Employee Benefits

A Primer for Human Resource Professionals

Seventh Edition

Joseph J. Martocchio
University of Illinois

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For My Students

—Joseph J. Martocchio

About the Author

Joseph J. Martocchio *Professor Emeritus in the School of Labor and Employment Relations, University of Illinois at Urbana-Champaign*

Professor Martocchio earned his Bachelor of Science degree in management and quantitative methods from Babson College, and both his Master's and PhD degrees in human resource management from Michigan State University's School of Labor and Industrial Relations. He teaches employee benefits and compensation courses for Penn State University and the University of Houston.

Martocchio's research and teaching interests include employee compensation, employee benefits, and employee training and development. Professor Martocchio's research appears in leading scholarly journals including the *Academy of Management Journal, Academy of Management Review, Journal of Applied Psychology, Journal of Management,* and *Personnel Psychology*. He has researched extensively, placing him in the top 5 percent of the most productive researchers published in premier applied-psychology journals in the 1990s, according to a survey conducted by the Society for Industrial and Organizational Psychology (SIOP). Professor Martocchio received the Ernest J. McCormick Award for Distinguished Early Career Contributions from the Society for Industrial and Organizational Psychology (SIOP), and was subsequently elected as a Fellow in both the American Psychological Association and SIOP. Following the attainment of this recognition, he served as the Chair of the HR Division of the Academy of Management as well as in various other leadership roles within that organization. He is the author of the textbooks *Strategic Compensation: A Human Resource Management Approach* (Pearson Higher Education) and *Human Resource Management* (Pearson Higher Education).

Preface

Employee benefits refer to compensation other than hourly wage, salary, or incentive payments. Three fundamental roles characterize benefits programs: protection, paid time off, and accommodation and enhancement. *Protection programs* provide family benefits, promote health, and guard against income loss caused by catastrophic factors such as unemployment, disability, and serious illnesses. *Paid time-off* policies compensate employees when they are not performing their primary work duties, for example, vacation and holidays. *Accommodation and enhancement benefits* promote opportunities for employees and their families, including stress management classes, and educational assistance.

Employee Benefits was written to provide an introduction to the most common employee practices used in U.S. firms. It is an appropriate source of information for those who want to learn the foundation and acquire a breadth of knowledge about these practices. College-level students taking an undergraduate or a graduate course in employee compensation and benefits will build the foundation for understanding the origin of specific benefits practices and fundamental design considerations. Practitioners who work with benefits professionals or are beginning to take on administrative or managerial roles regarding employee-benefits programs will find this book to be an excellent introduction.

This book contains 12 chapters, organized into four parts:

- Part 1: Introduction to Employee Benefits
- Part 2: Retirement, Health Care, and Life Insurance
- Part 3: Services
- Part 4: Extending Employee Benefits: Design, Contingent Workers, Remote Work, and Executives

Each chapter contains a chapter outline, learning objectives, key terms, discussion questions, and two brief cases.

NEW TO THE SEVENTH EDITION

The seventh edition has been substantially updated:

- New content has been added based on recent legislation, the influence of the COVID-19 pandemic on employee benefits practices, and trends in employee benefits.
- About half of the cases are new.
- An all-new chapter is included on benefits for contingent workers and for remote work arrangements.
- All statistics were the most current at the writing of this edition.

The following information summarizes the highlights of the chapter-by-chapter updates:

Chapter 1: The influence of the COVID-19 pandemic on strategic employee benefits has been added.

Chapter 2: New case: Cutting Costs at Builders Manufacturing.

Chapter 3: A new section on the 2020 Setting Every Community Up for Retirement Act (SECURE Act) has been added.

Chapter 4: New sections added on automatic enrollment, the SECURE Act, and benefits communication pooled employer plans. Also included is a new case: Reconsidering the Vesting Schedule at Syntax Software.

Chapter 5: A new section on telemedicine was added, as well as two new cases: Considering Consumer-Driven Health Care, and Expanding Health-Care Benefits.

Chapter 6: Updated statistics.

Chapter 7: Updated Medicare prescription drug benefit and catastrophic coverage, substantially revised section on minimum earnings and employment requirement for unemployment insurance benefits, and relevant information about the American Rescue Plan of 2021 and unemployment insurance added.

Chapter 8: Updated material on discretionary as well as mandatory paid family and sick leave policies and two new cases: Time Off to Help a Parent, and Formalizing Flexibility at Grandier Bank.

Chapter 9: New material on financial education and student loan repayment assistance programs, and updated material on legal issues pertaining to wellness program incentive payments. New case: Managing Anxiety at Work.

Chapter 10: New material on open enrollment, communication methods including virtual and social media, and two new cases: Getting Healthy and Saving Money, and Communicating Benefits at Riverside Resorts.

Chapter 11: All new chapter on benefits for contingent workers and benefits issues for remote work arrangements. The chapter on global benefits was removed to make room for this new chapter.

Chapter 12: New information about clawback provisions added.

SUPPLEMENTAL MATERIALS FOR INSTRUCTORS

All supplements are available from the book's Web site at www.mhhe.com/martocchio7e. Given the rapid and substantial changes in the benefits area, the Web site also offers updates to text coverage of important benefits topics and issues.

Instructor Supplements: Instructor's Resource Manual, TestBank, and PowerPoint Presentations.

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Many people made valuable contributions. I am also indebted to the reviewers who provided thoughtful remarks for the development of the seventh and previous editions: Among them are James C. Coulson from Chapman University; Wanjiku Jackson, Northwest Florida State College; Michael P Long, Oakland University; Larry Morgan from St. Mary's University; Lori Olson from Western Technical College; Barbara Rau from the University of Wisconsin, Oshkosh; Maureen Revane, Saint Xavier University; Joel Rudin from Rowan University; and Carol Spector from the University of North Florida, and Kenya Wilson, Tarrant County College. F. Jack Witt III, Vice President of Human Resources and Administration at Owens Community College, provided meticulous comments that draw not only from his extensive field experience, but also from his expertise teaching an employee-benefits course at Wayne State University. I offer a special thank you to Professor Lori Long, Baldwin Wallace University for her contributions of new end-of-chapter cases.

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Joseph J. Martocchio

Brief Contents

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Part One

Introduction to Employee Benefits

Chapter One

Introducing Employee Benefits

Chapter Outline

Learning Objectives

In this chapter, you will gain an understanding of:

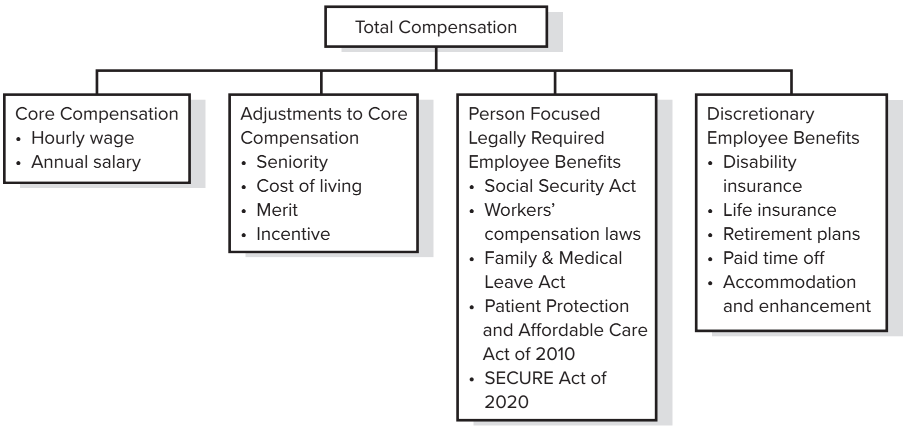
1. The fundamentals of employee benefits and fit in the total compensation scheme.
2. The field of employee-benefits practice.
3. Legal and regulatory influences on discretionary employee-benefits practices.
4. The strategic importance of benefits and approaches to strategically planning a benefits program.
5. Information used to develop strategic benefits plans.

Welcome to *Employee Benefits: A Primer for Human Resource Management Professionals*. Understanding employee-benefits practices is a worthwhile endeavor no matter whether you plan to become a specialist working in an employee-benefits department, a human resource generalist, or a manager in any department. For instance, employee-benefits professionals are experts in paid time-off policy design. These experts work with HR generalists who oversee all HR activities for employee groups and share developments in the employee-benefits offerings. Employee-benefits professionals also work with managers who are ultimately responsible for carrying out HR policies such as approving paid time off or knowing when to encourage a distressed worker to seek help through an employee assistance program. And, let's not forget, most people work for a living and either currently have or will likely have access to at least one employee benefit. As a bonus, this book will help you to understand the components of your benefits and the employer's rationale for offering them.

DEFINING AND EXPLORING EMPLOYEE BENEFITS

Let's start off with a brief definition of employee benefits. Next, we put employee benefits in the context of total compensation systems in companies (Exhibit 1.1) and from there expand the definition of employee benefits. Finally, we examine strategic considerations essential for establishing and maintaining effective employee-benefits programs.

EXHIBIT 1.1
Employee Benefits in the Total Compensation Scheme



Defining Employee Benefits

Employee benefits refer to compensation other than an hourly wage or salary. Examples of specific employee benefits include paid vacation, health-care coverage, tuition reimbursement, and many more. To organize the vast amount of benefits information efficiently, it is helpful to group benefits based on the role that the benefits serve for recipients and the source of the benefits.

The Fundamental Roles and Sources of Employee Benefits

Three fundamental roles characterize benefits programs: protection, paid time off, and accommodation and enhancement. **Protection programs** provide family benefits, promote health, and guard against income loss caused by catastrophic factors such as unemployment, disability, and serious illnesses. **Paid time-off** policies compensate employees when they are not performing their primary work duties under particular circumstances such as vacation or illness. **Accommodation and enhancement benefits** promote opportunities for employees and their families. Employers may choose to offer one or more of these benefits, including wellness programs, flexible work schedules, and educational assistance.

Employee benefits derive from two broad sources. First, the U.S. federal government requires that most employers, employees, or both make contributions so that certain government-sponsored benefits can be provided to employees. These are referred to as *legally required benefits*. Laws such as the Social Security Act of 1935 mandate a variety of programs designed to provide income to retired workers, disability income, survivor benefits, and health care for older Americans. Legally required benefits can take other forms such as workers' compensation insurance, which the employer purchases and administers. And, it should be noted that some cities and states have legislation that enhance federal government benefits such as paid sick leave. Second, companies may choose to offer additional benefits such as educational benefits and retirement savings plans as just two examples. Choice benefits are referred to as *discretionary benefits*.

Exhibit 1.2 lists typical employee benefits offered in U.S. companies. As this exhibit shows, legally required benefits focus on protection, and companies may choose to offer additional protection programs, which often enhance or supplement legally required benefits. For instance, discretionary disability protection, when added with Social Security disability insurance, could generate a higher income stream than would otherwise be possible.

Prior to the passage of the Patient Protection and Affordable Care Act, which mandates that most companies provide health-care coverage, companies offered health-care benefits on a discretionary basis. However, some companies still treat health care as a discretionary benefit. In lieu of offering health-care benefits, they are willing to pay a penalty to the federal government based on provisions of the law.

EXHIBIT 1.2
Typical Employee Benefit Offerings in the United States

Legally Required Benefits	
Old-Age, Survivor, and Disability Insurance (OASDI)	Medicare
Health-care coverage	Unemployment insurance
Prescription drugs	Workers' compensation
Mental health and substance abuse	Family and Medical leave
Maternity care	

Discretionary Benefits	
Protection Programs	Nonproduction time
Dental care	Volunteerism
Vision care	
Life insurance	*Accommodation and Enhancement Programs*
Disability insurance (short- and long-term)	Employees' and family members' mental and physical well-being
Retirement programs	Employee assistance programs
Paid Time Off	Wellness programs
Holidays	Family assistance programs
Vacation	Educational benefits for employees
Sick leave	Educational assistance programs
Personal leave	Tuition reimbursement programs
Bereavement or funeral leave	Scholarship programs
Sabbatical leave	Financial education
Jury duty and witness duty leaves	Student loan repayment assistance
Military leave	Support programs for daily living
	Transportation services
	Physical fitness

Employee Benefits in the Total Compensation Scheme

Employee benefits are a part of a company's total compensation system. **Total compensation** represents both core compensation (wages, salaries, and adjustments), and employee benefits represent compensation other than wages or salaries (see Exhibit 1.1). Compensation professionals establish core compensation programs to reward employees according to their job performance levels or for acquiring job-related knowledge or skills. Monetary compensation lies at the heart of core compensation. After briefly defining specific core and employee-benefits practices, we will subsequently discuss the origins of employee benefits. Understanding the origins enables employee-benefits professionals to better understand the rationale for benefits design.

Core Compensation

Employees receive **base pay**, or money, for performing their jobs. Companies disburse base pay to employees in one of two forms. Employees can earn an hourly pay, or a wage, for each hour worked, or they can earn a salary for performing their jobs, regardless of the number of hours worked. Companies measure salary on an annual basis.

Adjustments to Core Compensation

Over time, employers may choose to adjust employees' base for one or more reasons: increases in the cost of living, differences in employees' job performance, or differences in employees' attainment of job-related knowledge and skills. These elements are defined next.

Cost-of-living adjustments (COLAs) represent periodic base-pay increases often set to periodic changes in the U.S. Bureau of Labor Statistics' Consumer Price Index (CPI). COLAs enable workers to maintain purchasing power by having their base pay adjusted for inflation. Over time, most everything we buy costs more money, such as the price of a gallon of milk. Most companies choose not to apply COLAs to base pay. However, this practice is a common feature in the unionized workforce and in government employment.

How exactly does inflation affect purchasing power? Let's assume, for example, that a local grocery store employs college students, paying them $15 per hour. Let's also assume that a student works 10 hours per week, for a total of $150. Further, let's assume a student typically drives his car, paying $20 per week for gasoline. As gas prices rise, the weekly gasoline cost could increase to $30. As long as the hourly wage rate remains the same, the student will have 10 fewer dollars available for other pursuits. Rising costs erode purchasing power when wages do not increase accordingly.

Seniority-pay systems reward employees with periodic additions to base pay, according to length of service. Over time, employees presumably refine existing skills or acquire new ones that enable them to work more productively. This rationale comes from human capital theory, which states that employees' knowledge and skills generate productive capital, known as human capital. A person employed in a company for a long time knows rules and procedures from which he or she develops the skills (i.e., human capital) necessary to perform a job more quickly than newly hired employees. Today, most unionized private-sector and public-sector organizations continue to base salary on seniority or length of employee service, though the number of unionized workplaces is steadily declining. In 2020, the overall unionization rate was 12.1 percent. During the same period, unionization in the private sector was 7.2 percent and 38.4 percent in the public sector. Members of union-bargaining units whose contracts include seniority provisions, usually rank-and-file as well as clerical workers, receive automatic raises based on the number of years they have been with the company. In the public sector, most administrative, professional, and even managerial employees receive such automatic pay raises.[1]

Merit-pay programs assume that employees' compensation over time should be determined based on differences in job performance. Employees earn permanent increases to base pay according to their performance, which rewards excellent effort or results, motivates future performance, and helps employers retain valued employees. Merit pay increases are expressed as a percentage of current base pay, with higher percentage increases for better performers. For instance, an employee currently earning $50,000 annually receives a 10 percent merit pay increase, making her total annual pay $55,000 after the pay raise takes effect: [$50,000 + (10 percent × $50,000) = $5,000)]. In 2020, employees earned average merit increases of 3.0 percent across all industries, and the projected average increase for 2021 was 2.9.[2] This average increase was essentially the same for all employment groups, including nonexempt hourly (nonunion), nonexempt salaried, and exempt salaried. In addition, most companies relied on market-based pay increases. Most U.S. companies rely on merit pay to recognize employee performance.

Incentive pay rewards employees for partially or completely attaining a predetermined work objective. Incentive pay is defined as compensation other than base wages or salaries that fluctuates according to the attainment of individual or group goals (e.g., $1,000 to a customer sales representative whose customer-service ratings increased each month over a six-month period), or company earnings (for instance, employees share 2 percent of company profits when the company substantially exceeds its performance projections). Commonly used incentive plans include piece rate, gain sharing, and profit sharing.

Person-focused pay rewards employees for acquiring new knowledge and skills through designated curricula sponsored by an employer. This approach recognizes the range, depth, and types of skills or knowledge employees are *capable* of applying productively to their jobs following training. This feature distinguishes pay-for-knowledge plans from merit pay and incentive pay, which reward actual job performance. Some targeted studies and anecdotal information suggest that companies of various sizes use person-focused pay programs. Many of the companies known to be using this kind of pay system employ between approximately 150 and 2,000 employees, the majority operate in the manufacturing industry, and the average age of the companies is approximately 10 years.[3] More recently, technology companies favor skill-based pay programs because the skills and knowledge sets such as cybersecurity and artificial intelligence are not plentiful in the labor market. Rather than focusing exclusively on recruiting outsiders with these credentials, more companies are investing in upskilling current employees and providing pay increases as employees become certified.[4]

THE FIELD OF EMPLOYEE-BENEFITS PRACTICE

Virtually every company offers at least one benefit to employees, and most companies offer several. This book emphasizes the importance of benefits in achieving legal compliance and competitive advantage and how companies achieve these goals. Meeting these imperatives requires benefits professionals who work in departments within the broader human resource function or as external consultants offering expert advice. Employees in benefits departments span the organizational hierarchy, including clerical staff members, managerial employees, and executives.

One survey revealed that the typical number of employees working in a company's benefits department is 5.3, of whom 3 are professional or managerial staff and 2.3 are support or clerical staff.[5] In addition, the number of staff members varied by company size, ranging from an average of 2.9 employees in smaller companies to 11.3 in larger companies.

So, with which issues do employee-benefits professionals work? According to the *Occupational Outlook Handbook*:

> Benefits managers plan, direct, and coordinate retirement plans, health insurance, and other benefits that an organization offers its employees.[6]

Performance standards are established by members of the profession rather than by outsiders. Most professions also have effective representative organizations that permit members to exchange ideas of mutual concern. Several well-known organizations serve the benefits profession. Among the more prominent are the International Foundation of Employee Benefit Plans and WorldatWork.

Opportunities for employment as compensation and benefits managers are projected to grow at an annual rate of 3 percent through 2029.[7] The median annual compensation for compensation and benefits managers was $122,270, which is more than double the median annual earnings for all jobs.[8] The salary levels vary on a number of factors, including relevant work experience, educational credentials, and industry. For example, the mean annual compensation was lowest in the food services ($26,670) settings and highest in management ($122,480).

While the employee-benefits group is on the same team as HR, inevitably tensions arise. Employee-benefits professionals are inclined to develop the benefits program, but competition for limited funds creates challenges. For instance, recruitment professionals may wish to purchase costly selection tests to improve the quality of hires. Training and development professionals vie for greater resources to incorporate expensive technology into curricula. Moving forward, let's take a closer look at the components of benefits packages to gain an appreciation of the scope of employee benefits.

Legally Required Benefits

Legally required benefits are mandated by several laws, some of which include: the Social Security Act of 1935 (Chapter 7), various state workers' compensation laws (Chapter 6), the Family and Medical Leave Act of 1993 (Chapter 8), state and local paid leave laws (Chapter 8). All provide protection programs to employees and their dependents. A basic summary of each benefit follows, with detailed treatment deferred to the relevant chapters.

The Social Security Act of 1935

The economic devastation of the Great Depression era prompted the federal government into action because most people had used up their life savings to survive, and opportunities for gainful employment were scarce. **The Social Security Act of 1935** set up two programs: a federal system of income benefits for retired workers, and a system of unemployment insurance administered by the federal and state governments. Amendments to the Social Security Act established the disability insurance and Medicare programs. **Old-Age, Survivor, and Disability Insurance (OASDI)** refers to the programs that provide retirement income, income to the survivors of deceased workers, and income to disabled workers and their family members. **Medicare** serves nearly all U.S. citizens aged at least 65, as well as disabled Social Security beneficiaries, by providing insurance coverage for hospitalization, convalescent care, major doctor bills, and prescription drug coverage.

State Compulsory Disability Laws (Workers' Compensation)

Workers' compensation insurance came into existence during the early decades of the 20th century, when industrial accidents were very common and workers suffered from occupational illnesses at alarming rates.[9] During the early years of industrialization of the U.S. economy, no laws required employers to ensure the health and safety of employees. Seriously injured and ill workers were left with virtually no recourse because social insurance programs to protect such workers were nonexistent. **State compulsory disability laws** created workers' compensation programs. **Workers' compensation** insurance programs are designed to cover employee expenses incurred in work-related accidents or injuries.

The Family and Medical Leave Act of 1993

The **Family and Medical Leave Act (FMLA)** provides job protection to employees in cases of a family or personal medical emergency. FMLA permits eligible employees to take up to 12 workweeks of unpaid leave during any 12-month period. These employees retain the right to return to the position they left when the leave began or to an equivalent position with the same terms of employment, including pay and benefits. The passage of the FMLA reflected growing recognition that the parents of many employees are becoming elderly, rendering them susceptible to serious illnesses or medical conditions as well as the changing role of men regarding child care.

Paid Leave

As we will see in Chapter 8, many states and some cities have passed mandatory sick and family leave requirements. These laws can be likened to FMLA leave but with pay. The provisions of the state and local paid leave laws vary in terms of criteria for leave qualification, the length of leave, and level of pay replacement during leave.

The Patient Protection and Affordable Care Act of 2010

The Patient Protection and Affordable Care Act (PPACA or ACA), enacted on March 23, 2010, is a comprehensive law that requires employers to offer health-care benefits to most employees. **Health care** covers the costs of a variety of services that promote sound physical and mental health, including physical examinations, diagnostic testing (X-rays), surgery, and hospitalization. Companies can choose to rely on one or more broad approaches to providing health care, including **fee-for-service plans, alternative managed-care plans,** and **consumer-driven health care**. Companies may offer additional care options: **Dental care** benefits may cover routine preventative procedures and necessary procedures to help restore the health of teeth and gums. **Vision care** plans usually cover eye examinations, prescription lenses, frames, and fitting of glasses. **Prescription drug plans** cover a portion of the costs of legal drugs. **Mental health and substance abuse plans** cover the costs for treating mental health ailments such as clinical depression and alcohol or chemical substance abuse.

Discretionary Benefits

Discretionary benefits fulfill three main roles. The first, *protection programs,* most closely parallels legally required benefits by offering protections to employees and family members due to income loss or ill health. The second, *paid time off,* affords employees time off with pay for many purposes, including illness or to celebrate designated holidays. The third variety, *accommodation and enhancements,* offers improvements to employees and their families in many ways. Wellness programs and educational assistance programs are just two examples.

Protection Programs

Disability Insurance Disability insurance replaces income for employees who become unable to work on a regular basis because of an illness or injury. Employer-sponsored disability insurance is more encompassing than workers' compensation because these benefits generally apply to both work-and non-work-related illness or injury. Disability insurance programs are reviewed in greater detail in Chapter 6.

Life Insurance Employer-sponsored **life insurance** protects family members by paying a specified amount upon the employee's death. Most policies pay some multiple of the employee's salary—for instance, benefits paid at twice the employee's annual salary. Employees usually have the option of purchasing additional coverage. Frequently, employer-sponsored life insurance plans also include accidental death and dismemberment claims, which pay additional benefits if death was the result of an accident or if the insured incurs accidental loss of a limb. Life insurance is reviewed in Chapter 6.

Retirement Plans **Retirement plans**, provide income to individuals and beneficiaries throughout retirement. Individuals may participate in more than one retirement plan. Companies may establish retirement plans as defined contribution plans, defined benefit plans, or hybrid plans that combine features of defined contribution and defined benefit plans. Under a **defined contribution plan**, employees make annual contributions to their accounts, based on chosen percentage of annual pay. At their discretion, companies make matching contributions, which are determined by a formula. The amount each participant receives in retirement depends on the performance of the selected investment choices (e.g., company stock or government bonds). A **defined benefit plan** awards a monthly sum equal to a percentage of a participant's preretirement pay multiplied by the number of years worked for the employer. The level of required employer contributions fluctuates from year to year as necessary to ensure that promised benefits will be honored. Retirement plans are discussed in Chapter 4.

Paid Time Off

The second type of discretionary benefits is paid time off. **Paid time-off policies** compensate employees when they are not performing their primary work duties. Companies offer most paid time off as a matter of custom, particularly paid holidays, vacations, and sick leave. In unionized settings, paid time-off provisions are specified within the collective bargaining agreement. Relatively common paid time-off practices are jury duty, funeral leave, military leave, holidays, and vacations.

Accommodation and Enhancement Programs

Accommodation and enhancement benefits promote opportunities for employees and family members. These benefits are discussed in Chapter 9. Following are four objectives, with an example stated in parentheses:

- Mental and physical well-being of employees and family members (e.g., stress management).
- Family assistance programs (e.g., child care).
- Skills and knowledge acquisition through educational programs (e.g., tuition reimbursement).
- Opportunities to manage daily challenges (e.g., transportation services).

Basic Design Considerations for Discretionary Benefits

Employee-benefits professionals possess substantial leeway when designing discretionary benefits. Numerous design considerations are reviewed throughout this book as specific benefits are examined, and general design considerations are discussed in Chapter 10. As noted later in this chapter and in Chapter 2, companies strive to offer cost-effective benefits that will promote the recruitment and retention of highly qualified employees. Chapter 2 addresses these issues from a psychological perspective as well as from an economic perspective. The following is a basic introduction to common features of employee-benefits programs.

- *Eligibility provisions.* Companies must decide whether to limit participation to current employees, their dependent family members, and survivors of deceased current or retired employees. Companies may limit participation to current employees. For instance, many companies exclude part-time employees as a cost-control measure.
- *Kinds of benefits.* Which benefits do companies offer to eligible individuals? Companies may sponsor a variety of broad benefits, including retirement plans, health care, and paid time off. Then they select specific benefits from these broad categories. For instance, defined contribution retirement plans are often preferred because these plans are more cost-effective than defined benefit plans.
- *Level of benefits.* Companies choose benefits based on maximum benefit limits. For example, life insurance policies specify the dollar benefit amount for the death of an employee.
- *Waiting periods.* Waiting periods specify the minimum number of months an employee must remain employed before becoming eligible for one or more benefits. Some waiting periods correspond with the length of probationary periods, while others are limited by law. Companies impose

probationary periods to judge a newcomer's job performance, and they explicitly reserve the right to terminate employees who demonstrate low job performance.

- *Financing benefits.* Employers choose from four approaches: noncontributory, contributory, employee-financed programs, or some combination. **Noncontributory financing** means that the company pays the total costs for designated discretionary benefits. Under **contributory financing**, the company and its employees share the costs. Under **employee-financed benefits**, employees bear the entire cost. The majority of benefit plans today are contributory, largely because benefits costs have risen so dramatically.
- *Employee choice.* Traditionally, a company provided the same benefits to most or all employees. Increasingly, companies offer employees varying degrees of choice. **Flexible benefits plans** enable employees to choose from among a set of benefits and different levels of these benefits (Chapter 10). The increasing diversity of the workforce has made standardized benefits offerings less practical because of greater differences in needs and preferences for particular benefits. For instance, workers with preschool-age children find day-care assistance programs most appealing, and workers nearing retirement age find value in company-sponsored retiree health-care benefits. Voluntary benefits provide additional options. **Voluntary benefits** are supplemental benefits that companies offer on an employee-financed basis, whereas flexible benefits provide employees with a choice from a menu of benefits, which follow contributory or noncontributory financing approaches. Examples of voluntary benefits include identity theft protection, home or renter's insurance, college savings plans, or, even pet insurance. Why offer these benefits when employees can purchase them outside the employment setting? Employers negotiate a lower rate than employees could ascertain on an individual basis. Also, the variety of discounted benefits should be appealing to a diverse workforce. For example, younger employees with children may find a college savings plan an attractive benefit compared to employees approaching retirement whose children have already completed their education.
- *Communication.* Oftentimes, employees either are unaware of or undervalue their benefits. Communicating the features and costs of benefits is essential. Effective communication creates an awareness of, and appreciation for, the way current benefits improve the financial security and physical and mental well-being of employees.

Origins of Employee Benefits

Different forces account for legally required and discretionary employee benefits. The U.S. government established programs to protect individuals from catastrophic events such as disability and unemployment. As highlighted earlier, legally required benefits are protection programs that attempt to promote health, maintain family income streams, and assist families in crisis.

Historically, legally required benefits provided a form of social insurance, which were prompted largely by the rapid growth of industrialization in the United States during the late 19th and early 20th centuries as well as the Great Depression of the 1930s. Early social insurance programs were designed to minimize the possibility of destitution for individuals who were unemployed or became severely injured while working. In addition, social insurance programs aimed to stabilize the well-being of dependent family members. Further, early social insurance programs enabled retirees to maintain subsistence income levels. These objectives remain the cornerstones of today's benefits practices.

The first signs of contemporary discretionary employee benefits were evident in the late 1800s, when large companies such as American Express offered retirement plans. For the next few decades, the development in employee-benefits practice resulted from government legislation. Then, discretionary benefits offerings became more prominent in the 1940s and 1950s due in large part to federal government wage freezes. Employee benefits were not subject to those restrictions, allowing expansion of discretionary benefits as an alternative to wage increases or as a motivational tool. During that period, the term *welfare practices* described some of the employee benefits. **Welfare practices** were "anything for the comfort and improvement, intellectual or social, of the employees, over and above wages paid, which is not a necessity of the industry nor required by law."[10]

The opportunities available to employees through welfare practices varied. For instance, some employers offered libraries and recreational areas, while others provided financial assistance for education and home improvements. In addition, employer sponsorship of health care became common. Employee unions also contributed directly to the increase in employee welfare practices. The National Labor Relations Act (NLRA) of 1935 legitimized bargaining for employee benefits. Union workers have access to more benefits, and lucrative ones, than nonunion employees do.[11] Still, unions contributed indirectly to the rise in benefits offerings in nonunion settings. Nonunion companies strive to minimize unionization by offering their employees benefits comparable to those received by employees in union companies.

Employees typically view employer-sponsored benefits as entitlements. Anecdotal evidence suggests that most employees still feel this way: Company membership entitles them to benefits because participation in benefits programs are not tied to job performance. Until recently, companies also treated virtually all elements of benefits as entitlements. However, rising benefits costs, increased foreign competition, and the so-called Great Recession (2007–2009) led companies to question this entitlement ethic. Increasingly, companies are shifting responsibility for the cost of some benefits to employees. For example, in Chapter 5, employer-sponsored high-deductible health care plans are discussed.

LEGAL AND REGULATORY INFLUENCES ON DISCRETIONARY BENEFITS PRACTICES

While employers are free to offer discretionary benefits, specific laws influence the application of these practices. To understand these influences, it is necessary to distinguish between private-sector employers and governmental employers, because different regulations influence discretionary benefits practices in these sectors of the U.S. economy. The private sector refers to nongovernmental employers that strive to maximize profits or offer charitable services to the public in need (nonprofit companies). Apple and PepsiCo are examples of for-profit companies, and the American Red Cross and the United Way are examples of nonprofit companies. In 2020, private-sector companies employed about 122 million persons—all U.S. civilian employees, and most of the companies were for-profit. Profit maximization is the foundation of the U.S. economy. Private-sector employers strive to increase profits, market share, and returns on investment for the owners and shareholders. Employers expect workers to be as productive as possible to promote these goals. At the same time, containing pay and benefits costs contributes to profit maximization.

Conflicting goals between employees and profit-oriented employers necessitate regulations to protect employees from unfair treatment. The following excerpt captures the natural clash between employers and employees, employer profit maximization goals, and employee desires for equitable and fair treatment:

> As competition increased in the textile industry, the original concern of the mill owners for their employees gave way to stricter controls which had nothing to do with the well-being of the workers. Employers reduced wages, lengthened hours, and intensified work. For a workday from 11.5 to 13 hours, making up an average week of 75 hours, the women operatives were generally earning less than $1.50 a week (exclusive of board) by the late 1840s, and they were being compelled to tend four looms whereas in the 1830s they had only taken care of two . . . [The manager] ordered them [the female textile workers] to come before breakfast. "I regard my work-people just as I regard my machinery. So long as they can do my work for what I choose to pay them, I keep them, getting out of them all I can."[12]

Employees strive to attain high wages, comprehensive benefits, safe and healthful work conditions, and job security. Prior to the passage of the National Labor Relations Act, employees were not required to negotiate terms and conditions of employment. As a result, many workers were subjected to unsafe and unhealthful working conditions, inadequate pay and benefits, and excessive work hours. Today, employment legislation and labor unions protect the rights and status of workers, and employer abuses are much less prevalent than before legal protections and labor unions. For example, prior to the Employee Retirement Income Security Act (ERISA) of 1974, employees could easily lose company retirement benefits after decades of service simply because the employer chose to use retirement funds for other purposes that benefited company profits. Also, employees did not possess the right to keep their retirement assets if they left a company before reaching retirement age. Years of congressional testimony and investigations led to the passage of ERISA based on the conclusion that employer-sponsored retirement plans were essential to the country's economic security and as an essential supplement to government-sponsored retirement programs through the Social Security Act of 1935.

Public-sector employers include the U.S. federal government, state governments, and local governments. Approximately 2.9 million people are employed in the federal government's three branches: executive, judicial, and legislative. Public-sector employers work on behalf of citizens, and none exists to make profits. At the state and local levels, public-sector employers include local police forces, community colleges, state colleges and universities, court systems, social service agencies, and public works departments (such as road maintenance), totaling approximately 21 million workers. Although government employers do not seek profits, they still must operate within a budget to provide pay and benefits to employees and services to citizens.

It is important to note that the government is a buyer and consumer of the products and services that private-sector companies produce. Indeed, the government spends more than $1 trillion each year on these items. The government uses energy to run its buildings, and it engages in contracts with private-sector companies for a multitude of goods and services ranging from building construction to multimillion-dollar defense systems. Various laws require the government to pay contract employees the customary wage in the local area. This is an important fact because many benefits, such as retirement earnings, are tied to pay levels.

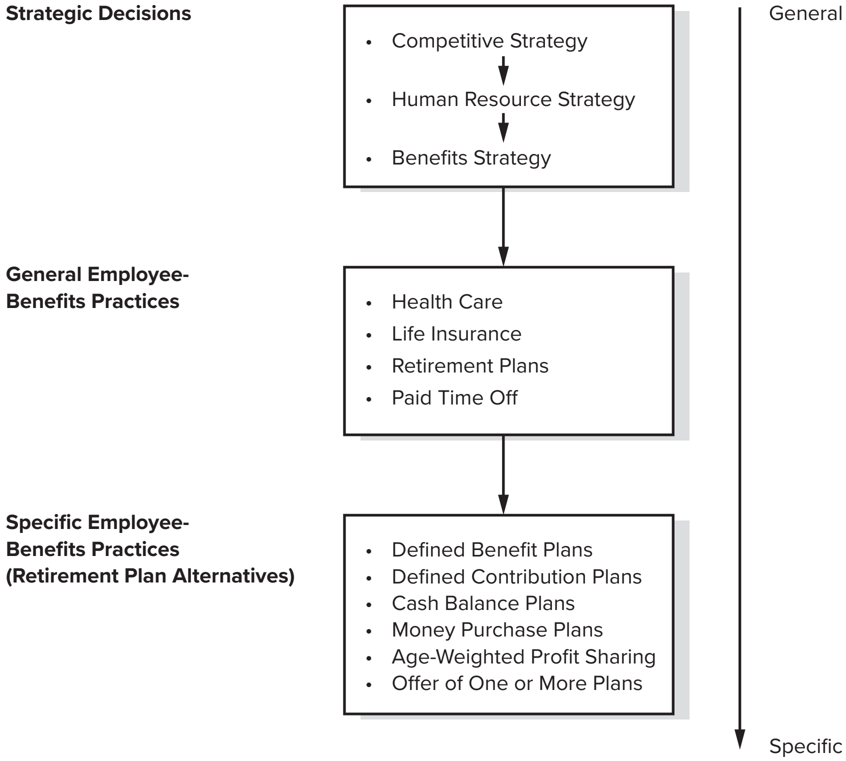
STRATEGIC PLANNING FOR A BENEFITS PROGRAM

The development of successful benefits programs matches the priorities of ongoing strategic planning efforts within companies. One survey found that high-performing companies align total compensation programs with business objectives.[13] Many U.S. companies build their success through creating and marketing innovative products and services to customers. Increasingly, companies emphasize the importance of employing diverse workforces to promote the inventive processes necessary for innovation. For instance, Bristol-Myers Squibb pledges the following: "Through a culture of inclusion, we create an agile and responsive work environment where the diverse experiences and perspectives of all our employees help to drive innovation and transformative business results."[14]

Basic Strategic Planning Concepts

Strategic planning entails a series of judgments, made under uncertainty, that companies direct toward making strategic decisions. Companies base their decisions on environmental scanning activities, which are discussed later in this chapter. Business professionals make two kinds of decisions: strategic decisions and, in the context of employee benefits, the design of specific practices such as retirement plans. Briefly, strategic decisions guide the activities of companies in the market. The choice about the design of employee-benefits practices support the fulfillment of strategic decisions, which are discussed shortly. Exhibit 1.3

EXHIBIT 1.3
Relationship between Strategic Decisions and Employee-Benefits Practices



shows the relationship between strategic decisions as well as the design of employee-benefits practices.

Strategic planning supports business objectives. Company executives communicate business objectives in competitive strategy statements. **Competitive strategy** refers to the planned use of company resources—technology, capital, and human resources (HR)—to promote and sustain competitive advantage. For example, ExxonMobil Corporation, a company in the oil and gas exploration industry, strives to be the world's premier petroleum and petrochemical company by achieving superior financial and operating results while simultaneously adhering to high ethical standards.[15] Eli Lilly and Company, a manufacturer of pharmaceutical products, pursues a competitive strategy, which focuses on creating innovative medicines that improve patient health outcomes.[16]

Human resource executives collaborate with other company executives to develop **HR strategies**, which specify the use of multiple HR practices. These statements are consistent with a company's competitive strategy. For example, Eli Lilly is well known for the innovative environment that it creates for employees to make discoveries for pharmaceutical products that will enhance the life of people throughout the world.[17]

Compensation and benefits managers and executives work with the lead HR executive and the company's chief budget officer to prepare total compensation strategies. **Total compensation strategies** describe the use of compensation and benefits practices that support both HR strategies and competitive strategies. Benefits professionals craft **benefits strategies** based on information contained in strategic benefit plans.

Strategic benefit plans detail different scenarios that may reasonably affect the company, and these plans emphasize long-term changes in how a company's benefit plan operates.[18] Companies establish strategic benefit plans based on the interpretation of pertinent information in the external and internal environments, which will be discussed shortly.

At Lilly, it is evident that the use of compensation and benefits practices supports both human resource strategies and competitive strategies. Eli Lilly is well known for offering a balanced compensation and benefits program which recognizes employee contributions and embraces employees through recognition of their needs outside the workplace.

As Exhibit 1.3 shows, managers throughout a company make decisions to specify policy for promoting competitive advantage. Benefits decisions are based on two questions: Does offering particular benefits (e.g., paid vacations) support the company's benefits strategy? and What is the optimal design (of vacation benefits)? Descriptions of five employee benefits practices at ExxonMobil follow.

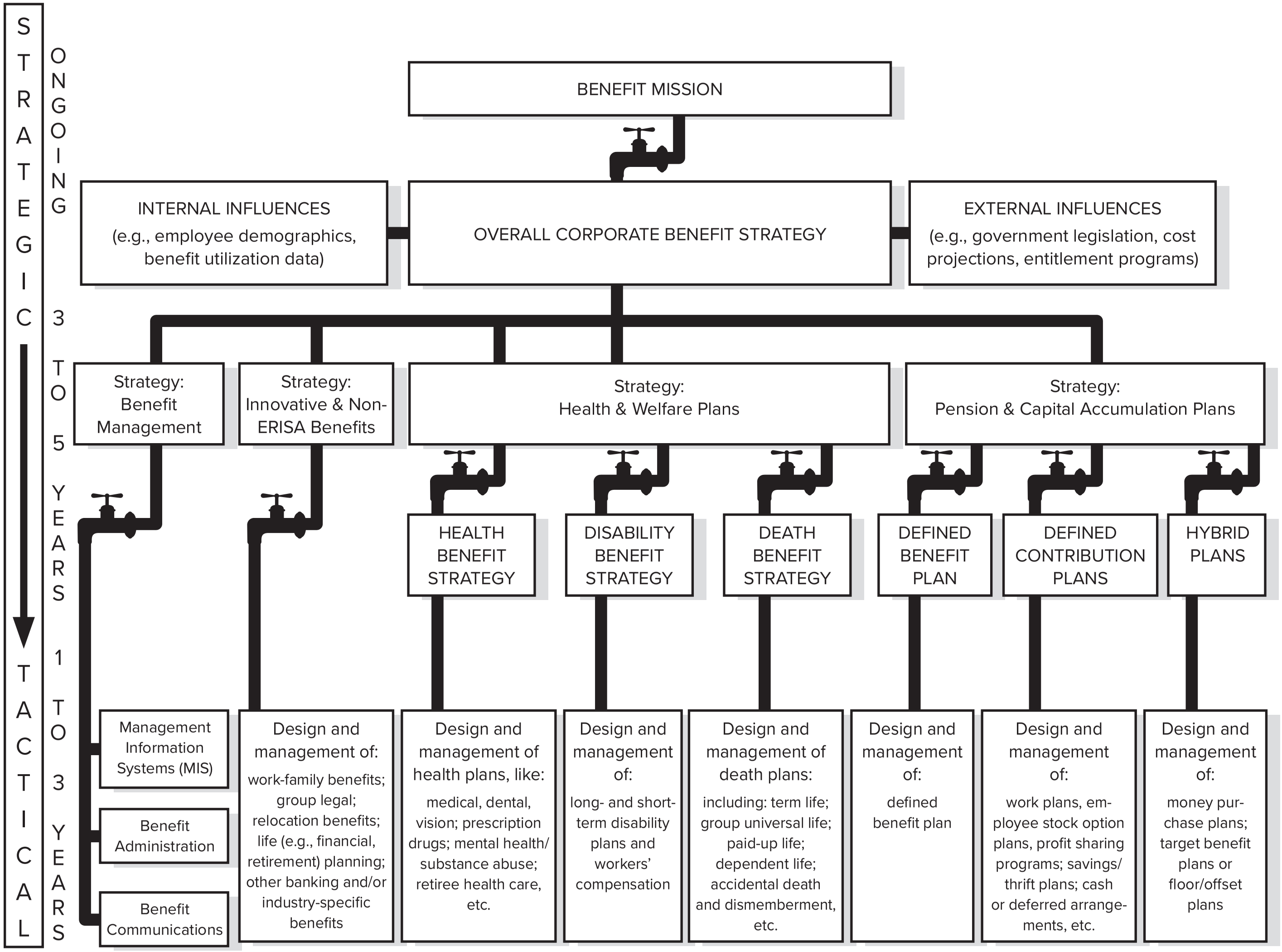
1. *Education assistance*—After employment, ExxonMobil reimburses 100 percent of college-related expenses for approved courses to maintain or improve your skills.
2. *Matching gifts program*—Three-to-one matching funds for employee and alumni donations to their alma mater.
3. *Volunteer involvement program*—Grant moneys awarded for volunteering at eligible nonprofit organizations.
4. *Flexible work arrangements*—Options for adjustable work hours, telecommuting, part-time extensions for family-care needs, and personal time off.
5. *Life assistance resources*—For child care, elder care, adoption, teen issues, stress, and a variety of other issues.[19]

Approaches to Strategic Benefits Planning

This section begins with a review of two approaches to strategic benefit planning. Afterward, the kinds of information that companies use in this planning process will be touched upon. In most companies, either compensation or benefits-program executives (in some companies, one person is responsible for both) take the lead in strategic benefit planning. Two possible general approaches characterize strategic benefit planning: top-down and backing-in.[20] The **top-down approach** represents a proactive process: Companies regularly review their entire benefits programs or particular parts of the programs. This process may lead to a reformulation of an entire program or specific parts. Exhibit 1.4 illustrates how the top-down approach unfolds and shows the representative time frames for particular stages of this process.

EXHIBIT 1.4 **A Top-Down Approach to Strategic Benefit Planning: A Conceptual Framework**

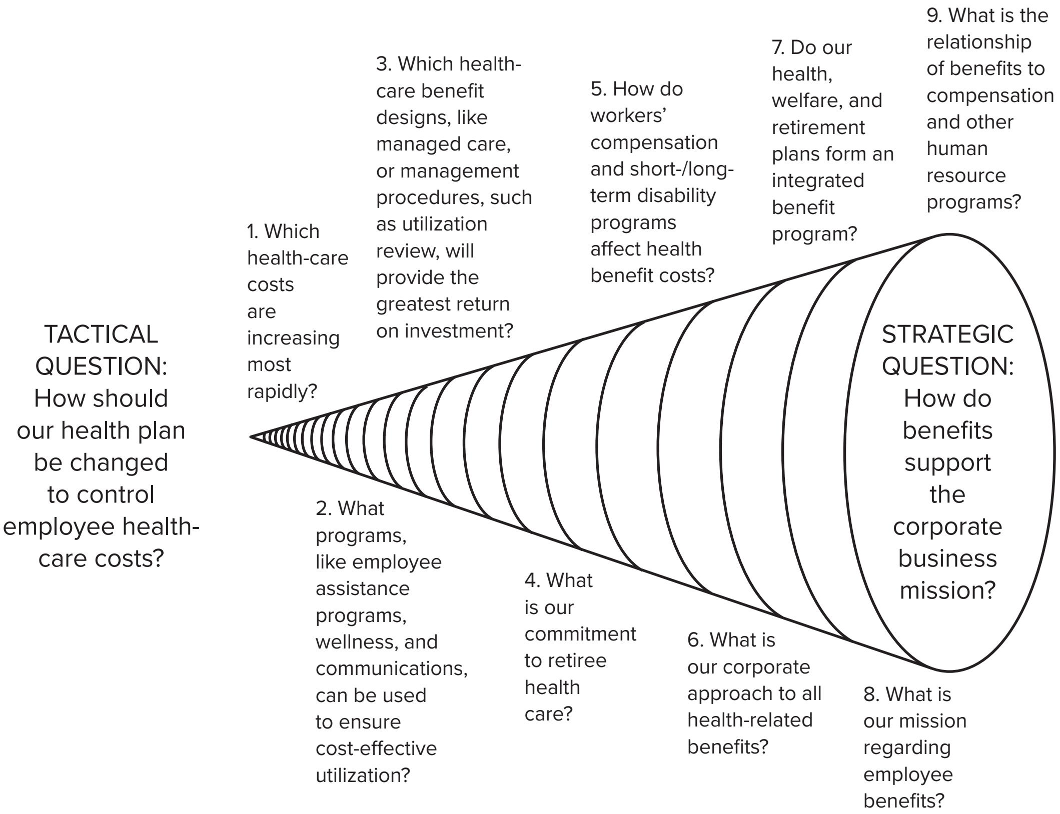
Source: V. Barocas. *Strategic Benefits Planning* (New York: The Conference Board, 1992), 15.



The **backing-in approach** is a reactive process because companies evaluate the benefits program only when unexpected problems arise. Exhibit 1.5 illustrates how the backing-in approach unfolds, along with the representative time frames for particular stages of this process. For instance, Company A, a manufacturing company, built a reputation as a great place to work for many reasons, including competitive pay and benefits. Recently, excessive turnover has occurred among its assembly-line employees, many of whom have taken jobs at another local manufacturing company. Company A's HR staff conducted exit interviews to identify possible causes of turnover. Most exit interviews revealed significant dissatisfaction with wage freezes, steep rises in employee contributions for health-care coverage, and the termination of dental benefits. Company management had instituted these changes in response to inflated raw material costs. Its goal was to maintain profits while keeping the prices for company products constant. Intense economic pressures necessitated cuts, and these cuts made it difficult for the company to reduce turnover.

EXHIBIT 1.5 A Backing-in Approach to Strategic Benefit Planning

Source: V. Barocas, *Strategic Benefits Planning* (New York: The Conference Board, 1992), 16.



INFORMATION USED IN STRATEGIC BENEFIT PLANNING

Companies review and interpret several types of information for strategic benefits planning. This process permits business professionals to understand their company's standing in the market. For example, companies with strong potential to increase sales levels tend to be in better standing than companies with weak potential to maintain or increase sales. Companies in strong standing should be able to devote more financial resources to fund benefits programs than companies in weak standing. Beyond this fact, the COVID-19 pandemic influenced the way companies addressed employee benefits, which we note here and where relevant throughout the book. Two information sources include the external market environment and the internal company environment.

External Environment

External environmental factors include:

- Industry prospects, economic conditions, and forecasts
- Employer costs for compensation and benefits
- Government regulation of employee benefits
- Changing demographics of the labor force
- COVID-19 pandemic

Industry Prospects, Economic Conditions, and Forecasts

The first factor, industry prospects and current and anticipated economic conditions, sets the backdrop for establishing strategic benefits plans. Industry prospects and economic forecasts set the backdrop for strategic benefits planning because these factors are indicators of the future of companies. Forecasts indicating growth possibly call for strengthening discretionary benefits offerings and levels to help recruit and retain the most-qualified employees. Pessimistic forecasts emphasize the need to save costs by shifting more of the responsibility on employees. For example, more and more companies require that employees share a greater percentage of the cost of health-care plans. Also, there has been a shift away from employer-sponsored defined benefit retirement plans to employer-sponsored defined contribution plans, which makes it easier for companies to predict their costs. Further, negative outlooks may lead companies to expand outplacement services (i.e., helping unwanted employees find jobs elsewhere) in anticipation of large-scale layoffs. Still, employers will very likely continue to sponsor employee benefits despite economic conditions for two reasons. First, the Internal Revenue Code and the Employee Retirement Income Security Act create tax advantages for companies that offer qualified benefits plans (see Chapter 3). Employers may exclude limited contributions to these plans from taxable annual income, leading to reduced tax payments to the federal government. Second, as we discuss in Chapter 2, generous benefits offerings facilitate a company's attempt to attract and retain the best-qualified employees. Although employer-sponsored benefits costs are significant, well-qualified workforces presumably create lucrative advantages for companies, as evidenced by high-quality customer service, competent business functions such as innovative marketing, and research and development.

Employer Costs for Compensation and Benefits

The U.S. Bureau of Labor Statistics (BLS) regularly publishes current information about employer costs for employee compensation and benefits in the United States and changes in these costs over time (www.bls.gov). Benefits professionals may use these data to benchmark current benefits costs against reported averages or as a starting point for budget planning. The following is an excerpt from a BLS news release.

> Private industry worker compensation costs for employers averaged $36.64 per hour worked in March 2021. Wages and salaries averaged $25.80 and accounted for 70.4 percent of employer costs, while benefit costs averaged $10.83 and accounted for 29.6 percent.[21]

The BLS presents data for average hourly pay and specific benefits for the entire civilian workforce, private industry, state and local governments, and by particular categories: industry, occupational group, region, establishment size, and worker characteristics, such as bargaining status and full- or part-time status. Employer costs per hour worked are available for five major occupational groups. Employer compensation costs also vary by industry, region, union status, and establishment size. For instance, the total cost of benefits for union workers was $20.49 compared to $10.03 for nonunion workers.

Overall, benefits accounted for approximately 30 percent of total compensation costs in the private sector. At first glance, the cost of specific benefits does not appear to be particularly high because private-sector employers spent an average of $10.83 per employee per hour to provide discretionary and legally required benefits. However, aggregating these costs for a one-year period (per employee) paints a different picture. Assuming that an employee works 1,850 hours per year, an employer spends nearly $20,000 for each employee.

Government Regulation of Employee Benefits

Four broad forces contribute to an employer's choice of discretionary benefits and its ability to fund them. The first two, adequacy of legally required benefits and employee expectations, directly influence an employer's choice. The third, the cost of legally required benefits, influences a company's ability to fund discretionary benefits. The fourth entails a variety of economic considerations, which will be discussed in Chapter 2.

First, the workers' plight during the industrialization of the U.S. economy and the Great Depression promoted the rise of many legally required benefits. Examples include workers' compensation and both retirement income and health care under the Social Security Act (Chapters 6 and 7). The U.S. economy is based on free-market principles, not on socialist principles more commonly found in many Eastern European countries and in large segments of the People's Republic of

China where government benefits represent the lion's share of support following injury, disability, or in retirement. In addition, the cost of living has risen more quickly than the dollar amount of government benefits. Finally, legislators during the early part of the 20th century could not anticipate the very high costs of health care due, in large part, to advances in medicine and health-care technology. The entire structure of the health-care industry is fundamentally different now than it was in the 1930s. Since then, medical research and development have led to the ability to diagnose diseases in the early stages, and thus life expectancy of people born in more recent years has increased notably. These changes make the funding formulas inadequate to meet today's realities.

Second, the federal government's imposition of wage freezes during World War II gave rise to many present-day discretionary benefits. Employers withdrew costly offerings after the government ended the wage freeze. The withdrawal of these benefits created discontent among employees, because many viewed employer-sponsored benefits as an entitlement. For instance, employees strongly reacted to the withdrawal of health-care benefits. Legal battles followed based on unions' and workers' claims that employer-sponsored health care is a fundamental right. Health-care benefits subsequently became a mandatory subject of collective bargaining in union settings.

Third, the federal government requires companies to support legally required benefits. For example, the **Federal Insurance Contributions Act (FICA)**[22] helps support the Social Security Old-Age, Survivor, and Disability Insurance program (OASDI). Unemployment insurance benefits are financed by federal and, sometimes, state taxes levied on employers. A federal tax is levied on employers under the **Federal Unemployment Tax Act (FUTA).**[23] Both acts are discussed more fully in Chapter 7. Under the **Patient Protection and Affordable Care Act of 2010,** most employers are required to provide health-care coverage to full-time workers; otherwise, they face stiff monetary penalties.

Changing Demographics of the Labor Force

According to the Bureau of Labor Statistics, labor force diversity will continue to increase based on gender, age, race, and ethnicity. An employer-sponsored benefits program is most effective when the workforce is relatively similar in terms of needs and preferences. For example, let's assume that a company's workforce has 60 percent women and 40 percent men. Most of the women are of child-bearing age and most of the men range in age between their 50s and 60s. On the surface, one could say that this workforce is not very similar in terms of needs and preferences for benefits because its composition varies considerably by gender and age. Below the surface, one could reasonably conclude that there will be substantial differences in the needs and preferences for benefits. Chances are that most of the women may place a high value on day-care benefits, while most of the men will not have a need for such benefits because their children are likely to be near or at adulthood.

Employees are more likely to endorse employer-sponsored benefits as long as these benefits fulfill their needs and preferences. Also, employees should believe that contributions to receive benefits are determined fairly. Workforce diversity challenges a company's quest to establish benefits that satisfy the needs and preferences of workers. For example, the younger segment of the workforce may benefit from family assistance programs and educational assistance programs, while the older segments of the workforce rely on generous health-care benefits and defined benefit plans that support progressive retirement-income streams. Health-care benefits may be redundant for some dual-income families. One spouse or partner will not elect these benefits because he or she already receives coverage as a family member under the other's plan. As employee needs diversify and desires for benefits become apparent to workforce members, some employees will likely protest benefits that they believe disproportionately suit coworkers. Certainly, differences in employee preferences and needs based on life stage and life circumstances call for flexible benefits offerings, which will be discussed shortly.

COVID-19 Pandemic

In March 2020, the onset of the COVID-19 pandemic shocked the world, negatively impacting most aspects of work and life. Companies moved to remote work arrangements at breakneck speed to prevent the spread of the virus among their employees, leaving them with little time to plan for working at home. At the same time, school closures and the rapid implementation of remote student learning methods put many parents in the role of educator, helping children adjust to the new way of learning and to maintain focus. Individuals living alone were highly susceptible to the effects of social isolation. Added to these stressors, the unemployment rate rose dramatically, and most people were worried about layoffs and their financial future. Anecdotal information suggests that these and other stressors contributed to higher rates of burnout and clinical depression.

Many companies reconsidered the strategic role of benefits, effectively through the backing-in approach discussed earlier, and focused on developing current or offering new benefits to help employees and their family members better cope. Enhanced emphasis has been placed on wellness programs and employee assistance, including easier access to psychological counseling (Chapter 9). Where affordable, improved childcare benefits were offered. Among the many concerns, some also felt greater uncertainty about the financial future and their ability to build savings to support retirement. Many companies responded with new offerings of financial wellness education or enhancing existing programs. Other benefits emerged such as enhanced paid time-off.

After life appears to return to normal, many will still feel the ill-effects of the pandemic. It will likely be the case that companies will continue to emphasize various wellness programs. Moreover, recognizing that improbable events like the pandemic could occur again, promoting comprehensive wellness approaches will inevitably be an important consideration in the strategic employee benefits planning process.

Internal Environment

Internal environmental factors include workforce demographics and collective bargaining agreements.

Workforce Demographics

The workforce characteristics of companies usually represent the characteristics of the broad labor force. Over time, company workforces have become more demographically diverse as labor force diversity has increased. Not surprisingly, workforce diversity has created challenges for companies in establishing benefits programs. Demographic characteristics to a large extent symbolize employee needs and preferences, which are often associated with life events. Exhibit 1.6 shows typical benefits preferred by employees according to demographic characteristics and probable life events.

Should companies presume the needs and preferences of employees? Probably not. Benefits professionals may use surveys once every year or two to collect information about employee demographics, needs, preferences, recent or anticipated life changes, and the extent to which they find particular benefits useful. Statistical analyses will show whether there is an association among these factors. Then, benefits professionals may compare current offerings with survey results. Over time, they can determine whether changes in age, family status, needs, and preferences influence employees' views of benefits.

Collective Bargaining Agreements

Collective bargaining agreements specify terms of employment, including pay, benefits, and working conditions. These agreements arise out of negotiations

EXHIBIT 1.6
Likely Preferred Benefits According to Demographics and Life Events

Demographics	Life Events Benefits
Unmarried male and female employees (uncoupled employees)	Physical fitness programs Generous vacation allowances
Employees with dependent elderly parents or relatives	Elder care benefits Flexible work schedules
Married male and female employees	Flexible work schedules
Employees with children, male or female, coupled or uncoupled	Day-care assistance Life insurance Health care with dependent coverage Education benefits for children
Older workers (nearing retirement)	Retirement plans with accelerated benefits accumulation Health-care coverage with prescription drug benefits Generous sick-leave allowances Disability insurance Retiree health-care benefits

between management and labor unions that represent some or all employees in a company. In Chapter 3, we discuss the National Labor Relations Act of 1935 established that both labor unions and employers possess a duty to bargain with the other party in good faith over terms of employment. Also, this act sets forth mandatory subjects of bargaining in the benefits area, including retirement plans, health care, and paid time off. Over the years, unions have successfully negotiated generous benefits for employees. As noted earlier, private-sector employers spend more money on benefits for union workers ($20.49 per hour worked) than nonunion workers ($10.03 per hour worked).

Summary

This chapter provided a definition of employee benefits and its placement in the total compensation framework. We also introduced the difference between discretionary benefits and legally required benefits. Further, we learned that employee benefits are heavily regulated, setting parameters on the design of discretionary benefits. Finally, we put the employee benefits field in a business strategy context and explained two approaches for casting employee benefits strategically. Internal and external environmental factors were discussed as considerations in the strategic benefit planning process.

Key Terms

employee benefits, *5*
protection programs, *5*
paid time off, *5*
accommodation and enhancement benefits, *5*
total compensation, *6*
base pay, *6*
cost-of-living adjustments (COLAs), *7*
seniority pay, *7*
merit pay, *7*
incentive pay, *8*
person-focused pay, *8*
The Social Security Act of 1935, *9*
Old-Age, Survivor, and Disability Insurance (OASDI), *9*
Medicare, *10*
state compulsory disability laws (workers' compensation), *10*
workers' compensation, *10*
Family and Medical Leave Act (FMLA), *10*
health care, *10*
fee-for-service plans, *10*
alternative managed-care plans, *10*
consumer-driven health care, *10*
dental care, *10*
vision care, *10*
prescription drug plans, *10*
mental health and substance abuse plans, *10*
life insurance, *11*
retirement plans, *11*
defined contribution plan, *11*
defined benefit plan, *11*
paid time-off policies, *11*
noncontributory financing, *13*
contributory financing, *13*
employee-financed benefits, *13*
flexible benefits plans, *13*
voluntary benefits, *13*
welfare practices, *14*
strategic planning, *16*
competitive strategy, *17*
HR strategies, *17*
total compensation strategies, *18*
benefits strategies, *18*
strategic benefit plans, *18*
top-down approach, *18*
backing-in approach, *20*
Federal Insurance Contributions Act (FICA), *23*
Federal Unemployment Tax Act (FUTA), *23*
Patient Protection and Affordable Care Act of 2010, *23*
collective bargaining agreements, *25*

Discussion Questions

1. Describe how employee benefits fit into the total compensation function.
2. Offer some suggestions for how companies might lessen the entitlement mentality among employees toward employee benefits.
3. Companies possess limited budgets to fund employee benefits. From an employee's perspective, which employee-benefits practices should be funded? Which are easily dispensable? Now respond to these questions as a company representative. Explain your answers.
4. Describe the differences between strategic benefits plans and benefits practices. Should strategic benefits plans be developed before setting benefits practices? Explain your answer.
5. Consider the varieties of internal and external information that companies consider when planning a benefits program. Which piece of information do you believe is most important to this planning process? Least important? Explain your answers.

Cases

1. Understanding Your Employee Benefits: Understanding a Job Offer

As a recent college graduate, you are excited to start the search for your first career position. You have already started interviewing for opportunities as a management trainee. You have been fortunate to have two interviews so far, and you identified several other companies to apply to at a recent job fair. From what you have learned, it seems that the starting salary for a job as a management trainee in your area is about the same at all companies. Therefore, you know that salary isn't going to differentiate one job offer from another. It will, of course, be important to understand the work environment and future career opportunities at a given company as you compare offers. As you think back to some of the career-search seminars you've attended, you remember that you should also compare benefit offerings.

As you look through the Web sites of the companies you have applied to, you quickly see that there are lots of different benefits plans offered. In fact, as you look at this information, you start to become concerned that comparing benefits is going to be a challenge. You think that you need to have a better understanding of the value of different benefits when you consider the total compensation you would receive from a company. You decide to start by more closely looking at the benefits offered by your current best prospect, which is a position at a large established corporation where you interviewed last week. You pull up the careers page on the company Web site and find a chart that lists the benefits offered.

Old age, survivor, and disability insurance	Health care	Vacation days
Medicare	Dental insurance	Holidays
Unemployment insurance	Employee assistance program	Sick days
Workers' compensation	Tuition reimbursement	
Family and medical leave	Defined contribution retirement plan	

As you review the chart, you aren't sure what you should pay attention to and what will make a difference in evaluating an offer. You think about lists that you've read on other company's Web sites and think that other companies seem to offer benefits plans very similar to this one. At this point, you think that maybe benefit offerings don't really make a difference. You decide you need to learn more before you go much further in the interview process. If the benefits information provided to you is unclear, you know you should be prepared to ask questions. The future is exciting, but you know that once you receive an offer, it is an important decision that you should make with full information.

1. If two different companies list the same benefits offerings, should you assume that the value of the benefits are the same?
2. What are some benefits offered from this company that you should find more information about in order to fully understand a job offer from the company? Why?
3. Why don't all companies just offer the same benefits?

2. Managing Employee Benefits: Strategic Benefits Planning at Makers Craft

Makers Crafts is facing strong competition in the retail craft chain-store market. Easy Crafts, a new discount craft-store chain, is opening stores in many of Makers Crafts' market areas. Makers Crafts has been a leader in the craft supply marketplace due to the company's superior customer service provided by a well-trained and compensated retail staff that are experts in crafts. Customers have enjoyed the opportunity to gain advice and ideas from the company's talented workers over the years, and customers are loyal to the committed staff. However, the new discount chain is drawing away customers by recruiting the experienced staff from Makers Crafts. Adding experienced staff to the lower prices at Easy Crafts is quickly drawing business away from Makers Crafts, and company executives are concerned.

The sudden employee attrition at Makers Crafts is a top priority for new Director of Human Resources Latonya Thomas. Her initial evaluation of the situation suggests that the company needs to examine its benefit offerings. Makers Crafts has done well at recruiting and training staff; however, little attention has been paid to the company benefits offerings to complement the competitive employee pay. While the company pays its employees above market-average wages, it has slowly changed benefits offerings in response to cost concerns. In the last five years, employee contributions to health-care premiums have increased, and the company has scaled back its contribution to the employee retirement plan. While these changes have helped the company control benefit costs, the changes have led to frustration by the employees.

Easy Crafts has capitalized on employee dissatisfaction at Makers Crafts by offering a generous benefits package to draw away workers. The frustrated employees that have moved to Easy Crafts have accepted minor pay cuts in exchange for benefits that better meet their needs. For example, many of the company workers are older, and their concerns about retirement benefits in particular are more pronounced as they know retirement is not far away. Part of Easy Crafts' strategic planning process to grow its market share included determining the types of benefits that would be attractive to these workers. Thus, Easy Crafts offers a retirement plan that provides more significant contributions by the company than Makers Crafts' plan provides. Given the successful recruitment of so many Makers Crafts workers, it seems that Easy Crafts' planning was effective.

Latonya knows that the company needs to make some changes to its benefits plan. However, she also knows that it is important to not make any hasty decisions in response to this challenge. Latonya needs to begin collecting information in order to start the planning needed to determine appropriate changes to Makers Crafts' benefits plan.

1. What kind of strategic planning approach is Latonya taking for Makers Crafts? Is this an effective approach?
2. What kind of information does Latonya need for the strategic benefits planning process for Makers Crafts?

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Chapter Two

The Psychology and Economics of Employee Benefits*

Chapter Outline

Learning Objectives

In this chapter, you will gain an understanding of:

1. The employment relationship as an exchange relationship and the psychology behind why firms provide employee benefits.
2. Employee benefits as part of the psychological contract and how some

*The material in this chapter pertaining to the psychology of employee benefits was prepared by Professor Niti Pandey, Department of Business Administration, Eastern Connecticut State University, and edited for this edition by Joseph Martocchio. The material in this chapter pertaining to the economics of employee benefits was prepared by Professor Darren Lubotsky, Department of Economics and the Institute for Government and Public Affairs, University of Illinois at Chicago, and edited for this edition by Joseph Martocchio.

employee expectations about benefits might be formed.

3. How employee perceptions of justice or fairness are important to understanding how pay and benefits practices influence employee attitudes.
4. The economic rationales for why companies offer employee benefits.
5. Who pays for employee benefits.

The purpose of this chapter is twofold. First, it is important to learn about the *psychological* basis of employee benefits. Employers can use this knowledge to understand how employee benefits influence the attitudes and performance of their employees. Also, employers can then develop and maintain effective benefits programs aimed at promoting worker satisfaction, commitment, and productivity.

Second, it is important to understand the *economic* basis of employee benefits. Employee benefits are a costly proposition. Even though employee benefits are expensive, most employers continue to offer them. Still, it begs the question pertaining to whether companies should have workers pay for life or disability insurance. After considering the psychology of employee benefits, we will take up topics about the economics of employee benefits.

THE PSYCHOLOGY OF EMPLOYEE BENEFITS

This discussion of the psychology of employee benefits is organized into three sections. First, the employment relationship as social exchange is considered. Second, psychological contracts are discussed. Third, we look at the relationship between having a benefits program and employee attitudes.

Employment Relationship as Social Exchange

Most voluntary human behaviors are driven, in part, by some expectation of outcomes. Work behaviors are no exception. In fact, work behaviors are some of the most deliberated and goal-directed behaviors. In the most general terms, the employment relationship consists of clusters of human resource practices offered to a group of employees along with the resulting employee contributions to the employer.[1]

The basis for understanding the employment relationship lies in the concept of **social exchange**—the most basic concept explaining social behavior. All social behavior can be seen as "an exchange of activity (*work effort*), tangible (*visible performance*) or intangible (*motivation and commitment*), and more or less rewarding or costly (*pay and benefits*), between at least two persons (*employee and employer*)."[2] Thus, social exchange in the employer-employee relationship is one in which the employer offers inducements (e.g., wages and employee benefits) in return for employee contributions (e.g., performance and commitment).[3]

How Employee Benefits Constitute Social Exchange

For companies, employee benefits not only offer cost advantages and tax incentives, but also act as a recruitment tool for attracting and retaining desired employees. Employee benefits provide employees with economic and income security, and also with personal and family welfare. People choose to work in exchange for remuneration. While wages or salary act as basic remuneration, employee benefits act as remuneration for the welfare of employees and fulfill such needs as health care, dependent care, retirement planning, vacations, and education. As such, in exchange, they elicit increased motivation and commitment from employees toward the company and its goals.

The employment relationship can be said to constitute both economic exchange and social exchange.[4] **Economic exchange**, as with wages and salary, is one in which the nature of the exchange has been specified at the time of employment. (Of course, economic exchange can also be renegotiated at any time during employment, as with yearly pay raises). Explicit company policies and procedures help to ensure that each party (i.e., the employer and the employee) fulfills the obligations in the exchange relationship. In other words, in exchange for continued employment and wages, employees are obligated to work for the employer. Certain employee benefits can fall under the category of economic exchange. For example, health insurance can be viewed in monetary terms, since it costs employers to pay for employees to have health insurance and is usually a part of the explicit agreement at the time of employment.

Social exchange tends to evolve over the employment period and is not necessarily established at the time of employment. The nature of the social exchange is left to the discretion of the employer and employee. As employees become aware of policies or use various employer practices over the period of their employment, they reciprocate with increased or decreased job effort and commitment. Employee-benefits practices are numerous and versatile, as indicated by the range and variety of practices presented in Chapter 1. Employees' needs change over the duration of their employment with a company. This change may be in terms of personal career needs or self, family health, and welfare needs. Different employee benefits are likely to be relevant to employees at different circumstances and stages of their lives and careers. If an employer can provide an employee with benefits suitable to an employee's evolving needs, the employee is likely to reciprocate with increased work effort and commitment. Hence, employee benefits are an especially relevant component of the social exchange between the employer and employee.

Workforce Changes and the Employment Relationship

To understand the importance of employee benefits for both employees and employers, it is important to understand the dynamic nature of the employment relationship. The nature of the employment relationship, especially in developed economies, has undergone several changes over the past few decades. Jobs are no longer characterized by traditional job security, strong loyalty to the organization, or the patriarchal role of the organization in the life of the employee. Instead, work arrangements and careers have become more flexible. There has been an increase in part-time and contingent workers. Regular layoffs have been taking place, especially in certain industries, such as manufacturing.

From economic and market challenges, the workforce in the United States and other developed economies is becoming increasingly diverse. Diversity in the workforce is stemming from an aging population[5] poised on the brink of retirement,[6] increased labor force participation by those over the age of 60,[7] decreasing age cohorts,[8] an increase in the proportion of racial and ethnic minorities and immigrants,[9] and an increase in single-person households.[10] Some of these trends and projections for the future are presented in Exhibit 2.1.

Traditionally, the design of compensation and benefits packages had assumed a similarity among employees of attitudes, needs, and expectations, particularly on a white, married, male workforce from a single-earner household. Exhibit 2.1 illustrates the expected changes in workforce demographics through 2029. Through the decades, employees developed a strong entitlement mentality. Until recently, employers did little to manage these expectations. Nowadays, companies are shifting some of the costs of benefits to employers, with one example being higher contributions for

EXHIBIT 2.1
Civilian Labor Force by Age, Gender, Race, and Ethnicity for 1999, 2019, and Projected to 2029

Source: U.S. Bureau of Labor Statistics, 2020. Table 3.1 Civilian Labor Force by Age, Sex, Race, and Ethnicity. Accessed February 27, 2021, at www.bls.gov/emp/tables/civilian-labor-force-summary.htm.

	Percent Change		
Group	**1999–2004**	**2009–2019**	**2019–2029**
Total, 16 years and older	10.5	6.1	4.9
Age, years			
16–24	−4.1	−1.3	−7.7
25–54	4.4	0.4	4.4
55 and older	64.2	31.8	13.1
Gender			
Men	10.2	5.6	3.6
Women	11.0	6.7	6.3
Race			
White	7.8	0.8	1.7
Black	7.7	17.0	8.3
All other races	67.3	50.1	24.9
Ethnicity			
Hispanic origin	52.4	30.0	23.8
Other than Hispanic origin	5.7	2.0	0.8

health-care coverage. These dynamics can be better understood by becoming familiar with the role of economic challenges facing companies and changing workforce demographics. Both of these will determine the emerging role of employee-benefits practices in the social exchange relationship between employers and employees.

The cost of benefits surely is noteworthy, with companies often spending about 30 percent of the total compensation budget on employee benefits. Companies stand to miss opportunities to promote employee satisfaction, commitment, and productivity unless the set of employee benefits is placed in the context of the psychological contract. We now will learn about some well-established psychological concepts relevant for explaining the importance, role, and impact of employee benefits for employees and employers.

PSYCHOLOGICAL CONTRACTS

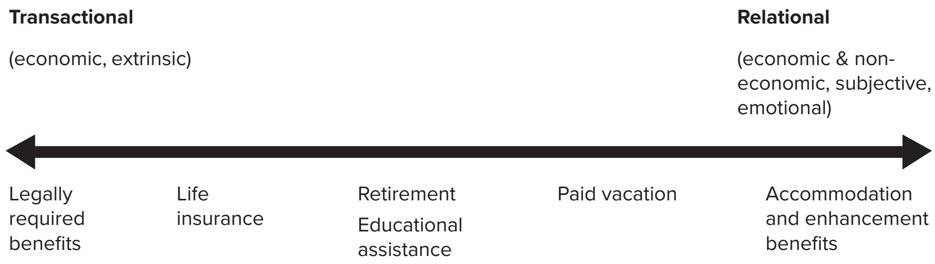
Psychological contracts are an articulation of the exchange relationship between the employer and the employee. A *psychological contract* has been defined as an employee's subjective perceptions of the relationship of mutual obligations with the employer and company.[11] Employee benefits can be a part of the psychological contract that employees hold about the employer's obligations to them in exchange for their work efforts. (Similarly, employers can expect employees to work and be committed to the company in exchange for the benefits they provide.)

Psychological contracts *implicitly* establish terms of employment, which stands in contrast to exchange agreements, such as wage and salary levels. As an example, company policies might imply that an employee will be eligible for educational assistance after five years of continuous employment and satisfactory levels of performance. An employee who is interested in making use of this benefit would reciprocate by remaining with the company and working hard. The employee's psychological contract with the company would include the employee's obligations (five years of hard work) and the employer's obligations (educational assistance). Psychological contracts are not an either-or proposition. Expectations of the employer fall on a continuum, ranging from pay and promotions to career development and family welfare.

Exhibit 2.2 illustrates the continuum of expectations encompassed between **transactional psychological contracts** and **relational psychological contracts.** Toward the transactional end of the continuum, employees' expectations of the employer are more economic and extrinsic in nature, which translate to expectations of high pay and promotions or career advancement in exchange for hard work represent transactional types of expectations in the psychological contract. Toward the relational end, employees' expectations might focus on either economic or noneconomic, and these expectations are emotional, subjective, and intrinsic in nature. Employees' expectations of job security in exchange for loyalty to the employer represent relational types of expectations in the psychological contract.

Transactional psychological contracts can be understood with an example of short-term employment. An independent contractor or consultant hired by a firm is more likely to have transactional expectations of the hiring firm. The

EXHIBIT 2.2
Transactional–Relational Continuum of Employee Expectations (Employee Benefits as Examples)



independent consultant or contractor would expect the firm to provide good pay, as well as the opportunity to build his or her marketability by adding the firm to his or her client portfolio. Once the project or assignment for which the independent contractor was hired is completed, the exchange relationship with the firm might end. Relational expectations can be understood by looking at the employee-employer relationship. Employees hired by a company or firm with the understanding of full-time employment are more likely to hold both transactional and relational expectations of their employer. For instance, not only will such employees expect pay, promotion, and career advancement in exchange for work efforts, but also they will expect job security, recognition, and support in exchange for commitment and loyalty to the employer. The main features of the continuum of expectations in psychological contracts can be summarized in Exhibit 2.3.

Employee-benefits practices could fulfill both transactional and relational expectations. Some employee benefits might fulfill more transactional expectations. For example, as suggested earlier, U.S. employees might expect employers to provide life and disability insurance in addition to competitive wages. Legally required benefits are a part of employees' transactional expectations of the employer. Employee benefits such as the paid time-off and accommodation and enhancement benefits examined might help fulfill employees' relational expectations. An employee might expect longer paid vacation as their tenure increases or educational assistance such as scholarships for their children.

Additionally, some employee benefits might fulfill both transactional and relational expectations of employees, such as retirement plans. For instance, employees might expect the employer to increase matching contributions as organizational

EXHIBIT 2.3
Psychological Contract Continuum

Source: D. M. Rousseau, "New Hire Perceptions of Their Own and Their Employer's Obligations: A Study of Psychological Contracts," 11 *Journal of Organizational Behavior,* (1990): 389–400.

	Transactional Contract	**Relational Contract**
Focus	Economic, extrinsic	Economic and noneconomic, Socio-emotional, intrinsic
Time frame	Closed-ended, specific	Open-ended, indefinite
Stability	Static	Dynamic
Scope	Narrow	Pervasive
Tangibility	Public, observable	Subjective, understood

tenure increases. This would increase their sense of security from the employment relationship. Similarly, educational assistance benefits aimed at rewarding continued employment as well as career development would help fulfill both transactional and relational expectations. As noted, Exhibit 2.2 presents the transactional–relational continuum of employee expectations in the exchange relationship with some examples of employee benefits.

Psychological contracts usually change over time. If employees have unrealistic expectations of the employer, they are likely to anticipate that the employer will fulfill obligations that may be beyond the employer's scope. For instance, a sense of entitlement might lead employees to expect a company to provide them with certain employee benefits. However, the company might eliminate the matching contribution to retirement plans or substantially raise the employee contribution for health-care coverage. In such instances, companies should keep employees apprised of the changes on a timely basis. If employee benefits are understood to be a part of employees' psychological contracts, then communication and education about the employee-benefits practices of the company are critical in establishing reasonable employee expectations. These approaches to benefits communications will be discussed in Chapter 11.

Psychological Contract Development

Most psychological contracts take shape in the pre-employment phase, when people seek information during recruitment and after receiving a job offer. Employees might seek information about both transactional and relational expectations of their potential employer. For instance, employees might address their transactional expectations by seeking information about a company's health coverage plan and promotion policies before accepting employment. In addition, they might address their relational expectations by seeking more information about the company's employee assistance or family welfare policies. Ultimately, the knowledge gained will help shape expectations along this transactional–relational continuum.

Through direct inquiry, monitoring, and negotiation, employees may gather information from various sources in the company about these issues. It is expected that, over time, the expectations of the employee and employer will match.[12] Employees can form expectations from two sources: interactions with other members of the company, and their perceptions of the company's culture.[13] If either source is inaccurate, employees might form unrealistic expectations.

Psychological contracts are flexible in nature,[14] undergoing constant change based on interactions with the company and other employees. This flexibility allows employees to adapt to changes in the company's practices. If employees hold relatively stable expectations, any changes in the policies and practices will lead to the employees' feeling betrayed unless changes entail offering more rather than less.

Psychological Contract Violation

A violation of the psychological contract occurs when an employee perceives a discrepancy between the promises made by the employer and the actual fulfillment of the promises.[15] If a company withdraws or changes certain benefits, and those practices are an employee's psychological expectation of the company, then that employee will feel that the contract has been violated.

Violations of psychological contracts differ from unmet expectations. The responses to the violation of psychological contracts are likely to be more intense.[16] Violation of employees' expectations can cause feelings of betrayal and the onset of mistrust. There may be two basic causes for violations of psychological contracts: reneging and incongruence.[17] When a company deliberately breaks a promise to employees, either willingly or because of circumstances, reneging is said to occur. Incongruence violations occur when the employee and the employer have different conceptualizations of the employment relationship. In other words, the employee might hold certain expectations of the employer. However, if the employee's actual experiences are different from these expectations, then the employee will feel that the psychological contract has been violated.[18]

Employee Benefits as Constituting Psychological Contracts

If employee benefits are a part of employees' psychological contracts, then it is important for employers to ensure that employee expectations about benefits are clearly articulated and flexible. This will allow employers to avoid any psychological contract violations and the associated costs (lawsuits, lost trust, low morale, turnover, etc.). Sometimes, employees may not be affected by minor contract violations. In the course of adjusting to the work environment, employees might also overlook certain violations. However, any serious violations can be avoided by clear communication and education about the nature and scope of the employee-benefits practices offered by the company. For instance, a company with a large Spanish-speaking workforce might be well served by providing information about its benefits practices in both English and Spanish. Companies also can hold training sessions where explanations of the design and eligibility requirements are explained. This will allow employees to form clear and accurate expectations about employee benefits as part of their psychological contracts.

Just as employees have expectations of the employer, the employer is also likely to have expectations of the employee. Incomplete effort, bad citizenship behavior, voluntary turnover, and low motivation can all be perceived by an organization as breaches of contract by the employee. The actions of the employee might also in some way contribute to the violations by the organization.[19] Thus, if the organization feels that employee performance is not what is expected, it can decide to withhold certain employee benefits, especially discretionary benefits. Once again, effective communication on the part of the organization could ensure that the psychological contract consists of explicit, rather than implicit, promises.[20]

Employee benefits have, over the years, become a growing source of employees' psychological contract violations.[21] Earlier, we stated that employers are shifting some of the costs for employee benefits to employees. As benefits costs increase, especially health-care costs, an increasing number of companies are shifting some of the benefits costs to their employees. As the employee cost burden associated with benefits increases, particularly when wages become stagnant, employee satisfaction decreases.[22] Additionally, how benefits are administered is also important. Employees will likely perceive a benefit as unfair if they are not receiving it according to either their needs or perceptions of entitlement.[23] Thus, expectations about employees' cost burden, needs, and benefits design will all affect employee satisfaction. While some benefits may not be the most cost-effective way to meet employee needs, to avoid perceptions of psychological contract violations, companies will need to find lower-priced alternatives without sacrificing employee satisfaction.[24]

EMPLOYEE ATTITUDES AND EMPLOYEE BENEFITS

As discussed earlier, employment can be implicit, such as psychological contracts, and explicit, such as documented in a job offer letter or employment handbook. Employee benefits can be a part of both, with some benefits likely to be more explicitly offered while others are more implicitly available. Congruence between employees' and the employer's expectations will lead to greater fit between the employee and the employer as well as a sense of fairness. Violations of contracts will lead to perceptions of injustice.

Justice and Perceived Organizational Support

The concept of justice is concerned with the distribution of conditions and goods that affect individual well-being. In a work setting, the distribution of rewards (such as pay and benefits), information, and other resources will all lead to perceptions of justice. Perceptions of justice may be based on the rules by which distributions are made, the way rules are implemented, or the way decisions are made. The basis on which employees are eligible for benefits, the value of those benefits, how the benefits are administered, and employer decisions about which benefits to offer to employees would all influence employees' justice perceptions.

There are four types of justice perceptions. **Distributive justice** is perceived fairness about how rewards are distributed; **procedural justice** is the perceived fairness of processes; **informational justice** is the fairness of the accounts given for certain procedures; and **interpersonal justice** is perceived fairness of the interpersonal treatment people receive from others.[25] Job satisfaction, organizational commitment, evaluation of authority, organizational citizenship behavior, withdrawal, and performance are all affected by employees' perceptions of justice along these dimensions.[26]

Distributive justice is employees' perceptions of fairness of the outcomes they receive.[27] Where employee benefits are concerned, employees will form perceptions of fairness based on the benefits they are eligible for. If employees believe that the employer should provide them with certain benefits in exchange for their work efforts, and the employer fails to do so, then employees will conclude that the employer is being unfair. As a result, they might withhold effort and lower their commitment to the employer.

Procedural justice deals with employees' perceptions of fairness of the process by which decisions are made and includes the extent to which employees can participate in the process as well as the rules followed.[28] For example, by establishing rules for eligibility and contributions to retirement plans, employers can ensure procedural justice perceptions. Additionally, allowing employees to have voice in the use of such benefits as self-development and education can also enhance their perceptions of procedural fairness.

Interpersonal justice is the perception of the degree to which the employer demonstrates concern and social sensitivity toward employees.[29] As an illustration, managers' awareness and concern for employee development and needs and encouraging employees to participate in the benefits program is likely to lead to fairness perceptions about interpersonal justice.

Informational justice deals with perceptions about the quality of information used to explain organizational decision making.[30] If an employer decided to offer certain benefits or change/withhold others, the accuracy and timeliness of information will influence their perceptions of informational justice. For example, a company eliminates transportation benefits (deeply discounted public transportation passes). If the company intentionally or unintentionally fails to inform and educate their employees about elimination of transportation benefits, employees may judge the employer's decision as unfair.

While earlier human resource practices were standardized, today there has been a shift toward nonstandardized, idiosyncratic work arrangements.[31] This is largely driven by the increased competition to attract and retain top talent on the part of companies[32] as well as increased expectations of employee involvement.[33] Employee benefits can be a part of this new individualized employment relationship.

In addition to perceptions of justice and fairness, employees can also form perceptions of organizational support based on their experiences. **Perceived organizational support** is an employee's perception of the degree to which the employer values the employee's contributions and well-being.[34] Organizational support may implicitly incentivize higher job performance, becoming a part of the social exchange relationship.

Certain employee benefits practices can act to signal organizational support. Employee benefits that signal the organization's concern for the well-being of the employee, such as mental health benefits, wellness programs, smoking cessation programs, and stress management, as well as those aimed at recognizing the employees' contributions such as recognitions and rewards, will help in fostering perceptions of perceived organizational support.

Emotionally committed employees have increased performance, reduced absenteeism, and decreased likelihood of turnover. Employers can ensure commitment by showing support to employees in the form of pay and promotion, approval and respect, and other aids needed to be effective in the company.[35] Certain rewards and job conditions are more likely to lead to perceived organization support, such as recognition, pay, promotions, job security, autonomy, and training.[36]

Those human resource practices that indicate investment in human capital and demonstrate recognition of employee contributions will certainly promote perceptions of organizational support.[37] For instance, educational assistance programs are an example of investment in human capital, and pay raises and promotions recognize employee contributions. Thus, these practices will lead to employees feeling supported by the company.

From a social exchange perspective, employees will value the employer's discretionary efforts more highly than those that are beyond the employer's control.[38] Thus, discretionary employee benefits, offered to employees at the employer's own choice, are more likely to generate perceptions of organizational support than legally required benefits. Additionally, those discretionary benefits that address most closely the employee's needs for well-being and development are more likely to elicit perceptions of organizational support. The importance of flexible benefits practices, suited to the diverse necessities of the changing workforce, can hence be understood in terms of critical employee attitudes such as perceptions of fairness and perceived organizational support.

Organizational Citizenship Behavior

Employees' discretionary behavior, not explicitly or directly recognized by the formal reward system of the employer, but in aggregate promoting organizational effectiveness, is termed as **organizational citizenship behavior.**[39] Thus, behaviors such as helping other employees, looking out for the employer's interests, going beyond job requirements to help achieve company goals, are all examples of organizational citizenship behavior. Satisfied employees engage in good citizenship behavior. A company's employee benefits practices can influence employees' satisfaction.

Organizational citizenship behavior is discretionary—it is not enforceable but rather a matter of personal choice. Citizenship behaviors tend to go beyond the formal job requirements. Such behaviors are not easily governed by individual incentive schemes because they are often difficult to discern and measure.[40] For instance, an employee who is helping a coworker to succeed without any motive of recognition or reward from the employer is exhibiting citizenship behavior. Organizational citizenship behavior is a deliberate attempt by the employee to maintain the balance in the social exchange between the employee and the employer and is directly intended to benefit the employer.[41] If employees perceive their employer as generous and fair, they will seek to reciprocate by showing good citizenship behavior (in addition to job performance and commitment).

Employees' perceptions of both distributive and procedural justice are likely to affect citizenship behavior. If employees perceive that the employer is unfair, they will withhold good citizenship behavior.[42] For instance, if an employer decides to stop offering flextime benefits to an employee, and the employee perceives this as unfair, the employee can decide to stop putting in extra hours of work that she was previously doing in order to finish a project faster. Employee-benefits practices that lead to perceptions of injustice or feelings of contract violations might also lead not only to poor performance, reduced commitment, and increased likelihood of turnover, but also reduction in extra-role, prosocial behaviors to help the employer be effective.

As stated earlier, job satisfaction can lead to organizational citizenship behavior that has effects on job performance.[43] There could be two reasons why job satisfaction would lead to organizational citizenship behaviors. It could be because people tend to reciprocate those who benefit them. Hence, if satisfaction comes largely from work, then employees may reciprocate with helping behaviors in the workplace. Also, employees who are satisfied and experience positive mood states tend to engage in good citizenship behaviors.

The concept of organizational citizenship behavior is based on social exchange. As such, employee benefits can be seen as eliciting job satisfaction and citizenship behaviors. In exchange for generous benefits and human resource practices, employees can use good citizenship behaviors to reciprocate and signal commitment and loyalty to the employer. Thus, employee benefits are an important part of the social exchange process that characterizes the employment relationship. They can be an important component of employees' psychological contract with the employer.

How companies design, communicate, and implement employee benefits can lead to varying perceptions of fairness and organizational support. As a result of these attitudes, employees will engage in related organizational outcomes such as job performance, commitment, and citizenship behavior. Thus, the role of employee benefits in eliciting organizational effectiveness is undeniably important.

THE ECONOMICS OF EMPLOYEE BENEFITS: WHY DO EMPLOYERS OFFER BENEFITS?

Most employers compensate employees with some combination of cash and benefits, such as health insurance. This combination of cash and benefits represents the extrinsic component of total compensation, as discussed in Chapter 1. At first glance, it might seem that employees and employers would both prefer a cash-only compensation package rather than a mixture of cash and benefits. After all, employees can use cash to buy life or disability insurance, save for retirement, or buy any other goods or services they want. This freedom would allow employees who want a generous life insurance plan to have it, while employees who prefer a cheaper life insurance plan could spend less on life insurance and have more money available for other goods and services. Additionally, benefits are expensive and time-consuming for employers to administer. Year-to-year changes in the costs of health insurance make benefits planning particularly difficult. It would seem, therefore, that employers also might prefer to pay all employees in cash only. So what advantages are there to employers and employees from having benefits?

Before answering this question, it is important to clarify that the question is not meant to ask whether an employer should pay, for example, a salary of $50,000 per year plus a tuition reimbursement plan and a retirement plan, or whether the company should pay $50,000 per year without the tuition reimbursement and retirement plans. Clearly, if an employer could recruit and retain the same workforce with both pay packages, it would prefer not to offer the costly benefits. Instead, the