The Talent Management and Rewards Imperative for 2012

Leading Through Uncertain Times

The 2011/2012 Talent Management and Rewards Study, North America

WorldatWork
The Total Rewards Association

TOWERS WATSON

"By articulating and documenting their employee value proposition (EVP) and their total rewards strategy, and then applying the three key principles of integration, segmentation and agility to their reward and talent management model, organizations can significantly improve their human capital risk management and the return on their investment in talent."

The Talent Management and Rewards Imperative for 2012

Leading Through Uncertain Times

The 2011/2012 Talent Management and Rewards Study, North America

Table of Contents

Executive Summary

Despite a volatile economy and high unemployment, almost 60% of North American companies are having trouble attracting critical-skill employees, an increase over 2010. In addition, organizations will continue to face strong pressure to manage costs in the coming year as they experience slow growth in productivity and sales.

These are some of the top findings of the 2011/2012 Towers Watson North American Talent Management and Rewards Survey, conducted in early summer 2011. Findings also showed that a majority of employers are responding to the economy by expecting employees to work longer hours than before the recession and sharply decreasing the rate of increase of merit budgets.

This report focuses on trends in reward and talent management programs, accompanied by our related insights to drive effective design and delivery. We encourage you to consider these concepts in the broader context of your organization's EVP and total rewards strategy.

Note: To put employer views in context, this report sometimes compares responses to this survey with responses to an unpublished 2011 survey of over 10,000 full-time employees in North America on topics such as total rewards, communication and other work-related issues.

Key Findings

Attraction and retention

- Almost six in 10 companies have difficulty attracting critical-skill employees.
- Only 11% have trouble retaining employees generally, but those struggling to retain critical-skill employees increased by five percentage points in the U.S. (from 31% to 36%) and four percentage points in Canada (from 35% to 39%) since 2010.

The changing employment deal

- Most organizations (65%) expect employees to work more hours than before the recession, and over half (53%) expect this to continue.
- Organizations underestimate the effect work-related stress and work/life balance have on employee retention, and do not recognize the significance of job security in attracting top talent.
- Many employees suffer from change fatigue, leading to greater retention risks.

Aligning programs with objectives

- Organizations with reward and talent management programs that support their business goals are more than twice as likely to report being high-performing companies (28% versus 12%).
- Those with reward and talent management programs that support their attraction and retention goals are less likely to report having trouble attracting critical-skill employees (52% versus 68%) or retaining critical-skill employees (29% versus 43%).
- Those whose programs support the desired culture are more than twice as likely to report having a high-performance work culture (56% versus 26%).

Integration of reward and talent management programs

- Only 36% of organizations with a competency model have linked it to their reward programs.
- Most organizations have been unable to effectively leverage their investment in HR technology.

Segmentation

- Only 44% of organizations formally identify employees with critical skills.
- Fully 68% identify high potentials, but only 28% inform those employees who have been identified.

Agility

Short-term incentive (STI) programs provide greater flexibility because payouts can rise or fall depending on business conditions. Funding for STI programs increased sharply last year, from 88% to 111% of target as profits increased, and employers expect to fully fund STI programs in 2011.

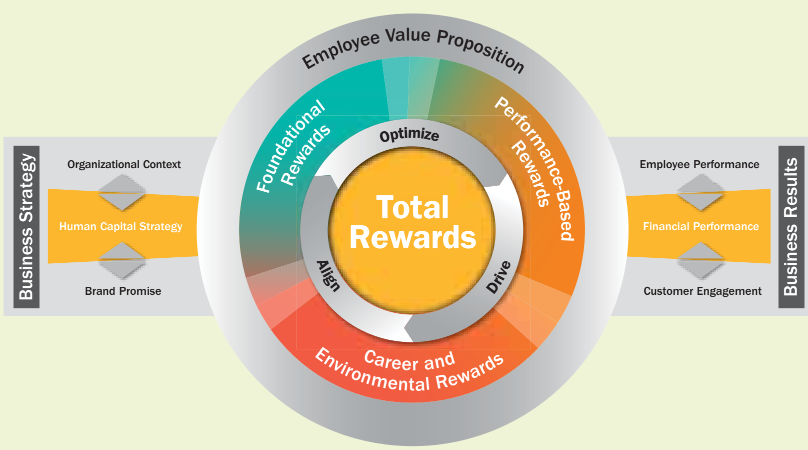
The Changing Face of Total Rewards

Just as a business can't stand still, neither can a rewards model. An effective total rewards program aligns with business strategy and gives shape to the broader EVP, which defines the "give and get" between employer and employee.

A total rewards framework allows an organization to identify the right combination of rewards for its workforce. Reward elements include the foundational (e.g., pay or retirement), performance-based (e.g., incentives), and career and environmental (e.g., training and development programs). The organization must allocate its budget among them in ways that drive the right behaviors, deliver high perceived value to employees and improve return on investment.

This report focuses on trends in reward and talent management programs, accompanied by our related insights on ways to drive effective design and delivery. We encourage you to consider these concepts in the broader context of your organization's EVP and total rewards strategy. For more information, please contact your Towers Watson consultant, or visit us at towerswatson.com.

Towers Watson Total Rewards Model



Introduction

Economic conditions have slightly improved in North America since 2009 as the GDP has grown somewhat and unemployment rates have declined marginally. Corporate profits rebounded in 2010 and continued to improve through the first two quarters of 2011, reflecting sales growth and the continued savings from cost management and cost-cutting activities.

While 2011 has been a good year for corporate profits, overall economic conditions in Canada and the U.S. have not been robust. GDP growth rates are below what would be expected coming out of a major recession, and they are expected to slow for the remainder of the year. Market volatility has increased sharply. Many corporations are cash-rich but are reluctant to make more capital expenditures or increase staffing levels. In fact, many companies have spent the past three years paying off debt. In addition, employees have been reluctant to change jobs, which has helped organizations reduce unwanted turnover, and led to stronger balance sheets and increased financial flexibility.

In Canada, productivity growth has stagnated at less than 1% per year from 2009 to 2011. In the U.S., productivity has increased faster than labor costs, contributing to profit growth. Although hiring rates have increased somewhat, unemployment in both the U.S. and Canada remains relatively high *(Figure 1)*.

Figure 1. Economic conditions in North America have improved from the lows of 2008 and 2009

		2007	2008	2009	2010	2011 (projected)	2012 (projected)
GDP growth	U.S.	1.9%	0.0%	– 2.6%	2.9%	1.8%	2.5%
	Canada	2.7%	0.4%	– 2.5%	3.1%	2.7%	2.6%
Inflation	U.S.	2.8%	3.8%	– 0.4%	1.6%	3.0%	2.2%
	Canada	2.0%	2.1%	0.3%	1.6%	2.8%	2.1%
Unemployment	U.S.	4.6%	5.8%	9.3%	9.6%	9.0%	8.7%
	Canada	6.0%	6.1%	8.3%	8.0%	7.2%*	—
Growth in corporate profits	U.S.	– 6.1%	– 16.4%	– 0.4%	29.2%	6.6%	5.3%
	Canada	10.3%	– 1.7%	– 19.3%	49.4%	—	—

Source: Blue Chip Economic Indicators, August 7, 2011, and Stats Canada
*As of July 2011

Excluding critical-skill employees, employers are not having a difficult time retaining employees. There are currently 4.6 unemployed people for every job opening in the U.S. — more than double the typical range of 1.5 to 2.5. Before the recession, approximately five million U.S. employees per month left their jobs, but fewer than 3.5 million people per month have changed jobs over the past two years — a 30% drop caused by the decline in voluntary turnover and improved retention rates *(Figure 2).*

However, more U.S. companies are having difficulty attracting employees with critical skills. Companies are taking longer to fill these positions, and more remain open. At the current U.S. unemployment rate (approximately 9%), a typical job opening rate would be 1.6% to 1.8%. But it is actually closer to 2.3%, suggesting that 600,000 to 900,000 vacancies are attributable to the greater-than-normal mismatch between the skills employers seek and those that are available in the market *(Figure 3).*

Perhaps as a result of high levels of unemployment (and despite the difficulty of attracting critical-skill employees), organizations are making a number of notable changes. These include lower rates of merit pay increases, longer work hours and — because of uncertain economic conditions — less job security. While these factors may contribute to short-term ROI improvements, they could have negative long-term effects on employers' ability to attract and retain employees.

Figure 2. Easing retention difficulties reflect declining quit rates

	U.S.								Canada	
	2004	2005	2006	2007	2008	2009	2010	2011	2010	2011
Critical-skill employees*	30%	39%	43%	49%	47%	16%	31%	36%	35%	39%
Top-performing employees*	27%	30%	36%	40%	37%	14%	25%	28%	35%	31%
All employees*	17%	20%	20%	27%	19%	5%	11%	11%	12%	11%
Quit rate	1.8%	2.0%	2.1%	2.1%	1.9%	1.2%	1.3%	1.3%	n.a.	n.a.
Number of quits per month (in millions)	2.5	2.9	3.1	3.1	2.7	1.7	1.8	1.9	n.a.	n.a.

Source: Data on quit rates and number of quits per month come from the U.S. Bureau of Labor Services. Other data are from Towers Watson survey data.
*Percentages indicate the percentage of companies that are having difficulty retaining each group of workers to a moderate or great extent.

Figure 3. Organizations are having more difficulty attracting critical-skill employees despite the abundance of potential employees

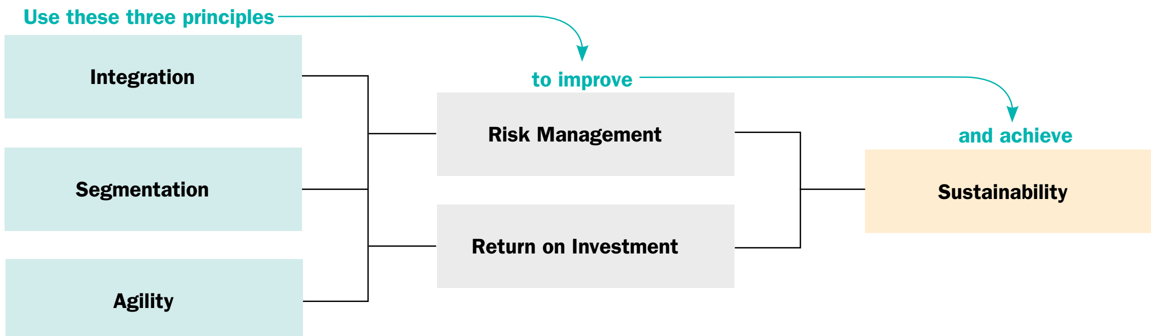
	U.S.								Canada	
	2004	2005	2006	2007	2008	2009	2010	2011	2010	2011
Critical-skill employees*	46%	58%	63%	64%	66%	28%	52%	59%	61%	57%
Top-performing employees*	42%	48%	53%	60%	54%	25%	45%	42%	57%	43%
All employees*	18%	22%	29%	34%	28%	8%	15%	13%	22%	20%
Number of unemployed per job opening	2.20	1.96	1.52	1.49	2.14	6.13	5.33	4.63	n.a.	n.a.

Source: Data on number of unemployed per job opening come from the U.S. Bureau of Labor Services. Other data are from Towers Watson survey data.
*Percentages indicate the percentage of companies that are having difficulty attracting each group of workers to a moderate or great extent.

Our view: Successful organizations develop and implement human capital strategies and EVPs that are sustainable through the ups and downs of the business cycle, allowing them to effectively manage risks and deliver a positive return on investment (ROI). The key risks addressed by a human capital strategy and EVP are related to attraction and retention, engagement, lost time due to absenteeism or presenteeism, and decreased innovation due to the inability or unwillingness of employees to be creative or take risks. Organizations cannot afford to eliminate all these risks, however, because the investment in reward and talent management programs would be too great to achieve a positive ROI.

The key is to find a balance between costs (both hard-dollar costs and the cost of missed opportunities) and risks (including both the upside of potential returns and the downside of losses in the event of changing business conditions). Three key principles can guide organizations as they design and implement their reward and talent management programs to manage risks and improve ROI: integration, segmentation and agility *(Figure 4)*.

Figure 4. Creating a sustainable reward and talent management approach



Principles for Creating a Sustainable Talent Management and Reward Model

Creating a sustainable talent management and reward model incorporates three basic principles:

Principle 1 — Integration: Aligning reward and talent management programs with each other and within the larger framework of the business's strategy and objectives:

- Align your reward and talent management programs with what you stand for both in the market (your company brand) and your EVP (your employment brand).
- Align your reward and talent management programs with your strategic objectives.
- Integrate programs with each other.
  - Leverage the performance management process across a range of programs.
  - Integrate your competency model with other reward and talent management programs.
- Leverage technology to deliver reward and talent management programs.

Principle 2 — Segmentation: Delivering a different employee experience to employee segments in order to meet their needs cost effectively:

- Define workforce segments, and differentiate the employment deal.
- Meet the execution challenge (execution is key).
- Drive diversity (diversity is not an accident).
- Be on the lookout for emerging segments.

Principle 3 — Agility: Adjusting or adapting programs to changing business or economic conditions in order to more effectively manage risks and improve performance:

- Use more flexible reward programs.
- Monitor program effectiveness to make data-driven decisions.
- Manage change effectively.
  - Use managers to deliver your programs to meet employee needs.
  - Communicate with employees and then let them have more self-direction.
- Develop leadership capability.

Changes in the employee-employer deal

Perhaps as a result of the large pool of available talent, employers have sharply reduced their merit budget increases since 2007, according to Towers Watson data. Merit increase budgets declined by nearly a full percentage point from 2008 to 2010 and rose only modestly this year. This action has helped employers remain profitable, although it could have a negative impact on long-term retention *(Figure 5)*.

Nevertheless, although organizations are under pressure to improve ROI from limited merit budgets, most still give significant increases to employees who only partially meet expectations *(Figure 6)*.

Figure 5. Merit budget increases have been reduced sharply since 2007

Median merit increases — U.S.

	Executive	Management	Exempt	Nonexempt salaried	Nonexempt hourly
2008	3.7%	3.5%	3.5%	3.5%	3.4%
2009	3.3%	2.9%	2.8%	2.8%	2.8%
2010	3.0%	2.8%	2.8%	2.7%	2.7%
2011	3.0%	3.0%	3.0%	2.9%	2.8%
2012 (projected)	3.0%	3.0%	3.0%	3.0%	3.0%

Source: Towers Watson Data Services

Median merit increases — Canada

	Executive	Management	Professional	Administrative/ Support	Hourly
2008	3.5%	3.4%	3.3%	3.2%	3.0%
2009	3.2%	2.9%	2.8%	2.8%	2.8%
2010	2.5%	2.5%	2.7%	2.6%	2.5%
2011	3.0%	3.0%	3.0%	3.0%	2.9%
2012 (projected)	3.0%	3.0%	3.0%	3.0%	3.0%

Source: Towers Watson Data Services

Figure 6. Employers differentiating pay increases based on performance

What is the average merit increase as a percentage of salary for each employee group at your organization?	High-performing organizations	Low-performing organizations
Employees who did not meet expectations	0.0%	0.0%
Employees who partially met expectations	1.0%	0.7%
Employees who met expectations	2.8%	2.5%
Employees who exceeded expectations	4.0%	3.1%
Employees who far exceeded expectations	5.0%	4.5%

What's more, while employees seek factors such as job security, good base pay, benefits, time off and shorter commutes, companies emphasize factors such as reputation, values, career development opportunities and challenging work. In short, there is a disconnect between what employers think will attract critical-skill employees and what employees themselves say they want *(Figure 7)*. These EVP mismatches will not prevent employers from filling most openings today, but they could present big challenges in the future.

In addition, there are significant differences between employees' reasons for leaving a company and what employers think cause departures *(Figure 8)*. Employers tend to overestimate the importance employees place on their relationship with their supervisor while underestimating the lack of trust and confidence in senior management, work-related stress, production expectations and long work hours. Indeed, employees report that work-related stress and poor work/life balance are key reasons for leaving their organizations.

Figure 7. Organizations underestimate the importance of job security in attracting top talent

	All employees				High-potential performers			
	U.S.		Canada		U.S.		Canada	
Rank	Employers	Employees	Employers	Employees	Employers	Employees	Employers	Employees
1	Base pay	Job security	Career development opportunity	Job security	Challenging work	Job security	Challenging work	Job security
2	Organization's mission, vision and values	Base pay	Organization's reputation as a great place to work	Base pay	Career development opportunity	Base pay	Career development opportunity	Career development opportunity
3	Organization's reputation as a great place to work	Health care benefits	Challenging work	Health care benefits	Organization's mission, vision and values	Career development opportunity	Base pay	Base pay
4	Career development opportunity	Length of commute	Base pay	Challenging work	Base pay	Promotion opportunity	Organization's reputation as a great place to work	Challenging work
5	Challenging work	Vacation/PTO	Job security	Length of commute	Organization's financial performance	Health care benefits	Promotion opportunity	Health care benefits

*Rank represents the frequency the item was selected as one of the top five reasons an employee would join an organization, from a list of 23 items.

Figure 8. Employers are not always aware of the reasons employees would change jobs

	All employees				Top performers			
	U.S.		Canada		U.S.		Canada	
Rank	Employers	Employees	Employers	Employees	Employers	Employees	Employers	Employees
1	Base pay	Work-related stress	Promotion opportunity	Work-related stress	Promotion opportunity	Work-related stress	Career development opportunity	Work-related stress
2	Promotion opportunity	Base pay	Relationship with supervisor	Base pay	Career development opportunity	Promotion opportunity	Promotion opportunity	Promotion opportunity
3	Relationship with supervisor	Promotion opportunity	Career development opportunity	Promotion opportunity	Base pay	Base pay	Relationship with supervisor	Base pay
4	Career development opportunity	Trust/ Confidence in management	Base pay	Trust/ Confidence in management	Relationship with supervisor	Trust/ Confidence in management	Base pay	Trust/ Confidence in management
5	Work-related stress	Incentive pay opportunity	Work-related stress	Incentive pay opportunity	Incentive pay opportunity	Length of commute	Work-related stress	Job security

*Rank represents the frequency the item was selected as one of the top five reasons an employee would leave an organization, from a list of 23 items.

“There is no question that organizations have placed additional burdens on employees since the beginning of this recession.”

Have organizational changes created new risks?

Almost two-thirds of all organizations have made significant changes in the HR area as a result of broader organizational changes, and many expect to continue to do so *(Figure 9)*.

There is no question that organizations have placed additional burdens on employees since the beginning of this recession. Almost two-thirds of organizations report that employees have been working more hours over the past three years, and over half expect this to continue over the next three *(Figure 10)*; many also report employees have been taking less time off.

But employee attitudes on these issues vary significantly by job level, with people in senior or mid-level managerial roles most likely to agree that expectations have shifted toward acceptance of longer working hours and fewer vacation days, and almost half reporting taking less time off. Additionally, a plurality of other professionals say they have been expected to work more hours and will continue to do so. These numbers are significantly lower for supervisors, team leaders or people in administrative, clerical or manual labor positions.

Figure 9. More changes to key programs are on the way

Because of recent organizational changes, have you already redesigned or do you anticipate redesigning any of the following?	Have already made change	Plan to change over next 24 months	No changes made or anticipated
Organizational structure	51%	17%	32%
Talent management strategy	31%	35%	34%
Reward (compensation) strategy	23%	39%	39%
Job leveling or job evaluation process	19%	32%	49%
Competencies	22%	33%	45%
Made some changes to at least one of these	66%	65%	70%

Figure 10. The employment deal has shifted to require more hours from senior managers and professionals

		Employees have been working more hours than normal over the past three years	Employees will be expected to work more hours than normal over the next three years	Employees have been using less of their vacation or personal time off over the past three years
Employers		65%	53%	31%
Employees	Senior and middle managers	57%	47%	44%
	First-line supervisors and team leaders	35%	32%	27%
	Professional individual contributors	46%	40%	30%
	Administrative/ Clerical/ Manual labor	37%	33%	24%
	Exempt	50%	43%	33%
	Nonexempt	35%	31%	25%

Note: Values are the percentage of employers or employees who agreed or strongly agreed with these statements.

"U.S. employers are more concerned today than they were in 2010 about the effect of organizational changes on employees' productivity and willingness to take risks."

Figure 11. Organizations are concerned over the long-term risks of the changes they have made

<table>
<tr><th rowspan="2">Percentage reporting adverse impact of changes at their organization on:</th><th colspan="2">U.S.</th><th colspan="2">Canada</th></tr>
<tr><th>2010</th><th>2011</th><th>2010</th><th>2011</th></tr>
<tr><td>Employee productivity</td><td>34%</td><td>39%</td><td>30%</td><td>29%</td></tr>
<tr><td>Quality</td><td rowspan="2">23%*</td><td>20%</td><td rowspan="2">23%*</td><td>15%</td></tr>
<tr><td>Customer service</td><td>21%</td><td>13%</td></tr>
<tr><td>Employee willingness to take risks</td><td>28%</td><td>37%</td><td>18%</td><td>18%</td></tr>
<tr><td>Overall employee engagement</td><td>58%</td><td>43%</td><td>56%</td><td>46%</td></tr>
<tr><td>Employees' ability to have a healthy balance between work and their personal lives</td><td>62%</td><td>56%</td><td>50%</td><td>48%</td></tr>
<tr><td>Employees' desire to remain with the organization when the labor market improves</td><td>n.a.</td><td>46%</td><td>n.a.</td><td>27%</td></tr>
</table>

*In 2010, the item combined quality and customer service.
Values represent the percentage of organizations indicating the changes have had an adverse impact in that area.

Figure 12. Three out of 10 employees are staying with their organization because they have to

Employees at the organization are suffering from change fatigue	Stay by choice	Stay because they have to	Intend to leave
Employees who agree	59%	35%	6%
Employees who disagree	73%	21%	6%
All employees	65%	29%	6%

A majority of companies in the U.S. and 48% in Canada are concerned about the long-term effect that changes they instituted to remain profitable are having on employee work/life balance *(Figure 11)*. U.S. employers are more concerned today than they were in 2010 about the effect of organizational changes on employees' productivity and willingness to take risks. However, respondents have less concern about the negative impact of change on engagement, which could cause problems now by increasing absenteeism and later by increasing retention risk.

As a result of organizational changes, employees may begin to suffer from change fatigue. Forty-one percent of employees who report that their coworkers are suffering from change fatigue are themselves retention risks, either because they intend to leave, or because they feel they have to stay. On the other hand, 73% of employees who say their coworkers are not suffering from change fatigue are staying with their organizations by choice *(Figure 12)*.

Over the past few years, there have been 10 million fewer people per year leaving their organizations voluntarily. But the voluntary turnover rate is likely to increase by at least 45% when the economy returns to normal. Only 6% of employees intend to leave their organization over the next year, while another 29% are "soft stays" — people who could depart if a comparable job becomes available elsewhere.

Our view: Companies that address their concerns over the long-term risks that recent changes may have created will position themselves to compete effectively by attracting and retaining key talent as the economy begins to improve.

By articulating their total rewards strategy and EVP, and applying the guiding principles of integration, segmentation and agility to their reward and talent management model, organizations can significantly improve the return on their human capital investments and enhance business performance.

Principles for Sustainable Reward and Talent Management Program Design and Delivery

To better manage human capital risks and improve ROI in reward and talent management programs, organizations should focus on three reward and talent management principles:

1. **Integration.** Aligning reward and talent management programs with each other and within the larger framework of the business's strategy and objectives
2. **Segmentation.** Delivering a different experience to employee segments to meet their needs cost effectively
3. **Agility.** Adapting programs to changing business or economic conditions in order to more effectively manage risks and improve performance

Integration

In our 2008 study, we found that organizations with integrated reward and talent management strategies were:

- 20% less likely to report having trouble attracting critical-skill employees
- 25% less likely to report having trouble attracting top-performing employees
- 33% less likely to report having trouble retaining critical-skill employees
- 18% less likely to report having trouble retaining top-performing employees
- 18% more likely to report performing significantly better than their peers

Integrated programs can also help reduce the overall spend on reward and talent management, while delivering a compelling employee experience.

Align reward and talent management programs with your strategic objectives

Our view: Organizations that align their reward and talent management programs with their strategic objectives achieve better results. Companies with reward and talent management that support their business goals are more than twice as likely to report being high-performing companies (28% versus 12%). In addition, those that align these programs with their attraction and retention goals are less likely to report having trouble attracting critical-skill employees (52% versus 68%) or retaining critical-skill employees (29% versus 43%). Finally, those companies that align talent and reward programs with their desired culture are more than twice as likely to report having a high-performance work culture (56% versus 26%). Integrating these key elements can also increase organizational efficiency and the effectiveness of other programs, including performance management.

"Aligning performance management with other reward and talent management programs requires calibration across departments and functions."

Leverage performance management to facilitate integration

Most organizations have a formal performance management process. About half of respondents think their managers are somewhat effective at using the performance management process to conduct career development discussions and set development plans, providing direction and boosting engagement *(Figure 13).*

Our view: Aligning performance management with other reward and talent management programs requires calibration across departments and functions. This includes reviewing performance ratings for consistency against the company's rating definitions, and auditing base pay and bonus recommendations for alignment with the company's pay-for-performance philosophy. Fewer than half of respondents say they complete a calibration process. Most do not include assessments of potential or review recommended pay increases, and only one-quarter review recommended bonuses.

Integrate the competency model with other reward and talent management programs

Most organizations (70%) have implemented a competency model for all employees *(Figure 14)*. Along with an organization-wide job-leveling system and career framework, competency models help employees understand expectations and rewards, and serve as a solid foundation for integrated reward and talent management.

Figure 13. Most organizations' performance management processes do not effectively incorporate career development or competencies

	All firms	High-performing firms	Average-performing firms	Low-performing firms
My organization's performance management process is effective at incorporating career development	53%	56%	53%	43%
My organization's performance management process is effective at incorporating competencies	63%	75%	59%	60%
Managers at my organization are effective at conducting career development as part of the performance management process	54%	60%	53%	39%
Managers at my organization are effective at utilizing performance results to determine development plans	57%	67%	54%	55%

Note: Values indicate the percentage of respondents that said their organization was at least somewhat effective in their action.

Figure 14. Most organizations have some form of competency model(s) they use for employees

Our organization has:	Percentage of companies agreeing
Implemented an enterprise-level competency model that applies to all employees	70%
Implemented function-specific competency models that apply to the employees in a function (e.g., finance or engineering)	51%
Implemented technical competency models that apply to a specific set of employees in a job or role	41%
Aligned our development plans with the knowledge, skills and abilities outlined in our competency model	59%

Note: Values indicate the percentage of companies that agree or strongly agree with this statement.

A significant majority of organizations with a competency model have integrated it into their performance management process. By and large, these organizations have also tied their competencies to career development plans, succession planning, selection and assessments, but only 36% tie it to their pay decisions *(Figure 15).*

Aligning reward and talent management programs with company and employee brands

Fewer than four in 10 respondents think their organization does a good job communicating the employment deal to employees *(Figure 16)*. Delivering on the employment deal can have a powerful impact on both employee engagement and company performance, and aligning these EVP-related programs with the brand communicates an integrated and consistent message to employees. However, this strategy requires a strong partnership between HR and marketing.

Leveraging technology to deliver reward and talent management

Technology helps organizations align and deliver their reward and talent management programs more efficiently and cost effectively. While organizations have increased investments over the past few years to improve their program delivery, most respondents say they have not been able to use these investments to improve their reward programs *(Figure 17).* They feel they are somewhat better at using technology to deliver talent management programs such as learning and development opportunities.

Figure 15. Most organizations have linked their competencies to their talent management programs

Our competencies are tied to:	Percentage of companies agreeing
Performance management	89%
Career development	70%
Succession management	68%
Assessment (e.g., 360-degree feedback)	68%
Selection	65%
Reward programs	36%

Note: Values indicate the percentage of companies that agree or strongly agree with this statement.

Figure 16. High-performing organizations offer a good employment deal and deliver on it

	All firms	High performers	Average performers	Low performers
Our organization does a good job communicating the employment deal to employees	38%	40%	38%	32%
Our organization's employment deal is clearly aligned with what we stand for in the marketplace	53%	56%	54%	53%
Our organization has done a good job delivering on the employment deal over the past three years	44%	51%	46%	32%

Note: Values indicate the percentage of companies that agree or strongly agree with this statement.

Figure 17. Organizations have not been able to effectively leverage their investments in HR technology in delivering their talent management and reward programs

Our organization effectively leverages technology to deliver our:	Percentage of companies agreeing
Base pay programs	40%
STI programs	39%
LTI programs	30%
Sales compensation programs	27%
Recognition programs	29%
Performance management programs	41%
Leadership development	41%
Competency models	44%
Career management	17%
Learning and development	47%

Note: Values indicate the percentage of companies that agree or strongly agree with this statement.

Segmentation

Defining segments and differentiating the employment deal

Our view: Employee segmentation reduces ineffective spending on human capital programs. By understanding which employees have the most impact on the bottom line and customizing talent management and reward programs to retain and engage them, employers can maximize ROI.

The first step is to identify the most strategically important segments of the employee population — those that have the greatest impact on business performance. Surprisingly, only 44% of respondents identify critical-skill employees. However, most companies formally identify top performers, and 68% formally identify high potentials. However, only 28% actually inform employees identified as high potentials *(Figure 18)*. This is a lost opportunity to enhance engagement and reduce retention risks.

Figure 19. Many organizations do not differentiate their programs for critical employee segments

For each HR program listed below, does your organization invest more financial or other resources in the following employee groups than in other groups?

Program	Not differentiated	Critical-skill employees	High potentials	Top performers
Base pay	34%	45%	39%	57%
STIs	47%	26%	27%	49%
LTIs	53%	25%	29%	37%
Coaching or mentoring	42%	15%	55%	29%
Recognition programs	74%	9%	11%	24%
Recruiting and selection	50%	46%	23%	17%
Career pathing and planning	47%	19%	51%	32%
Employee learning and development	58%	21%	37%	27%
Leadership development	31%	16%	65%	40%
Succession management	30%	26%	65%	44%

Figure 18. Less than half of employers are identifying critical-skill employees or informing high potentials

The company:	Percentage of companies agreeing
Formally identifies employees with critical skills	44%
Formally identifies high-potential employees	68%
Formally identifies top-performing employees	71%
Informs employees who have been identified as high-potential employees	28%

Note: Values indicate the percentage of companies that agree or strongly agree with this statement.

After identifying employees in key segments, and informing them when appropriate, organizations need to recognize the contribution they make. Very few companies offer customized employment deals for pivotal employee segments. They should consider investing more resources to differentiate their offerings to them.

About two-thirds of organizations are investing more in leadership development and succession management for high-potential employees, but only slightly more than half are dedicating extra resources to coaching, mentoring, career pathing and planning. About half allocate more resources to base pay (57%) or STIs (49%) for top-performing employees, and only 37% dedicate additional resources to long-term incentives (LTIs) for top-performing employees *(Figure 19)*. For critical-skill employees, the focus is on recruiting and selection as well as extra base pay, but only one in four organizations dedicates extra resources to succession management for this segment.

The challenge: Execution is key

Many companies differentiate rewards based on individual performance to increase the return on compensation resources and retain key employees *(Figure 20)*. Nonetheless, payouts are more skewed to lower-performing groups than intended. Payouts are targeted so top performers will receive 120% more than employees who only partially meet expectations, but they typically only get about 70% more.

Differentiating pay for performance is not new, but employees frequently cite lack of incentive pay opportunities as a reason to leave. Organizations segment the employee population by performance level, and provide processes and tools to facilitate differentiation, but the concept is not socialized throughout the organization to overcome the disinclination of many managers to treat different employee groups differently. Employees recognize their organizations' failure to execute these programs well, with fewer than half reporting a clear link between job performance and individual pay.

Drive diversity — It doesn't happen on its own

Fewer than half of respondents use specific programs to drive diversity in their organizations. The most common programs are employee learning and development, and a targeted acquisition strategy, but they have utilization rates below 50% *(Figure 21).* Organizations need to employ targeted talent acquisition strategies, as well as address shortcomings in development and retention through programs that help employees grow and move through the organization.

Look out for emerging segments

Many older employees are delaying retirement, necessitating the development of approaches to deal with workers who are past their expected retirement dates. Other groups may consist of high-potential employees whose career advancement is blocked due to a lack of opportunities, as well as younger employees from the graduating classes of 2009 or 2010 who have been passed over in the job market and are unemployed or underemployed. Some of these groups represent a relatively recent employee segment and a different managerial challenge. Organizations can gain a competitive advantage by addressing this issue.

Figure 20. Organizations are not differentiating as much on STI payouts as targeted

	Target funding	Actual funding
Employees who did not meet expectations	0%	0%
Employees who partially met expectations	60%	74%
Employees who met expectations	100%	100%
Employees who exceeded expectations	112%	112%
Employees who far exceeded expectations (e.g., top 10%)	133%	128%
Differentiation*	2.2%	1.7%

*The ratio of payouts to employees who far exceed expectations relative to those who partially met expectations

Figure 21. Organizations use a combination of programs to support their diversity goals

	Percentage of companies that use program to support diversity goals
Coaching or mentoring	44%
Career pathing and planning	32%
Network of employee resource groups	44%
Employee learning and development	48%
Leadership development	44%
Succession management	40%
Targeted talent acquisition strategy	46%
Engagement surveys	40%
Action planning (developing targeted actions based on findings of engagement surveys or other employee feedback)	43%

Agility

Agility means having the flexibility to make changes quickly, being the first to seize opportunities and being resilient in the face of difficulties. There are several ways that organizations can use reward and talent management programs to support organizational agility.

Flexible reward programs

Our view: The simplest way to create agile reward and talent management programs is to build in flexible benefits, comp time, alternative work schedules or remote work arrangements. Variable pay programs promote agility by altering funding levels to reflect business performance and setting targets as a percentage of net income *(Figure 22).*

STI programs can enhance organizational agility by adjusting performance targets up or down based on past and expected performance. In 2006 and 2007, roughly half of organizations increased their financial performance targets, while in 2009, only one out of six raised their targets *(Figure 23).*

Figure 22. Organizational funding for short-term incentives varies dramatically with performance

	2005	2006	2007	2008	2009	2010	2011 (projected)
Average funding (as a percent of target)	91%	102%	78%	82%	88%	111%	101%

Figure 23. Organizations adjust organizational performance targets and individual performance expectations frequently to reflect changing conditions

How have you adjusted these features of your STI program over the past 12 months?	2006	2007	2008	2009	2010	2011
Organization financial performance targets						
Decreased	4%	3%	11%	19%	16%	4%
Stayed the same	39%	51%	51%	64%	55%	56%
Increased	56%	46%	39%	17%	29%	40%
Individual performance expectations						
Decreased	2%	0%	1%	3%	3%	1%
Stayed the same	69%	68%	69%	78%	74%	77%
Increased	28%	32%	30%	19%	23%	22%

Monitor program effectiveness to make data-driven decisions

Our view: Organizations can also increase their agility by tracking the effectiveness of programs and making adjustments. Most organizations monitor leadership development programs, base pay and STI because they generate significant hard-dollar costs, but only one in four monitors career management programs. Recognition programs can have a very high ROI. Because they are timely, they have a large impact on behavior and engagement. Recognition programs are often underutilized, and fewer than half of all organizations monitor their effectiveness *(Figure 24).*

Manage change

Both effective communication and change management are associated with significant increases in organizational performance. Good change management comes about through a four-stage process:

- Planning
- Building
- Implementing
- Improving

Communication is a key lever of effective change management. Other levers include:

- Employee learning through change
- Project management
- Measuring the effectiveness of change
- Involving employees in change
- Leading change
- Supporting change

Our view: Senior leaders and managers play a key role in communicating and managing change. Early in the change management process, senior leadership sponsorship and direction are essential. Over time, organizations rely more on managers and supervisors to drive change. After implementation, employees should take on more ownership of the process through the improving phase.

"Recognition programs can have a very high ROI. Because they are timely, they have a large impact on behavior and engagement."

Figure 24. Organizations are monitoring leadership development, base pay and STI programs but not career management

Our organization monitors the implementation of programs to make sure they are consistent with program objectives and guidelines	Percentage of companies agreeing
Base pay	72%
STIs	75%
LTIs	54%
Sales force compensation	64%
Recognition	46%
Leadership development	77%
Competencies	54%
Career management	26%
Learning and development	49%

Note: Values indicate the percentage of companies that agree or strongly agree with this statement.

Use managers to deliver programs to meet employee needs

Managers are the front line in delivering most programs or changes, but have limited flexibility to adjust programs and apply policies to create a compelling employee experience. Not surprisingly, respondents have very mixed views on how well programs are executed. Most (59%) believe their managers are effective in executing sales force compensation programs, but only 43% think they are effective in managing base pay programs, and 49% for managing STI programs. Only 14% believe managers execute career management programs well *(Figure 25).*

Figure 25. Organizations do not think managers are executing programs well

Our managers execute our programs well	Percentage of companies agreeing
Base pay	43%
STIs	49%
LTIs	32%
Sales force compensation	59%
Recognition	35%
Competencies	40%
Career management	14%

Note: Values indicate the percentage of companies that agree or strongly agree with this statement.

Communicate with employees, and allow more self-direction

Towers Watson research has shown that employees have more favorable views of programs they understand. Improving communication can have a greater effect on program utilization and satisfaction than making programs richer — and at a much lower cost.

Nevertheless, organizations do not believe employees understand most programs very well, and the percentage of employees who say their organization does a good job explaining their reward and talent management programs tends to be low. But while 22% of companies have a negative view of employees' understanding of career management, roughly two-thirds of employees think their managers are effective at explaining the skills they need to succeed, and over 40% think their organization does a good job regarding career management *(Figure 26).*

Our research shows that employees are taking advantage of self-directed learning opportunities, or external job search tools or networks, to manage their career development and advancement. This approach can greatly facilitate agility as employees become willing to take on new roles and are better able to adjust more quickly.

Figure 26. Employees and employers agree on understanding and communication of most programs

Our employees understand our programs	Companies	U.S. employees	Canada employees
Base pay	44%	49%	50%
STIs	58%	45%	40%
LTIs	31%	36%	34%
Recognition	46%	41%	38%
Competencies	46%	65%	61%
Career management	22%	41%	39%

Note: Values indicate the percentage of companies that agree or strongly agree with this statement.

Most organizations (54%) want a balanced approach where employees and managers have joint responsibility for career development. Although only 2% of organizations want managers to guide employees' careers, employees are relatively evenly divided between those who think their organization expects employees to take ownership of their own careers and those who believe it expects a mix of employee-manager ownership. In fact, roughly one in five employees expect their managers to guide their careers, despite the solid claim that an agile organization requires flexible employees who take responsibility for their own advancement *(Figure 27).*

Figure 27. Most employees understand their responsibility for managing their own career

At our organization, we want:	Companies	U.S. employees	Canada employees
Employees to take ownership of their own careers	45%	41%	37%
Employees and managers to have joint ownership	54%	38%	44%
Managers to guide employees' careers	2%	21%	19%

Note: Values in each column may not add up to 100% due to rounding.

Figure 28. Organizations utilize a variety of learning approaches to build leadership capability

Which of the following activities or programs are included in the leadership development programs at your organization?	Percentage of companies
Assessment using formal instruments	69%
360-degree evaluation	72%
Simulations	31%
Rotational assignments	31%
Project assignments	62%
Action learning	48%
University executive education	46%
Leaders teaching leaders	47%
Internal coaching	66%
External coaching	55%
Mentoring	51%

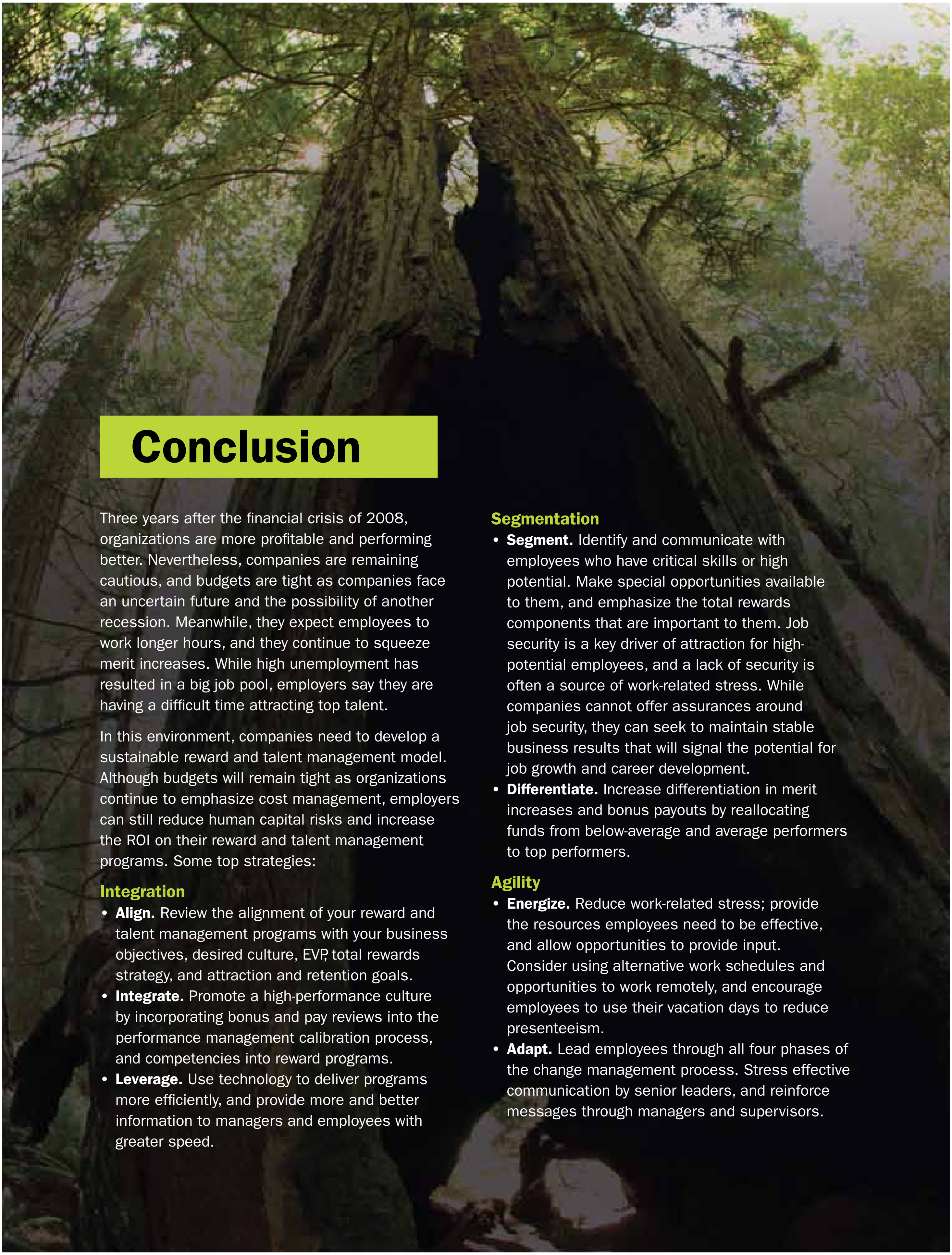
Figure 29. Implement effective succession planning processes to continually develop new leaders

Our organization has:	Strongly disagree/ disagree	Neither agree nor disagree	Strongly agree/ agree
Linked our succession management process with other talent programs	16%	35%	49%
Implemented an effective process to identify high-potential employees	23%	27%	49%
Created talent pools for key organizational roles as part of our succession planning process	30%	22%	48%

Develop leadership capability

Developing effective leaders means giving them a broad understanding of the business and investing in their capabilities *(Figure 28).* This includes formal education programs and simulations as well as project assignments and action learning, or rotational assignments that help develop a variety of skills and deliver different experiences. Coaching and mentoring are also very effective.

Successful organizations develop programs to prepare leaders for new roles before they need to fill them. When companies identify high potentials and link talent programs to the succession management process, they develop leaders who can handle critical new assignments effectively or make organizational changes quickly *(Figure 29).*



Conclusion

Three years after the financial crisis of 2008, organizations are more profitable and performing better. Nevertheless, companies are remaining cautious, and budgets are tight as companies face an uncertain future and the possibility of another recession. Meanwhile, they expect employees to work longer hours, and they continue to squeeze merit increases. While high unemployment has resulted in a big job pool, employers say they are having a difficult time attracting top talent.

In this environment, companies need to develop a sustainable reward and talent management model. Although budgets will remain tight as organizations continue to emphasize cost management, employers can still reduce human capital risks and increase the ROI on their reward and talent management programs. Some top strategies:

Integration

- **Align.** Review the alignment of your reward and talent management programs with your business objectives, desired culture, EVP, total rewards strategy, and attraction and retention goals.
- **Integrate.** Promote a high-performance culture by incorporating bonus and pay reviews into the performance management calibration process, and competencies into reward programs.
- **Leverage.** Use technology to deliver programs more efficiently, and provide more and better information to managers and employees with greater speed.

Segmentation

- **Segment.** Identify and communicate with employees who have critical skills or high potential. Make special opportunities available to them, and emphasize the total rewards components that are important to them. Job security is a key driver of attraction for high-potential employees, and a lack of security is often a source of work-related stress. While companies cannot offer assurances around job security, they can seek to maintain stable business results that will signal the potential for job growth and career development.
- **Differentiate.** Increase differentiation in merit increases and bonus payouts by reallocating funds from below-average and average performers to top performers.

Agility

- **Energize.** Reduce work-related stress; provide the resources employees need to be effective, and allow opportunities to provide input. Consider using alternative work schedules and opportunities to work remotely, and encourage employees to use their vacation days to reduce presenteeism.
- **Adapt.** Lead employees through all four phases of the change management process. Stress effective communication by senior leaders, and reinforce messages through managers and supervisors.

About the Survey

The 2011 North American Talent Management and Rewards Study is based on a survey of organizations conducted in May and June 2011. The survey was completed by HR professionals with responsibilities encompassing a broad array of organizational programs across 316 organizations, 218 in the U.S. and 98 in Canada. Over half of survey respondents (51%) represent organizations that are domestic, with the remainder from international (22%) or global (27%) companies.

Respondents represent a variety of industries. Financial services firms, including insurance, account for 17% of all responses *(Figure 31)*. Other industries with a significant number of responses include manufacturing, high tech, retail, and energy and utilities.

To be included in the survey, U.S. companies had to have at least 1,000 employees, and Canadian firms had to have at least 250. Most survey respondents were from significantly larger companies, and 38% had 10,000 employees or more *(Figure 32)*.

Figure 30. Survey respondents have responsibility for a broad array of HR programs

Which areas are you responsible for within your organization? (Please check all that apply.)	Percentage
Base pay programs	81%
STI programs	75%
LTI programs	53%
Sales force compensation programs	39%
Recognition programs	54%
Leadership development programs	36%
Competency models and associated applications	34%
Career management programs	34%
Succession planning programs	39%
Coaching or mentoring programs	32%
Learning or development programs	32%
Other (please specify)	20%

Figure 31. Industry breakdown of survey respondents

Sector	Percentage
Financial Services	17%
Manufacturing	16%
Wholesale and Retail	15%
IT and Telecom	14%
Energy and Utilities	14%
General Services	9%
Health Care	9%
Public Sector and Education	6%

Figure 32. Survey respondents by size

Number of employees	Percentage
Greater than 10,000	38%
5,000 – 10,000	22%
2,000 – 4,999	25%
Less than 2,000	15%

Key Terms and Definitions Used in the Report

High-performing organizations. This report differentiates financially high- and low-performing companies based on self-reported responses to the question, "How well did your total organization perform financially compared with other firms *in your industry* during the past year?" Respondents were given five choices, ranging from "substantially below peer group" to "substantially above peer group." Companies that identified themselves as "substantially above peer group" are high-performing, and those that said their performance was "slightly above peer group" or "about the same as peer group" are average-performing. The remainder was characterized as low performing.

Critical-skill employees. Critical-skill employees are those who possess skills the organization needs most to compete.

Top-performing employees. Top-performing employees are those whose performance was rated "far exceeds expectations" (i.e., in the top 10%) by their supervisors in their most recent performance review.

Presenteeism. Presenteeism occurs when an employee is physically at work but not fully productive because of physical or mental health conditions or stress related to job, personal or financial matters.

Change fatigue. Change fatigue can be experienced by organizations that undergo too much change at once. It is characterized by a drop in employee engagement or lack of participation by key stakeholders.

Employee value proposition. The term "employee value proposition," or EVP, refers to the collective array of programs that an organization offers in exchange for employment. The EVP includes pay, benefits (perquisites), work environment and career opportunities. It is also referred to as the "employment deal."

About WorldatWork®

The Total Rewards Association

WorldatWork (www.worldatwork.org) is a global human resources association focused on compensation, benefits, work-life and integrated total rewards to attract, motivate and retain a talented workforce. Founded in 1955, WorldatWork provides a network of nearly 30,000 members in more than 100 countries with training, certification, research, conferences and community. It has offices in Scottsdale, Arizona and Washington, D.C.

About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.

TW-NA-2011-19957

towerswatson.com

TOWERS WATSON