The Bigger Picture on improving employee engagement with benefits

Who’s responsible: The role of each stakeholder

South Africa | 01 June 2014 | Insight

Authors and contributers


Kelsy Moodley


Amy Underwood

Risk benefit offered by each sector

In 1968, Garrett Hardin identified the ‘Tragedy of the Commons’ as a scenario in which individuals acting on a rational basis end up over-exploiting the resources needed by a group. Since then, economists have identified a range of similar scenarios, including the ‘Prisoner’s Dilemma’, where acting in rational self-interest on an individual basis ends up harming the group, sometimes to the extent of imperilling survival.

This dichotomy between the interests of the group and the interests of the individual is evident in social protection. When we get it right, we get all the benefits outlined in our article called 'Why it matters?' – including, most significantly in South Africa’s case, an inclusive growth path. But because of all the parties involved, the withdrawal of key stakeholders from the process could imperil it.

If this sounds similar to our analysis in The employee benefits system, that is because it is. In the employee benefits system, we looked at how fragmentation affects employee benefits; what we are realising now is that this fragmentation extends further into the fabric of the entire social protection system. This shows how imperative it is to appreciate the bigger picture and bring all stakeholders to the table.

> **Bringing all the stakeholders to the table means that each needs to appreciate the significance of getting employee benefits right, the role they can play and the benefits for each of them.**

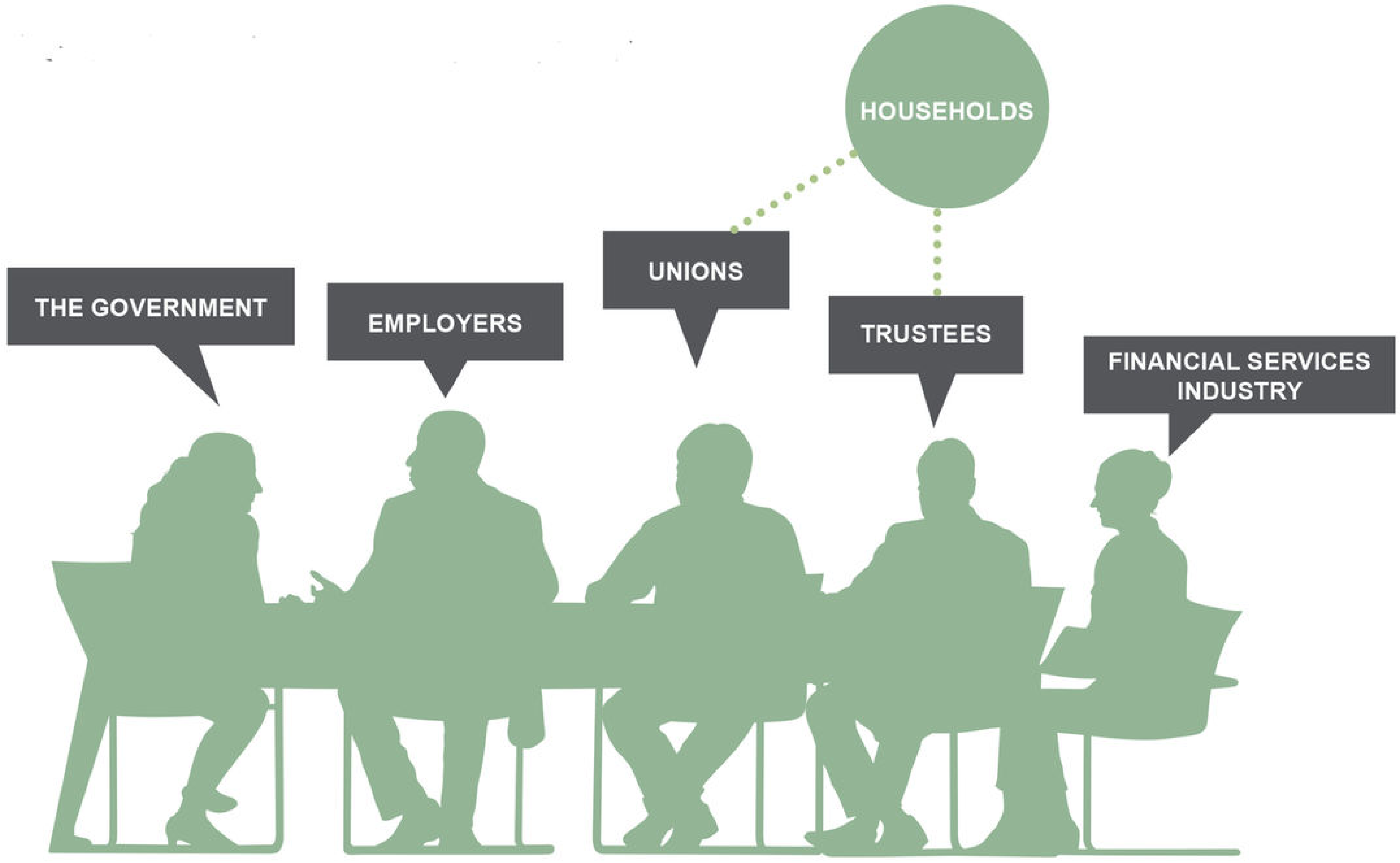
To paint the bigger picture we have discussed how:

- Employee benefits fit into social protection, and how getting employee benefits right contributes to South Africa’s future.
- Communities and families play a significant role in social protection for households, and how a deeper understanding of how households use these mechanisms can enhance private provision.
- The roles and responsibilities in private provision of social protection, primarily employee benefits, have shifted and the implication for employers, households and the financial services industry.

Having understood the bigger picture into which employee benefits fit, we return to a more focused discussion of stakeholders specific to employee benefits. Bringing all the stakeholders to the table means that each needs to appreciate the significance of getting employee benefits right, the role they can play and the benefits for each of them. While we have touched on this in the preceding chapters, this chapter pins it down before diving into the detail of how we can start improving employee benefits.

STAKEHOLDERS IN EMPLOYEE BENEFITS

Case study/ Lesson



The government

As the primary representative of society as a whole, it should be clearest to the government why we need a comprehensive system for social protection and why we need to get employee benefits right. As the Finance Minister put it in the 2014 Budget Speech:

"We need to do more, together with labour, business and all stakeholders, to lead our economy in a new, bold direction for higher growth, decent work and greater equality".

The National Development Plan (NDP), as quoted in 'Why it matters?', shows that the government fully appreciates the role that a good social protection system can play in meeting the twin goals of eliminating poverty and reducing inequality. This is particularly significant given that both the President's State of the Nation address and the Finance Minister's Budget Speech affirmed the government's commitment to the NDP.

Within the context of employee benefits, the specific role of the government is to provide the framework, including regulating, providing incentives, making certain actions compulsory and guiding the financial education framework. At present, the National Treasury has been focusing specifically on retirement reform and improving outcomes within this sphere. The key benefit for the government if it manages to get this sphere right is to reduce dependency on the government and its fiscus when individuals reach pensionable age.

Various aspects of the retirement reform process – including tightening the rules around preservation, mandating enrolment to capture the millions of unenrolled employees and creating options for vulnerable workers – should increase the pools of patient capital available for the economy's development.

The government is also focusing on the implementation of a National Health Insurance (NHI) system, which is aimed at ensuring that everyone in South Africa will have access to appropriate, efficient and quality health services[1]. If effectively implemented, this would reshape the employer's approach to healthcare benefits.

The specific role of the government is to provide the framework, including regulating, providing incentives, making certain actions compulsory and guiding the financial education framework.

> **Clearly, getting retirement funding right across the economy is good for employers – a vibrant economy with robust spending power is good for firms.**

Employers

As discussed in 'How has it changed', the role of employers has changed substantially as part of the shift from the defined benefit (DB) to the defined contribution (DC) framework. In some ways, this has blurred their stake in getting employee benefits right, as they no longer directly bear the burden of getting it wrong. Yet they still remain the central point for providing access for many individuals to the tools needed to protect their standard of living through employee benefits. What does this mean for them?

We identified four components of employee benefits in The employee benefits system: healthcare benefits, financial education, risk benefits, and retirement funding.

It is still clearly in the interests of the employer to provide some of these. Health-related benefits and employee wellness systems, including financial education, that seek to maintain individual productivity, have a clear-cut link to the employer's operations. As long as the costs of the benefits and systems which maintain productivity are less than the costs of lost time and employee turnover, this makes clear economic sense.

Long-term benefits, for risk and retirement, are more complex. When individuals value employee benefits, this provides a strong case for the employer providing them, as it assists with employee attraction and retention. But where individuals see employee benefits as infringements on their take-home pay, this motivation is weakened.

Employees often appreciate risk benefits, particularly funeral cover, and not offering these benefits can have reputational implications for the employer. Consider the risks of neglecting life cover: leaving widows and orphans without an income doesn't look good, either in public or within an organisation where it can affect morale.

Retirement funding is the trickiest portion of the employee benefits package. It is a key portion of social protection, and yet with employees switching jobs at more frequent intervals, the impact of each employer and fund becomes more and more muted in the overall outcome.

Clearly, getting retirement funding right across the economy is good for employers – a vibrant economy with robust spending power is good for firms. But how much does each individual employer's contribution really matter?

This creates a classic free-rider problem, such as those common to such economic quandaries as the Tragedy of the Commons as outlined on page 40. Free-riders are those who fail to contribute to a collective solution that is in their best interests. Because their individual contribution makes little difference, it is rational to withdraw, hoping that everyone else will do the right thing, and so the system will work without their contribution. The problem is that this logic is common to all, and if everyone withdraws, the whole system fails.

We need employers at the table, and getting all of this right will benefit them in the long term. However, as we discussed in 'How has it changed', other stakeholders may need to step in to help employers to make it as easy as possible for them to make their contribution.

> **The central objective is to make households sufficiently secure. It is through this security that we are able to build a more inclusive economy.**

Households and their representatives

From the discussion about social protection, it should be clear that the central objective is to make households sufficiently secure. It is through this security that we are able to build a more inclusive economy.

This security should also be valuable to the household, but as we discussed in 'What's the context?' about communities and families, many South African households seek this security through other non-financial, informal arrangements. They also often have different priorities and see more security in a house or a well-educated child than they do in a retirement pot. As work from the World Bank and Organisation for Economic Co-operation and Development showed in 'Why it matters?', this is neither irrational nor unfounded. But it does complicate matters for employee benefits.

What further complicates this is that households seldom represent themselves at the table. Instead, they are represented by various agents in different phases of the development of employee benefits.

This use of agents may be eminently sensible. Many of the decisions raised by employee benefits are both cognitively complex and clouded by multiple behavioural biases. However, where it can complicate matters is when the interests of households and their agents are not entirely aligned.

In the first phase of negotiating an overall pay package, many households are represented by unions. Unionised workers rely on collective bargaining to shape their remuneration structure, which includes their employee benefits. By bulking their bargaining power and using informed representatives, this in theory provides better outcomes for individual workers.

Once an overall remuneration structure is set, households are typically represented by trustees. These trustees are drawn from unions, employers and directly elected by members. Where umbrella funds and open medical schemes are involved, trustees are typically professionals from the financial services industry. There is an option for management committees from the participating employer to be involved and represent the specific needs of their employees, particularly in restricted medical schemes.

While these agents are meant to represent the interests of households and seek the best solutions for them, interests may not always be aligned. For instance, sometimes pension fund trustees interpret their fiduciary duty to protect member interests as best achieved by taking the most conservative route – minimising contributions and investment risk – but this may mean that households are unlikely to accumulate what they need.

The same may be true in medical schemes where trustees might choose lower investment risk for fear of reducing solvency levels, but where a less conservative – but still well-thought-out – strategy may assist in reducing contribution inflation over time and improve solvency levels.

Control of the considerable assets at the disposal of some pension funds can also confer significant power on the wielder. Using this power could be an attractive lure to distract agents from their primary purpose of safeguarding household interests. Households may not always understand or agree that a particular decision is in their interests.

Financial services industry

As a stakeholder in the private sector, a more inclusive and sustained growth path should be eminently valuable to the financial services industry. But as social protection, especially employee benefits, evolves to close gaps and respond to government reform, the industry's role in the system is likely to shift.

In 'What's the context?' on culture, we indicated that the financial services industry needs to apply their expertise and resources to a wider demographic. Critically, experts in the financial services industry can help households manage the complex issues around trade-offs in their financial decisions.

To this end, the more we can understand about the complete picture for the individual and their dependants the more meaningful the advice on trade-offs can become. The industry needs to move toward helping individuals assemble the complete picture.

In 'How has it changed' we discussed how moving from DB to DC has changed the industry's roles and responsibilities. As risks have shifted from employers to households, this has created the need for the financial services industry to redirect its expertise towards helping households manage these risks.

In all of this, a key challenge remains resolving the information asymmetries in the industry. It is in this vein that much of the reform in this industry is emerging, including Treating Customers Fairly (TCF). It is difficult for households to understand the products provided by this industry and how they can be used to meet the households' goals. The expertise of the industry needs to be directed continually towards helping households to understand what they do need, what they don't need and the simplest way to meet their needs.

The financial services industry has a key role to play in employee benefits. In playing this role, it will need to ensure profit-making and social purpose remain aligned. If it does this, it can regain trust, make money and make a difference.

> **Critically, experts in the financial services industry can help households manage the trade-offs between different types of security in ways that will help them to get the best outcomes out of their journey.**

Conclusion

As we argued in *Benefits Barometer 2013:* 'the employee benefits system and its inter-dependencies', employee benefits cannot continue in its fragmented state and hope to make a meaningful contribution to employees' financial, physical and mental health. This fragmentation can be addressed only if all stakeholders agree to come to the table. Because of the key role that employee benefits plays in the broader system of social protection, fixing it has significant benefits for each role player. But these benefits can be realised only if employee benefits fulfils its promise to provide financial security for South African households. As we shift our thoughts to 'The way forward' to improving employee benefit engagement, we hope that you will keep the bigger picture in mind and remember the key role you can play in this country.

References

1 Department of Health (2011)

SOCIAL PROTECTION | GOVERNMENT | EMPLOYER | HOUSEHOLDS | INDIVIDUALS | FINANCIAL SERVICES | EMPLOYEE BENEFITS | STAKEHOLDERS