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Compensation issues are so intertwined with the most basic components of our society that every event, no matter how far removed from the seemingly mundane world of pay systems and benefit plans, ultimately bears consequences for compensation and benefits programs. Within the first few hours of the September 11 terrorist attacks on the World Trade Center and the Pentagon, questions arose about the wisdom of paying $6 an hour for airport security personnel with huge responsibilities. Within days of the attack, more questions arose about workers’ compensation payments for employees who were injured or killed and unemployment benefits and severance payments for those who lost their jobs. Before the week ended, President Bush announced that the U.S. government would call as many as 50,000 reservists to report for active duty, forcing compensation and benefit professionals to review corporate compliance with detailed regulations concerning the treatment of these employees.

EAPs designed to help employees handle more common problems were stretched to the breaking point as thousands of workers across the country requested counseling for grief and anxiety. Expatriate pay policies that once seemed adequate have been called into question, as traveling and working abroad suddenly seem far more hazardous. With the collapse of the stock market in the month following the attacks, new questions arose about the adequacy of retirement savings plans, pension plan funding and 401(k) investment choices.

As corporations registered losses nationwide, economists predicted that the national unemployment rate could rise to 5.5%, up from 4.9% reported before the tragedy. The economic consequences for entire industries are drastically changing staffing and pay schedules and forcing companies to cut labor costs to levels that were unimaginable before the attacks.

The compensation and benefit issues emerging from the attacks stand against a backdrop of a slowing economy where the relationship between rewards and performance grows more critical with each passing day. In our lead article for this issue, CBR Board Member Robert L. Heneman of the Fisher College of Business, Ohio State University, teams up with Katherine E. Dixon of Intel Corporation to tackle the critical problem of aligning reward system design with business strategy and organizational structure and culture. Drawing from the experiences of major corporations, they offer an expert system for creating and implementing this alignment.

Another article in this issue of CBR, a discussion of ransom and kidnap insurance as a growing employee benefit, was in process before the attacks occurred. With the world a far more dangerous place today than it was a few months ago, this article takes on a special relevance for all benefit managers concerned about the safety of employees who travel abroad. Only a few days after the terrorist attack, the U.S. State Department issued a worldwide caution for all Americans traveling abroad.

As is the case with most aspects of living and doing business in the United States, compensation and benefits issues are now far more complicated than they were before September 11. In the coming issues of CBR, we will continue to provide articles that help practitioners push through these troubled times.

Fay Hansen
Editor
When organizations design compensation programs, they often resort to implementing an off-the-shelf or “flavor of the month” design rather than tailoring their programs to fit their organizations’ specific needs. Because the most effective compensation programs align reward systems with business strategy, organizational structure and organizational culture, it makes sense to take the time and effort to customize reward programs. This article examines the different design choices that are appropriate for any combination of business strategy (defender or prospector), organizational structure (mechanistic or organic) and organizational culture (traditional or involvement). The article illustrates these combinations with case studies and recommendations for reward system design and implementation practices.

Many organizations have a new interest in 360 assessment, or multirater feedback, and are anxious to implement this tool. Evidence suggests, however, than fewer than 15% of top companies are actually doing so in any organization-wide way. This article discusses the reasons behind the recent explosion of interest in 360 assessment and examines some of the inherent pitfalls in approaching this process without adequate preparation. The article notes the importance of skilled facilitators and cautions that the success of any multirater tool depends on the effort that goes into it as well as the thoroughness of the follow-up process.

More companies are turning to kidnapping and ransom insurance (K&R) to protect their employees. Until recently, companies purchased K&R only for top-level international executives. However, kidnappings continue to rise worldwide, and as a result organizations are routinely providing K&R coverage to more employees. The industry has seen 15% to 20% growth each year for the past seven to eight years. The list of parallel industries spawned by kidnapping crises also continues to grow. This article reviews the current trends in K&R and reviews companies providing this insurance. The article also outlines types of coverage, prevention strategies and issues to consider when choosing a provider.
The Future of ADR in the Workplace

Mary E. Bruno
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The U.S. Supreme Court recently issued another decision endorsing the use of mandatory arbitration agreements in the workplace as a means of alternative dispute resolution of employment-related claims. Given the Supreme Court’s decision in *Circuit City Stores, Inc. v. Adams*, this article reviews the status of mandatory arbitration agreements as they apply to employment claims, in particular, claims of employment discrimination. For years, the Federal Arbitration Act has been at the center of continued controversy over employment contracts requiring arbitration of claims arising out of the employment relationship. This article focuses on the state of the law regarding the use of compulsory/mandatory arbitration agreements for employment-related disputes and reviews studies and empirical information about the cost benefit of arbitration to resolve employment-related disputes. The article includes some practical suggestions for employers who wish to consider using alternative dispute mechanisms and compulsory/mandatory arbitration.
Fay Hansen, Editor

**SALARY AND WAGE TRENDS**

- **Competition for talent remains fierce.** A new Towers Perrin study of nearly 6,000 North American workers across all organizational levels found a significant change in the mind-set of employees, creating a workforce that is more sophisticated, knowledgeable and individualistic than ever before. Far from being able to feel secure about needed talent, employers still see a need to compete aggressively in the labor markets and find new and creative ways to recruit, retain and engage the talent they do need for success.

  The study, titled *The Towers Perrin Talent Report: New Realities in Today's Workforce*, focused on employee views, examining attitudes of a diverse range of people working for medium to large companies across regions and industries. It also targeted a subset of respondents who have managerial roles and are involved in recruiting and retention. Both groups affirmed that the shifting dynamics at work in managing talent in today’s business environment have created a new reality for employers.

  From the employee perspective, four key trends emerged:

  - Employees generally are “in the market,” in some way, most of the time.
  - Employees do not place much emphasis on a long-term relationship with a particular employer.
  - Employees define their relationships with their employer in increasingly complex ways.
  - Employees care about different things when they are joining a company than when they are deciding whether to stay or how much of their discretionary effort to give.

  “Attracting the right people, who have a clear handle on their market value, and then getting them to do their best work requires employers to think more in terms of a collection of individuals—each with very different goals and needs—than a homogeneous group of workers,” said Chris Michalak, a Towers Perrin principal.

  From the company perspective, based on views of managers with people responsibilities, there is a corresponding recognition that finding and managing talent is a much more difficult game than in the past, requiring new strategies and tactics. Two trends emerged here:

  - Talent remains hard to find.
  - Companies are laying off and hiring simultaneously.

  “The fact is, the power between employer and employee in recruiting and retention shifts continually today and will continue to do so across industries, skill sets and locales,” Michalak noted. “Employers must make talent management a priority. Understanding the environment, the workforce and the key levers to unleashing employee potential is imperative.”

  The study also found that more than half (56%) of all U.S. workers in the study are in the job market in some capacity, and of these, 12% said they are actively looking. The remaining 44% are essentially “job scanners,” saying they would consider new opportunities or other offers. Employees in this group keep their eyes and ears open in various ways: 40% have talked with friends at other companies, 36% have researched job-posting Web sites and 30% have talked with a former colleague who has recently left the company.

  The job scanners are a whole new category—people who may not be ready to leave tomorrow, or even next year, but who are scanning job boards, posting resumes and waiting for something interesting to pursue. And they represent a potential “time bomb” for employers, especially because those most likely to be job scanners are the 30- to 44-year-olds who are potentially the future leaders of an organization.

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  The Internet is one of the driving factors behind the rise of this large group of job scanners. With this powerful tool at their fingertips, employees have become far more knowledgeable and sophisticated about employment and job searches than ever before. They have a wealth of information about jobs, salaries, culture and
management style readily available to them that they can collect without indicating their desire to change jobs in any overt way. Indeed, Web research is among the activities most closely related to employees’ intent to leave, and well more than one third (39%) of U.S. respondents use it in some way, as follows:

- 29% researched job-posting Web sites,
- 15% researched salary surveys,
- 12% submitted a resume to a job-posting Web site,
- 10% used a salary calculator on the Web and
- 7% researched job discussion bulletin boards.

“The bottom line is that employees are highly informed about their options, and the Internet gives them the ability and ready access to find whatever they want to know, all without risk to their current position,” said Michalak. (See Exhibit 2.)

Intensifying the mobility factor is the fact that mobility itself no longer carries the stigma it once held. Fully 60% of U.S. respondents believe that there is no longer an appropriate amount of time that one should remain with the same company. Only 10% cited 3 to 5 years as appropriate. Very few respondents, just 3%, indicated an appropriate tenure of 10 to 15 years.

Consistent with employee perspectives, the U.S. managers in the study confirmed that, despite the current economic climate, talent remains a scarce resource. The vast majority (88%) of these respondents believe that, compared with more favorable times less than a year ago, it is now just as difficult or even more difficult to recruit and retain talented employees. And even more, 92%, believe that it is as difficult or more difficult to motivate and engage employees.

Given the complex dynamic of employee mobility, scarce talent, and the need to operate and staff as efficiently as possible, especially during the current economic downturn, it is perhaps no surprise that the nature of downsizing has changed. Employers now hire and fire at the same time.

First, the study found that the vast majority of U.S. employers making cuts are still out in the market looking for talented employees:

- 73% continue to hire talented employees in the midst of downsizing, and
- 42% have created targeted programs to retain top performers.

Moreover, the study found that performance-based downsizing far outpaced other methods and decision criteria. (See Exhibit 3.) Specifically:

**EXHIBIT 1**

**Employees in the Job Market**

<table>
<thead>
<tr>
<th>Percentage of employees considering other opportunities</th>
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<tbody>
<tr>
<td>44% not considering other opportunities</td>
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<tr>
<td>44% would consider other opportunities</td>
</tr>
<tr>
<td>12% actively seeking other job opportunities</td>
</tr>
</tbody>
</table>

*Source: Towers Perrin.*

**EXHIBIT 2**

**Employees’ Use of Web for Job Search**

<table>
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<th>Research Activity</th>
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*Source: Towers Perrin.*

NOVEMBER/DECEMBER 2001
• More than half (54%) are making cuts based on performance, first trimming low-performing employees (35%) and/or business units (33%).

• Only 24% are making across-the-board cuts, and just 14% are downsizing based on tenure.

“What we are seeing, possibly for the first time, is a market where at the very time employers are laying off large numbers of people, they are also recruiting needed talent and undertaking major efforts to retain their top talent,” said Michalak. “They’re focused on identifying the key skills and talents they need and distinguishing between top and average or poor performers.”

In this environment, employers need to know more about the workforce and what levers they can pull to get the results they want. To get a better understanding of how employees view their employment relationships and how varied their desired ideals might be, the survey asked employee respondents to self-select into five categories, which included the following:

• balanced careerist: making work/life balance a priority;
• company-dedicated careerist: interested in long-term skill development;
• fast-tracker: seeking high involvement in the job, quick advancement and high rewards;
• experimenter: trying many different things and building a portfolio of skills; and
• free agent: moving quickly between/within companies where their skills are in highest demand.

Significantly, this inquiry revealed that

• 42% of U.S. employees selected balanced careerist, with company-dedicated careerist following second at 28%,
• only 6% called themselves free agents and
• equal numbers (12% each) selected fast-tracker and experimenter.

The fact that only a combined 30% of respondents called themselves either fast-trackers, experimenters or free agents—categories more likely to be associated with individual success than a company relationship—gives lie to the well-publicized myth of the “free agent nation.” Most employees, by far, want some kind of relationship with an employer, but only if it is based on mutual respect and a deal that suits their individual needs.

The study findings confirm that employees not only value a range of tangible and intangible rewards but also value different things at different stages of their careers and working relationships with a company. Although competitive base pay and health care benefits are critical fundamentals, other elements are more or less important depending on whether the employee is deciding to join, stay or fully commit.

For instance, pay is certainly an important factor in attracting potential employees, but according to the study findings, employees indicate that pay alone will not keep them in a job. When asked to estimate how much of a compensation (base salary plus annual incentive) increase they would need to leave their current job, 54% of U.S. respondents said they would require an increase of just 5% to 10%.

“What brings someone to a company is different from what keeps him or her there and is also different from what engages that person; that is, capturing the discretionary effort that produces top performance,” said Michalak. “If employers fail to distinguish among these, they fail to realize a full return on their investments in people and rewards.”
“Companies that aspire to top performance need to focus just as much attention, if not more, on engaging employees once they’re on board, and focusing them on the things that will produce results for the business,” Michalak noted.

According to the study, the specific drivers of employee engagement include such things as a reputation in the marketplace as a good employer, an environment that supports teamwork and innovation, leadership effectiveness, a culture that recognizes top performers, development and advancement opportunities and a clear line of sight between employees’ day-to-day activities and business goals.

The study included U.S. employees working for publicly traded companies, allowing for a comparison between high-performing companies (those producing top-quartile total shareholder returns, or TSR) and low-performing companies (those with bottom quartile TSR) in critical areas. There are significant differences, including the following:

- 72% of employees in high-TSR companies said that the company has a reputation in the job market as a good employer, versus 52% for low-TSR companies;
- 45% of employees in high-TSR companies said that the organization rewards top performers more than average performers, compared to 27% for low-TSR companies; and
- 44% of employees in high-TSR companies said the organization provides recognition for talented employees, but only 32% in low-TSR companies had this view.

“Companies in our study that have consistently delivered superior total shareholder return get higher ratings from employees on many of the factors that engage the workforce,” said Michalak. “These companies also ’seal the deal,’ scoring higher on performance-based pay and other rewards for performance.”

The study was conducted in the United States and Canada during April and May of 2001. A total of 5,707 randomly selected employees from companies with more than 500 employees responded. Of those, 4,942 were from the United States, and 765 were Canadian. More than three quarters of the respondents were from Fortune 1000 companies, and nearly 30% of the respondents were managers.

For more information, go to http://www.towers.com.

**Study reveals continued salary increases for IT professionals, despite dragging economy.** IT professionals with “hot” skills (skills in short supply and high demand, resulting in rapid changes in market value) are still receiving pay and perks comparable to—if not higher than—past years, according to the new Hewitt Associates 2001 U.S. HOT Technologies Survey. Hewitt, a global consulting and outsourcing firm, surveyed 198 companies, reporting data on nearly 42,000 employees with hot skills, and found that the median increase for base pay during the past 12 months was 7.5%, whereas the median total cash increase (annual base salary plus bonuses received during the year) was more than 6%. In 2000, the median increase for base pay was nearly 5%, and the median total cash increase was close to 6%. (See Exhibit 4.)

As for other types of compensation, approximately 61% of these hot skill employees received a bonus, which, on average, equaled 13% of base pay. The most common types of bonuses were planned individual (36%) and group incentive (30%). Meanwhile, 15% of employees received a long-term incentive such as stock options or grants. On average, the fair market value of these incentives equaled 82% of base pay. (The method for determining fair market value consisted of multiplying the number of shares an employee receives by the fair market value at the time of the grant.) Furthermore, study participants ranked casual dress (73%), discounts on entertainment (71%) and on-site ATM or banking services (68%) as top convenience/personal services offered. This is similar to last year when 73% of surveyed employers had a casual dress policy, 66% offered discounts on entertainment and 63% had an on-site ATM or banking service. “Although the economic slowdown has impacted the job market,
there is still a significant need to recruit, motivate and retain the best and brightest talent regardless of industry,” said Teresa Guelich, IT consultant for Hewitt Associates. “However, in the IT field especially, the scarcity of hot skill employees means that pay and/or perks need to be as competitive as possible.”

For additional information, call 847-442-7656 or go to http://www.hewittassoc.com.

**Web site employees may be long on cash compensation, but the nation’s economic slowdown has left them short on stock options and signing bonuses.** Buck Consultants’ sixth-annual Web Site Compensation Survey has found that although Web site employees’ total cash compensation increased in the range of 6% to 8% since 2000, added incentives, including signing bonuses, have decreased in popularity.

“The paychecks are getting bigger for these employees, but the bells and whistles are slowly evaporating from their total compensation package,” said Buck Consultants principal and compensation consultant Paul Gavejian. “Alternative pay structures, such as stock options and project completion bonuses, are less in vogue than they were just one year ago. So while Web site employees are bringing home more cash each week, they generally have fewer ‘extras’ to look forward to.”

Total compensation packages ranged from $33,700 for Internet customer service representatives to $363,900 for the president of an online enterprise. Online presidents saw their total compensation rise more than 12%, from $323,300 in 2000. The top 10 highest paying positions—president/online enterprise, vice president/online, head of strategic planning, head of online business development and marketing, director of online sales, director of Internet software architecture, product director/online, Web site general manager/administrator, director of network security and director of quality assurance—all experienced significant increases in base salary over the past year, and their total cash compensation overall averaged $156,790 as of February 1, 2001.

The 2001 survey examined compensation practices of 245 employers from nine industries: financial services/insurance, communications, business services/consulting/real estate, wholesale/retail, utility/transportation, publishing, manufacturing, not for profit, and “other,” which includes healthcare/hospitality/food services. The study reported on salaries of 45 Web site-related positions in 2001, up from 42 in 2000.

For additional information, go to www.buckconsultants.com.

**Female network employees earn less.** The high-pressure and often unappreciated job of running and maintaining the complex computer networks of the world’s largest companies requires sophisticated job skills, but—according to a survey of network computer professionals conducted by TechTarget—the pay is greater if you are a man. Results from more than 12,000 respondents revealed that female network professionals averaged $46,678 in annual salary, whereas their male counterparts earned $53,086.

With the demands to keep corporate networks up and running smoothly around the clock, job satisfaction among network professionals is waning. Only about 9% of all respondents indicated they were “very satisfied” with their jobs; more than 36% said their overall level of job satisfaction decreased over the past year. The online survey was conducted on TechTarget’s SearchNetworking.com, a Web site serving more than 116,000 computer-networking professionals.

Other key results from the TechTarget salary survey include the following:

- The average workweek for the network professional is 50 hours.
- Self-employed contractors earn the most money, averaging $62,892 a year. Network professionals working for utilities ranked second, averaging $62,059 annually. The education sector pays the least ($42,242 a year). Forty-four percent of respondents said they are looking for a new job primarily for better pay and benefits.
- Professional training and certification are directly related to increased compensation. For example, a Cisco certified internetwork expert (CCIE) averages $88,714 a year, topping the next highest level of network certification (Cisco certified design professional, or CCDP) by nearly $18,000.
- Network professionals want to be challenged. A third of respondents cited learning and professional growth as the reasons they would consider a new job. More than 20% said they would consider changing jobs for the opportuni-
ty to work with new technologies, and 13% said they would do so for “more of a challenge.”

- Working for a huge company does not necessarily equate to a huge difference in pay. Network professionals at small companies (less than $10 million in annual sales) average $46,101 in annual pay. Network professionals at companies more than 100 times larger ($1 billion or more in annual sales) average $62,329, only 33% more than their small-company counterparts.

For more information, call 781-657-1539 or go to http://www.techtarget.com.

**Shopping online remains popular among small but growing groups of incentive users.** American Express Incentive Services, L.L.C.’s latest Achieve More survey asked employed adults if they were rewarded with a gift card redeemable online, in stores or both, where would they be most likely to use it? Sixty percent of respondents said they would use the card in stores; only 5% said online. However, an emerging market of incentive users, more than one third, said they would want to use the card in both places.

“We are becoming a nation of multi-channel consumers,” explained Brad Boa, editor of Where It’s @, an online publication devoted to multi-channel retailing that is distributed to more than 15,000 retail professionals in 30 countries. “The need for solutions that work both online and offline is becoming more obvious.” However, most people are not ready for online options. According to the AEIS survey,

- 48% of respondents do not have a computer and/or access to the Internet at home,
- 63% cannot freely browse the Internet at work,
- 67% have never made an online purchase and
- 64% are not likely to make an online purchase in the next 12 months.

For more information, call 913-897-2400, ext. 28, or go to http://www.aeis.com.

**EXECUTIVE COMPENSATION**

**New information released on executive employment contracts.** Executive Compensation Advisory Services, a provider of executive compensation intelligence, recently released the Guide to Executive Employment Contracts—Third Edition, which features information from 100 of the most recent executive employment agreements at leading U.S. corporations. Recent trends include the following:

- The average total CEO signing bonus (cash and stock) is worth $11,194,954.
- The average new CEO receives a salary of $598,615 compared to the outgoing CEO, whose salary averaged $481,152; cash signing bonuses for recruited CEOs averaged $1,320,000.
- Employment contracts with recruited executives are less likely to contain noncompete clauses (74%) than new employment with nonrecruited executives (82%).
- Forty-six percent of continuing executives were given a company car versus 41% of recruited executives.
- Twenty-seven percent of the continuing executives signing new contracts received financial counseling benefits, compared with 11% of those recruited.
- Only 7% of the recruited executives received country club fees, whereas 29% of continuing executives received that perk.

For further information, call 703-837-9019.

**New resource available for per diem cost comparisons.** If a company sends a senior executive overseas on a short business trip to handle the delicate negotiations of a multi-million dollar deal in a foreign capital city, it must have some idea of potential travel expenses. “In response to the needs of today’s multinational employer for accurate and easily accessible per diem travel costs,” Geoffrey W. Latta, executive vice president and head of the international compensation practice for Organization Resources Counselors, Inc. (ORC), explained, “we have designed a new Microsoft Excel program that provides daily foreign living costs for 275 worldwide cities in three categories—expensive, moderate, and inexpensive—to fit your corporate budget.”

For example, lodgings at an expensive hotel in Buenos Aires are about U.S.$342 a day, whereas total daily costs for an upper-echelon traveler to the Argentine capital would run about U.S.$519 a day. Compare that with Canberra, Australia,
where an expensive hotel only charges U.S.$130, and the total daily expenses add up to U.S.$227. Beijing, China, falls somewhere in between, with the more exclusive hotels running about U.S.$228 a day and total daily expenses calculated at U.S.$350.

ORC’s new program provides rates for hotels, meals, and miscellaneous charges in both home and local currency and also quotes expenses in U.S. dollars for hard-currency locations whose exchange rates tend to devalue. “We designed the program to be updated and delivered to our clients on a quarterly basis,” Latta said, “allowing the HR administrator to set realistic guidelines for reimbursing actual expenses or establish a flat per diem that reflects accurate costs.”

For additional information, call 212-852-0439 or go to http://www.orcinc.com.

LABOR MARKETS

**Overflow of weaker candidates may make hiring top performers difficult.** Employers who believe it will get easier to find high-quality job candidates in the wake of major corporate layoffs may be in for a rude awakening. Jane Paradiso, business leader for recruiting solutions at Watson Wyatt Worldwide, said that despite the swelling number of laid-off workers, employers face new recruiting challenges that, in some cases, will be even more difficult than they faced during booming economic times. “It’s been nearly a decade since employers have been forced to hire candidates in a slowing economy, and many of them simply aren’t ready to address the different recruiting challenges that go along with that,” said Paradiso, who advises many large employers on their recruiting strategies.

One of the biggest challenges awaiting employers is a potential flood of unsolicited resumes. “Employers need to make sure that their human resources staff and systems are prepared to deal with a large volume of unsolicited resumes. Resume spamming, which easily allows candidates to send their resumes to multitudes of online job boards and corporate Web sites, is a source of potentially huge volumes of resumes,” said Paradiso. Another challenge employers face is the ability to identify the best candidates among hundreds of resumes and applications. “The vast majority of new resumes will be from weaker-performing candidates since, in many cases, companies do not lay off their top performers,” said Paradiso. “Aside from having an applicant tracking system with a sophisticated search engine, an effective way to find qualified candidates is through screen and assessment tools. There are many available online that can be integrated with a corporate Web site or third party assessment site.”

Recruiting passive candidates—highly talented workers who are usually in high demand but not actively looking for a new job—represents another challenge for employers. “Hiring a passive candidate from another company is a real coup, but these sought-after workers are often reluctant to make a change in what they perceive to be an uncertain labor market,” Paradiso observed. Paradiso tells employers that one of the best ways to attract passive candidates is with a long-term employment branding campaign. “The goal is to make sure top-performing employees at other companies view the hiring company as an attractive, if not the best, place to work. The most easily recognized method for fostering a well-respected employment brand is to build a Web site that effectively targets and interests job seekers, and makes it easy for candidates to apply,” said Paradiso.

For additional information, call 202-715-7094 or go to http://www.watsonwyatt.com.

**Turnover and staff shortages in healthcare.** Unifi Network, a subsidiary of PricewaterhouseCoopers LLP, released the findings of its Total Compensation in Integrated Healthcare Systems: 2001 Survey. Findings indicated that the healthcare industry faces increasing employee turnover costs and critical staff shortages as it confronts significant challenges attracting and retaining top talent while containing costs.

Based on survey results, a conservative estimate of employee turnover costs for a typical healthcare system ranges from $14 million to $27 million per year. To minimize the direct costs associated with turnover and maintain or increase the quality of patient care, Unifi Network recommends that healthcare systems do more in terms of implementing creative solutions that attract and retain talent. “Organizations within the healthcare industry do not see turnover and retention as costs that affect their bottom line as much as other costs, and don’t realize that there are ways to reduce them significantly without affecting quality of service,” said David Hofrichter, national compensation practice leader at Unifi Network. “Improving the cost of retention alone
in the typical healthcare system creates some real opportunities that could mean the difference between moving a losing year to break-even, or a break-even year to a good year.”

Additional efforts that can be taken by organizations to contain costs include initiating business process initiatives, managing employee compensation and benefits expenses and outsourcing various services. At the corporate executive level, Uniﬁ Network recommends that organizations consider using performance metrics that are more growth oriented as opposed to simply cost driven and focus people on redefining the total service model. The survey found that CEOs and other executives are currently being held accountable for overall metrics such as operating income (100%) and revenue (66.7% for CEOs and more than 50% for other executives), but these goals are not necessarily driven down through the rest of the organization.

Seventy-ﬁve percent of the healthcare systems surveyed said that their ﬁnancial results are the same or worse than in recent years. Close to 100% of these organizations are looking to reduce their own healthcare spending as a major cost savings initiative to support better business performance. Alarmingly, the survey found that 90% of organizations interviewed face critical staffing shortages that could be attributed to fewer qualiﬁed candidates. Those companies also stated that they expect to experience staffing shortages in the next 12 months, particularly in the nursing sector. Furthermore, 35% of participants indicated having a long-term vacancy (6 months or more) in key positions within the past 18 months.

For further information, call 201-530-2021 or go to http://www.unifi.com.

The Bureau of Labor Statistics reports productivity declines. The Bureau of Labor Statistics of the U.S. Department of Labor recently reported revised productivity data—as measured by output per hour of all persons—for the ﬁrst quarter of 2001. The revised seasonally adjusted annual rates of productivity change in the ﬁrst quarter were the following:

• 1.4% in the business sector and
• 1.2% in the nonfarm business sector.

In both sectors, the ﬁrst-quarter productivity gains were lower than those reported initially on May 8. In manufacturing, the revised productivity changes in the first quarter were

• 2.1% in manufacturing,
• 2.4% in durable goods manufacturing and
• 2.0% in nondurable goods manufacturing.

The declines in manufacturing productivity reﬂected decreases in output that were larger than the corresponding decreases in hours worked. The productivity decline in manufacturing was the ﬁrst recorded since the third quarter of 1993, when it fell 0.6%. Output and hours in manufacturing, which includes about 16% of U.S. business sector employment, tend to vary more from quarter to quarter than data for the more aggregate business and nonfarm business sectors.

For more information, call 202-691-5902 or go to http://stats.bls.gov.

INTERNATIONAL TRENDS

Worldwide coordination of retirement assets holds promise. The globalization of business, with its increased competition, is placing greater demands on companies to achieve quality improvement, rapid innovation and effective cost management. One area in which globalization itself holds promise for meeting these goals is in the coordination of retirement plan assets across a company’s worldwide operations. A survey conducted by global human resource consulting ﬁrm William M. Mercer found that there is growing interest among multinational corporations in this area. However, activities are mixed, and there is little empirical data as to what constitutes best practices. “Some very signiﬁcant and measurable beneﬁts are available to multinationals that focus centrally on their global pension investments,” said Mercer consultant Robert Baker. “These have been recognized by the multinationals that have already started down this road. Companies that have not yet done so are missing out on real ﬁnancial savings.” Many multinational head ofﬁces are already coordinating the investments of their local plan subsidiaries to some degree; this trend seems set to accelerate, particularly in the United States. More than half of the survey respondents (51% of U.S. multinationals, 56% of non-U.S. multinationals) already exercise some form of corporate involvement in, or oversight of, local plan investment decisions. There is
a distinction, however, between involvement in the decision process and control of it, reflecting the role of local fiduciaries.

The difficulties of fully controlling the local process do not appear to deter headquarters executives from seeking some form of oversight. More than 72% of the U.S. multinationals that do not currently exercise oversight expect to start doing so in the next two years; among non-U.S. multinationals—primarily European—the corresponding figure is 39%. “The survey underscores the existence of a global interest in greater oversight, and suggests that it will accelerate sharply in the next couple of years,” Baker said. “Those who have started down this path are looking to deepen their involvement, suggesting they are satisfied with the initial results.”

For additional information, call 202-331-5210 or go to http://www.wmmercer.com.

**Despite concerns about complex legislation and administration, global share plans continue to be used by most FTSE-350 companies.** British multinationals are extending their employee share plans outside of the United Kingdom, with global share plans now operated by 64% of FTSE-350 companies participating in a survey by Watson Wyatt. However, many U.K. companies believe they are constrained by complex legislation in other countries, as well as tax and exchange rate issues in the setting up and operation of global share plans. “These are the problem factors highlighted by those companies already operating global share plans,” said Richard Cockman, the partner at Watson Wyatt with responsibility for the Watson Wyatt Global Share Plans UK Survey Report 2001. “Interestingly, those companies considering introducing global share plans have concerns about complex administration, inappropriate pay conditions and the cost of operation. Our findings suggest that such companies may unnecessarily fear certain challenges and underestimate other issues when planning the introduction of a global share plan.”

Savings-related share option schemes are the most common type of global share plan, used by 60% of companies in Watson Wyatt’s survey that operate global share plans. Share purchase schemes are used by 37% of companies with global share plans, and a further 17% of companies operate “free shares” schemes. Some companies operate more than one type of scheme. “In an increasingly competitive and global market, share plans are becoming the preferred tool to focus employees on common business goals,” said Cockman. “As companies are becoming increasingly global they are taking a global approach to all-employee share plans.”

For more information, call +44 (0)1737 284938 or go to http://www.watsonwyatt.com.

**Benefit Trends**

- **Majority of relocation packages go to senior executives.** A Towers Perrin analysis of 363 proxy statements between 1998 and 2000 found that more than half of the top 50 corporate relocation packages, constituting expense amounts of $250,000 or more, went to senior executives inside organizations as opposed to new hires. This study provides evidence of two important facts of corporate life,” said Ted Jarvis, a Towers Perrin consultant. “First, even senior executives in the highest echelons in their organizations are from time to time asked to relocate. Second, relocation payments can represent significant additional executive compensation value, regardless of whether such payments are made to either retain or attract top executive talent.

“The general assumption has been that the largest relocation packages are negotiated at the outset of the business relationship, when the negotiation leverage over the size of pay and benefits is thought to be greatest,” Jarvis continued. “Yet the actual finding shows that only slightly less than half of the top relocation packages go to new hires. That’s something of a surprise.” Average cost of the top 50 corporate relocation packages in the study was $452,168, whereas the average cost of all of the 363 relocation packages measured in the study was $128,663. A significant proportion of the largest relocation packages is for moves to some of the most expensive geographic markets in the world, including the New York City metropolitan area, the San Francisco Bay area, London and Hong Kong. Tax gross-ups can often comprise 40% to 60% of a relocation package and are estimated to comprise 30% to 50% of the aggregate value of the executive relocation packages in the sample.

For further information, call 914-745-4179 or go to http://www.towersperrin.com.

- **Automatic enrollment may hurt employees’ asset accumulation.** Research shows that automatic enrollment—the practice of auto-
matically signing up employees to participate in a company’s 401(k) plan unless they specifically choose not to—can increase participation rates, but according to new research by Hewitt Associates, in conjunction with faculty and researchers from Harvard University and the University of Chicago, automatic enrollment can work against some employees’ asset accumulation as well, affecting their ultimate retirement income security.

Earlier research indicates that although automatic enrollment increases 401(k) plan participation rates, automatically enrolled participants tend to remain at the company’s default elections, which often involve contribution rates of just 2% to 3% and conservative, low-returning investment funds, such as money market or stable value funds. The Hewitt study examined the participation and default behavior of 100,000 eligible employees hired before and after automatic enrollment was initiated at three U.S. companies over a two- to three-year period. The study indicated that many employees remain at the contribution rate and asset allocation elections from the automatic enrollment default even after years in the plan. At one company, more than three quarters (76%) of automatically enrolled employees with 5 months of tenure were contributing at the default savings rate of 3% and had 100% in the default money market investment fund. Two years later, although the number had dropped, it was still high—more than one third (39%) of automatically enrolled employees with 26 months of tenure were contributing at the default savings rate of 3% and had 100% in the default money market option. In contrast, only 2% of participants hired prior to automatic enrollment were contributing at the default rate and invested 100% in the most conservative investment option.

For additional information, call 847-442-7663 or go to http://www.hewittassoc.com.

Health promotion programs grow. Even with double-digit health care cost increases, a slowing economy and new legislative regulations, a new study by Hewitt Associates still showed that 92% of U.S. companies currently offer some kind of health promotion program, up from 88% in 1995. “Due to increased cost pressures, employers are looking for creative and effective solutions, such as health promotion and medical management programs, that can provide cost savings, reduce absenteeism and increase productivity,” said Camille Haltom, a health care consultant with Hewitt Associates. “Organizations will continue to offer health programs in an effort to contain skyrocketing health care costs and enhance employees’ health.” The following summarizes various types of initiatives that a growing number of companies are offering:

- Seventy-one percent of companies now offer employees some kind of education or training, a 5 percentage point increase since 1995. Programs range from seminars and workshops to counseling for lifestyle habits that contribute to chronic or acute conditions.

- Financial incentive and disincentive programs hold steady with 40% of companies continuing to offer them, compared with 32% in 1995. The most common incentives companies offer are gifts or monetary awards for employees who participate in health appraisals or screenings. Examples of disincentives include charging employees higher medical or life insurance premiums if they smoke, or giving employees a lower medical benefit payout if they were not wearing a safety belt while involved in a car accident or are under the influence of alcohol or drugs.

- Nearly three quarters (74%) of employers use health screenings, compared with 67% in 1995. Most administer screenings to detect high blood pressure or cholesterol through their health plans or via on-site health fairs, mobile units for mammography or other screenings.

- The majority of employers offer disease management (77%) and wellness programs (67%) to employees as part of their health plan benefits design, whereas some companies self-administer wellness (34%) and disease management (10%) programs. “Many companies have either implemented disease management programs this past year, or are exploring them as part of their health care strategy for 2002,” said Haltom. “Organizations have been interested in disease management programs for several years now and it’s growing in popularity because the market is mature enough for health plans and specialty providers to address employer’s needs and help contain costs.” (See Exhibit 5.)

Earlier this year, new regulations on the nondiscrimination provisions of the Health Insurance Portability and Accountability Act were issued stating that HMOs and group health plans (both insured and self-insured) may not discrimi-
inate against individuals by basing eligibility, enrollment, premiums or contributions on any “health status–related factors.” Many employers closely watched these regulations and wondered what the impact would be on their health programs. “The majority of wellness and medical management programs will not have to change in order to comply with the proposed regulations because most programs do not require participants to attain lower risk levels or health status improvements in order to qualify for rewards or incentives, but instead focus on participation, risk reduction and/or better self-directed health management,” said Haltom. “However, employers should still review their wellness programs and medical management programs to ensure that they either comply or are excepted from the regulations. In some cases, focusing on actual risk reduction may be okay as long as the employer provides support in the form of a bona fide wellness program or initiative.”

For more information, go to http://www.hewittassoc.com.

<table>
<thead>
<tr>
<th>Percentage of employees offering benefits</th>
<th>77% disease management</th>
<th>74% health screenings</th>
<th>71% health education</th>
<th>67% wellness programs</th>
<th>40% financial incentives/disincentives</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Source:</strong> Hewitt Associates.</td>
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</table>

Rising health care costs spur supplemental insurance. Higher out-of-pocket expenses for employees will increase their need for supplemental insurance products, according to Cherie Tibbetts, vice president for products and marketing at Colonial Life & Accident Insurance Company. “Employees may be forced to select lower levels of coverage or plans with higher deductibles in order to afford their major medical insurance,” Tibbetts explained. “That can leave them with coverage gaps or increased financial exposure in the event of an accident or serious illness.”

A new study recently released by Health Industries Research Companies (HIRC) showed that employers will increase employee contributions and raise pharmacy benefit copayments to combat the double-digit health care cost increases expected in the next two years. Supplemental insurance is designed to complement an employer’s benefits plan by offering employees additional coverage that they select and pay for themselves to meet their personal family needs. This allows employers to offer an expanded benefits package at no direct cost to the company. According to the HIRC study, employers are looking for this kind of innovative solution to share the financial burden of employee benefits. Supplemental plans typically pay benefits directly to policyholders (unless the policyholders direct otherwise) no matter what other insurance they may have. Policyholders can use the money to pay deductibles, copayments or additional living expenses not covered by traditional major medical plans.

For further information, go to http://www.hirco.com.

**Majority of employees are willing to pay more for less-restrictive medical plans.** When it comes to employer-sponsored health benefits, a majority of workers want more choices and are even willing to pay more to receive them. Many workers also favor a “defined contribution” payment system but do not want their employers to get out of the business of administering health benefits. These are among the major findings of a study of employees and employers conducted by Watson Wyatt.

Watson Wyatt’s 2001 Best Practices in Health Care Vendor Management study is based on face-to-face interviews with 255 large employers and survey responses from more than 10,000 workers at 18 organizations. More than half of employees surveyed (55%) want a greater choice in their medical plan, and most are willing to pay more for plans they perceive as less restrictive. Fifty-four percent of employees also prefer paying larger copayments at the time a service is received, whereas 25% prefer paying higher premiums.

“Allowing employees to choose from a variety of health plans is associated with employee satisfaction, and consumers are now demanding a choice of physicians and treatments,” said Steve
Richter, a senior health care consultant with Watson Wyatt and coauthor of the study. “But employers will need to carefully consider the various implications of expanding employee choice.” Even though their employees want more plan choices, only 15% of companies say adding more health plan choices is a high priority. A majority of companies believe that adding options would ultimately increase their administrative burden, reduce their negotiating power with health plans and increase employee confusion.

For additional information, call 202-715-7094 or go to http://www.watsonwyatt.com.

Funded status for pension plans declines in 2000. A preliminary analysis of 20 of the largest U.S. corporations by Milliman USA revealed that the funded status of their pension funds declined more than $30 billion during 2000. The average loss per company was more than $1.5 billion. For this group, the loss represented more than 25% of pension surplus. During the same period, the pension plans of these companies posted almost $7 billion to corporate profits, averaging about $350 million per company. Had the actual return on assets during 2000 been immediately and fully reflected in the year 2000 income figures, those companies would have reported an expense of more than $19 billion instead of the income of $7 billion—a $26 billion swing. This reverses a trend in recent years in which actual returns exceeded those expected by equally significant margins.

It is anticipated that these same firms will once again report income—not expense—from their pension plans for 2001 and for the foreseeable future. Pension accounting techniques allow for the deferral and smoothing of gains and losses, insulating a company’s own financial results from temporary market fluctuations. Under these smoothing techniques, pension expense for 2000 will reflect only a small portion of the loss in 2000, offset by deferred gains earned in prior years.

The drop in funded status for these plans was primarily the combined effect of three separate factors, each with different implications:

- **Weak asset returns.** For this group of large employers, expected investment return for 2000 was $32.7 billion. Actual investment return on plan assets turned out to be $6.5 billion. These pension funds earned more than $26 billion less than expected. On average, although these plans had been expecting to earn a 9.5% return, they actually earned only 1.3%.

- **Lower interest rates.** During 2000, the interest rate used to measure pension liabilities declined by 25 to 50 basis points. This drop in interest rates generally raises pension liabilities in plans like these by 2% to 5%. For these plans, a change within that range would have eroded funded status by $6 billion to $14 billion. In other words, the remeasurement due to changing interest rates was a large component of the $15 billion increase in liabilities for the firms studied.

- **Maturity of plans.** The strong funded status of these plans meant that current cash contributions to these plans were relatively low, only $6 billion for the group. Due to the aging of the labor force, benefits paid from the plans were almost $27 billion, almost $21 billion more than the contributions into the pension funds.

For most plans, a drop in funded status does not adversely affect the current balance sheet of the employer. Any eventual adverse effect on the employer’s balance sheet would require numerous additional years of adverse pension investment experience, combined with low funding from employers, along with further maturing of the workforce. An employer’s balance sheet is immediately and directly affected by current market and interest rate conditions for any plan with insufficient assets to cover currently accrued benefits. For such underfunded plans, a minimum liability rule under SFAS 87 applies. Although overall the pension plans for the companies included in this study were sufficiently funded to avoid this rule, many other employers do have plans with minimum liability requirements that could be highly volatile, moving with market conditions.

For more information, go to http://www.millimanusa.com.
Reward system design and implementation is most often guided by best practice surveys or by normative models established by the compensation profession. This practice of imitating the reward systems of other organizations benefits those organizations that intend to use reward system practices to move company performance from below average industry performance to average industry performance. On the other hand, companies need to create unique reward systems (as well as other HR practices) to use reward systems to drive company performance above the industry average.

One critical element in designing and implementing a unique reward system is to carefully tailor the design and implementation of the reward system to the business strategy, structure and culture of the organization. The effectiveness of creating an alignment between these organizational systems has been clearly established in the practitioner and academic literature. Missing from both the practitioner and academic literature, however, is guidance on how to align these organizational systems.

This article describes and illustrates an expert system that can be used to align reward systems with the business strategy, structure and culture of organizations. The phrase “expert system” in the context of this objective refers to recommended reward system design and implementation practices for various forms of business strategy, structure and culture. The article first describes four major systems of the organization: business strategy, structure, culture and rewards. It then describes the alignment of these systems with one another. Finally, it presents recommended reward systems for each configuration of business strategy, structure and culture.

Organizational Systems
Many different frameworks of systems that comprise organizations have been advanced over the
years. Common to many of these frameworks are the following systems in organizations: business strategy, organizational structure, organizational culture and rewards. Then, adding further complexity, each of these three systems of the organization have been operationalized with a variety of models. In this section, each one of these systems will be described using the most well-known models in the literature. By using the most well-known models, the reader will be able to link this discussion of reward systems to the broader literature on these organizational systems and their relationships with organizational effectiveness.

**Business Strategy**
According to Miles, Snow, and colleagues,7–9 organizations differ from one another by the business strategies that they pursue. Organizations may be prospectors or defenders depending on their business strategies. Exhibit 1 shows the business strategies of prospector and defender strategies. Prospector firms are proactive in their interactions with the environment. They actively seek out new business opportunities to expand on or redefine their existing lines of products and/or services. Defender firms are more reactive in their interactions with the environment. These businesses act to enhance and fortify existing product or service lines through increased quality, changing prices and other activities.

Because organizations often have multiple business strategies rather than a single business strategy, a traditional, bureaucratic organization may or may not have a defender business strategy for all of its business units. A traditional bureaucracy might, for example, have new start-up firms to enhance their offerings.

Public as well as private sector organizations have business strategies. Given the bureaucracy associated with government, it is tempting to assume that all public sector organizations follow a defender strategy. Although this often occurs, there are exceptions. For example, in Ohio, a new state agency was created to help the K-12 school system wire all classrooms in the state for Internet access as well as to learn how to best use this technology. Legislation was passed to, in essence, make this new agency independent of the bureaucratic ground rules found in many state government agencies. As a result, this new agency was able to pursue a prospector strategy.

As a last cautionary note, sometimes people assume that unionized organizations are all defender-type organizations. As a general rule, this holds true; however, there are exceptions. Increasingly, unions organize employees in companies with prospector strategies, including information systems and health care.

Given that traditional stereotypes regarding business strategy may not hold, designers and implementers of reward systems must carefully assess the business strategy of each part of the organization. To do this, they must collect data from the organization, including mission and vision statements and operational plans. From this information, they can make an assessment about which segments of the organization follow which business strategy.

**Organizational Structure**
Burns and Stalker10 made an important distinction in the different ways that work can be organized to achieve the organizational goals spelled out in the business plan. Exhibit 2 shows the two major ways to organize, or structure, work.

When work is organized in a mechanistic structure, it resembles a bureaucracy. Customers of an organization with a mechanistic structure are likely to encounter service representatives that can only play a limited role in resolving problems. Customer service providers must escalate any problems that fall outside standard scripted responses to their managers for resolution; frontline personnel have almost no latitude to exercise discretion. Although this mechanistic approach is slow and not very responsive to customer needs, it does ensure predictable and consistent products and services.

By contrast, customers of organic organizations are likely to find much more tailored

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**EXHIBIT 1**
Defender versus Prospector Business Strategies

<table>
<thead>
<tr>
<th>Defender</th>
<th>Prospector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Located in stable product or service markets</td>
<td>Located in changing product or service markets</td>
</tr>
<tr>
<td>Offers a narrow range of products or services</td>
<td>Offers a wide range of products or services</td>
</tr>
<tr>
<td>Protects product or service market from competitors</td>
<td>Locates and exploits new product and service markets</td>
</tr>
<tr>
<td>Competes on the basis of low cost and/or high quality</td>
<td>Competes on the basis of innovation</td>
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</table>
Responses to their problems. Employees have a wide range of latitude in performing their jobs and can operate across organizational boundaries to resolve problems. Although service providers may be quick to respond in organic organizations, customers may not receive predictable or consistent services.

Organizational Culture
Business strategy and organizational structure are formal systems of organizations that can be verified through formal statements such as mission statements and organizational charts. Organizational culture, a system that reflects the values and benefits held by the organization, tends to be a less formal system. As such, culture is much more difficult to assess using archival records. Instead, surveys and unobtrusive measures need to be used to assess the culture of the organization. For example, at NCR, employees completed upward appraisals about their supervisors as to how empowered they feel. At Xerox, anthropologists have conducted participant/observer studies to describe employees’ beliefs and values.

One way to view culture in an organization is to determine whether it is a traditional culture or an employee involvement culture. Exhibit 3 shows differences between a traditional and an involvement culture. Traditional cultures are grounded in a military command-and-control model in which orders come from the top of the chain of command and are communicated down through the organization for execution by employees. Control systems exist to ensure that the plans are executed in the intended manner.

Involvement cultures are grounded in the concept of clans, in which people bond together to do whatever it takes to get the goal of the clan accomplished. Members of clans share in the decisions about what needs to be done to further the goals of the clan. Feedback from the job itself, rather than control systems by managers, is used to ensure that the goals of the organization are met.

Rewards
It has long been known that reward systems are multidimensional, and the process used to determine rewards can be as important as the amount of the reward received. Given these long-standing premises of reward systems, Exhibit 4 shows the important characteristics of reward systems.

➤ Reward form. There are two types of rewards that organizations can use for goal achievement: monetary and nonmonetary. Monetary rewards refer to rewards with a recognized cash value like base pay, pay increases, bonus pay, stock options and benefits. Nonmonetary rewards are rewards with less well-known cash value such as recognition, training and psychological characteristics of work.

➤ Unit of analysis. Organizations can allocate rewards either on the basis of the employee’s duties and responsibilities or the employee’s qualifications. When duties and responsibilities determine rewards, they are referred to as job-based pay. When rewards are allocated for the
qualifications that an employee brings to the job, they are referred to as person-based pay.

➤ **Value comparisons.** In determining the value of the rewards to offer employees, the organization must establish a value benchmark. Organizations can assess value either through an internal or external comparison. Companies use work evaluation to establish the internal value of jobs and people to the organization. Organizations conduct market surveys to assess the external value of jobs and people (i.e., the amount of reward provided for a comparable job or person in a similar organization).

➤ **Reward measures.** To issue rewards, an organization must assess how well the employee is performing the job, and some sort of measure is needed to assess performance. Performance standards typically include both behaviors and results. Behaviors measure what the person does, whereas results measure what the person accomplishes. At General Electric, behaviors are referred to as the “how,” and results are referred to as the “what.”

➤ **Reward levels.** An employee is a member of a number of groups in an organization. Different types of groups include teams, departments, divisions, sectors and the entire organization. Collectively, these groups are often labeled as business units. Organizations must decide whether to deliver rewards based on individual employee performance or business unit performance.

➤ **Administrative level.** Decision rules and reward system administration can be managed at a centralized level (i.e., corporate) or at a decentralized level (i.e., business unit).

➤ **Timing.** A reward system can either lead or lag the implementation of other organizational systems (i.e., business strategy, organizational structure and organizational culture). That is, the reward system can be designed and implemented before (lead) or after (lag) the design and implementation of other organizational systems.

➤ **Communications.** Organizations can communicate information about the design and implementation of a reward system in an open fashion whereby all employees have access to the information or in a closed manner whereby only some employees (usually managers) have access to the information.

### Alignment of Organizational Systems
For organizations to perform successfully, the business strategy, organizational structure, and reward systems must align with one another. The ideas and practices within each system must be consistent with those of the other systems, as depicted in Exhibit 5.

### Strategy and Structure
The business environment surrounding an organization drives the alignment of strategy and structure. In a stable business environment, organizations have the luxury of time to react to changes in the environment because they do not occur frequently. As a result, a stable environment is consistent with a defender business strategy and mechanistic organizational structure. Infrequent changes in the business environment along with a stable strategy also allow time for organizations to develop mechanistic structures to withstand the test of time. Although there still are some examples of stable business environments in the world, the business environment for most organizations is becoming much more turbulent.

Misalignment between strategy and structure usually occurs when an organization adopts a new prospector strategy but retains its mechanistic structure. Under this common scenario, a new CEO hastily enacts a new business strategy in response to changes in the business environ-
ment. Because of the length of time it takes to create a new structure, the old structure may be left intact and decrease organizational effectiveness. Alternatively, the old structure may be retained because there is fear that employees will not have the skills or willingness to work under a new structure.

**Strategy and Culture**

Both an organization’s formal strategy as well as its informal culture must align with its structure. This alignment between culture and strategy contributes much to organizational effectiveness. Among other things, a willing culture provides energy to overcome the formal structure that may require change.

Alignment of strategy with culture takes place when a defender strategy is coupled with a traditional culture and when a prospector strategy is aligned with an involvement culture. In the former example, people expect to perform in rigid roles, and the strategy allows them to because of a stable business environment. In the latter case, people expect to develop new roles, and the strategy requires them to do so because the rapidly changing business environment no longer provides role stability.

A common misalignment between business strategy and organizational culture takes place when an organization imposes a prospector business strategy on a traditional culture. If people are not ready or capable of adjusting to new roles required by the formal business strategy, the traditional culture may thwart efforts at change. A less common misalignment happens most frequently in corporate mergers or acquisitions. If a company with a defender strategy acquires a group with an involvement culture, employees may become frustrated at the parent company’s bureaucracy and inward-focused practices.

**Strategy and Rewards**

Rewards can encourage employees to carry out a business strategy. By providing rewards for producing results consistent with the business strategy, organizations can use new forms of rewards such as competency or skill-based pay to motivate employees to learn new behaviors.

For reward systems to align with the business strategy, each component of a pay system must be consistent with the business strategy. Pay system components include job analysis, job evaluation, market surveys, pay structures and performance measures. Heneman provided theory and case studies that indicate that prospector strategies are more likely to be successful when the business strategy is supported by a competency-based job analysis and job evaluation systems, when broad pay ranges are used and when performance measures are used at all levels of the organization. Alternatively, defender strategies succeed more often when the business strategy is supported by a job-based job analysis and job evaluation system, when pay ranges are narrow and when incentives emphasize cost and quality performance measures.

**Structure and Culture**

Organizational structure describes what employees should do, whereas culture describes what employees actually do. For organizations to be effective, what employees should do and what they actually do should align with one another. Mechanistic structures work well with traditional cultures, whereas organic structures work well with involvement cultures.

A common form of misalignment that can detract from organizational effectiveness occurs when an organic structure is imposed on a traditional culture. Employees may be very fearful of new roles because they may not have the skills
required to operate in an organic structure. Also, they may not be interested in doing the new things required by an organic structure, like being more flexible, working longer and exhibiting creativity.

Structure and Rewards
Many organizations in today’s business environments are attempting to move from mechanistic to organic organizational structures. Reward systems can help motivate employees to welcome organic structures. One type of organic structure receiving recent attention is the virtual organization. A virtual organization usually has the following characteristics: team based, temporary, alliances across functions or companies and a technology backbone.

To encourage employees to perform in these new work environments, virtual organizations use nontraditional forms of pay including stock options, profit sharing and variable pay plans. Moreover, as an organization evolves to become more virtual, it may offer pay forms that change to support that evolution.12

An example of virtual organizations can be seen with new product development and operations teams in a computer storage company that we have consulted. These highly effective teams, composed of members from different departments, work together for approximately 18 to 36 months and are then disbanded. The teams have evolved over time to become more highly functional and more virtual; as the teams’ structure and culture evolved, so have their reward systems.

The first reward program, developed for novice, nonvirtual teams, added team members to a discretionary cash bonus plan designed for senior managers and key employees. The next iteration of team rewards corresponded to the intermediate stage of the teams’ development and “virtualness.” This separate team incentive plan used business results and team development as the main measures and scored each using individual and team components.

The company, with consulting from us, designed the third reward system to address the needs of the newly advanced and high-functioning virtual teams. The team-based incentive program uses both strategic and competency measures. With guidance from senior management, the teams themselves develop, review and revise their own incentive plans. Although their plan currently pays out in cash, the company plans to move to a flexible, cafeteria-style menu of payout options as the program and the teams themselves evolve.

Culture and Rewards
Rewards can also help hasten change from traditional to involvement cultures. For example, Exhibit 3 shows that risk taking is an element of an involvement culture. When people take risks, they sometimes need rewards to justify the risks. New forms of rewards, such as bonuses and stock options, provide incentives for risk taking.

**Even organizations with traditional cultures that have been in place for a long time can move toward a more involvement-type culture.**

Even organizations with traditional cultures that have been in place for a long time can move toward a more involvement-type culture. The first author has worked with several unionized organizations where it would be unthinkable to arrange for mutually agreed on terms of employment outside of those agreed on at the collective-bargaining table. However, when pay for performance was used to supplement traditional seniority-based pay, the unthinkable happened. The conditions for the pay-for-performance plan were agreed on by consensus outside of the collective-bargaining process. Moreover, other issues (e.g., grievances) also began to be resolved outside the formal labor-arbitration process. Hence, changes in the pay system helped provide a change in the culture from one of formal conflict resolution procedures to less formal problem solving between the parties without the assistance of a third-party arbitrator.

Integration of the Alignment Model and Reward System Components
For reward systems to add value to the organization, the components of the reward system shown in Exhibit 4 must be integrated with the alignment scenarios between the business strategy, organizational structure and organizational culture. Exhibit 6 shows an expert system of reward system integration with business strategy, structures and culture. Exhibit 7 shows each reward
system component required by various alignment scenarios. Each compensation system is described below in turn.

**Reward System 1**

Reward System 1 requires a very traditional compensation system for a traditional business organization. Examples here include public sector agencies that have defender strategies, are bureaucratic in design, mechanistic in operation and staffed by unionized employees. Under these circumstances, the reward system lags the business strategy, is developed and administered by a central group and focuses on rewarding individuals on the basis of the successful completion of work activities spelled out in a job description.

For example, one of the authors has worked with a large state agency and with a large county agency. Both agencies had a large number of unionized employees. The reward systems developed had a heavy emphasis on the job and individual contributions to the job. In the case of the state agency, the successful completion of job duties was evaluated by evaluators in a merit pay system, whereas in the county agency, both seniority and performance counted toward pay increase decisions. Performance, often not used in unionized settings, was recommended by the consultant and accepted by the union because they could see that the changing demands of the business environment would eventually translate into a new business strategy, structure and culture more consistent with rewarding performance rather than membership in the organization (seniority).

**Reward System 2**

A more fluid approach to rewards is required under Reward System 2 than under Reward System 1 because the involvement culture of the organization demands it. However, because the organization's strategy (defender) and its structure (mechanistic) are highly disciplined, rewards in this system are still relatively conservative.
### EXHIBIT 7
**Recommended Reward System Characteristics for Each Reward System Type**

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<tr>
<th>Reward System Characteristic</th>
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<tr>
<td>Unit of analysis</td>
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<td>Job/ person</td>
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<td>Reward measures</td>
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<td>Central/ decentralized</td>
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<td>Lead</td>
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<td>Closed</td>
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One author worked with a unionized team within an old-line industrial manufacturing organization to implement a small, team-specific profit-sharing plan. This plan, negotiated with the union, rewarded employees for saving energy and increasing production. Because the affected employees all had long tenure with the company and had developed a high degree of trust and teamwork, the profit-sharing program was implemented easily and showed positive results quickly. Because this new reward program was limited to the part of the organization with an involvement culture, it did not cause issues with the more traditional culture of the company at large.

To fit an involvement culture together with a defender strategy and mechanistic structure, the reward system needs to be composed of elements of a traditional reward system and a more fluid reward system.

To fit an involvement culture together with a defender strategy and mechanistic structure, the reward system needs to be composed of elements of a traditional reward system and a more fluid reward system. By having elements of both, the command-and-control culture does not overwhelm the involvement culture or vice versa.

**Reward System 3**

Reward System 3 is appropriate for an organization with a defender strategy, an organic structure and a traditional culture. The type of situation appropriate for Reward System 3 is one in which a traditional organization realizes that it must change, and to do so uses the organizational system as the platform for change. For example, one of the authors developed a reward system for a new state agency charged with developing the information technology capabilities of all primary and secondary schools in the state. This task was highly complex because it required integrating state-of-the-art computers and learning methodologies with a large number of traditional school districts with almost no technology. Initial funding was extremely large, so the business strategy adopted was a defender position. Most employees hired for the project came from state agencies with a traditional culture. To adapt to the constantly changing needs of the client base, the structure was very organic and changed often.

Presented with this set of contingencies, a Type-3 reward system was designed and implemented. To support the command-and-control culture, elements of traditional reward systems were retained including a job, internal equity and individual emphasis. To support desired changes in the business strategy from defender to prospector and organizational culture from traditional to involvement, new pay elements were also put in place including an emphasis on the person, internal equity and business unit measures. Finally, to warm the organization to a new business strategy and culture, the leading reward system emphasized variable pay and a focus on behaviors rather than results. This approach showed employees that pay increases would not always be permanent and showed them how to behave under a new business strategy, culture and structure (e.g., customer service orientation).

**Reward System 4**

Reward System 4 is appropriate for organizations that have an involvement culture, organic structure and defender business strategy. Like the examples for Reward Systems 2 and 3, the organizational systems do not align; however, the reward system can guide the alignment of the organizational strategy with its culture and structure.

An example of this type of situation is a national educational products distribution company that used an organic structure to work with those employees highly involved in business decision making coupled with a defender business strategy. The company used a defender business strategy because it was the only one-stop location for primary and secondary school teachers to buy supplies. Senior management failed to recognize that their competitors could copy their business model and that a smaller company might eventually buy out the company.

At this organization, the consultant installed Reward System 4. It was implemented as a lead...
rather than lag system in hopes of showing senior management how they needed to be more sensitive to possible changes in the business environment. To make the point, greater emphasis was placed on external rather than internal equity, on results rather than behaviors, on business unit performance rather than individual performance and variable pay rather than fixed pay. Also, data about the market (e.g., salary data) were made accessible to employees as well as managers to sensitize them to market realities.

**Reward System 5**

In the situation most appropriate for Reward System 5, the business strategy (prospector) is not in alignment with the structure (mechanistic) or culture (command and control). Again, the reward system can be used in a lead fashion to bring about alignment. For example, one of the authors consulted with a gourmet food packager and distributor. Owned by an industrial engineer in a rural, midwestern community, it used a mechanistic structure with a command-and-control culture. Out of fear of competitor organizations, the company diversified their product lines and adapted a prospector strategy.

Reward System 5, which was recommended in this situation, had several elements of a traditional reward system to help support the current structure and culture. These elements included an internal value comparison, an individual level of rewards and fixed payments. To get the employees in the organization to think about the need to develop a more fluid structure and culture in alignment with the prospector strategy, the company implemented new reward system components as well. Critical elements of Reward System 5 included an emphasis on results as well as behaviors for reward measures, rewards at the business unit level, variable pay and open communications about the new reward system. The company involved employees in the design and implementation phases to teach the organization about the value of employee participation in decision making.

**Reward System 6**

Reward System 6 is appropriate for a situation in which a prospector business strategy is coupled with a mechanistic organizational structure and an involvement culture. Such was the situation encountered by one of the authors when consulting with a large computer company. Because the company was so large, it used a mechanistic structure to control its business processes. Employee involvement had long been a hallmark of a strong human resource function in the organization. As competition escalated in the computer industry, the company used a prospector strategy to avoid price warfare over traditional product lines.

*Employee involvement had long been a hallmark of a strong human resource function in the organization.*

The company’s solution, critiqued by one of the authors, was Reward System 6. The organization’s rewards were used as a lead system to transform the company’s structure into a more organic one salient to senior management. To do so, Reward System 6 emphasizes the person as well as the job. The new reward system reinforced skill sets needed in a more flexible organizational structure. Similarly, business performance was emphasized over individual performance; for example, rewards were higher for employees who figured out ways to organize the business more effectively than for individuals who simply performed the duties spelled out in their job descriptions.

**Reward System 7**

Reward System 7 is intended for fairly progressive companies that have adopted a prospector strategy and an organic structure and have a traditional culture that emphasizes command and control. As an example, one of the authors worked with a telecommunications company. Given radical transformations in the telecommunications industry, new leadership was brought in to transform the organization and its systems. The new president decided to lead with a new business strategy (prospector) and a new structure (organic). To change the culture of the organization to one of involvement, consistent with the new business strategy and structure, Reward System 6 was used to support (lag) the desired cultural change.

Several elements of Reward System 7 emphasized that employees needed to shift to a new set of beliefs and values. First, the company rewarded employees for enhancing their skills as well
as performing their job duties. Second, to sensitize employees to new skills valued in the market and by their current employer (such as leadership), the company emphasized market competitiveness over internal equity. Third, the company stressed business unit performance over individual performance to motivate employees to perform work that would benefit their entire business unit. The company placed less emphasis on individual results to encourage behaviors consistent with an empowered culture (e.g., teamwork).

**Reward System 8**

Reward System 8 is to be used with progressive organizations that have alignment between organizational systems. That is, Reward System 8 is to be used in an organization with a prospector strategy, an organic structure and an involvement culture. In this progressive context, organizations need significant departures from traditional reward systems.

Many start-up and dot.com companies show alignment between their strategy, structure and culture. One author has worked extensively designing compensation systems for high-tech startup companies. These organizations, highly concerned with expenses, tend to view rewards as “return on investment” items; each piece of employee rewards must show a payback for the organization.

Although a certain level of base pay is required for any company to compete for talent, rewards beyond base pay in Reward System 8 vary widely. Nontraditional benefits such as the ability to bring pets to work and giving bonuses of sports cars instead of cash allow companies to showcase their unique “deal” for employees and capture the attention of employees in a highly competitive, ultra-prospector environment. Rewards developed in direct response to employee needs (such as concierge services and support of nontraditional work hours) reflect both the organic structure and the involvement culture of these organizations.

Reward System 8 also promotes less traditional reward administration. An organization might pay a company-wide bonus or give stock options without a formal program to recognize a business milestone. Reward systems are highly fluid and dynamic; timing, amounts and forms of rewards can vary from business unit to business unit and reward period to reward period. Many organizations reward employees heavily with stock options early in the start-up phase and move toward bonuses as the organization matures.

**Conclusions**

As shown in the models and case studies presented, reward system design and implementation work most effectively when they align with business strategy, structure and culture. Organizations may use defender or prospector strategies, mechanistic or organic structures and traditional or involvement cultures. Elements of reward strategy include reward form, unit of analysis, value comparisons, reward measures and levels, administrative processes, timing and communications. Each combination of business strategy, structure and culture is best served by a unique reward strategy.

Although research and academic literature clearly show the effectiveness of creating alignment between these organizational systems, little guidance exists on the process of making this alignment. Reward design and implementation plans should include tactics for aligning with (or driving) desired strategy, structure and culture. Organizations need to create innovative rewards to drive and maintain company performance above industry averages. The expert systems described in this article allow designers to select appropriate rewards strategies to enable desired business results.

**Notes**


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Creating a Powerful Customized Workplace Reward Brand

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Workplace branding helps attract the right employees and adds value to the business.

What’s in a name? Ask the likes of Pepsi, Coke, General Mills, BMW, and Disney—it’s customer holding power. A top brand name delivers lots of it. Company name recognition really counts. A familiar and notable product or service brand that invokes a recall of positive experiences gets the attention of customers. Without a recognizable brand, advertising dollars focused on capturing customers are wasted. Workplace brands are geared toward the same thing—attracting the people a company wants and needs to be a success. Companies require effective product and workplace branding.

Southwest Airlines and General Electric created workplace brands to support their product and service brand. Although widely different, these brands define the types of people they require. These companies provide a special work environment as a magnet to employees who fit their workforce model—the model that describes the work characteristics of persons that succeed in these businesses. Custom workplace branding lets people know what it is like to work in the company. Having a workplace brand, top companies suggest, often leads to gaining customer advantage. If people like the company they work for, they will reflect this in how they treat customers.

Unique Workplace Brands
Companies spend billions annually on human resource programs and initiatives. This expenditure is comparable to other major business investments. But does the organization get maximum mileage in terms of workforce trust and commitment from this cost? Workplace branding may give companies the best chance to maximize their return in terms of investment in their people.

The workplace, career, employment or other custom brand designation should make the company attractive to the people the company wants. As advertising products and services attempts to suggest unique value to targeted customers, workplace branding intends to make the company unique to employees. Branding makes a positive statement about what it is like to work for a com-
pany, and it communicates what people can expect in the future. A company can advertise a name workplace brand rather than a generic brand.

You do not need to be a Baldridge winner to provide quality, and you do not need to be selected as a best place to work to offer a positive workplace.

Workplace branding isn’t new. “Employers of choice” and “best places to work” designations by Fortune and Working Mother acknowledge companies that are successful in developing a highly positive workplace. These workplace-branded companies go the extra mile to ensure that everyone, with emphasis on people below the management levels, experiences an attractive work situation.

Our review of the Fortune and Working Mother best companies suggests they share a number of characteristics in common. Most critically, these companies

- are family friendly,
- provide liberal benefits,
- support education,
- are diversity biased,
- are somewhat egalitarian,
- emphasize collaboration and
- provide something distinguished about the workplace.

“Best places” usually provide fairly uniform benefits and perquisites from top to bottom. For example, executive parking, dining rooms, special retirement plans and the like are less common among companies seeking this distinction. They also tend to emphasize collaboration and participation or worker involvement to gather input or help make decisions. All have something special for their employees, ranging from day care and sabbatical leaves to a special ergonomic chair, exercise facilities and pet insurance. They try to distinguish themselves and make people an important ingredient in their formula.

Who Is Branding Your Workplace?

You do not need to be a Baldridge winner to provide quality, and you do not need to be selected as a best place to work to offer a positive workplace. At issue with these best places is who does the workplace branding for your company? Both Fortune and Working Mother provide inclusion criteria and guidelines for potential participants to follow. Although it is helpful to have a workplace brand confirmed by a prestigious magazine, the actual branding must cascade from the company’s business goals rather than an external source.

The workplace brands typified by Fortune and Working Mother provide many of the elements of total rewards shown in opportunities for individual growth, a compelling future, a positive workplace, and pay components, including base and variable pay, benefits, and recognition. The brand is supportive and positive and geared to attracting a quality workforce that is often characterized by good morale and reasonable turnover. This workplace design has proven to be highly attractive to a very wide range of people, many of whom possess scarce and business-critical skills companies need to thrive.

These are clearly priorities for making a workplace attractive in both good and less-than-excellent company performance times. However, it is essential to ensure that your workplace features will not be cast off when financial performance is not entirely satisfactory. “Best places to work” and “employer of preference” designations were established during some of the most fruitful business times of the past 20 years. These benefits must not be just fair-weather friends that disappear when business slows. Imagine the negative implications from an announcement such as, “Because of lagging financial performance, our company must suspend providing a family-friendly work environment and work/life balance for the time being. We are sure that once our financial performance has improved, we will be in a position to provide these benefits again.”

Why Brand Your Workplace?

Fortune and Working Mother “best companies” focus on making the company attractive to every-
one who has the skill and talent to work there. They say little about employee obligations to perform to company standards—and they say nearly nothing about a win-win between company and workforce. If you review the list of what these companies tend to offer, they make themselves attractive to any qualified employee. Once an employee is with the organization, it tries to retain them. This makes an organization very appealing but implies a more costly and liberal pay and reward solution characteristic of companies not always strongly focused on developing unique workforce environments.

Some say merely providing extremely liberal benefits attracts only people interested in a comfortable workplace, one in which results and personal growth are not priorities. On the other hand, companies that really emphasize performance-based reward elements such as incentives and stock options may have a different workplace brand. They will tell you that their performance-based brand makes them attractive principally to people interested in working in a performance culture rather than one driven only by attractive benefits.

The most powerful reason for branding is to make your company uniquely attractive, specifically to people with characteristics and capabilities in which you have interest. In other words, you should specify those who match your specific workforce model. This means putting in place what the people you want would view as important to influencing them to join and stay. This discourages people from joining you with expectations that you will not be able or do not elect to meet. This is critical for long-term workforce relationships. There is no sense in hiring or keeping people who do not match your expectations—it is unfair to everyone.

**Business Performance Culture Branding**

Any positive workplace brand is valuable. Following the best companies model is well worthwhile. Companies should go beyond providing a nice place to work. The components of total rewards should additionally take on a performance culture bias that provides advantage to both the business and the workforce.

Workplace brands should ensure that both the employee and the organization are winners—a win-win on both sides of the employment deal. No company is going to continue a human resource strategy that does not prove to add value to the business over time. This means the components of total rewards—compelling future, individual growth, positive workplace and total pay—are geared toward creating a true performance culture. In such a workplace, people add increasing value to the enterprise's business as stakeholders and subsequently share as stakeholders according to their contribution to organizational measures of success.

Additional ingredients are necessary to create a performance culture workplace brand. Some of these are worth a bit of explaining. Specifically, companies should do the following:

- **Emphasize results.** Reinforce the culture by a workplace brand designed to be attractive to people focused on both generating measurable outcomes that add value to the business and personal growth in necessary business skills. They are not risk adverse and want to be rewarded for their performance.

- **Deploy clear business metrics throughout.** Use measures and goals for rewards that are based on the business. People are helped to understand how they add value to the business and how they should perform, and they should be provided with tools to perform effectively.

- **Provide open communications concerning expectations.** Provide information required to understand the business, and the role of the workforce flows freely. People have the information they need to do their jobs.

- **Emphasize skill and competency the business needs.** Build a learning process around skill
that is essential to the business of the enterprise. Link pay growth to the acquisition and application of these skills.

➤ **Develop a strong “bench.”** Create backup talent for key roles and responsibilities. Have a succession plan that permits backup to be grown so the talent reservoir is sufficiently deep and effective.

➤ **Provide clear career tracks.** Provide a route for people to follow so they can become more valuable to your company. People are worth more when they learn more. The company should provide the opportunity for workers to improve through their own efforts.

➤ **Implement win-win rewards.** Ensure that both sides of the workforce deal come out ahead if goals are met and people help reach these goals. It makes no sense to have rewards that do not reward both sides of a workplace brand.

Why do this? Why create a performance culture workplace brand? Because it communicates to prospective and current employees what it is like at your company. It declares that you have a specific way of doing business and requires that you define this for your people. It says you use business metrics to judge how everyone is doing so that performance counts at all levels. The message is that you do not just have jobs people do, you have skills you need, and you want people to acquire them to get necessary business results.

It states that you want excellent people growing all the time, and you provide a track that helps them grow in the directions you must go. And the bottom line is that the company will share success, and lack of success, with the people who continue to fit the model. It is the best way to make clear the rules of the road when someone joins your company team.

The most important distinction has to do with the workplace model that the performance culture brand creates for the organization. Although the more typical branded workplace is attractive to every potential employee, the performance culture model is likely to be most attractive to candidates who are more willing to have their performance judged and who can work in a performance culture where business measures and goals are used to make people stakeholders in company success.

**Workplace Branding for Your Company?**

Companies can follow a wide range of possible courses relative to how they manage human resource matters. Branding makes sense for your products and services and for your workplace. How far your company elects to go is clearly a subject of business strategy and direction. But logic suggests that the only reason to brand products or workplaces is to make the business more successful. In turn, this success should be shared with those who make it a reality.

Is branding for you? You are providing a work environment of some sort for your people—that is obvious. It is also true that your company wants to provide a workplace that satisfies your people and encourages trust, commitment and even effective performance. Matching the best place workforce models is clearly a place to start, but going one step further and branding your workplace adds value to the business.

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Untangling the Myths of 360: Straight Talk for Successful Outcomes

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Rule 1: Know Why You Are Doing It

You cannot use one tool to do everything. Tools are always better for some tasks than others. If a tool is misused, it is often damaged and weaker for doing the tasks it was designed for. 360 itself is nothing more than a tool. If you want to use it for assessment, realize that this will probably affect the reliability of the data, lower its value for development, reduce people's willingness to actively engage with it and increase the likelihood of litigation.

Evidence suggests that fewer than 15% of top companies are actually doing so in an organization-wide way.

Still, myths and the legends already abound. There are now more experts speaking on the conference circuit than ever before. Interestingly, many of them have only one experience with multirater feedback, and some have never even experienced the processes they describe. Next time you are in the conference audience thinking, “This all sounds very obvious to me,” ask them about their breadth of experience. It really can enliven otherwise dull presentations. Meanwhile, let's look at some of the issues and set forth some basic rules.

Successful implementation of 360 assessment depends on effort, thoroughness of follow-up and use of skilled facilitators.

60 assessment or multirater feedback has been around for much longer than most people think. Some of the earliest examples go back as far as the early 1960s. Three factors have contributed to its recent popularity:

1. Contemporary technology now makes it easier to deliver. (Remember the DOS-based spreadsheet packages? They are the stuff of which legends and myths are made.)

2. HR has become much more data thirsty. (It is no longer acceptable to go to board meetings and say, “We deal with people. You can't measure the softer issues that are so important.”)

3. Timing. Many of the other more recent performance measurement “flavors of the month” have not had the mass appeal that total quality, process reengineering and balanced scorecards once did. Yet, the quest for a compelling initiative is never-ending.

For these reasons, many organizations are anxious to implement 360 assessment. However,
If you want to use it for development, this will probably limit the number of people who can have access to the data, require more effort to get people to take it seriously, demand extensive communications, require support processes and materials and slow down the time to gain a return on the investment.

Think through what the organization’s priorities are and who those priorities are intended to serve. Look at both short- and long-term implications. Consider all of the resources that will be consumed, not just the cost per head of the instrument. Reflect on how this can be integrated with other processes to gain the benefit of reinforcement.

**Rule 2: Determine the Effort You Are Prepared to Invest**

We see many organizations racing into 360 believing that it is the answer to years of development neglect. In truth, what you get out is proportional to what you put in. You cannot make experienced managers change their behavior just by telling them that some other people do not see things the way they do. They have spent years practicing the same behavior, and they are quite adept at it—whatever its implications.

Collecting feedback is relatively easy. Ensuring that people engage with the feedback, make sense of it and then actually change their behavior is substantially harder. Comments such as, “I went through a 360 process and it was really interesting,” abound. Stimulating interest is not the objective.

**Rule 3: Do Not Imagine Intelligent People Will Change More Easily**

So often we hear, “We want a simple instrument and report. We employ intelligent people so they can work through the feedback themselves.” This is nonsense. If these people are so intelligent, why aren’t they seeking out and working with the feedback already? If they are so intelligent, why can’t they work with a report that presents them with a rich source of data? Why does it have to be so simple? The work on their desks is probably far more complex than any 360 report you can design.

The real issue is that intelligence and the ability to activate a focused development program have little in common. We must prepare people to invest time in the process and go through the pain of change. If anything, intelligent people are better equipped to resist and fight off change.

**Rule 4: Do Not Encourage “Big Solution” Thinking**

Most managers reach their roles without ever having been equipped to receive feedback, set it in context, understand it, develop priorities and develop from those priorities a practical action plan. They simply do not know how. Unfortunately, many trainers do not know how to do this either. It is then all too easy to go for the “big solution.” The subject feels privileged to have a problem that needs such a big solution.

**Most managers reach their roles without ever having been equipped to receive feedback, set it in context, understand it, develop priorities and develop from those priorities a practical action plan.**

As the following anecdote illustrates, smaller solutions often suffice: A senior manager received very harsh feedback about how he acted in meetings. “Arrogant” and “pig” appeared in the narrative comments. After reviewing his feedback and eventually realizing that this was an issue to address, the training department recommended that he attend a $3,000 two-week Interpersonal Effectiveness program covering TA, Johari window, situational leadership, meeting skills, and—amazing enough—assertiveness. Excellent content, but what he needed?

After a 15-minute discussion with one of our consultants, he purchased a 75-cent pack of yellow plastic cards, called his team together and said, “As you clearly find it difficult to handle me in meetings or to tell me that I am taking over,
next time any one of you sees me getting out of hand, wave one of these cards at me.” (He was a soccer fan, hence the appeal.) Two weeks later, card waving had occurred on more than one occasion, to great hoots of derision and outbursts of laughter, and the manager’s entire pattern of behavior changed dramatically.

**Rule 5: Do Not Overinvest in the Instrument**

There are extremely few instruments that have been appropriately validated. Most competence frameworks are acts of faith disguised as researched models. Getting even a few hundred current managers to tell you, through focus groups and interviews, which behaviors are needed is no guarantee that you have the right answer. Most organizations do not even have a reliable measure of performance against which to validate such models.

Can they be validated? Of course. How much time do you have, and how much do you want to spend? If you are not going to go for a properly validated model, the one you come up with is likely to look very much like a thousand others.

**If you are not going to go for a properly validated model, the one you come up with is likely to look very much like a thousand others.**

After all, we all employ humans, we have similar management tasks and most good behaviors are similar. The difference that a good model and an excellent model will make to the feedback is going to be smaller than the subtlety that most recipients would be prepared to worry about.

As discussed, what is done with the feedback is more important, but it is also important to use a robust instrument. Here are some thoughts:

➤ **The instrument should not be too short or too long.** If it is too short, the questions will be too broad for the answers to be clear and useful, or they will omit aspects of behavior that may be critical to the recipient. If it is too long, people will tire of completing it, so the data on the latter questions will be poor. Twenty-five to 45 rated questions and 2 or 3 narrative ones work well.

➤ **Keep the language simple and the questions short.** Most of us would not say, “Oh, John is very good. He never abdicates his responsibility when faced with personally threatening situations.” We might say, “Oh, John? He never passes the buck.”

➤ **Check for ambiguity or possible misinterpretation.** We have studied how different wordings perform in questionnaires and accumulated a vast database to assist in checking this issue. Even apparently clear statements can produce poor data. Do not ask, “Does this say what I meant?” Ask, “How else could someone interpret this?”

➤ **Avoid complex questions.** Some behaviors naturally go together, and combining them in a question can make the intent more clear. Likewise, some apparently single behaviors mask myriad different actions, for example, “Runs effective meetings.” One trainer catalogued more than 60 different skills/behaviors for this one competency.

➤ **Ask focused narrative questions.** “Comment” typically elicits a mass of information that is hard for the recipient to understand. A question such as, “What does the person do that makes it difficult to work with her/him?” would typically elicit more specific and useful responses.

➤ **Test each question for usability.** If I got a low rating, would I be able to make sense of it and do something about it?

➤ **Use a sensible scale.** Individually anchored scales are excellent for coaching but poor for 360 assessments. People tire very quickly of having to do so much reading, and our own evidence suggests that they actually stop and just get into the habit of assuming that, say, the fourth choice is good, the third is mediocre and so forth. A common 6-point agreement or frequency scale will suit most needs.

➤ **Imagine having to look the person in the eye and tell them the value on the scale.** For example, it is easier to say, “You do that rarely” or “I tend to disagree (that the statement describes your behavior)” than it is to say, “You are less than competent.”
Rule 6: Do Not Fall for the “Comments” Trap
Comments are useful, but they can also be greatly misleading. They are typically unstructured, often driven by more recent incidents, and they cannot be compared. The feedback delivery process should focus recipients on the data and take them through a process of making sense of it. Comments should be used to explain the data, increase understanding or identify possible improvement actions. In themselves, they are not the feedback.

Rule 7: Do Not Wait for the “Right Time”
There is no right time. It will always be a burden. Choose a time when other factors or processes may help to reinforce this process.

Rule 8: Choose the Right Data Collection Method
Face to face is very hard to implement and do well. However, this can be achieved. Paper-based and Web-based questionnaires are far more common processes. Do not think that you have to do everything via the Web. Some people still prefer paper. Some senior managers still do not make active day-to-day use of their PCs, so do not force them to complete such a personal and sensitive process via computer if this is the case in your organization. If the Web is right for your organization, then think about whether you need paper options to complement it or if you want to bar these.

Rule 9: Communicate, Communicate, Communicate
We all know that communications need to be content rich, clear, concise and consistent. Consistency is often the downfall in 360. All too often we hear, for example, that three messages have been issued: “This is for development only,” “This is primarily for development” and “We do not foresee using this for assessment in the foreseeable future.” This type of unnecessary sloppiness does irreparable damage and can be avoided. The cynics feed off it. Give someone the role of “continuity contact”—someone who checks each communication and listens to the “word on the street” to make sure that the messages are getting across correctly. Communications can make or break a 360 process.

Rule 10: Make It Happen
Once you start a 360 process, make sure that it happens. Do not tolerate delinquents. You would not allow people to raise purchase orders and then forget about whether the product was delivered or, worse still, receive it and throw it in the bottom of a closet. You would not give your bank money and then forget about the interest. It is not acceptable to spend money on a 360 process and then allow some people to fail to do what is asked of them. Unfortunately, we have found organizations that have accepted 60% response rates.

It is not acceptable to spend money on a 360 process and then allow some people to fail to do what is asked of them.

360 processes are serious potential drains on resources. There must be a payback. That means that recipients, providers and management all have to do their part. Chase late responses. Insist that people go through a process to receive their report, and do not give it to them if they do not comply. Demand to see development plans, and check to see if they were implemented. Show that it is a serious, business-focused process.

Rule 11: Let People Choose Their Own Providers
You may assume that they will simply pick their friends. They might, but wouldn’t it be useful to know that this is the way this person sees things and how they respond to opportunities? Don’t you want to know about people who play games with such a serious process? Moreover, how positively are they going to engage with the feedback if you force a provider list on them? Doing so will trigger defensiveness, for example, “Well, those people would say that, wouldn’t they? If you had asked so-and-so they would have said something else.” Also, our own research tells us that friends are actually more likely to tell a person the truth than others. If the choice of friends is intended to improve the ratings, the recipient might be in for a surprise. You can always use a process through
which the individual and the manager agree on the list. The process itself (e.g., via the Web) can even inform the manager of the person’s choices each time they are made or altered.

**Rule 12: Do Not Assume That You Have to Start at the Top**

All processes benefit from senior-level commitment. Your senior executives probably have in-baskets overflowing with great ideas. The simple reality is that they cannot and should not attempt to implement or personally engage in all of them. Ask yourself, Are the senior executives genuinely going to give up the time to do this and are they going to make it widely known that they have? If so, excellent. If not, get your feet on the floor and find some real champions who will commit to making a positive attempt and to sharing the results.

**Electronic feedback reports are becoming quite popular, primarily among those who do not understand the processes involved in behavioral change.**

**Rule 13: Choose the Right Feedback Medium**

Electronic feedback reports are becoming quite popular, primarily among those who do not understand the processes involved in behavioral change. Some Web-based interactive development planning tools can assist with finding development options and drafting development plans. However, behavior change requires thought, planning and reinforcement. Giving the recipient of feedback paper-based reports and supporting materials as well as personal facilitation best supports these objectives.

**Rule 14: Use Skilled Facilitators**

“I have worked in HR for many years” or “I have been running management development programs for three years” are not adequate qualifications. Use people who can

- challenge the feedback recipient to recognize and face up to any tough messages,
- help senior people work with feedback without threatening them,
- remain independent and assist the individual to come to her or his own conclusions,
- handle a range of unpredictable responses (e.g., laughter, anger, tears, disbelief) and
- be discreet and not allow what they learn in confidence to become public or to affect their judgment inappropriately.

**Rule 15: Focus on Strengths More Than Weaknesses**

Unfortunately, too many 360 processes encourage recipients to focus on the weaknesses such as the bottom four behaviors. Why? These may not be critical to what the person has to achieve in the upcoming period. They are probably behaviors that he or she has spent years perfecting. The recipient may even have developed coping strategies such as using people around her or him to compensate, compensating herself or himself by using other behaviors and avoiding situations that call for the behaviors. Put simply, effort expended on these may not be a good investment.

On the other hand, behaviors on which people score in the average range may be ones that, with a little effort, they could develop into strengths. Some organizations are moving to the use of perceived importance as well as perceived performance scales in their questionnaires to bring out this issue and to help feedback recipients prioritize their actions.

**Rule 16: Look at the Aggregate Data**

Learn from the data. What are the organization-wide issues? How did the questionnaire perform? Which items provided differentiating feedback? Which items produced very poor feedback? Are there any apparent rater biases (e.g., harsh or lenient departments, ethnicity or gender biases)?

One organization performed a concurrent 360 and employee opinion survey during a long period when managers were being trained to empower their staff. Without breaking any guarantees of anonymity or confidentiality, we studied the cor-
relations and found that the managers who were displaying the empowering behaviors were now managing the least satisfied employees and had higher attrition rates. A follow-up investigation revealed a major problem in the making. Staff who had previously viewed management as being tough, decisive, business focused, knowledgeable, demanding of high standards and strong leaders in a tough market now viewed the new regime as soft, hesitant and lacking clarity and direction. The company did not return to what it saw as outdated autocratic management, but it quickly developed a program to help managers to empower people and to provide very clear direction and establish high standards. The warning paid off.

Rule 17: Keep the Process Alive
Be prepared to change the process. Do not try to keep repeating the same assessment format. The first time around is often very interesting and informative. However, most of us change our behaviors very little during the course of a year, even with substantial development. Consequently, the same process with the same instrument will show very little change over a year and prove less and less interesting as time goes on. Some organizations are allowing their staff to use “drill down” questionnaires in second and subsequent rounds. In this way, they get more detailed and focused feedback on specific behavioral areas identified by prior, more general feedback.

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Kidnap & Ransom Insurance: A Rapidly Growing Benefit

More companies are turning to K&R insurance to protect their employees.

roof of Life, a December 2000 Warner Brothers movie, is a kidnapping drama dealing with the abduction of corporate employees by rebel groups seeking ransom money. The movie was based on the memoir *The Long March to Freedom* by kidnapped employee Thomas Hargrove and William Prochnau's book *Adventures in the Ransom Trade*.¹ Hargrove's and Prochnau's books give great insight into many of the angles of the kidnap and ransom (K&R) industry, which has become a growing threat to an increasingly broad group of companies and their employees.

Prochnau describes “fast-food kidnappings,” in which middle-class businessmen are held for quickly paid ransoms of $30,000 to $60,000. He also describes “express kidnappings,” in which the victim is taken from one ATM to the next, withdrawing the maximum amount of cash each day until the accounts are emptied and the victim is freed. “Amateur kidnappings” are by far the most difficult to deal with because they are committed by freelance opportunists who are oblivious to the unwritten rules that can help assure a safe release.²

K&R Frequency

Since 1980, more than a billion dollars has been paid out in ransom for kidnapped executives. It is difficult to compile accurate statistics on global kidnappings because of the shroud of secrecy surrounding kidnappings, ransom payments, K&R insurance policies and professional negotiators.³ The secrecy is a double-edged sword. The extent and seriousness of the crimes are masked, which gives a false sense of security. At the same time, when kidnappings are reported, an increase in ransom dollars usually follows. If insured parties were identified, the number of kidnaps would certainly rise.

The global estimate is that between 10,000 to 15,000 kidnappings occur per year. Of these, more than 80% are in Latin America, with a large percentage involving ransom.⁴ However, most specialists agree that only about 50% of all kid-
nappings are reported. The general consensus among researchers includes unofficial estimates of 3,000 to 4,000 kidnaps yearly in Colombia, 1,500 to 3,000 in Mexico, 1,200 in Brazil, followed by the rest of Latin America. Russia, Indonesia and the Philippines ranked as numbers five, six and seven in 1997, but by 1999 China, Pakistan and the former Soviet republics moved into these rankings. By 2001, Latin America again dominated the list. (See Exhibit 1.)

In response to these figures, Travelers Insurance is no longer underwriting K&R policies in Colombia, and two of the other largest insurers are planning on following suit. The London insurance syndicates are currently pricing Colombia K&R policies extremely high, asking as much as $25,000 per person for basic coverage.

In the United States, 95% of all kidnappers are caught and face severe and consistent penalties, as opposed to Colombia, where 99% of all kidnappers are never convicted if caught. In Manila, kidnappers have been known to take personal checks without retribution. Many times, there is a feeling of deja vu as the same kidnap negotiators deal with the same gangs, time and time again. One of the few consistent threads running through the kidnap side of the industry is one basic code of conduct, informally known as the “porcelain rule”—keep the victim alive. The name comes from the notion of not breaking china dishes—they are delicate and worthless when broken—the same as a dead hostage.

**K&R Insurance Providers and Negotiators**

The old-timers in the K&R insurance field are American International Group and Reliance National. Gulf Insurance Group is a member of Citigroup and is one of the few providers that actually have their application for Corporate Kidnap, Extortion and Detention Insurance and a specimen K&R insurance policy on their Web site. (See Exhibit 2.) Lloyd’s of London also competes in this arena. Chubb Corporation, one of the first providers of K&R insurance, is one of the few that accumulate general statistics that are released to the press. (See Exhibit 3.)

One of the standard benefits of most K&R insurers is their association with professional negotiators, the other big group in the industry. One widely respected American K&R negotiator company is The Ackerman Group. Probably the best-known international business risk consultancy is headquartered in London. Control Risks Group, the oldest of the K&R firms, has a client list that includes 91 of the Fortune 100 and 9 of the top 10 Forbes multinationals. The Control Risk Group’s Web site offers travel and risk information on 124 countries, updated daily.

The main consideration in choosing a provider is its track record and history in the industry. Expansion of coverage with the company’s current life insurance provider may be a consideration. Name recognition can be a key element in gaining support for the program with the corporate executive sponsor because those insured should not know the details of the policy. Services to be provided are fairly standard but should still be reviewed and compared if more than one provider is being examined. Once chosen, the provider should offer extensive guidance on preventing and responding to incidents.

**Is K&R Insurance Necessary?**

K&R insurance is considered by most travelers to be the ultimate defensive weapon. The survival rate for insured victims is estimated by some to be 85%, whereas others say that insured victims are four times more likely to survive than uninsured victims are. Many multinational companies use K&R insurance because it provides a much better history of bringing the hostages back alive while minimizing problems in the kidnap country. In today’s global economy, an employee at any organizational level who is traveling internationally for the employer should expect K&R coverage to be as standard as health insurance, although most companies will not confirm coverage to an employee because the employee may divulge the information if kidnapped.

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**EXHIBIT 1**

Top 10 Countries for Kidnapping 1993-2001

1. Colombia (three times the rate of second-place Mexico)
2. Mexico
3. Philippines
4. Brazil
5. Former Soviet Union Republics
6. India
7. Guatemala
8. United States
9. Venezuela
10. Ecuador

Note: These results are based on kidnappings confirmed by Control Risks Group. They may not represent the full extent of the problem.
**How Much Coverage and for Whom?**

The standard amount of coverage for the general multinational employee is $1 million, with executives insured at a higher rate. For a U.S. employee traveling only in Europe, Canada and the United Kingdom, this coverage can cost as little as $500 per year. According to the few statistics released, only a handful of companies buy more than $5 million in insurance coverage for one individual.

Providers will assist in tailoring the coverage to precisely meet the policyholder’s needs and to help reach the desired level of comfort required by the policyholder. Once the coverage is underwritten and the annual premium paid, the provider assigns a number to a key, nontraveling employee with the employer. The provider subsequently replaces all references to the employer in the plan documents with this number. The provider then files the policy in a secure location with only the number reference to the covered company.
Coverage and Costs

Lloyd’s of London released a study stating that 60% of Fortune 500 companies now have K&R insurance coverage. The total cost of protection is far greater than the ransoms paid. The worldwide K&R insurance industry alone now generates in excess of $150 million in annual premiums.8

K&R coverage can be fairly inexpensive, especially compared with the alternative. For example, the annual price for a $1 million, three-year customary contract, depending on where and how frequently the client travels, can run as low as $1,000. This would make the average annual premium for a large multinational corporation about $25,000 to $50,000.

On the other hand, more extensive plans can range from an annual premium of $10,000 to more than $150,000 per person, again depending on options, location and frequency of travel of the client. For example, at the height of his career, international tennis star Boris Becker carried $10 million of K&R insurance, costing $160,000 annually. Becker was outraged when this information was reported in the press because his policy was canceled. To advertise insurance coverage is to invite kidnappers.

Some discounts are available to help offset the premiums. To qualify for these discounts, the company must train their traveling employees in kidnap prevention techniques, but without telling them the real reason. The company must also implement office and factory security measures as dictated by the insurers. These discount-qualifying actions make good business sense; many companies implement as many suggestions as possible.

In addition to the ransom, K&R policies generally cover the victim’s lost wages, hiring a replacement while the victim is held and cosmetic surgery and psychiatric treatment for the victim and the family when the ordeal is over.9 Other common policy features also cover interpreters, travel expenses, financial losses arising from such events as failure to exercise stock options while being held and defending lawsuits, including lawsuits that arise when the spouse of a victim believes that the employer did not do enough for the victim.

Policies include a second ransom if the first is lost in transit and pay for one or more negotiators, as deemed necessary by the conditions. Professional kidnap negotiator fees rank second only to the ransom as the largest cost and can run $15,000 per week. In many cases, a second negotiator is needed as part of the team. (See Exhibit 4.) The key is keeping the secrecy that prevents K&R insurance from becoming a self-fulfilling prophecy. In fact, most policies are immediately canceled if it becomes known that the customer is insured, as was the case with Boris Becker.

Policy Comparison and Evaluation

Purchasing K&R coverage is different from most types of insurance because decisions do not rest on premium differences between the insurers. The essential issue in evaluating policies is scrutinizing the risk consultant that the insurer uses. When an employee is kidnapped, the risk consultant is the quarterback and makes all the calls. The negotiating company’s level of experience and its contacts in the local setting is the number one criterion in policy selection. Numerous start-up risk consultants crop up every year and offer K&R insurers cheaper fees for negotiating. These consultants should be scrutinized carefully. The top U.S. K&R insurers only work with Kroll, The Ackerman Group or Control Risks Group and have long-standing relationships with them.

Key questions to ask the insurer about the risk consultants relate to experience, consultant profiles, diversity of kidnap cases, opposition groups worked with, research and forensic support. For example, to help clients evaluate their level of experience and success rate, one of the large risk consultants provided these recent figures:

- At July 2001, we have consulted on 1,035 cases with 26,281 man-days aggregate duration in 90 different countries.

### Exhibit 4

**Typical Kidnap and Ransom Policy Coverage**

- **Ransom money** and coverage on money while in transit
- **Professional negotiators**
- **Consultant** to handle media, law and family communications
- **Bodily injury** of abductee
- **Security** company fees
- **Extortion** against company property, product contamination, and computer systems
- **Travel expenses** for negotiators, family and employee
- **Lost salary** of abductee
- **Psychological counseling** for employee and family
• Experience in every region of the world, with particular expertise in crisis hot spots.
• Since 1995, an average of 28 abduction cases and 37 extortion cases per year.

When looking at consultant profiles, ask about languages spoken and their military, intelligence, diplomatic, special services or other experience. Question the diversity of types of kidnap cases. Has the risk consultant’s experience been mainly with political kidnappings, short-term cases, disappearances with no demands from a group or long-term cases with protracted negotiations over months? A firm with the broadest range of previous experience is an obvious advantage.

Has the risk consultant worked with a wide spectrum of opposition groups? Have they worked with FARC (Colombia), RUF (Sierra Leone), ULFA (India), the Red Scorpion Group (Philippines) and the Arizmendi Gang (Mexico)? When kidnapping is concerned, it is essential that the risk consultant have experience with a wide range of political groups, gangs and even tribesmen. Previous experience with these groups and strong local contacts are essential.

When kidnapping is concerned, it is essential that the risk consultant have experience with a wide range of political groups, gangs and even tribesmen.

Finally, ask the insurer about the research and forensic support that the risk consultant can provide. Find out what kind of experts the consultant employs in research, the type and detail level of databases and how the data were used to resolve previous kidnappings. One large risk consultant provided this information for the insurer’s clients:

• The research team maintains a database of more than 17,000 kidnap for ransom cases worldwide, dating back to 1975. In the last five years, researchers have collected data on more than 7,500 cases. The researchers also maintain a product contamination and other extortion database.
• Response consultants are assisted by in-house dedicated teams of kidnap and extortion researchers who provide them with relevant background information on all aspects of kidnapping, extortion and product contamination. Detailed precedent material relating to the relevant opposition groups, negotiations, duration of cases and likely outcomes is regularly supplied to consultants. The research team is also able to provide details of local contacts whose assistance could benefit case progress.

The answers to these key questions will help determine the level of confidence a company will have in the risk consultant their insurer uses and which insurer they purchase K&R coverage from.

Prevention and Protection
Preventive measures are perhaps the strongest deterrent to those who would randomly kidnap or plan a high-level kidnapping, and prevention measures definitely make kidnapping more difficult. K&R insurers may reduce policy premiums based on the prevention training that is undertaken. Knowledge and mental preparedness are excellent kidnap deterrents. Preventive measures can be as simple as avoiding patterns of travel or behavior. Another strong preventive measure is basic travel security and awareness training, also known as predeployment training. This should be mandatory for all international travelers and should include family members or anyone who will be exposed to risk. Topics that should be included in the training are guidelines on how to keep a low profile, how to use public transportation and limiting the number of people who know the travel itinerary.

Physical preventive measures are numerous and can be expensive. The first option is bodyguards. Although avoiding ostentation is key, firms that recommend bodyguards usually also suggest the use of a security driver who knows how to avoid surveillance and the use of a backup car. Another option is armored vehicles, which have become a booming business for several companies. Training business travelers and their families in preventive measures can be an effective deterrent to kidnapping. Organizations need to place top priority on such training measures and allocate funds for further protective measures as needed.
Conclusions
The K&R industry continues to flourish. The secrecy surrounding the K&R industry is truly a double-edged sword. Publicity can turn an employee into a potential hostage, as well as making a hostage appear more valuable. But the secrecy and lack of information also mask the extent and seriousness of the crime, providing a false sense of security for companies and their employees.

The growth of both the K&R industry and the associated prevention and protection industries is only expected to continue, especially as more companies become multinational and as more multinational companies continue to expand into developing countries where there are great disparities in income levels. K&R insurance is but one of many issues that must be explored. Human resources professionals should ensure that they have adequate information and have pursued appropriate precautions before—not after—a K&R crisis occurs.

Notes

Sheri Merkling is a financial consultant in the Minneapolis office of Parson Group LLC, primarily focusing in the areas of planning, forecasting and accounting management. Prior to that she was employed by Caterpillar Incorporated in accounting management. She is a certified public accountant (CPA) and a certified management accountant (CMA). She is active in the Institute of Management Accountants, the American Institute of Certified Public Accountants and Minnesota Certified Public Accountants.

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The U.S. Supreme Court recently issued another decision endorsing the use of mandatory arbitration agreements in the workplace as a means of alternative dispute resolution of employment-related claims. In *Circuit City Stores, Inc. v. Adams* (2001), the Supreme Court squarely addressed the applicability of the Federal Arbitration Act (FAA) to employment disputes. The FAA is a 76-year-old law that requires the enforcement of valid arbitration agreements in a variety of circumstances. For years, this law has been at the center of continued controversy over employment contracts requiring arbitration of claims arising out of the employment relationship.

The Court held that the FAA supports the use of valid arbitration agreements between an employer and employee whereby the employee agrees to arbitrate claims related to employment, including employment termination and alleged discrimination. The Supreme Court's decision in this case resolved a conflict among several lower federal courts about whether employees could be forced to arbitrate employment discrimination claims.

The facts of the *Circuit City* case are typical of many employment discrimination cases. Adams, the plaintiff in the case, had applied for a job with Circuit City Stores, a national retailer of consumer electronics, in October 1995. The application for employment that he signed contained a statement saying that he agreed to "settle any and all . . . disputes or controversies arising out of or relating to [his] . . . employment and/or cessation of employment with Circuit City exclusively by final and binding arbitration before a neutral Arbitrator" (*Circuit City*, 85 FEP Cases at 268). The application specified that he agreed to arbitrate claims arising out of his employment under a variety of federal, state and local laws. Two years after being hired, Adams sued Circuit City in California state court, asserting employment discrimination claims under California's Fair Employment and Housing Act and general tort claims based on incidents arising during the employment relationship.

Rather than merely asserting the arbitration agreement in response to the lawsuit in state court, the company aggressively pursued arbitration. Based on the arbitration language in the application that Adams had signed, Circuit City filed suit against Adams in federal district court, relying on the FAA to invoke the federal court's jurisdiction. Circuit City asked that the federal court order Adams to arbitrate his claims against the company rather than litigating them in state court.

The federal district court for the Northern District of California agreed with Circuit City and ruled that Adams must submit his claims of discrimination under state civil rights laws and his tort claims to arbitration, precluding the state court lawsuit. The Ninth Circuit, however, determined that the FAA did not apply to employment-related disputes and held in favor of the employee.

The U.S. Supreme Court agreed to review the case. By way of its opinion in *Circuit City*, the Supreme Court decided two key issues that had
plagued lower courts for years following the last Supreme Court decision that endorsed the use of compulsory arbitration agreements requiring employees to arbitrate certain types of employment-related claims (see *Gilmer v. Interstate/Johnson Lane Corp.*, 1991). The nation’s highest court made it clear that the FAA applies to employment contracts that contain arbitration provisions (rather than just commercial contracts, as opponents had argued) and that the exemption to the FAA was limited to transportation workers. As a result, because Adams was not a worker in the transportation industry, he was required to arbitrate his claims of employment discrimination and related torts based on the language in the application that he had signed, agreeing to arbitration of employment-related claims.

**Pre–Circuit City Status of Compulsory Arbitration**

In deciding this case, the Supreme Court followed its decision in *Gilmer* and a more recent decision endorsing the use of arbitration as a means of alternative dispute resolution in consumer contract disputes. In the employment context, the Supreme Court has historically favored the resolution of employment disputes through arbitration provisions in collectively bargained agreements, in which the dispute falls within the contract terms and requires interpretation of the collective bargaining agreement. However, employment discrimination claims of unionized workers were excluded from the arbitration provisions in many cases based on a previous Supreme Court ruling in *Alexander v. Gardner-Denver Co.* (1979). Thus, when the Court decided the *Gilmer* case in the early 1990s, upholding the enforcement of an arbitration agreement (outside the collective bargaining context) between an employer and an individual employee to resolve a claim of age discrimination in violation of the Age Discrimination in Employment Act (ADEA), the legal community heralded the decision as a green light to the development of private alternative dispute resolution mechanisms to address employment disputes, including discrimination claims. Employers and their lawyers honed the use of mandatory arbitration agreements in employment contracts, personnel manuals or employment applications, such as in the *Circuit City* case, to a fine art.

It is important to note that over the years following *Gilmer*, many federal courts reviewing federal employment statutes prohibiting discrimination in employment on a number of protected bases have determined that employment discrimination statutes themselves do not prohibit the enforcement of mandatory arbitration agreements based on the nature of the claims themselves, that is, prohibited employment discrimination: *Bercovitch v. Baldwin School, Inc.* (1998), *Miller v. Public Storage Management, Inc.* (1997), *Rojas v. TK Communications Inc.* (1996) and *Williams v. Katten, Muchin & Zavis* (1993). These holdings followed the reasoning of the Supreme Court in *Gilmer* in analyzing whether there is a statutory prohibition on such agreements found in the particular statute on which the employee asserts a claim of discrimination (e.g., Title VII, Americans with Disabilities Act and ADEA) or an inherent conflict between arbitration and the purpose of the statute.

Furthermore, many of them addressed the amendments to the Civil Rights Act in 1991, which appear to encourage the use of alternative dispute resolution mechanisms for employment discrimination claims, without expressly mandating alternative dispute processes in this context. The *Duffield* case, finding that Title VII claims could not be subject to forced arbitration, is one of the few decisions that comes to this conclusion in federal court case law. The Ninth Circuit came to this conclusion, in part, because it concluded that Congress had not intended the Civil Rights Act of 1991 to support the use of alternative dispute resolution mechanisms, such as predispute agreements to arbitrate Title VII claims.

However, several other circuit courts have reached the opposite conclusion. See, for example, *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1999); *Seus v. John Nuveen & Co., Inc.* (1998, 1999); *Austin v. Owens-Brockway Glass Container, Inc.* (1996); and *Patterson v. Tenet Healthcare, Inc.* (1997). (See also Exhibit 1.) This dispute among federal courts further set the stage for the *Circuit City* decision.

**Circuit City Gap**

The Supreme Court has not specifically concluded that Title VII of the Civil Rights Act of 1964, the nation’s primary statute prohibiting employment discrimination on the basis of race, sex, color, creed, religion or national origin, bars the enforcement of a predispute private agreement to arbitrate employment-related claims of discrimina-
This particular issue was not presented before the court in the Circuit City case because the plaintiff raised only state civil rights act claims. However, the trend of the federal case law in this area (with the exception of the Ninth Circuit) is clearly supportive of the use of arbitration, by way of a compulsory arbitration agreement, as a means of resolving claims for employment discrimination under Title VII, the ADA and the ADEA.

Use of Arbitration—Weighing of Costs

As a result of this overwhelming support for enforcement of agreements to arbitrate employment-related disputes, employers have proceeded down a path of aggressive use of alternative dispute mechanisms in this context. Overall, America’s largest companies have embraced alternative dispute resolution in many forms in the past decade and apply it to many different types of disputes. A survey conducted by Cornell University among 1,000 of the largest U.S. corporations found that from 1994 to 1997, the vast majority of the survey participants had used one or more of the alternative dispute resolution procedures.10

According to the Cornell study, 88% of the companies reported using mediation, 79% had used arbitration and there was widespread use of mediation and arbitration in employment disputes. Indeed, many arbitration procedures adopted in the employment context have been adopted in recent years (since 1994), and at least one study reported that 75% of employers surveyed adopted the ADR procedure to reduce litigation costs.11

In most of these cases, ADR plans were adopted by the human resources or legal staff, without input from employees, and 75% of them required employees to agree to arbitrate employment-related claims as a condition of employment (McGeorge Law Review, Vol. 29, pp. 232-233). In other words, these plans, like the Circuit City employment application, required compulsory arbitration of employment discrimination claims as defined by the Ninth Circuit Court of Appeals.

The large corporations surveyed in the Cornell study expected the use of arbitration to grow in employment disputes.12 The Cornell study indicated that many corporate leaders use alternative dispute resolution in the hope that it will reduce the costs of the legal disputes. Another study comparing settled, litigated and arbitrated employment discrimination case outcomes supported this perception to a certain extent.13 In that study, the mean and median jury verdicts in employment discrimination cases were discovered to be at least three times higher than comparable mean and median arbitration awards (McGeorge Law Review, Vol. 29, pp. 232-233).

It is important for employers to note that arbitration itself is not necessarily an inexpensive process. These perceptions of litigation costs are relative when compared to litigation in state or federal court, which can be protracted and involve significant costs related to discovery. The U.S. Circuit Court of Appeals for the District of Columbia noted that arbitrator fees range “between $500 to $1000 or more” per day, based on the stipulation of the parties in Cole v. Burns Intern. Security Services (1997).14 In the Cole case, the court referred to the American Arbitration Association-cited average arbitrator’s fee of $700 per day (Cole, 105 F.3d at 1481, fn 8).

However, some arbitrators charge as much as $500 to $600 per hour, and JAMS/ENDISPUTE reported arbitration fees of as much as $400 per hour (Cole, 105 F.3d at 1481, fn 8). Employment case arbitration fees can range between $1,000 to $3,000 on the low end (McGeorge Law Review, Vol. 29, pp. 223, 257, 1998). However, “the CPR Institute for Dispute Resolution estimates arbitrators’ fee of $250-$350 per hour and 15-40 hours of arbitrator time in a typical employment case, for a total of arbitrators’ fees of $3,750-$14,000 of an ‘average’ case” (Cole, 105 F.3d at 1481 fn 8, citing CPR Inst. for Dispute Resolution, Employment ADR: A Dispute Resolution Program for Corporate Employees I-13, 1995).15 These numbers do not include attorney fees and court reporter fees and appear to be based on single-employee issues.

However, there is no comprehensive compilation of data regarding costs associated with arbitrations versus litigation to evaluate the soundness of the perception that arbitration of employment-related claims is cheaper, better and faster. In fact, there is some indication to the contrary. “Employers now have their own horror stories describing instances where arbitration has become so expensive and overblown that is was not worthwhile or was costly as litigation, without the same safeguards to achieve a fair result”16

Many employers and attorneys have expressed concern over the narrow bases on which unfavorable arbitrator’s awards can be overturned and inconsistencies in decisions among arbitrators deciding cases with similar fact patterns. Thus, there has been some backlash against arbitration in recent years.
Notwithstanding the lack of empirical evidence regarding costs, in light of the Supreme Court’s decision in Circuit City and the decisions of the circuit courts of appeal, with the exception of the Ninth Circuit, there is little reason to curtail this path toward alternative dispute resolution and even compulsory arbitration of employment-related claims. However, it is a path full of pitfalls that must be carefully navigated. The key to establishing an enforceable arbitration agreement is fundamental fairness. This is best accomplished in a multiple-faceted approach that includes several alternative dispute resolution mechanisms that may culminate in mandatory arbitration, under a predispute agreement to arbitrate employment claims.

The key to establishing an enforceable arbitration agreement is fundamental fairness.

Favored Alternative Dispute Mechanisms

In fact, the U.S. Equal Employment Opportunity Commission’s (EEOC’s) list of best practices by companies with alternative dispute resolution practices encompasses several different mechanisms, including an open door policy, a grievance procedure (nonunion), discussion with the employer’s EEO or Human Resources Office, the use of an ombudsman, mediation, peer review and arbitration. The companies whose practices were cited by the EEOC as exhibiting the best practices in alternative dispute resolution used some combination of these mechanisms. The EEOC itself, however, has taken the position that an employee cannot be forced to arbitrate employment discrimination claims falling under Title VII, the Americans with Disabilities Act, the Age Discrimination in Employment Act or other acts falling within the EEOC’s jurisdiction by way of a compulsory arbitration agreement.

The EEOC takes the position that predispute agreements—whereby the employee or applicant agrees to arbitrate claims arising out of employment, including employment discrimination claims, as a condition of becoming employed or remaining employed—are “contrary to the fundamental principles evinced” in the nation’s employment discrimination laws. The EEOC continues to take this antiarbitration position even after the Supreme Court’s decision in Circuit City. The EEOC’s current position is that not only can the employee not be required to forego going to the EEOC to file a charge of employment discrimination or retaliation, the employee must be free to go to state or federal court to litigate those claims as well.

Thus, notwithstanding an employer’s alternative dispute resolution processes and the employee’s predispute agreement to arbitrate employment-related claims, the EEOC will continue to process, investigate and pursue the charges of discrimination of employees and former employees who have signed compulsory arbitration agreements. Reviewing courts have found that the EEOC’s policy statement is merely that: a statement of the EEOC’s stance on this issue but not a statement of the law in this area.

Fair or Foul?

Notwithstanding the EEOC’s position in this area, the arbitration provision may still fail based on inherent unfairness in the process or attempts to limit substantive rights that would otherwise be available to the employee if the employee was litigating the matter in a court. Many courts have found that the arbitration process may be unfair or overreaching in its attempts to limit an employee’s rights to pursue statutory claims, for example, through limitations on the process used to select the arbitrator, limits on the time frame to file a claim under the procedure, limits on the damages/remedies available to the employee or lack of mutuality (see Hooters of America, Inc. v. R. Phillips, 1999). Despite the Fourth Circuit’s general support of mandatory arbitration agreements for claims arising under Title VII and other similar federal statutes, the court declared the Hooters’ agreement void as a matter of public policy because it was a one-sided agreement and violated Phillips’ due process rights.

The court cited several factors that exhibited the agreement’s unfairness:

1. limited time for employee review,
2. employees were not provided with a copy of the arbitration rules and procedures,
3. the rules were one-sided,
4. the mechanism for selecting a group of three arbitrators to preside only allowed the employee to select one of the three from the list that Hooters had created and

5. Hooters had reserved the right to modify the rules, in whole or part, at any time before or during the proceeding. (Hooters of America, Inc. v. R. Phillips, 1999)

Practical Standards
Courts have set forth minimum standards for compulsory arbitration agreements requiring employees to litigate employment-related claims, including employment discrimination claims,

The arbitration agreement should be between the employer and the employee rather than the employee and a third-party arbitration group.

to stand a chance of enforcement. The District of Columbia Circuit Court of Appeals has held that to be enforceable, the agreement must, at a minimum,

1. provide for neutral arbitrators,
2. provide for more than minimal discovery,
3. require a written award,
4. provide for all types of relief that would otherwise be available in court and
5. “does not require employees to pay for either unreasonable costs or any arbitrator's fees or expenses as a condition of access to the arbitration forum.” (Cole v. Burns Intern. Security Services, 1997, pp. 1465, 1482)

Furthermore, the arbitration agreement/provision cannot curtail the statute of limitations for the employee or former employee to file for arbitration of the dispute.20 This means that the employer cannot shorten the time that would have been allowed for the employee to file a claim in the court system by way of the arbitration agreement or procedure.

The agreement must be mutual and bilateral, meaning that the employer must also be required to bring claims against the employee or former employee through arbitration.21 Thus, an employer cannot carve out its claims from this process and still enforce the agreement against the employee. Many employers have attempted to exclude from the arbitration process things like violations of noncompetition provisions, in which the employer may want to go to court to seek injunctive relief against the employee.22 The resultant effect of these “carve outs” is to nullify the agreement, meaning the employee is free to litigate his or her claims in court.

The agreement should be between the employer and the employee and a third-party arbitration group. This issue has been litigated repeatedly by Ryan's Family Steakhouse in its attempts to enforce the arbitration agreement that its employees enter into with an outside arbitration company, which provides that Ryan's is the third-party beneficiary of the agreement.23

Federal courts have taken different views of the enforceability of the agreement to arbitrate employment-related disputes arising out of the employee's employment with Ryan's. Their opinions weigh the fact that the agreement to arbitrate is not directly with Ryan's but rather with an arbitration company that was selected by Ryan's to be responsible for all of its employment arbitrations. Courts have expressed the concern that because Ryan's is a “repeat player,” directing significant business to this arbitration company, there is a potential for bias by the arbitration company in favor of Ryan's to keep their business.

The agreement to arbitrate employment-related disputes must be “knowing and voluntary.” This means that the language about arbitration of employment-related claims should be clear, written in plain English and obvious to the employee or applicant, rather than in fine print somewhere. Preferably, the arbitration provision should be set forth by itself distinctly from other language in the application, policy manual or agreement.

The arbitration agreement or provision should clearly set forth the types of claims that are subject to arbitration, should include a reference to employment discrimination claims and civil rights statutes, should clearly state that the right
to a jury trial is being waived and that arbitration is the exclusive form of dispute resolution, with limited exceptions for administrative charges with certain agencies like the EEOC and the National Labor Relations Board. In addition, it should contain a severability clause.

The arbitration provision or agreement should refer to the process that must be used to file claims and select arbitrators as well as how costs will be handled. Courts tend to disfavor payment by the employee in advance, complete fee shifting or burdening the employee with unreasonable or excessive responsibility for costs. The arbitration agreement or provision should clearly set forth a time period for making claims, referencing the applicable statute of limitations.

Furthermore, if the arbitration agreement or provision references outside procedures (such as the AAA Employment Dispute Resolution Rules), a copy of those procedures should be given to the employee or applicant. The arbitration provision or agreement should contain a separate signature line indicating that the employee or applicant is signing in agreement to arbitrate employment-related claims. A signed employee manual acknowledgement form that contains an arbitration provision/policy may not be enough to compel arbitration of employment-related claims and may create other issues for the company—that is, is the employee manual a contract?

End of the Road?
Even after successfully maneuvering around this area, an employer is still subject to EEOC charges, but the EEOC’s role may be limited to a large extent by virtue of the arbitration agreement. Most courts have concluded that the agreement between the employer and the employee will not be binding on the EEOC, which means that the EEOC cannot be forced to arbitrate discrimination claims raised by the employee against the employer by way of an EEOC charge (EEOC v. Waffle House, Inc., 1999). However, the Supreme Court will next review the remedies that the EEOC may pursue on behalf of an individual employee who has signed a compulsory arbitration agreement and filed a charge of discrimination. The Supreme Court accepted certiorari of the Waffle House case, which had held that the EEOC could not pursue monetary remedies for an employee who had filed a discrimination charge and signed a predispute compulsory arbitration agreement.

Survey of Circuit Court Decisions Addressing Compulsory Arbitration Agreements of Employment-Related Claims

First Circuit
In January 2001, the U.S. District Court in the District of Maine in Snow v. BE&K Constr. Co., 126 F. Supp.2d 5 (D. Me. 2001), held that an arbitration agreement contained within an employee handbook is not enforceable when the employee has not signed a contract assenting to the terms of the handbook. Monica Snow sued her former employer in federal district court alleging sexual harassment and constructive discharge in violation of Title VII. The employer argued that the claim should be dismissed, or in the alternative, that Snow should be compelled to arbitrate her claims pursuant to the employer’s arbitration agreement.

During the course of her employment, Snow received an employee handbook outlining the rules and procedures in the workplace, including BE&K’s “Employee Solution Program.” Under that program, the company provided employees with five options for dispute resolution, including mediation and arbitration. Snow was not asked to sign a document assenting to the terms of the handbook, or any other employment terms, at any time. The First Circuit noted that although “the First Circuit generally approves of the use of arbitration as an alternative means of dispute resolution” including claims arising under Title VII, Snow was not bound to the terms outlined in the handbook because it was not a legally binding term.

Second Circuit
In Stadtlander v. Ryan’s Family Steakhouses, Inc., 2001 WL 322727 (2d Cir. 2001), the Second Circuit Court of Appeals held that an employer could force an employee to arbitrate his or her claims under the Federal Arbitration Act (FAA), even though the employer was not a formal party to the arbitration agreement. See Stadtlander at *3. Two employees, Charles Stadtlander and
Christina Robinson, sued Ryan's Steakhouse in federal district court, alleging that they were forced to work without compensation. See *Stadtlander* at *1*. Ryan's argued that the employees were precluded from bringing their claims to court by the arbitration agreement that each signed prior to starting their employment.

The court agreed, and held that although Ryan's was not a formal party to the agreement, the agreement clearly stated that Ryan's was a third-party beneficiary to the contract between the employees and Employment Dispute Services, Inc., Ryan's arbitration company. As a result, Ryan's could legally enforce the agreement. In addition, the court rejected the employees' argument that the arbitration agreement itself was unconscionable because the employees were forced to sign it, without understanding its contents, before they were hired. See *Stadtlander* at *5-6*.

According to contract law, a party who signs a written contract is presumed to know, and understand, its contents and cannot avoid any obligations under the contract by claiming that he or she did not read it before signing it. See *Stadtlander* at *5*. Once the employees signed the arbitration agreements in this case, they were charged with full knowledge of its terms. Next, the court rejected the argument that the contract terms were invalid because they (a) were vague and ambiguous, and (b) represented a contract of adhesion. See *Stadtlander* at *5-6*. Although all arbitration agreements are subject to the general rules of contract interpretation, the court construed the terms in light of the overwhelming federal policy favoring arbitration as an alternative dispute mechanism. See *Stadtlander* at *4*. Despite the uneven bargaining power between the employer and employee, the contract terms were fair and enforceable. See *Stadtlander* at *4-8*.

**Third Circuit**

In *Seus v. John Nuveen & Co, Inc.*, 146 F.3d 175 (3d Cir. 1998), cert. denied, 525 U.S. 1139, 119 S.Ct. 1028 (1999), the Third Circuit Court of Appeals held that an employee could be compelled to arbitrate her Title VII discrimination and Age Discrimination in Employment Act (ADEA) age discrimination claims, pursuant to a mandatory arbitration agreement. See *Seus* at 177. Sheila Seus was employed at the Nuveen brokerage firm. As a member firm of the National Association of Securities Dealers, Nuveen required all employees to complete a Uniform Application for Securities Industry Registration sheet, including signing a mandatory arbitration agreement. Although the agreement provided for arbitration of “any dispute, claim, or controversy . . . arising out of the employment . . . of associated persons,” Seus sued her employer in federal district court, alleging that it had unfairly discriminated against her. See *Seus* at 177.

In its decision, the court first noted that the Third Circuit rule, as enunciated in *Great Western Mort. Corp. v. Peacock*, 110 F.3d 222 (3d Cir. 1997), cert. denied, *Peacock v. Great Western Mort. Corp.*, 522 U.S. 915, 118 S.Ct. 299 (1997), generally supported an employer’s use of mandatory arbitration agreements and limited the FAA’s exemptions to only those employees engaged in interstate commerce. See *Seus* at 178-179. The court held that even though Seus had been required to sign the arbitration agreement as a precondition to her employment, “mere inequality in bargaining power” was not a sufficient reason to declare the agreement invalid and unenforceable. See *Seus* at 180.

Seus was not denied any substantive statutory rights by submitting her claim to arbitration, nor were the arbitration rules and procedures so unfair as to deny Seus statutory and procedural due process rights. See *Seus* at 184, 187. Any inadequacies in the procedures could be reviewed by a court of law following the termination of the proceedings. See *Seus* at 187. It is important to note that although the court clearly supported the use of mandatory arbitration agreements in employment contracts, it would not compel the arbitration of any dispute that was not covered by the agreement itself. See *Seus* at 186-187.

**Fourth Circuit**

In 1999, the Fourth Circuit Court of Appeals held, in *Hooters of America, Inc. v. R. Phillips*, 173 F.3d 933 (4th Cir. 1999), that, although the employee signed a mandatory arbitration agreement, she could not be forced to arbitrate her Title VII claims. See *Hooters* at 935. Annette Phillips sued Hooters in federal district court, alleging that restaurant officials and managers sexually harassed her and that because of the harassment, she resigned. Hooters argued that she was precluded from bringing any suit because she had signed a mandatory arbitration agreement prior to leaving. See *Hooters* at 935-936.
Although the court noted that the Fourth Circuit generally supports, and enforces, mandatory arbitration agreements for claims arising under Title VII and other similar federal statutes, the court declared the Hooters agreement void as a matter of public policy because it was a one-sided agreement and violated Phillips’s due process rights. See Hooters at 936. At the time the employees were asked to sign the mandatory arbitration agreements, Hooters allowed them five days to review the agreement. However, no employees were provided with a copy of the rules and procedures by which all arbitration proceedings would be conducted.

Once the rules were distributed, the court determined that they were “so one-sided that their only possible purpose [was] to undermine the neutrality of the proceeding” (Hooters at 938). First, the rules provided a mechanism for selecting a group of three arbitrators to preside over the arbitration. See Hooters at 938-939. Although the employee was permitted to select one of the three, she was required to select a person from the list that Hooters had created. According to the court, this ensured that Hooters could control the panel and its bias. Second, Hooters reserved the right to modify the rules, in whole or part, at any time before or during the proceeding. See Hooters at 939 (emphasis added). Thus, the employee was bound to the arbitration rules, but Hooters was not. In its decision, the court noted that although submitting a claim to arbitration does not usually deny an employee her substantive statutory rights, the Hooters plan was so biased and one-sided as to deny her the opportunity to fairly arbitrate any claim. See Hooters at 941. As a result, she was permitted to bring all disputes before a court of law.

**Fifth Circuit**

In Rojas v. TK Communications, 87 F.3d 745 (5th Cir. 1996), the Fifth Circuit Court of Appeals held that a mandatory arbitration clause was to be construed broadly and that an employee could be forced to arbitrate all claims not specifically excluded from the agreement. See Rojas at 748-749. Camille Rojas, a disc jockey at TK Communications, sued her former employer under a Title VII claim for sexual discrimination. See Rojas at 746. Although she had signed a mandatory arbitration agreement as part of her employment contract, she argued that she was not required to arbitrate a Title VII claim. See Rojas at 747. The agreement itself provided that “any action contesting the validity of [her employment] agreement, the enforcement of its financial terms, or any other disputes” must be submitted to arbitration before a claim was filed in court. See Rojas at 746.

In its decision, the court first noted that all agreements to arbitrate should be construed broadly and consistent with the strong federal policy favoring arbitration as a means of alternative dispute resolution. See Rojas at 747. Despite the relatively limited language of the agreement, the term “any other dispute” was broad enough to encompass claims under federal statutes, including Title VII. See Rojas at 749.

**Sixth Circuit**

In Floss v. Ryan’s Family Steak Houses, Inc., 211 F.3d 306 (6th Cir. 2000), cert. denied, Ryan’s Family Steak Houses, Inc. v. Floss, 121 S.Ct. 763 (2001), the Sixth Circuit Court of Appeals held that although the Sixth Circuit supported employers’ use of mandatory arbitration agreements, the Ryan’s arbitration agreement was invalid and could not be enforced. See Floss at 309. Sharon Floss sued Ryan’s in federal district court under the Fair Labor Standards Act and alleged that they did not pay employees the legally required wages. See Floss at 310. In a somewhat related action, Kyle Daniels also sued Ryan’s under the Americans with Disabilities Act and argued that he had been terminated because of his disability.

In both actions, Ryan’s filed motions to compel arbitration of each claim pursuant to the mandatory arbitration agreement that each employee signed prior to employment. In its decision, the court recognized that most federal statutes support important social policies and that the individual arbitration of disputes arising under them does not necessarily further the social goals of the statutes. See Floss at 313. Nevertheless, an employee may be compelled to arbitrate employment disputes when the proceedings are fair, are conducted in a neutral forum and provide sufficient procedural due process. See Floss at 312-313.

In this case, however, the court found that the Ryan’s agreement was invalid for a number of reasons. First, although the employees were bound to abide by specific arbitration rules, the employer and Employment Dispute Services, Inc. (EDSI), Ryan’s arbitration company, were
entitled to change the rules and procedures of the proceeding at any time. See Floss at 315-316. In addition, EDSI was not obligated to notify, or receive the consent of, any of its employees when the rules were changed. See Floss at 316. Second, EDSI's arbitration rules at the time required the employee to pay one half of the arbitrator's fees as a condition to arbitration. See Floss at 314. Such a fee structure has the potential to deter employees from pursuing claims against their employer and denying them the right to enforce their substantive statutory rights.

**Seventh Circuit**

In *Koveleskie v. SBC Capital Markets, Inc.*, 167 E3d 361 (7th Cir. 1999), cert. denied, 528 US 811, 120 S.Ct. 44 (1999), the Seventh Circuit Court of Appeals affirmed the view of most other circuit courts and held that an employer is entitled to enforce mandatory arbitration agreements. See *Koveleskie* at 362. The employee, Mary Koveleskie, sued her former employer in federal district court for sex discrimination under Title VII. See *Koveleskie* at 363. Although she signed a mandatory arbitration agreement as a precondition to her employment, she argued that it was not valid and enforceable.

First, she claimed that the contract was unconscionable because she was forced to sign the agreement as a precondition of her employment. See *Koveleskie* at 364. Although the court noted that the agreements could be invalidated if obtained through duress or fraud, it rejected her claim in this case and held that mere inequality of bargaining power was not a sufficient argument to relieve her of her obligation to arbitrate. See *Koveleskie* at 367. Second, Koveleskie argued that the mandatory securities arbitration proceedings violated her due process rights because the arbitrators were not required to follow the law or respect her statutory rights. See *Koveleskie* at 365. Again, the court noted that in some circumstances, this argument may be valid but rejected it in this case because although the arbitrators are not specifically bound by the law; they are informed that if they “manifestly disregard the law, the award may be vacated.” See *Koveleskie* at 365. Further-more, the court recognized that any unfair arbitration proceedings are subject to judicial review after the completion of the arbitration to ensure that the arbitrator complied with the requirements of the law. See *Koveleskie* at 366. Third, Koveleskie argued that the proceedings were unfair because the arbitrators routinely refuse to follow Title VII’s fee-shifting principles, which allow a prevailing plaintiff to collect attorneys’ fees. See *Koveleskie* at 366. The court dismissed this argument by stating that under the prevailing securities arbitration rules, most employers paid all arbitration fees, and where they did not, plaintiffs routinely were able to waive their portion of the fee because of hardship. See *Koveleskie* at 366.

**Eighth Circuit**

In 1997, the Eighth Circuit Court of Appeals, in *Patterson v. Tenet Healthcare, Inc.*, 113 E3d 832 (8th Cir. 1997), overruled its previous holding in *Swenson v. Management Recruiters Intern., Inc.*, 858 F2d 1304 (8th Cir. 1988), and declared that all Title VII claims may be subject to a valid mandatory arbitration agreement. See *Patterson* at 838-839. In *Patterson*, the employee Deborah Patterson sued her former employer in federal district court, alleging employment discrimination in violation of Title VII and Missouri Human Rights Act. See *Patterson*, 113 E3d at 834. Patterson claimed that the employer's arbitration agreement was not valid because it was printed in an employee handbook, and even though she signed a form acknowledging that she had received, and read, the handbook and arbitration agreements, there was no valid contract. See *Patterson* at 834.

The court noted that although Missouri law does not generally consider employee handbooks to be valid and binding, the arbitration agreement was separate from the rest of the handbook and constituted an enforceable contract. See *Patterson* at 834. Furthermore, the arbitration agreement represented the interests of the individual, as opposed to agreements entered into as a result of a collective bargaining agreement, and Patterson could not be released from her obligations. See *Patterson* at 837. Through the use of neutral arbitrators, adequate discovery processes, adequate types of relief and judicial review following the proceedings, individual employees could be reassured that all statutory claims would be dealt with and fair and timely manner. See *Patterson* at 838.

**Ninth Circuit**

Interestingly, in *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal.4th 83
(2000), the California Supreme Court disagreed with the Ninth Circuit’s *Duffield* decision and held that employment discrimination claims under Title VII and California’s Fair Employment and Housing Act may be subjected to mandatory arbitration under a compulsory arbitration agreement. Since the *Circuit City* decision, the Federal District Court for the Central District of California has held that by agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the California Fair Employment and Housing Act, the California Family Rights Act and the Americans with Disabilities Act, but only submits their resolution to arbitrate rather than a judicial forum. See *Olivares v. Hispanic Broadcasting Corp.*, 2001 U.S. Dist. LEXIS 5760 (C. D. Cal. 2001).

**Tenth Circuit**

The Tenth Circuit, much like the majority of the circuits, approves of an employer’s use of mandatory arbitration agreements. Despite this, in *Metz v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 39 F.3d 1482 (10th Cir. 1994), the Tenth Circuit denied an employer’s motion to compel arbitration because it found that by pursuing litigation with the employee, the employer had waived all rights to arbitrate the employee’s claims. See *Metz* at 1491. Kelli Metz brought suit in a federal district court, alleging unlawful discrimination and discharge due to her pregnancy. See *Metz* at 1485.

In its decision, the court approved of the notion that an employee could be compelled to arbitrate all employment disputes, including Title VII claims. See *Metz* at 1487. However, “the right to arbitration, like any other contract right, can be waived.” See *Metz* at 1489. After its motion to enforce the agreement was denied at the trial court level, Merrill Lynch had preserved its right. See *Metz* at 1489. But, by dismissing its appeal and continuing with its previous litigation activities, Merrill Lynch effectively waived its right to enforce the agreement as written in the contract. See *Metz* at 1489. Once the employer waives its right to enforce the agreement, the employee is justified in continuing her litigation activities. See *Metz* at 1490.

**Eleventh Circuit**

In *Bender v. A. G. Edwards & Sons, Inc.*, 971 F.2d 698 (11th Cir. 1992), the Eleventh Circuit Court of Appeals held that an employee must submit all Title VII claims to arbitration under a mandatory arbitration clause. See *Bender* at 701. Linda Bender sued her employer on both state and federal law grounds and alleged that she had been sexually harassed by her supervisor. See *Bender* at 699.

The court of appeals reversed the trial court’s determination that an employee could not waive her right to federal adjudication of Title VII claims. See *Bender* at 700-701. Citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 111 S.Ct. 1647 (1991), the court held that Title VII claims should be treated in the same fashion as other federal statutes. See *Bender* at 700. As a result, an employee could be forced to arbitrate all disputes when she has signed a valid mandatory arbitration agreement. See *Bender* at 700. Although Bender was not able to select a forum for her dispute, she had not completely waived her right to a forum to exercise her statutory rights. See *Bender* at 700. In addition, if the arbitration was somehow legally deficient, Bender could bring the dispute to federal court for judicial review of the proceedings. See *Bender* at 700.

**District of Columbia Circuit**

In April 2001, the U.S. Court of Appeals for the District of Columbia Circuit, in *Borg-Warner Protective Services Corp. v. EEOC*, 245 F.3d 831 (D.C. Cir. 2001), dismissed an employer’s declaratory action against the EEOC for failure to state a claim. See *Borg-Warner* at 839. Borg-Warner filed suit against the EEOC seeking a declaratory statement from the court that its mandatory arbitration agreements were valid and enforceable, even when the employee was forced to sign the agreement as a condition of his employment. See *Borg-Warner* at 832-833.

In addition, Borg-Warner sought a nationwide injunction against the EEOC, forbidding it from litigating the validity of any Borg-Warner arbitration agreements. See *Borg-Warner* at 832-833. Although the court ultimately dismissed the suit, it did note that the D.C. Circuit held in 1997, in *Cole v. Burns Intern. Security Services*, 105 F.3d 1465 (D.C. Cir 1997), that an employer could lawfully compel arbitration in Title VII discrimination disputes with employees. See *Borg-Warner* at 832-833.

This decision followed most circuit court opinions at the time. The EEOC’s policy statement clearly supporting the employee’s right to bring suit in a discrimination claim, despite any mandatory arbitration agreements in effect, was not entitled to any special weight in the courts. See *Borg-Warner* at 836. Instead, the
Notes


2. The Court reads the Federal Arbitration Act (FAA) to allow the enforcement of such agreements, except in the case of employment in the maritime, railroad and other transportation industries, based on a specific and narrow reading of the exceptions in the FAA itself. This means that employers in those industries cannot force arbitration of employment-related claims by way of the employee's agreement to arbitrate them.

3. The Ninth Circuit had previously held that compulsory arbitration agreements do not bar an employee from raising civil rights claims under Title VII of the Civil Rights Act of 1964 in litigation in state or federal court, despite the employee's predispute agreement to submit employment-related claims to arbitration; see Duffield v. Robertson Stephens & Co., 144 F.3d 1182 (9th Cir. 1998), cert. denied, 525 U.S. 982, 119 S.Ct. 445 (1998). The Ninth Circuit strongly implied that compulsory arbitration of state civil rights act claims of employment discrimination would be similarly barred. In the Duffield case, the Ninth Circuit defined “compulsory arbitration agreements” as when “employers compel their prospective employees, as a condition of employment, to waive their rights to litigate future employment-related disputes in a judicial forum” or when “employees are subjected to such a requirement for the first time during the course of the employment” (Duffield, 144 F.3d at 1187). Using this definition, the Duffield court then proceeded to gut the effectiveness of arbitration agreements in the employment context. The Ninth Circuit found the agreement to arbitrate could only be enforced as to state law–based tort and contract claims but not employment discrimination claims. The agreement that Circuit City placed on its standard application for employment clearly fell within the definition of a compulsory arbitration agreement that the Ninth Circuit had previously disfavored in the Duffield case. Thus, the Ninth Circuit’s finding in favor of Adams, disallowing Circuit City to compel arbitration of the plaintiff’s state civil rights act claims of employment discrimination, was not surprising.

4. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 111 S.Ct. 1647 (1991). In Gilmer, the U.S. Supreme Court held that employees who had signed the Securities Industry Form U-4 and were subject to the New York Stock Exchange Rule 347, both of which address arbitration of disputes, could be required to arbitrate claims of unlawful discrimination in employment on the basis of age. The Supreme Court noted that although all statutory claims may not be appropriate for arbitration, individual agreements to arbitrate claims arising under statute should be enforced “unless Congress itself has evinced an intention [discoverable in a statute’s text, legislative history or through inherent conflict between arbitration and the purpose of the statute] to preclude a waiver of judicial remedies for the statutory rights at issue” (Gilmer, 500 U.S. at 24-26). In Gilmer, the Supreme Court found that there was nothing in the Age Discrimination in Employment Act (ADEA) or its amendments evidencing such a conflict or barring a claimant from arbitratiing statutory claims of age discrimination.

5. On May 22, 2001, in Harden v. Roadway Package Systems, Inc., 249 F.3d 1137, (9th Cir. 2001), the Ninth Circuit Court of Appeals held that a transportation employee could not be compelled to arbitrate his California Fair Employment and Housing Act claims because he was not subject to the FAA. See Harden at *1. Although the court accepted the Supreme Court’s holding in Circuit City as binding under certain circumstances, the court noted that it did not apply in this case.

a. It should be noted that this is the same type of agreement the Second Circuit enforced in Stadtlander v. Ryan’s Family Steakhouses, Inc., 2001 WL 322727 (2d Cir. 2001), described above.
because Harden, the employee, was a truck driver. See Harden at *2. This leaves open the issue for transportation industry employers as to whether state arbitration acts allow employers to enter into mandatory arbitration agreements requiring arbitration of employment-related claims. The issue of whether the FAA and its exemptions and federal employment statutes preempt state law–based arbitration agreements with transportation industry employees has been litigated and most likely will continue to be litigated. See Harden.


8. For example, in Gilmer, the U.S. Supreme Court did not find that the amendments to the ADEA requiring a knowing and voluntary waiver of age discrimination claims, barred the enforcement of the private agreement to arbitrate such claims. In Circuit City, the Court did not find that the California Fair Employment and Housing Act barred the enforcement of the private arbitration agreement between Adams and Circuit City.


10. The Cornell University, Price Waterhouse and PERC research team defined alternative dispute resolution as “the involvement of private parties to resolve disputes that might otherwise be litigated, and includes the techniques of mediation, arbitration, fact-finding, mini-trials, and the use of ombudspersons.” A total of 528 companies responded to the Cornell survey.


12. It is interesting to note that in other contexts, these corporations expected the use of mediation to grow and preferred mediation to arbitration as a form of alternative dispute resolution. Moreover, there was a general skepticism about the qualifications of arbitrators, with “almost half of the survey participants saying that they have a lack of confidence in arbitrators and close to 30 percent saying there is a shortage of qualified arbitrators.” Lipinsky, D. B., & Seeber, R. L. The use of ADR in U.S. corporations: Executive summary (A joint initiative of Cornell University, the Foundation for the Prevention and Early Resolution of Conflict (PERC) and Price Waterhouse LLP, Cornell University School of Industrial and Labor Relations Ithaca, NY 14853-3901). Retrieved from http://www.ilr.cornell.edu/ICR/NEW/execsum.html.


17. EEOC policy statement on mandatory binding arbitration of employment discrimination disputes (1997). The EEOC’s stance against compulsory arbitration agreements includes binding arbitration language in employment applications (such as Circuit City’s), employment policies, employment contracts, employee manuals or noncompete agreements.


20. Graham Oil Co. v. ARCO Products Co., 43 E3d 1244, 1248-49 (9th Cir. 1994).


24. The National Labor Relations Board has exclusive jurisdiction over employment claims regarding conduct that is arguably protected by Section 7 of the National Labor Relations Act or arguably prohibited by Section 8 of that act.

25. See Snow v. BE&K Constr. Co., 126 F.Supp.2d 5 (D. Me. 2001). Because BE&K created a specific disclaimer that allowed it to change the terms of the alternative dispute program at any time, it did not agree to be bound by the requirements in the handbook. In addition, Snow did not sign a contract indicating that she had read, understood and agreed to any terms in the handbook. The court found that her assent could not be assumed simply because she continued working. Also see Patterson v. Tenet Healthcare, Inc., 113 F.3d 832 (8th Cir. 1997).

26. The employee’s agreement to an arbitration provision/agreement of employment-related claims will not bar the EEOC from filing suit against the employer if it determines that there has been a violation of employment discrimination laws. EEOC v. Frank’s Nursery & Crafts, Inc., 177 F.3d 448 (6th Cir. 1999). However, the great majority of litigation in the area of employment discrimination flows from suits filed by individual employees rather than the EEOC. As a result, the possibility of an EEOC lawsuit should not deter employers who are interested in adopting an alternative dispute resolution program that includes compulsory arbitration of employment claims arising out of employment, including discrimination claims.


28. Similarly, the Second Circuit has held that the EEOC may not pursue monetary relief on behalf of a class of employees who had signed arbitration agreements and alleged violations of the ADEA but held that the EEOC could pursue injunctive relief. EEOC v. Kidder, Peabody & Co., Inc., 156 F.3d 298 (2d Cir. 1998).

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