

Reviewing and Revising Wal-Mart's Benefits Strategy

Memorandum to the Board of Directors

from Susan Chambers

The purpose of this memorandum is to update you on our efforts to review and revise Wal-Mart's benefits strategy. In response to concerns about cost trends and growing public scrutiny, I recently led a 15-person team, drawn from across the company, in (1) evaluating Wal-Mart's approach to benefits and (2) developing a strategy to address any short-comings.

We evaluated Wal-Mart's current benefits offering through three lenses – cost trends, Associate satisfaction, and public reputation – and are now recommending revisions to our benefits strategy built around nine “limited-risk” initiatives and five “bold steps.”

This memorandum summarizes our work and is divided into three sections:

Section 1 provides a detailed analysis of the three most significant benefits-related challenges we face:

Growth in benefits costs is unsustainable (15 percent per year) and driven by fundamental and persistent root causes (e.g., aging workforce, increasing average tenure). Unabated, benefits costs will consume an incremental 12 percent of our total profits in 2011, equal to \$30 billion to \$35 billion in market capitalization.

While Associates are satisfied overall with their benefits, they are opposed to most traditional cost-control levers (e.g., higher deductibles). Satisfaction also varies significantly by benefit and by segment of Associates. Most troubling, the least healthy, least productive Associates are more satisfied with their benefits than other segments and are interested in longer careers with Wal-Mart.

Healthcare is our most pressing reputation issue because well-funded, well-organized critics, as well as state government officials, are shining a bright light on Wal-Mart's offering. Moreover, our offering is vulnerable to at least some of their criticisms, especially with regard to the affordability of coverage and Associates' reliance on Medicaid.

Section 2 discusses in detail the nine limited-risk initiatives and five bold steps we are recommending. Given conflicts inherent in the challenges we face, any set of solutions will require carefully balancing, and sometimes making trade-offs between, cost, Associate satisfaction, and public reputation.

Limited-risk initiatives: We are recommending that Wal-Mart realign eligibility requirements for health insurance; decrease cross-subsidization of spouses; give Associates more information about how to use healthcare and health insurance; lower company-paid life insurance coverage levels; capture savings from current initiatives to improve labor productivity; add a combination of best practice care management programs; further develop high performance provider networks; offer Associates bundles of other benefits (e.g., paid-time off) from which to choose; and continue to explore

adding health clinics in stores. These initiatives will reduce costs and will slightly improve Associate satisfaction.

Bold steps: The nine limited-risk initiatives will not fully address all the benefits-related challenges we face. To fully address these challenges, we recommend that Wal-Mart take five bold steps that will require more explicit trade-offs between cost, Associate satisfaction, and public reputation. The first two recommended steps primarily address cost trends, the third addresses attracting a healthier workforce, and the last two steps address improving our public reputation.

Move all Associates to “progressively-designed” consumer-driven health plans to help control cost trends while allowing Associates to build up savings in Health Savings Accounts

Restructure the retirement program (i.e., profit sharing and 401(k) program) to reduce costs and help Associates better save for retirement
Redesign benefits and other aspects of the Associate experience, such as job design, to attract a healthier, more productive workforce

Make some select strategic investments in our healthcare offering (e.g., lower maximum out-of-pocket expenses) so it can better withstand external scrutiny
Improve communication of Wal-Mart’s benefits offering so we get more credit for what we provide, and, over the long-term, work to shape state and national outcomes on healthcare

Section 3 summarizes the combined impact of the limited-risk initiatives and the bold steps. The team believes this new strategy will bring powerful advantages to Wal-Mart, including:

Maintaining benefits spend at or below today’s level as a percentage of sales

Offering a more attractive benefits package for healthy Associates

Better positioning us to fight Wal-Mart’s critics

I presented this material to the Executive Benefits Steering Committee (Tom Hyde, Lawrence Jackson, and Tom Schoewe) in late July. They received the recommendations enthusiastically and asked that I syndicate them widely within Wal-Mart, something I have begun to do. They also asked that the team continue to test and refine the strategy, especially with Associates and external stakeholders. Our aspiration is to complete this work by late-September, receive Executive Committee approval on the overall strategy by early-October, and hold a special session with you in November for further discussion.

1 Major benefits-related challenges

We analyzed the benefits-related challenges facing Wal-Mart through three lenses – cost trends, Associate satisfaction, and public reputation.

Cost trends

From 2002 to 2005, our benefits costs grew significantly faster than sales, rising from 1.5 percent of sales to 1.9 percent. Benefits spend grew from \$2.8 billion to \$4.2 billion during this period, at a rate of 15 percent per year. Holding benefits costs as a percent of sales constant is critical for Wal-Mart's long-term economic success.

A few benefits made up the bulk of this increase: healthcare (\$1.5 billion) grew by 19 percent, paid time off (\$1.4 billion) grew by 14 percent, and the profit sharing and 401(k) program (\$740 million) grew by 13 percent. (Over the period, the domestic Associate base grew at 5 percent and domestic sales grew at 11 percent.)

Increased utilization of medical services, which grew by 10 percent per year, was the primary driver of the rapid growth in our healthcare costs (Exhibit 1). Almost half of this utilization growth was due to three Wal-Mart-specific workforce factors (distinct from national trends): Our workforce is aging faster (0.50 years per calendar year) than the national average (0.12 years per calendar year).

Our workers are getting sicker than the national population, particularly in obesity-related diseases. For example, the prevalence of coronary artery disease in Wal-Mart's population grew by 6 percent compared to a national average of 1 percent, and the prevalence of diabetes in our population grew by 10 percent compared to a national average of 3 percent. (That said, our workforce is no sicker at present in absolute terms than the national population.)

A segment of our workforce consumes healthcare inefficiently, in a pattern similar to a Medicaid population. Our population tends to over-utilize emergency room and hospital services and under-utilize prescriptions and doctor visits. This pattern is most evident among our low-income Associates, and the team hypothesizes that this behavior results from prior experience with Medicaid programs.

Compounding these problems are several national trends, such as the increased use of technological innovations, which are driving increased utilization of medical services across the U.S. healthcare system.

The cost of Wal-Mart's profit-sharing and 401(k) program and paid time off grew faster than overall Associate growth, due largely to increasing Associate tenure. Over the past 4 years, the average Associate tenure has increased by 0.2 months per calendar year. As a result, more Associates qualify for participation in benefits programs like the profit sharing and 401(k) plan and for more paid-time off. An even more important factor is wages, which increase in lock-step with tenure and directly drive the cost of many benefits (e.g., 401(k) is a percentage of wages).

Given the impact of tenure on wages and benefits, the cost of an Associate with 7 years of tenure is almost 55 percent more than the cost of an Associate with 1 year of tenure, yet there is no difference in his or her productivity (Exhibit 2). Moreover, because we pay an Associate more in salary and benefits as his or her tenure increases, we are pricing that Associate out of the labor market, increasing the likelihood that he or she will stay with Wal-Mart.

We have also not effectively leveraged our benefits spend per Associate, which should be thought of as a fixed cost for employing that Associate. We have allowed our full-time Associates to average only 34 hours of work per week; increasing the hours worked per Associate would enable Wal-Mart to lower our labor cost per hour by spreading benefits costs over more hours. We also have one of the highest percentages of full-time Associates in the retail industry, even though full-time Associates are more expensive per labor hour (in terms of both benefits and wages).

Associate satisfaction

Associates are satisfied with their overall benefits package, but they have expressed significant opposition to most traditional cost-control levers. For instance, Associates strongly oppose higher deductibles or limits to their choice of providers. Satisfaction varies significantly, however, by benefit and by segment of Associate, creating an opportunity to rebalance the benefits portfolio to improve satisfaction while reducing costs. In particular, the least healthy, least productive Associates are more satisfied with their benefits than other segments and are interested in longer careers with Wal-Mart.

Overall, Associates are satisfied with their benefits relative to peers at other retailers. In a survey of retail workers, Associates ranked Wal-Mart's benefits above the industry average in availability, ability to qualify, quality, and execution (e.g., claims processing). The cost of healthcare coverage was the only factor on which we scored poorly.

Associate satisfaction and view of importance vary significantly by specific benefit (Exhibit 3). For example, Associates rank health insurance as the most important benefit Wal-Mart offers, but they also say it is the one with which they are least satisfied. The stock purchase plan, the profit sharing and 401(k) program, and life insurance are all ranked high-satisfaction, low-importance, suggesting an opportunity to rebalance Wal-Mart's investment in these benefits into other more important benefits. Paid time-off and the discount card are the only high-satisfaction, high-importance benefits.

Associate satisfaction with benefits also varies significantly by segment of Associates. The team analyzed the Associate population on a wide variety of factors (e.g., attitude, health behavior, tenure), the most fruitful of which was annual healthcare spend. The so-called "low utilizers" are the most attractive Associate segment because they cost Wal-Mart less in terms of healthcare expenses and are more productive in their jobs. (Productivity findings were based on analysis of individual cashier items per hour data.) Moreover, this segment also showed healthier behaviors, specifically less prevalence of obesity. Unfortunately, the "low utilizers" were also least satisfied with our benefits and were planning shorter careers with Wal-Mart. This segment favors a different type of benefits package than the "high utilizers," a benefits package different than what we offer today: a health insurance offering more closely modeled on consumer-driven health plans – lower premiums, higher deductibles, and health savings accounts. They also prefer certain nonmedical benefits, such as help in saving to purchase a home and help in paying for more education, neither of which we offer in a robust way today.

It is worth noting, however, that overall benefits only play a small role in attracting Associates to Wal-Mart and in keeping Associates satisfied while at Wal-Mart. Our benefits offering played a key role in attracting just 3 percent of our Associates. Moreover, satisfaction with benefits does not correlate with satisfaction with Wal-Mart. A variety of factors – especially Associates’ interactions with management – are more important.

Public reputation

Healthcare is the most pressing reputation issue facing Wal-Mart. Survey work done last summer shows that people’s perception of our wages and benefits is a key driver of Wal-Mart’s overall reputation. Several groups are now mounting attacks against Wal-Mart focused on our healthcare offering. These increasingly well-organized and well-funded critics – especially the labor unions and related groups, such as Wal-Mart Watch – have selected healthcare as their main avenue of attack. Moreover, federal and state governments are increasingly concerned about healthcare costs, and many view Wal-Mart as part of the problem (a view due, in part, to the work of Wal-Mart’s critics). Medicaid costs are a major priority on most governors’ agendas; already a quarter of states are spending more than 25 percent of their budgets on Medicaid, and observers across the political spectrum assert that the current system – with spiraling costs, a large population of uninsured, and an increasing number of medical bankruptcies – is unsustainable (although there is little consensus on what should take its place). In this environment, we can expect efforts like those in Maryland (which is trying to mandate that companies spend a certain percentage of revenue on healthcare) and New Hampshire (which requires health services to track where Medicaid enrollees are employed) to accelerate.

Proposals such as these, if successful, will bring added costs to Wal-Mart. Moreover, these battles with critics and governments are contributing to the decline of Wal-Mart’s overall reputation.

Our healthcare offering is also vulnerable to attack. We have not effectively communicated the generosity of our healthcare benefits to the general public; instead, we have thus far allowed our critics to frame the debate. For instance, only 22 percent of Americans find it very believable that Wal-Mart provides health insurance to 900,000 people. Wal-Mart’s critics can also easily exploit some aspects of our benefits offering to make their case; in other words, our critics are correct in some of their observations. Specifically, our coverage is expensive for low-income families, and Wal-Mart has a significant percentage of Associates and their children on public assistance. Consider the following:

On average, Associates spend 8 percent of their income on healthcare (premiums plus deductibles plus out-of-pocket expenses) for themselves and their families, nearly twice the national average. The number varies significantly by plan type, rising to 13 percent for those on the Associate and Spouse plan.

Critics contend that the costliness of Wal-Mart’s healthcare coverage causes it to enroll fewer Associates in its health insurance plan than do most national employers (48 percent versus 68 percent) (Exhibit 4).

