2001 it was estimated, for example, that there were only 200 'fully-fledged' schemes in operation in the UK (Thompson and Milsome, 2001).

3. Drivers of Flexible Benefits

Organisations give many and varied reasons for introducing flexible benefits. The principal reasons are as follows:

- recruitment and retention needs
- legislative and social pressures
- cost-cutting requirements
- organisational alignment
- response to mergers and acquisitions
- pay harmonisation
- generating employee understanding.

3.1.1 Recruitment and retention needs

Without question, the primary reason most organisations give for implementing flexible benefits concerns recruitment and retention. A survey by Hewitt Associates (2001) revealed that over one-third of organisations believe that flexible benefits play an important role in recruiting and retaining employees. Indeed, Higginbottom (2001) cites a survey of 300 organisations conducted by the recruitment agency Office Angels which demonstrated that over 50 per cent of employees would prefer flexible benefits to a pay rise or promotion. There is evidence that giving employees the chance to tailor their own package improves retention and facilitates a better understanding of the cash value of the benefits they receive.

For example, How (1998) reports that a pre-flexible benefits employee survey found that only 53 per cent of employees were satisfied with their fixed benefit package. But in the first year after flexible benefits had been introduced, employee satisfaction increased to over 70 per cent.

'For many organisations the decision to implement flexible benefits has led to lower recruitment costs, improved employee satisfaction and increased retention.' (How, 1998)

Osborn-Jones (2001) concludes that the traditional psychological contract has been replaced by a complex mix of values, attitudes to employment and benefits. Offering more money to employees

no longer ensures success in attracting the right people because just offering more money is too easily matched (or even bettered) by competing organisations. Moreover, the needs and aspirations of younger employees are impacting on the recruitment and retention strategies of many organisations (Kent, 2001). The number of 16 to 25 year-olds in the UK has dropped significantly over the past 25 years. Organisations are facing increasing competition in recruitment and need to find new ways of recruiting and retaining key employees. Flexible benefits is one of the options they can use. For example, graduates may perceive an employer without flexible benefits as second rate. Certainly, How (1998) argues that the increase in flexible benefit usage may simply be a result of companies offering flexible benefits to remain at the cutting edge of recruitment practice.

The Royal Bank of Scotland set out in 1997 to improve its reward system in a bid to strengthen its employer brand in order to attract and retain key staff. In October 1998 they launched RBSelect, a flexible benefits scheme giving employees a wide choice of benefits and a great deal of flexibility in how they allocate the overall value of their package. (Blackman, 1999)

3.1.2 Legislative and social pressures

There is a large overlap between flexible benefits and family-friendly policies, for example, child-care vouchers, workplace nurseries, or buying and selling holiday entitlement. Currently, there is a certain amount of legislative pressure being applied to organisations to provide better work-life balance options for employees. This reflects a changing social context. Flexible benefits can allow employees to react to changing family circumstances, be they marriage, divorce, childbirth, house move, *etc.* With a more diverse workforce and greater social change the order of the day, the concept of flexible benefits aligns well with the current social environment.

However, Willmott (2003) argues that organisations are not buying into the family-friendly attitude espoused by the current government. In a detailed survey of over 1,000 organisations and advisers, it was found that most organisations offer the bare minimum of work-life balance policies, and the majority do not expect that their employees will want to take up their full statutory rights. Moreover, Willmott highlights the fact that many organisations are inadequately prepared to deal with the immediate impact of the changes in maternity, paternity and flexible working rules that have recently been introduced.

3.1.3 Cost cutting requirements

Many organisations perceive a strong financial incentive for implementing flexible benefits. Schuster and Zingheim (1992) thought that one of the principal drivers for a *new reward* strategy

on employee benefits (which they called 'indirect pay') was to cut costs. They acknowledged that this might sit alongside what could be a contrary driver of meeting employee needs in order to attract and retain staff (as covered above) and alongside the requirement to gain greater alignment between organisational goals and reward goals (dealt with below). They spoke of benefit flexibility as offering 'not only patterning choices to match employee preferences, but also containing indirect pay costs' (1992).

Although offering flexible benefits is no longer as tax-efficient a strategy as it once was, it still provides an opportunity to make some savings (eg a salary sacrifice to increase holidays reduces employer National Insurance charges), and review costs. By providing an allowance per employee, organisations are in a better position to predict and control their benefit costs. Moving to flexible benefits may provide the opportunity to shift from a defined benefit plan (a potentially open-ended financial agreement) to a defined contribution plan. Defined benefit plans usually cost the organisation about 18 per cent of an employee's salary, as opposed to a defined contribution plan that typically costs ten per cent. Whilst Additional Voluntary Contributions (AVCs) allow enhancements to defined benefit plans, in a flexible benefits' scheme more choice can be provided in the funding of a defined contribution arrangement.

Similarly, Das (2002) notes how flexible benefits can also save money by capping costs. Typically, the cost of benefits can fluctuate, so organisations do not have control over costs. With flexible benefits, however, organisations can establish benefits as a percentage of salary. The cost of benefits may fluctuate, but the risk of cost rises pass to employees.

Organisations can also use their corporate buying power to attract discounted rates for items covered within a benefits scheme. So, for example, employees may benefit by choosing gym membership at a discounted rate within the flexible benefits scheme, rather than taking the value in the form of a higher salary and then joining the same gym independently. Similar employee benefits arise when organisations are in a position to offer a not-for-profit service, such as childcare facilities or cheap loans within a flexible benefits scheme.

In addition, more subversive flexible benefits schemes can also be used to lower the paybill. For example, organisations can price particular benefits so cheaply that they are irresistible to employees, or highlight the most cost effective benefits in total reward statements to put them into the forefront of employee's minds. Over the years small changes like these can have a considerable impact.

One of the largest misconceptions organisations have about total reward is that they think it involves adding more reward elements

as opposed to reorganising them in a more efficient way. Organisations need to be aware that they can strengthen their reward strategies without necessarily increasing their overall investment:

'It's largely a matter of reallocating resources, rather than finding more resources.' (Towers Perrin, 2000)

This may be because expensive benefits can be curtailed in exchange for greater flexibility. Thus, a flexible benefits system might allow the reduction of 'excessive' holiday entitlement or the removal of 'over-generous' pensionable allowances, as either the *quid pro quo* for the introduction of the scheme itself or in the design of the core benefits.

3.1.4 Organisational alignment

A move to flexible benefits is congruent with many HR strategies that are aimed to create more fluid and responsive organisations. This is the Schuster and Zingheim new pay (1992) argument. If organisations are to prosper in a world of increased competition and change, reward needs to be more flexible. It should adapt to changing business circumstances. Traditional benefits' packages, they regarded as too fixed as entitlements and too determined by length of service. They argued for benefit plans to both co-ordinate with other elements of remuneration and to get employees to 'focus on the strategy and tactics of their organisation' (1992).

Flexible benefits can both enhance and emphasise the flexibility of an organisation to change. The implementation of flexible benefits demonstrates to employees that different employees within an organisation have different needs. It reinforces the sense that differentiation in reward is legitimate. This concept can then be more successfully extended to performance driven elements in reward, including in benefits' provision.

Some organisations have suggested that the very fact of having to decide how to best compile their flexible benefits package promotes decision-making skills in employees. It certainly can improve their participation in organisational affairs and even engagement in its activities.

3.1.5 Response to mergers and acquisitions

Mergers and acquisitions also provide a significant business case to introduce flexible benefits. When two benefit environments are coming together in one organisation, flexible benefits are a good way to achieve '*benefit harmonisation*' (How, 1998). Benefits costs can be minimised by valuing the different remuneration packages and fixing values before the merger. Employees are then given the opportunity to choose their benefits within a flexible benefit scheme. This ensures that all employees are rewarded fairly.

When companies merge or form partnerships there are usually differences in benefits. It can be hard to keep someone motivated when they are sitting next to someone with extra holiday entitlement. Flexible benefits can help with that integration, as well as working as a good retaining instrument.' (Kent, 2001)

AstraZeneca's drive to introduce 'Advantage', its flexible benefits reward package, was the merger between Astra and Zeneca. There was a requirement to bring together ex-Astra and ex-Zeneca employment conditions. For management, this had to be done:

- quickly
- in an industry leading way
- that protected 'legacy' entitlements
- with minimal cost.

3.1.6 Pay harmonisation

The extension of benefits may be driven by a desire to create a 'single status' situation where all employees, irrespective of grade, are remunerated on the same terms. Organisations do this to signal that everyone is 'in the same boat, pulling together in the same direction'. It may be promoted in unionised organisations to weaken trade union power or it might be aimed at increasing employee commitment to and alignment with the goals of the organisation.

In practical terms, harmonisation may be made easier through flexible benefits in the same way as in a merger. It allows different sets of terms and conditions to be combined in a cost efficient way. As indicated earlier, the flexibility element also encourages employees to see the need for adaptability in remuneration, and the element of choice reduces the collectivist dimension to remuneration and emphasises the individual.

3.1.7 Generating employee understanding

A clear driver for flexible benefits is to generate a better understanding in the workforce of the high value of benefits provision. Thompson and Milsome (2001) point to two surveys that illustrate the problem. In one Towers Perrin survey, employees estimated the cost of benefit provision to be less than 20 per cent of pay, when in fact it typically represents 30 to 40 per cent. In another survey done by Hogg Robinson and the Prudential, it was estimated that 4.8 million employees covered by group life assurance were unaware of this benefit. This ignorance was not untypical of the benefits on offer.

To counter this situation some organisations have developed 'Total Reward Statements'. They typically include a summary of the benefits provided, an outline of the annual costs and a graphic display of the various components of an employee's total rewards.

Each total reward statement is personalised and, in a flexible benefits environment, can describe the individual choices made.

Statements can be a cost effective way of highlighting the major provisions of an organisation's reward scheme so that employees can have a better understanding and appreciation of their specific benefits and compensation provided to them. It can also communicate the significant cost to the organisation each year to provide these schemes. With benefits relating to share price, there can be an educative process in encouraging the realisation that the value of the company fluctuates in line with stock market prices.

Yorkshire Water was one of the first organisations to introduce total reward statements as part of its retention strategy. It was a move to be more open and transparent about the rewards and benefits they offer. The annual statement lists how much the employee receives in benefits and pension contributions and also details of other benefits. (*People Management, 2002*)

HSBC also produces total reward statements that distinguish between cash and non-cash benefits. Again transparency is the avowed driver of their production. They also detail share holdings and options. Cash and non-cash benefits are totalled separately and together and the full value is expressed as a percentage of basic salary. The share scheme elements show profit at the time of the valuation.

It would be wrong to assume that it is just lower-level employees who need to realise the total sum of their benefits. Line managers too often underestimate what is already offered to employees. This becomes apparent in recruitment and retention discussions. Managers may claim that their staff are underpaid by comparison with the competition, by focusing only on the basic salary, forgetting the importance of the benefits package.

Table 1 highlights data from a large-scale survey regarding the reasons why flexible benefits are introduced.

Table 1: Drivers of implementing flexible benefits

Driver	% of organisations
Meeting the diverse needs of employees	16.9
Helping retention	18.9
Increasing employee understanding of total reward	17.7
Helping recruitment	15.0
Containing future benefit cost increases	8.4
Harmonising total reward arrangements	7.7
Removing/reducing status symbols	2.9
Reducing the total cost of rewards	1.6

Source: Hewitt Associates (2001)

Centrica introduced flexible benefits to:

- establish common employment terms
- move towards a modern employment 'prospect'
- break down cultural barriers
- enhance staff choice and appreciation of benefits
- support the attraction and retention of high quality employees
- enhance employee satisfaction by recognising different lifestyles

4. Practical Issues

4.1 Planning and design

4.1.1 Strategic alignment

To implement a flexible benefits scheme, senior management must first understand what they want to achieve at a strategic level. For example, how would implementing flexible benefits influence issues such as recruitment, retention, and the organisation's ability to remain competitive? And how would it encourage certain behaviours and discourage others? Moreover, what proportion of the paybill ought to be spent on benefits as opposed to basic or variable pay? This insight should inform the decisions made about the design of the scheme.

The reach of the scheme also needs to be determined, that is, whether the scheme will apply to all employees or just specific groups of employees. The coverage of the scheme will depend upon the extent to which the organisation wants to introduce flexible benefits as a means of conveying that all employees are equally valuable, or to provide recruitment and retention incentives for key employees. The development of flexible benefits can be part of a drive to harmonise terms and conditions, or, conversely, as a means of differentiation by grade, or even possibly by performance.

4.1.2 Benefits on offer

This question can be viewed from different ends of the proverbial telescope. The organisation might decide on the basis of its strategic discussion above, what are the benefits that should be offered that will meet its business objectives in a cost effective way. The alternative perspective is to decide what will meet employee needs.

Which direction the organisation is coming from will impact on the benefits offered. Some organisations make the full range of benefits available to all groups of staff. This is particularly true where there has been an attempt to harmonise terms and conditions, or where the scheme is being promoted as demonstrating a commonality of interest in the organisation.

However, some benefits may be reserved for higher-graded staff (eg company cars) either for status or cost control reasons. Here the business need is the stronger driver.

In fact, it seems that, at least of late, most firms interested in flexible benefits have emphasised employee need rather than business requirement. This is no doubt a reflection of a tight labour market and growing emphasis on the requirement to attract and retain in the 'war for talent'. It also reflects the wider driver of demonstrating that the organisation is aware of work/life balance questions.

If the latter approach is taken, it is a good idea to conduct employee focus groups and/or surveys with employees in order to find out what they like about their existing scheme, and what they might like to see in a flexible benefits scheme. So this is partly establishing the range of benefits to be presented and partly about being aware of what items employees think should be open to flexing. This feeds into the next point.

To find out how employees felt, The Royal Bank of Scotland commissioned Hewitt Associates to conduct focus groups with their delivery among staff in London, Edinburgh and Manchester. Employees were also asked to complete questionnaires. A critical element of the review was a series of interviews with managers, in order to gain their strategic input and to secure their backing for the scheme. (Blackwell, 1999)

4.1.3 Benefits to flex

The next key decision is which benefits will remain core and which will be flexed. Practice seems to vary enormously, not least because the initial benefits on offer vary to a great extent.

The Work Foundation survey on flexible benefits (2000), in a study of nearly 300 HR and personnel professionals, reports that the benefits most often offered to flex were healthcare, extra holidays and company cars. Some organisations would also include life or medical insurance, share options, childcare vouchers and gym membership.

Lloyds TSB's (Employee Benefits, 2002) flexible benefits scheme allows a cash allowance of four per cent of basic salary, which employees can take as cash, or spend in the flexible benefits scheme. They can also buy benefits with up to 50 per cent of their salary. Flexible benefits are divided into three categories:

- health and well-being
- leisure and lifestyle
- protecting your future

AstraZeneca's flexible benefits plan, 'Advantage' offers:

- lifestyle options: nine choices
- health options: two choices
- financial options: three choices
- protection options: four choices

More recently, RebusHR (2002) found that the benefits most likely to be added to existing schemes in the future are:

- retail vouchers
- childcare vouchers
- financial advice
- healthcare benefits
- legal expenses
- personal insurance and travel insurance.

In this study, administrative workload did not appear to be a serious consideration in terms of which benefits were offered, and there was no relationship between the difficulty in administering particular benefits and their popularity.

Table 2 opposite shows data from three different surveys illustrating the most common benefits to flex.

The top ten benefits in Centrica's scheme are:

1. extending private medical insurance to partner/family
2. additional holiday
3. critical illness insurance
4. retail vouchers
5. life assurance
6. dental insurance
7. AA membership
8. AVCs
9. tax advice
10. childcare vouchers

Table 2: Most common benefits to flex (per cent)

Type of Benefit	(RebusHR)	(Employee Benefits)	(Hewitt Assoc.)
Private medical insurance	90	—	80.3
Holidays	83	28	75.3
Season-ticket loan	—	68	—
Life assurance	83	—	—
Pension scheme	75	—	—
Health screening	63	—	59.2
Dental insurance	63	56	74.0
Critical illness insurance	63	—	59.1
Permanent health insurance	63	48	—
Home insurance	—	56	—
Company cars	60	40	70.3
Pensions (AVCs)	60	32	—
Personal accident insurance	58	—	—
Childcare vouchers/allowance	55	24	—
Leisure club membership	50	24	—
Travel insurance	45	—	—
Dependant's pension on death in service	45	28	—
Financial counselling	40	44	—
Share options	—	40	—
Training allowance	30	—	—
Retail vouchers	28	32	—
Private car leasing	25	—	—
Health cash benefits	20	—	—
Legal expenses insurance	10	—	—

Source: RebusHR (2002); Employee Benefits magazine (2002); Hewitt Associates (2001).

4.2 Establishing the cost

Even if the organisation has taken the conscious decision to align benefit provision with employees' wishes, there is still an imperative to control costs. The issue of how much to spend per employee is critical in deciding what should be included in the flex scheme. Estimating what the take-up of the benefits will be is another aspect in the cost equation which needs to be considered.

How (1998) illustrates the importance of thinking about costs up front:

'Clearly performing a detailed cost analysis is crucial – and may yield surprising results. One organisation eventually decided against including holidays on its flex scheme, when it discovered that such a move would expose it to a £3m additional cost. Many of the firm's employees, who had fallen into the habit of not taking their full holiday entitlement, had not been claiming payment in lieu.'

4.2.1 Pricing the benefits and estimating take-up

A crucial aspect of implementing flexible benefits is giving each benefit a value, *ie* setting the price tags. A key question organisations need to consider is whether they want to price the benefits neutrally or price them slightly higher to cover the costs of administration until the scheme gets on its feet. Or put another way, should the organisation or the employee pay for the cost of implementation?

As mentioned previously, organisations can also price particular benefits in such a way that they will be more or less attractive to employees. This can be an effective tool in helping to estimate the take-up of the various benefits. In relation to this, How (1998) notes how it difficult to know, before the scheme is implemented, what the take-up and hence cost of various benefits will be. Although focus groups or surveys can help, financial estimates might rely on guesswork in estimating how many employees will take which options:

'The problem arises when giving people choice where choices can influence the absolute cost.' (How, 1998)

Another approach is to pilot a new flexible benefit scheme in a particular business unit or location before rolling the scheme out to the rest of the organisation.

Centrica piloted their flex scheme in their credit card Goldfish business. This had the advantage that it was a new company where employees did not have the baggage of historical terms and conditions of employment. Moreover, the workforce was young and enthusiastic for flexible benefits.

O'Farrell (2000) suggests that the most effective way of designing and pricing benefits is to take into account two factors: Firstly, demographic data that shows the relationship between population characteristics and typical employee choices; and secondly, data concerning previous patterns of choice for employees or a similar group. Looking at the demographics of the employees within an organisation can help to forecast which benefits may be more popular. For example, younger employees with few commitments may choose to get rid of dependants' benefits and take more pay or holidays, whereas employees with families are more likely to choose childcare benefits or better medical insurance.

Taking into account the various factors concerning pricing and take-up, statistical modelling techniques can be conducted to see the financial impact of a range of pricing options and take-up rates. These exercises may not be simple, as there are certain psychological considerations to bear in mind when designing options and pricing benefits:

'Experience shows that over-pricing options in relation to their true actuarial value promotes unnecessary use. Employees who are being over-charged take the view that "I've paid for it and, by George, I'm going to use it".' (O'Farrell, 2000)

AstraZeneca found that phasing the introduction of their flexible benefit scheme helped with the integration of the process, allowed understanding of it to develop and gave time to 'build the brand'. Moreover, given that it is critical to have clean data on your HR information system, phasing gives you the opportunity to get this right.

4.3 Monitoring and evaluation

One of the most important parts of the implementation process is reviewing the scheme to see if it has had the desired effect. This can be done at a number of levels:

- Has the scheme met its strategic objectives?
 - Has recruitment and retention improved?
 - Has it changed employee behaviour?
 - Is there evidence of incentivisation?
- Has the scheme stayed within budget?
- Which benefits have been popular and which have not?
- What degree of flexing has there been?

A newly implemented scheme should be given time to settle as it may take a while for the advantages about a particular benefit to spread across the organisation. Many employees will sit back and watch their colleagues test out particular choices before they opt for those choices themselves. So this evaluation might need to wait for a year of operation before being undertaken.

Meanwhile, organisations should monitor the extent of take-up and the benefit items that seem popular. Analysis should look at differences by grade, gender, ethnicity and occupational group. This will help identify where the scheme is hitting the mark, and where it is missing its target. Of course, the cost of the scheme needs to be carefully monitored and a check made on whether design assumptions are borne out.

5. Common Problems and Obstacles

5.1 Issues surrounding implementation

5.1.1 Contractual arrangements

When considering flexible benefits, it is critical for organisations to read the small print of policies and clarify exactly what a benefit entitles their employees to receive. The reason for this is that many organisations cannot rely on individual employees to do this for themselves. If things go wrong, a poor benefit can reflect very badly on the organisation. In addition, as employees should have the permission to review and change their choices annually, it is very important that contracts run on an annual basis.

5.1.2 Communication to employees

Poor communication is the principal reason why so many new benefits schemes run into trouble. Many organisations do not communicate enough, if any, benefits information to employees. As we described earlier, many employees never have a realistic idea of the true value of their benefits and who is footing the bill. Hence the interest in *'Total Reward Statements'*.

Employees also need to understand the basic mechanics of the benefits plan and how it operates. Although many employees are generally enthusiastic about being able to flex their benefits, some employees may show a significant amount of resistance.

The means of communication will depend on the specific situation of each employee. Many shopfloor workers, for example, do not have intranet access if the organisation is concentrating on an intranet campaign. Various other options exist: posters, mailing information with pay-slips, individual briefings and seminars. Organisations must also consider providing access to independent financial advisors or helplines to provide more detailed advice for employees.

The Royal Bank of Scotland's RBSelect requires much thought on the employees' part in making their selection. Employees were sent a 35-page booklet to help them with their calculations. They also produced a video explaining the scheme, while the internal television network provided briefings and bulletins. (Blackwell, 1999).

5.1.3 Valuation of benefits

Total reward statements seem straightforward enough, but practitioners still have difficult decisions to make. Is the value of the benefit stated in terms of the advantage it offers the employee or the cost to the organisation of providing the benefit? Usually, the former is chosen because the latter is a lower figure (partly because organisations can bulk purchase benefits). However, employees may put a different valuation on a benefit depending upon their personal circumstances. This might be age related (pensions loom larger in importance the closer retirement comes), be affected by the benefits enjoyed by a spouse (this might produce a duplication of benefits) or by say the state of individual health (making insurance or sick pay provision a priority for some employees and not others). In summary, employees or their representatives may dispute the corporate valuation, negating the objective of gaining greater acceptance of the worth of benefits and, in extreme cases, affecting the legitimacy of the way benefits are flexed.

5.1.4 Cultural dynamics

It is important to bear in mind the cultural dynamics that can result from moving to flexible benefits. For example, if an organisation decides to make holidays flexible, allowing people to swap annual leave for pay, they must consider that sickness absence rates may go up.

Another implication is that choosing flexible benefits will divert employee attention from their day-to-day work. There is evidence from the USA that this can occur: staff spend too much time looking at their benefits package on the corporate intranet. This problem is less likely to occur in the UK, largely because of the different benefit arrangements. Also, if options can only be made on an annual basis, this will limit employee interest in playing with their benefit plans.

On a more positive note, organisations have found that they can engage employee families more in the employment deal through flexible benefits. This might naturally occur because of the choices that had to be made have a family impact (say more leave versus healthcare insurance), but organisations can encourage this process. Some organisations do this by sending benefit statements to home addresses or by posting details on the Internet (rather than intranet) so that they can be read at home.

5.1.5 Specific problematic items

There are some benefits that are much more difficult to get right. This may be in design or in execution. In the RebusHR study (2002), it emerged that benefits which cause the most problems were:

- company cars
- holidays
- gym membership
- training and development allowances
- childcare vouchers
- pension schemes
- financial advice
- retail vouchers.

Without further information, it is not easy to know what the difficulties might be. Speculating, company cars are notoriously difficult to manage, as are pension schemes. For the rest, it is hard to know whether it is getting the right provider, determining the degree of flex, or administrative issues that are providing the problems. Interestingly, the least problematic benefits to manage were considered to be: personal accident insurance, private car leasing, health cash benefits and dental insurance.

5.2 Fears of administrative burden

One of the most common drawbacks given is the administrative burden, or the fear of an administrative burden. Implementation can be an elaborate procedure, especially at the start of the scheme. Employee Benefits Research Supplement (2002) illustrates the results of a survey in which the perceived barriers to introducing flexible benefits were assessed. The results reveal that the vast majority of organisations (71 per cent) say they would be concerned about the readiness of their current administration systems, while 76 per cent were worried about the complexity of administration. However, for organisations that had implemented flexible benefits, 64 per cent said it was straightforward or simple, while only one organisation found it extremely difficult. Thirty-two per cent said it was quite difficult. The interesting point to note is that the Employee Benefits survey of two years before came up with almost the same proportion of organisations expressing identical concerns, and that the authors again made the point that 'these problems were more imagined than real' (Employee Benefits, 2000). This raises the question of whether it is purely misconception of the difficulties on the part of those organisations that have not introduced flexible benefits, or that the problems are real enough, which is precisely why they have not proceeded. The principal obstacle may be the quality of the technological infrastructure. With a decent system, administrative concerns may indeed be groundless. Without a decent system, the concerns are probably justified.

The cost of implementation can also be high, and many organisations are reluctant to introduce a scheme that has no

immediate bottom-line benefits. Indeed, the Work Foundation report on flexible benefits (2000), in a survey of nearly 300 HR and personnel professionals, found that more than 50 per cent of respondents reported that flexible benefits schemes were costly to administer, and some said they were difficult to manage.

5.3 Trade union concerns

Ball (2003) notes that although unions usually welcome a reward scheme that addresses employees' needs, problems mainly arise in situations where the organisation wants to sign up to a new deal that better fits its business strategy: that is, where employees may gain some benefits, but possibly lose others. This clearly happens when part of the business strategy is to reduce, or contain costs. It might also be the consequence of trying to harmonise terms and conditions.

In addition, asking employees to be more flexible about working hours can be a particularly sensitive area, because some employees are unwilling or unable to accept higher tangible reward where it is offered as a substitute. Typically, employees lower down the organisational hierarchy are the ones who can least afford to buy services that put extra time into their life. Many need their basic pay just to cover bills. Childcare and retail vouchers are good examples where flexible benefits can still leverage the package of employees in this group. In some cases it may not make sense for the lower paid to join flexible benefits schemes, although voluntary benefits may be better suited to employees such as these.

5.4 How much choice are employees really offered?

In Hewitt Associates' survey (2001), 92 per cent of organisations that offered flexible benefits thought that it offered enough choice. Asked the question *'What's in it for the employee?'* Many organisations would give a very positive response. Indeed, much research suggests that flexible benefit schemes are highly regarded by employees and have a number of real advantages (Stredwick and Ellis, 1998):

- Younger employees with few commitments can choose benefits to suit their lifestyles. For example, to enhance their car, get rid of some of their dependent benefits or take more pay or holidays.
- Employees with families can choose childcare benefits and better medical insurance.
- Older employees can choose higher pension contributions and get rid of dependent benefits.
- Employees whose spouses are already covered for medical insurance will not choose this item.

- Allowing such a choice in the matter demonstrates that the employer has a thoughtful and flexible approach.
- When personal circumstances change, employees can change their benefits.
- There are certain tax-efficiency advantages, particularly in the area of company cars.

However, despite these positive benefits, there can sometimes be a perception among employees that when it comes to flexible benefits, organisations are giving with one hand and taking away with the other. Or despite the emphasis on flexibility, the reality is that there is limited choice in what people can opt for. This is either because the scheme design constrains or because many benefits are too important to flex. Moreover, employees may be cynical as to the true reasons why organisations are moving to flexible benefits. Is it that the organisation is being truly altruistic? Does the organisation really want to be attentive to the needs and preferences of its employees, to give them, as Zingheim and Schuster coin '*a better workforce deal*'? Or is it just a cost-cutting exercise? Or a bit of both?

Some authors have noted the possibility of a possible backlash against flexible benefits, particularly as the employment market gets tougher. There may be an increasing desire among employees to move away from what are often perceived as fringe add-ons, to something more tangible (Paton, 2003). And as we said earlier, for the low paid, base pay will always be more critical.

RebusHR (2002) report the results of an independent survey with 500 senior HR managers. Reasons were given as to why organisations were hesitant about introducing flexible benefits:

- current benefits were considered favourable
- inappropriate organisational culture
- expensive implementation and administration costs
- it had never been given consideration.

With regard to the perceived obstacles:

- 43 per cent of respondents reported the fear of an additional administrative burden.
- 37 per cent reported concern regarding communicating the scheme to employees.
- 28 per cent reported difficulties in deciding which benefits to flex and how to calculate their value.
- 28 per cent reported the need to modernise IT systems and integrate different databases.
- 23 per cent reported concerns about training employees to use the systems involved.
- 18 per cent reported the time and costs of setting up a scheme.

- 5 per cent reported concerns about measuring the perceived benefits, finding a consultant to manage the scheme.
- 9 per cent said they had not experienced, or did not expect to experience any real difficulties.

6. Conclusion

This paper has reviewed what appear to be two separate concepts. They are linked in that the provision of flexible benefits is likely to be a component of total reward. The very comprehensive nature of the latter means that few organisations will have succeeded in developing approaches that fulfil its requirements. This is because many organisations struggle to develop overarching reward strategies and to integrate their HR activities. Even if there is a desire to connect career management, development, recognition and reward, there are often obstacles that impede this ambition. Organisational structures, or culture, may be a barrier to joined-up people management. The HR function may not be working well with line management partners to deliver what is required. Corporate initiatives may founder on local, operational indifference.

Yet, though difficult to achieve, a total reward approach or philosophy has much to commend it. To achieve competitive advantage, especially in a tight labour market, companies need to offer a proposition to employees, and future employees, that resonates with the workers of today and tomorrow. The point made in this paper is that changes in the composition of the workforce and social developments mean that increasingly people want more from their work than simply money. They want job satisfaction, the chance to add skills, a balance between home and work life, *etc.* Total reward seeks to address these hopes and desires in a holistic way.

This leads to flexible benefits. Their aim is also to respond to the same diverse workforce with its varied needs. Having once been an unfulfilled aspiration for many organisations, technology now permits more sophisticated modelling and manipulation of benefits. The use of employee self service shifts the administrative burden onto staff, relieving the HR community of time consuming support. The variety of different types of employee, and the need to attract, retain and motivate them, provides an important driver to the growth of flexible benefit plans.

If the problem with total reward might be the absence of strategic and integrative thinking, the impediments to introducing flexible benefits are largely practical. Deciding which benefits to offer, costing them and estimating their take-up is essential for a well

designed scheme. Getting this right so that it offers real choice to employees in a cost efficient manner is not simple. It is no surprise to see organisations using external help in designing and operating their schemes. Nor is it surprising that the most effective users of flexible benefits are those companies that can afford to offer a range of benefits or through competitive pressures feel they must offer them.

Total reward is therefore a prize worth having if the organisation is prepared to develop the necessary thinking and have the persistence to drive through the change. Flexible benefits can be a component of this move or a stand alone element. To be successful at introducing flexible benefits requires a sufficiently varied offering of benefits in the first place, and the willingness to spend time and money on design and implementation. As with many HR policies and practices, half-hearted application would be an expensive mistake.

Schuster and Zingheim (2002) are concerned that organisations have thrown too much money at trying to attract new employees through flexible benefits systems in the war for talent without evaluating the costs of so doing, and without looking at alternative uses of their cash. They are especially concerned that there is insufficient link between benefits' provision and performance. This link is missed at individual and group level. Staff can, in their view, enjoy the advantages of extra benefits without any need for them or their organisation to perform better.

The answer to this fear is surely to make a better link between reward strategy and the business strategy. Total reward tries to offer an holistic approach to people management; flexible benefits may only be a tactical response to what turns out to be a short-term problem (attraction and retention in a tight labour market). As the labour market loosens, more HR professionals will start to agree with Schuster and Zingheim. But there are strategic reasons to develop flexible benefits. These might include the need for the organisation to emphasise adaptability and change in its people processes, as well as business processes; the need to develop adult/adult relationships between the employer and employee; to educate employees in the business realities, including the cost of their remuneration; the requirement to harmonise terms and conditions out of a merger/takeover or out of a desire to remove grade distinctions – the commonality driver; and the wish to emphasise the diversity of employees, as much as the diversity of customers. Linking reward changes in this way to wider organisational change or imperatives is likely to avoid the risk that flexible benefits, or even total reward, is merely today's passing fancy.

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