Creelman Lambert Research

July 2011

# The Board and HR

## How board oversight of human capital works

### SUMMARY REPORT

David Creelman & Andrew Lambert

"I was asked recently why I hadn't articulated 'people' as one of our 5 priorities. The answer is simple – people are the ultimate priority."

**Michael Dell, Chairman, Dell Computer**

# Contents



### Titles, terminology and 'US English'

The HR leader in US organizations is typically called the Chief Human Resource Officer (CHRO) or possibly Senior VP, HR (or similar).

In the UK the normal term is HR director (HRD), or Group HRD in larger organizations.

For the purpose of this report, we generally just use the term CHRO, although using HRD where this title is referred to by contributors.

Similarly, we have chosen to use US spelling of words such as rigor (rigour), labor (labour), behavior (behaviour), caliber (calibre), center (centre) and organization (organisation).

## About this report

This is an abridged version of a more detailed 70pp report that was provided to the 27 organizations that participated in this study.

The corporations we interviewed reflect a spread of organizational types and market sectors, and included Accenture, American Standard, Associated British Foods, BT, Bunzl, Campbell Soup, Comcast, Diageo, The Gap, IBM, Intel, Invensys, Level 3 Communications, MAN Group, NM Rothschild, Prudential, Rolls-Royce, Royal Bank of Scotland, Serco, Standard Chartered, Standard Life, SThree, Thomson, Reuters, United Biscuits, Zurich Financial Services, a U.K. government agency and a global airline.

David Creelman

Andrew Lambert

# About the authors

### David Creelman

David is an independent researcher, writer and consultant on human capital management. He works with a wide range of think tanks, academics, consultants and HR vendors in the US, Japan, Canada, the EU and the Middle East. He collaborates regularly with leading experts in HR such as Dave Ulrich, Norm Smallwood, John Boudreau, Henry Mintzberg and Ed Lawler.

### Andrew Lambert

Andrew has been a management consultant for 35 years, and also headed corporate functions in two UK banks. As co-founder of the Corporate Research Forum, he has published research and guidance on areas such as the future of HR, people risk, employee engagement, performance management, HR evaluation and measurement, the management of coaching and mentoring, internal communications, employee surveying, the management of global organisations, innovation and creativity, strategic workforce planning, and the role of HR in mergers and acquisitions.

# About the sponsor

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Dr. Franz Humer,
Chairman, Diageo plc

# Foreword

In the past few years, my experience is that boards are giving increasing priority to 'people' issues.

Five years ago, we spent much of our time on audit matters. Now performance and reward are just as important, and we also devote significant time to succession and talent.

Additionally, more and more companies and industries are developing their ethical standards. Thus business behavior is rightly a prominent item on our agenda, as we grapple with working in varied cultures and contexts across the globe.

Our reputation is critical in ensuring continued success – and thus boards must necessarily satisfy themselves that we are getting the best out of our people. Our cultures must foster both discipline and creativity to ensure we are a winning team over time.

Of course legislators in the many different jurisdictions we operate in are busy generating new and varied requirements. We have to anticipate and plan what this means for our people and how we work.

And in all this, boards must look at themselves, ensuring that they work well together in overseeing their companies and setting a good personal example. The way we work with both CEOs and HR directors is also an important factor.

For these reasons I feel this report is very timely. As far as I am aware, it is the first to take an in-depth look at how boards address the 'people dimension' of their governance responsibilities.

Like many of the other contributors, my company is always working to improve what we do and aspire to the highest standards in managing its human capital.

I therefore welcome the report's aim to highlight both the challenges and the way leading companies tackle them, and to spread the word about good practices.

**Dr. Franz Humer,**
Chairman, Diageo plc

# Introduction

As independent researchers we have the luxury of being able, from time to time, to tackle a topic purely because we think it is important.

We have long been fascinated by certain anomalies in business.

For example, while organizational leaders so often declare employees to be their most important asset, their boards rarely seem to include anyone with deep professional knowledge of people management practices and organizational development. Meanwhile financial analysts mostly display complete disinterest in HR, despite their need to discern the sources of lasting value.

Employee engagement is much spoken about, but it is striking how often organizational change has been managed in a way that undermines trust and employer reputations, and how many M&As and public sector re-organisations have destroyed value and failed to improve outputs.

In recent times, risk management has been exposed as shallow where it doesn't take human behavior fully into account, particularly at the top. In response, corporate governance requirements have been introduced with many 'people' implications (although without ever using the term HR). One striking aspect has been the increasing requirement for boards to demonstrate that they themselves are adhering to good people practices.

And what of the HR professional community in all this? Since the 1990s, unfortunately surveys and reports have consistently indicated dissatisfaction with HR – and indeed within HR – about its business impact. It is noticeable, for example, that in the media onslaught on executive pay, very little has been heard from the 'people experts'. From other work, we are aware how few HR managers see a connection between corporate governance and what they do – yet at the same time notions of 'HR governance' are beginning to spread.

Reflecting on these points, we decided to consult a cross-section of leading organizations headquartered in the US and UK about how

- their boards are now tackling oversight of how well executives get the best out of people

*and also*

- how boards are practicing what they might be expected to preach, in terms of good people management, and
- how this might affect their interactions with HR functions, and the implications for HR directors or chief human resource officers?

Our objective is to draw out useful lessons from these well-run companies for the benefit of the broader community of board directors and HR leaders. Our hope is that the results will aid the development of both good governance and good HR across all kinds of organizations.

Investment analysts, fund managers and business commentators traditionally pay little attention to human resource management.

Arguably this is bad for companies, bad for the economy and bad for employees.

Fortunately, we have found that – in the best-run companies – boards have been paying increasing attention to how people are managed, at the top and throughout the organization.

We are placing a spotlight on how boards are now addressing their responsibilities for oversight of human capital; how they themselves are changing their own behavior; and what part the senior 'people professionals' are now playing in facilitating boards in both of these dimensions.

**Michael Robinson,**
MAN Group

*"Over the past six to seven years my attendance at board meetings has increased exponentially – and it's by no means all about remuneration."*

**Michael Robinson**
Global head of human resources, MAN Group

*"Pre-1990s the relationship with the board could be described as perfunctory, but now there is much more of a relationship, much more back and forth. It's not just in the time taken on HR matters, but it's the importance given to them."*
CHRO

*"People aspects are embedded into every presentation people make to the board. This reflects the reality that our business is very much about human capital."*
CHRO

*"Human capital should be a priority for the boardroom. Developing and motivating people should have equal 'billing' with strategy creation and implementation. As well as spending sufficient time on their own development, directors should spend sufficient time on the development of others."*

**Dr. Neville Bain**
Chairman, Institute of Directors

# 1 What's the issue?

## Intangible value and board oversight of HR

It has long been understood that much of an organization's value is intangible, derived significantly from its human capital and not just monetary and fixed assets. While most financial analysts have paid remarkably little attention to how human resources are managed, what about governing boards? Do they keep a close eye on what enhances human capital? What represents good practice in board oversight of HR?

## Governance – behavior in the spotlight

Public and political disquiet about organisational leadership has triggered an explosion of corporate governance law, rules and guidance. Perceived failures of competence, integrity and social responsibility – ranging from the financial crisis to environmental and safety disasters, to bribery and varied examples of top executive hubris – have reinforced intrinsic belief in agency theory. Boards are now under pressure to do more and know more about executive behavior, and even to regulate the conduct of all staff and contractors. How well are boards and board committees adapting to a far broader and deeper exercise of oversight than just the traditional focus on the top team?

## Risk – the people factor

Recent events are also driving attempts to improve risk management. Traditional risk management approaches – reliance on rule books and on numerical analysis and models – have been exposed as inadequate. Again, human behavior is the fundamental issue – with the dawning realization that this is key to managing all risk. In addition, talent and skill shortages, succession, labor disputes, disengagement and other people-related shortfalls can be as important as, say, financial risks, and indeed have financial consequences. In particular, the behavior of senior management is critical, as is the overall risk culture they shape. How incisive are boards in addressing 'people risk'? How do they know whether organizational values and codes of conduct or ethics are being respected?

## Boards' own people management issues

In the interest of both transparency and better quality of oversight, governance codes are requiring boards to apply classic HR disciplines to themselves – eg performance and development reviews, tougher selection and greater diversity. How are the 'good and great' coping with the implicit demand for greater self-awareness, teamwork and role-modelling?

## HR – facilitator or bystander?

The HR community has been largely invisible in public debates about governance. Yet so many aspects – such as reward, performance and executive behavior – should surely be the province of 'people professionals'. Behind the scenes, what are HR leaders expected to contribute to a board's work in addressing both the strategic people agenda and a board's own people issues? How is the role of a chief human resources officer (CHRO) or HR director evolving? What capability challenges arise?

Individual chapters in our report analyzed these questions and more, as we will summarize in the pages to follow.

# 2 How do boards assess human capital?

What do 'good' boards do when they oversee human capital, and what topics should they cover?

## Two lenses converging

For effective oversight of human capital, boards should apply both supply and demand perspectives.

- A capabilities lens (supply) examines the broad question "is our human capital strong?" and concerns issues like depth and breadth of skills and talent, succession, engagement and diversity.
- A people lens (demand) looks at business questions, such as growth, innovation, risk, M&As, restructuring, new products and systems, and then asks what the people implications are.

## Scope of discussion

Traditionally, many boards concentrated primarily on the selection, performance and reward of the top executives and their potential successors. In the last 10 years, boards have devoted increasing attention to a wider talent pool. However, we found that boards exercising full responsibility for human capital ensure they understand and monitor the way the entire workforce is managed. Only then can they have a feel for the fundamental factors influencing performance, capability, and reputation – now and in the future – and also for what executive management is doing.

The people lens discussion depends entirely on the nature of the business issues and the sophistication of the board about HR matters. While set-piece yearly or twice-yearly examinations of people strategy are the norm, a people-focused board considers the human dimension in every business discussion. Some boards, however, are less alert to how people factors can undermine strategy, making the mistake of considering them to be 'operational' detail.

## What gets discussed

The main areas we identified for human capital oversight are:

- people strategy – as a part of organizational strategy
- people-related risk
- succession and talent
- reward and pensions
- legal requirements and codes of behavior
- vision and values
- employee relations and employer reputation
- change initiatives
- diversity and inclusion
- capability of the HR function.

In aggregate, this can take 25-35% of a board's time. Yet the hours invested can still seem small given the task at hand – spending a couple of hours reviewing the top one hundred people does not lend itself to an in-depth discussion of potential.

Boards' constrained time frames remind us that the board is providing oversight on human capital, not managing it. Improved effectiveness derives from better quality of discussion and becoming skillful at identifying which people issues have the greatest impact at that particular point in time.

**Stephen Dando**
Thomson Reuters

*"Employee engagement is certainly something any board should be interested in. It's not a 'nice to have,' but fuel in the tank for superior business performance."*

**Stephen Dando**
Executive vice president and chief human resources officer, Thomson Reuters

*"Good boards will demand at least once a year a full review of management succession, talent development, and important people issues such as engagement and diversity. And of course they must on a regular basis also address remuneration issues, which have become more complex."*

**Dr. Humer**
Chairman, Diageo

*"The board can help highlight the HR side of strategic issues. For example, if we want to be globalizing, what evidence do we have that this is happening? Globalization affects structure, it affects culture, it affects who we hire, how we develop people, and who we put in which roles."*

**Tom Brown**
Director - human resources, Rolls-Royce

*"There is only one strategy and people strategy is a subset of that. It's not an HR strategy, it is a people strategy. It's facilitated by HR, but management owns the people strategy – necessarily so, as 70% of our costs are people."*
CHRO

**Jill Smart**
Accenture

*"It's more than having us report data to the board. We have rich and productive discussions with our board, and this exchange of perspectives with the board members contributes to new thinking about the future."*
**Jill Smart**
Chief human resources officer, Accenture

*"You need to look at the metrics as a piece of 'hygiene,' but you have to be a little skeptical. It's essential to understand the context, or you can delude yourself that everything's fine."*
Non-Executive Director

*"We give the board a picture of several hundred people in the talent pool – they can see the broad picture and make a deep dive. The data's in a form they want – quite distilled and accessible, but cuts to the real core issues."*
**Gareth Williams**
Human resources director, Diageo

*"Good board members demand access to the business. That's partly because there's much more liability attaching to a board director position now."*
CHRO

# 3 Sources of information on HR

We examined how boards obtain the information they need for effective human capital oversight.

## Board packs – insight not information

Board packs should be concise yet incisive, with data that tells a story – it can take time to become good at this. Boards need to reflect on, and then specify clearly, the information they really need. Interviewees emphasized the quality of discussion triggered by board data, and were wary about reliance on 'the numbers'. (We advise 'triangulation' or different sources to check veracity.)

## Presentations that stimulate

As with board packs, the tension must be managed between too little information and too much, and the real value derives from stimulating debate that stretches executives' thinking and generates ideas. Boards should encourage well-integrated presentations – strategic, financial, technical and people information that demonstrates 'joined-up' thinking, and avoids silo perspectives.

## Passive receiver or active enquirer?

Only in a few instances did we find evidence of boards taking the initiative in probing about people issues – such as ensuring that talent supply is sufficient to match a growth strategy. Many CHROs commented that it fell to them to drive the people agenda. However, it made a great difference if the board was at least supportive, for example in influencing the priorities of business unit heads.

## Interacting with senior executives

The more board members meet and interact with the top echelon of executives, the better they should be able to assess at first hand the depth of leadership capability and succession, including executives' people management orientation. Boards should ensure there are sample occasions, for example socializing around board events or internal conferences. One-to-one meetings with top team members such as a CHRO are similarly useful to explore board-relevant topics, to share knowledge without compromising oversight obligations, and to sense top team dynamics.

## Experiencing the broader organization

Meeting a cross-section of managers and staff in different locations provides an essential opportunity for directors to 'feel' the organization and to verify the messages they receive from senior managers. Board directors should remember that the 'first line of defense' in risk management lies with front-line staff and managers, and so they should have a good appreciation of the realities they experience.

## Whistleblowing – managing the tensions

Boards are required to ensure effective whistle-blowing procedures – bearing in mind that when problems are exposed it often emerges that there was no shortage of people 'in the know,' but that 'listening' was impaired. It can be far more tempting to side with senior management in the event of conflict, but ultimately it is the board's duty to maintain the trust of all stakeholders.

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# Board committees and processes

Committees in principle allow greater specialization and more detailed oversight of an organization's affairs. What are the implications for human capital oversight in particular?

## Growth and variation

There are more board committees and different types than in the past, partly due to regulatory influences in different countries, but partly due to boards' own decisions about their priorities. Increasingly major companies have created committees focusing on Risk and on Governance, and sometimes in areas such as brand and reputation.

## People issues on all agendas

We found that there were people issues relevant to the agendas of all board committees. Some boards were more conscious of this than others, which in the former instance means the CHRO increasingly liaising with each committee and frequently being in attendance or on call.

## Co-ordination and integration

The CHRO has an important part to play in ensuring coherence when different committees address issues with people implications – through liaison with committee chairman in between meetings. For example, the Compensation/Remuneration and Nomination committees should both have – and often do – perspectives on talent management.

## Audit and risk

Apart from ensuring that all data is correct, the Audit committee should be concerned with the quality of information provided to shareholders, including the quality of human capital insights and what this says about an organization's long-term future. Also, it is here that responsibilities lie for handling whistleblowing.

While people risks of various kinds straddle most committees' agendas, the Risk committee clearly has the responsibility to form an overview, and 'join up the dots'. While risk committees have obviously been most prevalent in financial services, CHROs reported that the financial crisis and governance changes had been helpful in enabling them to get people risks fully on the agenda.

## Reward and selection

Similarly corporate governance pressures are encouraging greater rigor in ensuring that reward is healthily performance-related and not driving risky behavior, and that selection processes for directors are robust. Committee workloads are increasing, and in principle boards are expected to be more questioning of their advisors. All this is providing plenty to discuss with the CHRO.

## An HR committee?

There is a tendency in the US for the Compensation Committee to become the primary board group to discuss the HR agenda, and some have explicitly inserted HR into the committee title. This clearly helps to avoid a narrow concentration on reward by focusing on the many other related people issues. That said, there were some CHROs who resisted this in case it undermined the responsibility of ALL board members to deploy the 'people lens' in their work.

**Tom Brown**
Rolls-Royce

*"Our risk committee covers people risks now – but it didn't two years ago."*
CHRO

*"My experience in chairing two Remcos is that we have shifted from being just policemen guarding the purse strings for shareholders to being far more focused on performance, talent development and broader human capital issues."*
Non-executive director

*"As we continue to expand internationally, the board wants to be sure we have leaders who can be trusted to deliver in what can be high risk environments. So leadership quality is a strong theme in risk discussions."*
HRD

*"Our Remco's agenda starts with the top 12, but looks at reward structure for the top 400, and at actual approval of long-term incentives for 1,500. It also examines what we are doing for the top cadre vs. the larger population, and takes account of our union relationships."*
CHRO

*"We don't need an HR committee – 'people' is a matter for the entire board in our view."*
CHRO

**David Nish**
Standard Life

*"Boards need to have a good understanding of people issues if they are to be effective in their oversight of organizational change."*

**David Nish**
Chief executive, Standard Life

*"Great CEOs don't necessarily make good chairmen, and equally the best chairmen may not have been CEOs." Chairmen "need emotional maturity in spades", and the job is "not for alpha-males."*

**The behavioural drivers of board effectiveness**
MWM Consulting, 2010

*"As we develop the board, the company secretary looks at the mechanics and plumbing. I look at how board members and committees can be more effective."*
CHRO

*"I find the senior independent director to be a nebulous role. If there's a problem between chairman and CEO, the Remco chairman can be a useful ally."*
CHRO

*"I think boards should generally be more challenging about their organizations' preparedness for change."*

**Tom Brown**
Director - human resources, Rolls-Royce.

### Separating CEO and Chairman roles

A significant number of companies, particularly in the USA, have not yet adopted the model of a non-executive chairman overseeing the CEO, generally recognised as offering the best potential for 'checks and balances'. A range of dangers otherwise arise in terms of power distribution. Our research certainly supports this model from a people management perspective, starting with relationships at the top but ultimately impacting the whole organisation.

# 5 Roles and capabilities in people governance

## The Chairman (non-executive)

The chairman inevitably sets the tone for the board, and thus how people-oriented and attentive to its own membership disciplines it is. Expectations of chairmen are shifting significantly. Hitherto, a chairman's career background would have counted most. Now it's more about relevant skills, such as how well they can shape a team out of a group of strong-willed, independent individuals, and how good they are at subtly yet firmly performance-managing and coaching CEOs.

Non-exec chairmen themselves indicate that the 'directive' style of many CEOs is inappropriate for team leadership at board level. The many CEOs that become chairmen must make a major transition.

In terms of HR knowledge, a few chairmen excel, but CHROs reveal that many incumbents have much to learn. This can affect both board management and oversight of executives.

## The CEO

By definition the CEO is the primary 'people manager' in the company, and the most significant leadership role model. The strength of HR governance throughout the company depends as much on how the CEO ensures that his/her management subordinates adhere to good people disciplines as on anything a CHRO does. Their own personal example is critical.

"Does the CEO know what a good CHRO or HR function looks like?" While the answer was frequently 'no', CEOs do tend to notice HR underperformance. Generally we found CEOs actively encouraging better governance and the increasing focus on people issues at board level.

## Board committee chairmen and NEDs

Few non-executive directors (NEDs) have deep knowledge of HR or of psychology. Thus so do few committee chairmen. Yet overall, we found little concern about this, as long as chairmen were open to advice and guidance about the human capital aspects of their committee agendas. There are pros and cons to having board members with deep subject expertise. A NED with broad management experience, without a formed specialist viewpoint, can be better at challenging any fixed functional thinking by using the power of curiosity and the 'innocent question.' That said, CHROs did generally concur that boards would benefit from more in-depth HR knowledge.

## Senior independent directors

Called 'lead' or 'presiding' director in the US, SIDs are important when things go wrong. CHROs tended to see the role as nebulous, and were mostly not confident they can rely on a SID in the event of deeply troubling situations, or if they see the chairman as 'compromised. We sensed that SIDs are nervous about the potential level of their responsibilities.

## Company secretaries

With their formal responsibilities for guiding boards on governance, these are important colleagues for CHROs in dealing with the board. Usually there is a division of labor, with the CHRO acting as the guide on a board's people issues.

# 6 CHROs/HR directors

In most of the companies we interviewed, the CHRO has become an integral part of the support system for board effectiveness.*

## Interaction with the board

CHROs attend most board meetings, and some attend all. They are also involved with the many board committee meetings that address people issues. Most see board directors between meetings, particularly the board chairman and committee chairmen, to keep mutually informed. CHROs use these opportunities to help enrich NED knowledge about HR subjects. Good governance precautions should mean that the board can have direct and unfiltered access to a CHRO, and vice versa, where sensitive issues at the top need to be faced up to – similar to the position of a head of audit. CHROs, meanwhile, should define how HR governance connects with and supports corporate governance.

## The interlocutor role

As highlighted in Configuring HR for the Future (Lambert , CRF, 2010), leading CHROs are often called to facilitate top team effectiveness – providing coaching directly or indirectly, and acting as trusted interlocutors when necessary between CEOs and other members of the executive team. In this research we found this facilitation also increasingly applies to Chairman and CEO relationships. This is a delicate, and sometimes difficult, path to walk, requiring considerable trust and some risk.

## Holding the mirror, ringing the alarm bell

Related to that is being the 'conscience' of the organization – as frequently CHROs say they are – which can mean holding the mirror up to senior colleagues, including the CEO and chairman, where difficult behavioral issues arise. Early intervention is advisable, as delay indicates weakness. "You have to be able to command respect so that, when you 'ring the bell,' everyone listens", as one said. Boards meanwhile expect executive directors to deal with them openly in such circumstances – loyalty must be to the company, not to who recruited you.

## Capability

These sensitive aspects of a CHRO's role – rarely appearing in the initial job description – require a strength of character that engender both trust and innate authority, and also means standing aloof from any power-politics. In addition CHROs should be as much a business person as a functional expert – their particular contribution includes ensuring that the people ingredient in strategy and performance is fully understood and addressed, while deploying deep OD knowledge to guide organisational development. Corporate governance and risk are obviously now areas which CHROs must now also master.

## Workload

As supporting the board is now a significant part of a CHRO's job, good deputies should be developed both to ensure the function is well managed and to support board work, for example providing cover for holidays and illness. This also helps ensure good successors are in place.

**Alex Wilson**
BT

*"The responsibility is there for HR to hold up the mirror to board members, but it depends on the personal relationship you have with the individual, and how much time you want to spend on it."*
**Alex Wilson**
Group human resources director, BT

*"I talk to the chairman fortnightly on a range of subjects, including managing and developing the board and relationships with executive directors. I also talk to our SID monthly."*
CHRO

*"Yes, the board certainly takes more interest in people issues than a few years ago. But the impetus has come from me, I must admit."*
CHRO

*"If the HR head isn't of the right caliber – and it can certainly be patchy – there's a void. It affects lots of things, starting with the quality of appointments. A chief executive doesn't necessarily know what a good HR director looks like, and boards themselves may not understand the key executive roles. That's why we need experienced non-execs."*
NED

### *HR's power and influence

In this report, we reflect the general picture in global companies headquartered in the US and UK, whereby the power of HR and its influence at the top depends greatly on the personal capability of the HR leader and HR's track record in service delivery. Note that in other cultures, the HR or Personnel function can enjoy considerable inherent positional power, for example due to the relative importance of industrial relations and/or the role the function plays in enforcing rules in high-control organisations.

**Priscilla Vaccasin**
Prudential plc (until March 2011)

# 7 Board's own people processes

We examined boards' management of their own 'people issues,' and how HR can contribute.

## Board quality

Many boards we reviewed have consciously sought to strengthen board competences. Increasingly CHROs are asked to support both the 'what' and the 'how', injecting their professional expertise. The two main levers are 'buy' and 'grow' – ie recruit and develop.

Old complacencies are being challenged – for example that board directors are too experienced to require development, or that they are mainly useful for their contacts. Good governance demands higher standards in understanding both their own organizations and fast-shifting, surprise-laden external environments, as well as the ability to work collectively in taking tough decisions.

## Board recruitment and selection

New governance rules also encourage the shift from the 'old boys network' to a more planned and rigorous approach. Most CHROs are far more actively involved in NED recruitment than in the past. Here are just a few examples of tensions boards and their CHROs face in making selection choices.

- Regulators have encouraged financial services firms to boost specialist financial expertise on boards. Yet CHROs observe that narrow specialists on average compare poorly with directors from broader backgrounds in terms of strategic input, understanding people issues etc.
- Gender diversity pressures pose significant questions about how well organisations are developing potential board talent. Other board diversity issues also need addressing.
- This report highlights the many strategic challenges requiring good understanding of OD and organisational psychology. Yet where are the board members with this expertise? There are few former HR executives on boards. Do ex-general managers know enough about HR?

## Developing board directors

Good boards are aware of the example they set in taking learning and development seriously. There are many constraints, including time. It can be easier to get attention for briefings on technical subjects than to address 'soft' issues – bearing in mind that any emotional intelligence deficits should have been identified during recruitment. That said, some NEDs told us that they now discuss how they work together far more than in the past. Like any responsible team leader, chairmen are now expected to undertake thorough development planning with colleagues – CHROs and their L&D heads are increasingly asked to help, given that for some it is a new experience.

## Performance reviews

While board evaluations are scarcely new, stakeholders now expect that both individual director and whole board reviews will have real 'bite'. Some CHROs indicate that it is still early days for their boards in this respect, and the market for external expert board assessors is immature. The process is normally driven by the Chairman with the Company Secretary, but the professional expertise of CHROs is increasingly being called upon, and occasionally they are the drivers.

*"HR governance should be an extension of corporate governance, and has an essential role to play in providing glue to a large group structure."*
**Priscilla Vaccasin**
Group HR Director, Prudential plc (until March 2011)

*"The board should take the initiative to ensure they are educated in strategic issues around people management."*
**Larry Costello**
Formerly SVP human resources, American Standard/Trane

*"The importance of relationships at the top can often be underestimated. Where that applies, you see the lack of investment of time and energy – and then there's a price to pay."*
CHRO

*"We do now talk openly about board performance and development, much more than in the past. Our job is to make the board perform as effectively as possible. We are mindful of the knock-on effect we can have."*
NED

*"Diversity is extremely important, because what you want around the boardroom table is differing perspectives; if, for instance, you have 12 goalkeepers, then you won't let in many goals, but you won't score any!"*
From *Board dynamics – the chairman's perspective*, IDDAS (2010)

# 8 Conclusions and challenges

### People issues have become central to board discussions

We found there is no longer any question as to whether good boards take HR factors seriously. People issues are a major concern for most boards, relating to the performance and development of the board itself, the top team, the succession and talent pool and the broader workforce.

Increasingly the CHROs we interviewed felt that applying a' people lens' to business issues was not just being done better, but that it was becoming second nature.

While there is room for improvement, in good companies HR is no longer sitting on the sidelines hoping the board will start taking human capital seriously.

### Why good boards take human capital seriously

The top three reasons why boards are taking human capital seriously are to get good business results, to enable good risk management, and to achieve good organizational governance.

Do boards really make a difference to human capital management?

We discussed with CHROs the impact the board has on the organization by reviewing people strategy and HR topics like engagement, skills and talent pools. Some questioned whether boards could drill into sufficient detail, eg in talent reviews, to make any difference. Others disagreed, and the wider consensus among CHROs is that board attention to HR issues adds value in important ways, including asking tough questions; drawing on wide experience; providing a stamp of authority to HR decisions and policies; and creating accountability for better people management.

### The CHRO-board relationship is changing

When boards decide to take HR more seriously it truly changes the job of the CHRO. We found the role of high-achieving CHROs has shifted towards adding value to the board as well as to the executive team. Top CHROs are increasingly called upon to facilitate relationships not only between the CEO and top team members – including their performance and development – but also where necessary between chairman and CEO. At times of tension, the role becomes one of interlocutor, and can also involve the senior independent director (or equivalent).

### Where are the gaps?

These are some of the gaps within our select group of organizations that are leading the way.

- *Board directors rarely have deep expertise in HR, organization development and psychology.*
- *Some boards show less interest in broad workforce issues.**
- *Boards need to become expert in steering change and managing crises – leading the way in coping with what ever unexpected challenges emerge.*
- *Analysts and investors are generally not onside in understanding the impact of better people management.*
- *It is 'early days' in ensuring great role modeling in HR practices at the top.*
- *The talent pipeline of truly 'board capable' CHROs needs attention.*

In the world at large, many organizations will have a more extensive list of gaps to be addressed.

* **SEC rule changes**

Note that, in the USA, the SEC introduced rule changes in February 2010 requiring discussion about a company's compensation policies and practices for ***all*** employees if they create risks that are "reasonably likely" to have a materially adverse effect on the company.

### Extra requirements for financial services boards

Board oversight in financial services, particularly large banks, has extended far beyond the top team. For example, in the U.K. regulators are now checking the suitability of thousands of senior executives and placing requirements on companies in terms of reward, conduct and risk.

*"The company identified important business imperatives that required more HR expertise, for example better sales people, improved business processes and managing change. Having raised the level of HR leader they need, the board's expectations and involvement have also increased. Discussion is now about much more than succession and compensation."*

**CHRO**

*"The board has pushed to be kept up-to-date about how culture and values are being sustained as we acquire and grow people and businesses. We see people as part of our business advantage, and so they quite rightly challenge us here."*

**Tracy Clarke**

Group Head of HR and communications, Standard Chartered Bank

*"There is a reluctance to have HR at the board table, because the board does not see the role as strategic. In my opinion this is wrong. I challenge strategy, structure, remuneration and organisational change: this is all about performance and enhancing it. It is meat and drink for HR directors."*

From *Board dynamics – the non-executive director's perspective* IDDASO (2011)

**Randy MacDonald,**
IBM

*"Board oversight of people issues is not some special event, it's almost continuous. In the executive compensation and management development committee, yes, we are talking about reward, but always in the context of how do we retain the best talent, what is the best talent, and what areas we should be most concerned about. In IBM, developing leaders is a way of life; it is part of the DNA of both the management system and the board systems."*
**Randy MacDonald**
Senior vice president, human resources, IBM

*"I'm happy that the board wants to assess how we're developing our people and culture so that we can fulfill our growth agenda. They're getting into what counts."*
**David Nish**
Chief executive, Standard Life

*"I'm an honest broker between the chairman and the CEO. Yes, I hold the mirror up to them when needed. You need to be trusted, and not frightened of getting fired."*
CHRO

# 9 Recommendations

## Looking into the organization

In considering the many ways a board provides oversight on human capital, we particularly highlight these three practices: integrate the review of people issues with strategy and operations discussions; ensure sufficient time for reflection, deep debate and getting out into the organization, not just listening to presentations; and look at the whole organization, not just the leadership.

## Looking inward at the board

Consider these three areas for improvement. First, develop board HR oversight capabilities – the chairman should ensure these are prominent in the development plans for non-executives, especially committee chairmen. Secondly, work on the board's reputation as a high-performing team, for example role-modeling in reward, performance management, learning and development, but above all the ability to face up to tough issues and think ahead. Finally, focus on enabling change and managing crises - a crucial area for a board to add value, yet one picked out by a number of CHROs as a subject where their board directors could add more value. That includes ensuring that people factors are fully considered, so that good risks are taken and bad ones avoided.

## Looking at the CHRO

The CHRO should play a pivotal role in supporting board oversight of HR, in these ways.

- **Be the driver.** Some boards may consider that they don't have the time, inclination or expertise to prioritize oversight of human capital. If so, the CHRO should be a driver for improvement
- **Educate the board.** The CHRO should be intentional, if subtle, in developing the board's HR understanding. Any presentation to the board should be designed to educate as well as inform.
- **Demonstrate how the CHRO contribution has changed.** Take responsibility for being an organizational conscience, facilitator of working relationships at the top, and people risk expert. Build a pipeline of HR talent that is 'board-capable', and develop the HR aspects of governance.

## Looking ahead to the future

There are other initiatives CHROs and boards could take to enhance oversight of human capital.

- Get investors on-side, by providing meaningful evidence of how enterprise value is enhanced by people investment, for example through more sophisticated use of employee surveys. Underpin this by agreeing some more shared and standardized 'people measures'.*
- Focus on high value capabilities like learning, agility, resilience.
- Build board understanding of organizational development and psychology to enhance analysis and decision-making about people issues, and strengthen the HR dimension of governance.

It is encouraging to see that human capital is on the agenda, but many organizations can still make significant improvements in how the board provides oversight on people related issues, and thus help their management teams achieve lasting excellence.

* **Standardized people measures**
The various attempts to develop people measures for company annual reports have hitherto had limited impact. However note that SHRM in the US has a project underway to develop an ANSI standard for reporting human capital information to investors, which could become an ISO standard later. (Co-author David Creelman is associate work group lead on this project.)

David Ulrich

# 10 Afterword

## – by Dave Ulrich

Investors, regulators, customers, C-suite executives, leaders, and ultimately all employees pay increasing attention to how Boards fulfill their fiduciary responsibility to protect shareholder assets.

Traditionally shareholder interests are best served by boards paying attention to strategic and financial consideration. Boards attend to strategy by examining external environmental trends (e.g., technology, regulation, globalization), competitors, and customers to advise management on how to best position the organization to win. Boards attend to financial issues by regularly and rigorously attending to capital structure, cash flow, and financial covenants.

But increasingly boards recognize that strategic and financial considerations are necessary but not sufficient content areas for board consideration.

- Strategy is not just about where an organization is going, but how it gets there.
- Financial performance is not a single event, but a sustained pattern.
- Competitors may copy strategic and financial initiatives, but they have a more difficult time copying the less tangible, but increasingly relevant, human capital initiatives.

We have proposed that **human capital initiatives may be divided into three factors**, each of which Boards should attend to: individual, organization, and leadership. To deliver any strategy, individuals need to be more productive; organizations need to have the right capabilities; and leadership needs to be widely shared throughout the organization. Boards should be regularly asking these questions.

- **Individual:** What talent do we need to make our strategy and financial goals happen?
- **Organization:** What organization capabilities do we need to make our strategic and financial goals happen?
- **Leadership:** What do our leaders need to be good at to make our strategic and financial goals happen?

### Individual ability (talent)

At the risk of grossly oversimplifying, there is actually a deceptively simple formula for talent that can help Boards make talent more productive: Talent = Competence x Commitment x Contribution.

Competence means that individuals have the knowledge, skills, and values required for today's and tomorrow's jobs. Boards should make sure that employees have the right skills, right place, right job, right time.

But without commitment, competence is discounted. Highly competent employees who are not committed are smart, but don't work very hard. Committed or engaged employees work hard; put in their time; and do what they are asked to do. Boards should track whether their organization offers an employee value proposition to ensure that employees who give value to their organization will in turn receive value back.

### Dave Ulrich

Dave Ulrich is a professor of business at the Ross School of Business, University of Michigan and co-founder of The RBL Group. He has written fifteen books and over 100 articles covering topics in HR and Leadership, is currently on the Board of Directors for Herman Miller, is a Fellow in the National Academy of Human Resources, and is on the Board of Trustees of Southern Virginia University.

More recently, we have found the next generation of employees may be competent (able to do the work) and committed (willing to do the work), but unless they are making a real contribution through the work (finding meaning and purpose in their work), then their interest in what they are doing diminishes and their productivity wanes. Boards should make sure that employees find a sense of contribution through the work that they do. Boards can help assure that their organizations are a setting where individuals find abundance in their lives through their work.

Simply stated, competence deals with the head (being able), commitment with the hands and feet (being there), and contribution with the heart (simply being).

### Organization capability (culture)

Talent is not enough. Great individuals who do not work well together as a team, or in their organization, will not be successful. Some simple statistics show the importance of teamwork over talent.

- In hockey, the leading scorer is on the team that wins the Stanley cup 22% of the time.
- In soccer, the winner of the Golden Boot (leading scorer) is on the team that wins with World Cup 20% of the time.
- In basketball, the player who scores the most points is on the team that wins the NBA finals 15% of the time.
- In movies, the winner of the Oscar for leading actor or actress is in the move that wins the Best Movie of the Year 15% of the time.

Great individual talent may succeed 15 to 20% of the time, but teamwork matters most. Board members should regularly and rigorously assess the culture or work environment as much as they do talent. In the last decade a lot of restructuring organizations has been done to right-size, reshape, reengineer, redesign, delayer, and rebuild organizations, but this restructuring does not necessarily reflect the culture. Admired organizations (like GE, Apple, Microsoft) are not known for their structure, but for their capabilities.

Capabilities represent what the organization is known for, what it is good at doing, and how it creates patterns of activity to deliver value. The capabilities define many of the intangibles that investors pay attention to, the firm brand to which customers can relate, and the culture that shapes employee behavior.

A Duke client study found leaders today are "shifting their focus from individual competency to organizational capability."[1] McKinsey also looked to the future and found that capabilities will become more important than individual competencies: "Nearly 60 percent of respondents to a recent McKinsey survey1 say that building organizational capabilities such as lean operations or project or talent management is a top-three priority for their companies. Yet only a third of companies actually focus their training programs on building the capability that adds the most value to their companies' business performance."[2]

Boards should work to identify and build capabilities. Some of the traditional and accepted capabilities that have been discussed extensively have included efficiency (e.g. lean manufacturing), globalization, quality, customer service, and speed of change or agility. These are some emerging capabilities for organizations to succeed in the future.

**Notes**

[1] Duke's Corporate Education Client Study, Learning and Development in 2011: A focus on the future. Prepared by Duke Corporate Education.

[2] McKinsey Global Survey Results, Building organization capabilities. Sourced at http://www.mckinseyquarterly.com/Building_organizational_capabilities_McKinsey_Global_Survey_results_2540

- **Risk management.** In volatile and changing markets, organizations that can anticipate and manage risk will be more able to create sustainable change.[3]
- **Social responsibility**. With an increasing concern on environmental issues, organizations that have the ability to be socially responsible will attract employees, customers, and investors.
- **Simplicity.** As the business world becomes more complex, organizations that can remain simple in product design, customer interfacing, and administrative systems will be more responsive.[4]
- **Connection**. With technology being the workplace of the future, organizations that can form connections among employees, between employees and customers, and with partners will be more likely to have collaborative social networks around the world.[5]
- **Innovation.** While not a new topic, innovation will increasingly be broadened to include not only products, but customer interfaces or channels, administrative processes, and business models.[6]

When Boards connect organization capabilities to individual abilities, they begin to make the whole (organization) more than the sum of the individual parts (individual talent).

### Leadership brand

Ultimately, leaders bring together both individuals and organizations to solve customer problems. But, there is a difference between leaders and leadership.

- 'Leaders' refers to individuals who have unique abilities to guide the behavior of others.
- Leadership refers to an organization's capacity to build future leaders.

An individual leader matters, but an organization's leadership matters more over time. Looking forward, Boards will need to not only help individual leaders be more effective through coaching, 360 feedback, and individual development plans, but build leadership depth by investing in leadership development.

This means that Boards should not only prepare individuals to lead, but pay attention to staffing, training, compensation, promotion, communication, and other management practices that build future leadership.

Looking forward, Boards will mitigate risk, fulfill their fiduciary responsibility, and advise management by looking not only at strategic and financial decisions, but individual (talent), organization (culture), and leadership issues. These issues become the foundation on which sustainable strategy and financial results rest.

## Notes

[3] Deloitte, Designing a successful ERM function: A global perspective on risk management structure and governance for the insurance industry. The work on managing risk is laid out in Commission of Sponsoring Organizations of the Treadway Commission, Enterprise Risk Management – Integrated Framework, September 2004

[4] See work by Ron Ashkenas, 2009. Simply Effective: How to Cut Through Complexity in Your Organization and Get Things Done. Boston, MA: Harvard Business Press

[5] This logic is laid out in PwC report called. Managing Tomorrow's People. The Future of work to 2020. Sourced at http://www.pwc.com/gx/en/managing-tomorrows-people/future-of-work

[6] Excellent work on innovation is in Larry Keeley's work (www.doblin.com)

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# Creelman Lambert

Creelman Lambert provides advice and research to organizations in the areas of

- board oversight of people management and human capital
- reporting to investors about human capital
- the human dimension of corporate governance
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