Boards as overseers of human capital

Directors don't get enough of the right data, nor are enough experts sitting on the board. Improvement is needed: this was true before the recession, and even truer now.

By Edward E. Lawler III

One of the most important assets, if not the most important asset, of corporations is their human capital. CEOs and board chairs recognize this and frequently make such statements as "People are our company's most important asset." Confirming this, researchers have shown that intangibles account for an increasing percentage of the market value of corporations; and, of course, human capital, along with the knowledge and intellectual property they create, is one of the most important intangible assets that corporations have. This was true before the current recession and it is still true.

This recession has forced and will continue to force many companies to make a number of critical decisions about their human capital. Decisions concerning layoffs, the funding of retirement plans, reductions in training, retention of key employees, and so on all have both a short- and long-term impact on the performance of corporations. They can boost or destroy a company's reputation as an employer and can lead to the wrong talent leaving an organization (e.g., financial advisers in brokerage firms).

Given the many critical decisions that need to be made, it is important that a board carefully monitors the condition of the organization's human capital and how it is being managed. Indeed, it might be argued that even in today's economy, boards should spend as much time focusing on human capital as they spend on the financial and physical assets of their corporations.

An information deficit

In order to determine how much and what kind of attention boards give to their organizations' human capital, the October 2008 Heidrick & Struggles/Center for Effective Organizations' annual survey of board members focused on human capital. It surveyed board members of large U.S. corporations and received responses from 116 firms.

The results of the survey suggest that boards have been and continue to be largely missing in action when it comes to monitoring human capital. They do focus on succession planning at the top, and many of them do see this as an important activity of the board. But, when it comes to monitoring most of the talent in the organization, its condition, and how it is managed, the situation is very different. In order to be effective in managing human capital, board members need information about management practices and the results of these practices as well as knowledge and expertise in human capital management. Survey results suggest that boards lack

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both information and expertise.

Board members are confident that they receive sufficient information to carry out their board responsibilities — 90% say they do. But, their reports concerning how much data they receive about their company's assets vary tremendously. At the bottom is information about the company's human capital, its culture, and how it is managed. With respect to these issues, board members report that overall they receive only small amounts of information.

When asked whether the board receives specific kinds of information about human capital, the results are mixed. As can be seen in Exhibit 1, boards do get succession planning data for most management positions; those that don't get it say that they should. The situation is quite different, however, with respect to succession planning for technical positions, metrics on turnover, metrics on recruiting success, and attitude survey data. In these cases only about half of the boards get information, although those that don't typically say that they should get it.

There is no obvious explanation for why so many boards report that they don't get information about human capital management but feel that they should. It certainly is the type of information boards need to receive in order for them to judge how effectively their organization is responding to the economic downturn. Perhaps management is hesitant to report these data because they fear board micromanagement, and boards are simply not demanding enough when dealing with management on this issue. Another possibility is that management simply doesn't have the data. Obviously, without the kind of data that boards say they should get but don't, it is difficult for them to play an informed role in monitoring the human capital management programs and practices of their firms.

EXHIBIT 1 Information given to the board

	Get and should	Get but shouldn't	Don't get but should	Don't get and shouldn't
Succession planning data for most management positions	73.1	0	24.4	2.6
Succession planning data for key technical positions	46.8	1.3	32.5	19.5
Metrics on turnover	59.0	3.8	33.3	3.8
Metrics on recruiting success	49.4	5.2	36.4	9.1
Attitude survey data	51.9	1.3	42.9	3.9

EXHIBIT 2 Human capital experts on boards

	Percent of boards with
HR VPs	10.3
HR Consultants	6.4
HR University Faculty	11.5
Any of the Above	21.8

No HR expertise on the board

Critical to effective decision making with respect to an organization's human capital is board expertise in human capital management. A good indicator of the expertise board members have is whether they have worked in an HR-related job. Our survey results reveal that most boards have no members with a background in HR management. When asked if their boards have either HR VPs, HR consultants, or university faculty members with expertise in HR, board members typically replied that they had no such experts (see Exhibit 2). Only about one board in five has a member who has expertise in human capital management.

When asked who they rely on for expert knowledge pertaining to human capital management, the most frequent response by board members was "other board members." This is a bit surprising, given the fact that few boards actually have HR experts on them. They also reported that they rely on corporate HR staff members as a credible and potentially valuable source of information. Another source they utilize is consultants, but this is a less frequent source than other board members and corporate HR staff members.

One way to increase the focus of a board on human capital is to have a board committee that is responsible for monitoring the organization's workforce. Of the organizations studied, only 13% report that they have a human capital committee; 75% report that they have never even considered having one. Clearly this is not a popular option.

Board members are aware that they are not particularly effective at monitoring how the workforce is managed. When asked to rate on performance effectiveness areas of board activity ranging from long-term strategy development to assuring accurate financial reporting, they rated monitoring the firm's management workforce area lowest in effectiveness. Slightly less than half said they are effective at this, whereas when it comes to monitoring financial performance almost 90% said they are effective at it.

What needs to be done

Overall, the data clearly indicate that human capital receives little attention at the board level and that board members feel their performance in this area could be much better. Some of this may reflect the fact that the increasing importance of human capital has caught boards by surprise since their membership and structure has not been targeted toward dealing with human capital issues. Further, for some organizations, human capital may not be a very important asset. For these companies, lack of attention to human capital is not a problem, and they most likely do not need to change.

But what about companies where human capital truly is one of their most important assets? What do they need to do to be sure they make good decisions during the current recession and during the recovery that will follow it? I have four suggestions:

1. Scorecard. Organizations need to establish a balanced human capital management scorecard. Exactly what the metrics are that need to be in the scorecard will vary from organization to organization. At the very least, however it should report on the condition of the human capital of the organization and how it is managed. This means that it should include data on turnover and recruiting success as well as attitude and culture data. Particularly critical is succession data for management positions and key technical positions. Not all of these measures need to be discussed at every board meeting, but many of the items on the balanced scorecard should be considered at each board meeting. It is particularly important that scorecard data be reviewed in times of change so that the impact of new policies and practices can be determined.

2. Board Knowledge. As part of the required development experience for board members, they should be educated in human capital management. There is an enormous amount of research evidence about what constitutes good human capital management and what practices are effective and ineffective. Most board members are not familiar with this content, and they need to be exposed to it so that they can interpret the HR scorecard data they receive and evaluate the HR practices and policies of their company.

3. Board Membership. All boards should have at least one member who has in-depth expertise in human capital management. There is no shortage of individuals who have this expertise. There are a number of outstanding HR VPs who can bring this expertise to boards and, of course, there are numerous consultants and academics who are available and have this expertise.

4. Create a Committee. The complexity and importance of the human capital issues that companies face today warrant boards creating a human

A board member with an HR background concurs

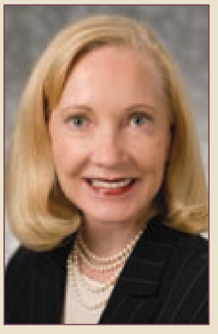
By Jacqueline P. Kane

Consistent with his other work, Prof. Lawler has produced a thoughtful piece that should be given significant consideration by boards (and their nominating committees, in particular) in reviewing the competencies possessed by the members. While the Heidrick & Struggles/USC data pertained to corporations and, therefore, Dr. Lawler's article was limited to companies, in my experience human capital issues are important for the governance bodies of all types of enterprises to address.

A seismic shift has taken place in the public's perception of the accountability of boards for the actions of their enterprises. This requires significantly more scrutiny than under the historical model where the board's focus was basically on strategic issues and review of results.

Due to the impossibility of competently reviewing all key functions of a company, the board instead must learn to judge the capabilities of the leaders in those areas. Having a background in human capital management may be advantageous as a result. Additionally, external scrutiny, if not outrage, can occur when the public perceives a particular benefit or compensation award as exorbitant. Having a director who has sufficient knowledge to ask the right questions before a plan is put into place can save significant embarrassment later and allows the board to support the final actions of management.

Ultimately, it is the confidence and belief shareholders have in the company's ability to deliver that drives value. Increasingly, directors will need to be able to measure the tangible and intangible — many of which are human capital — drivers of that value.



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capital committee. This was true before the recession, but now that the recession is requiring that companies make tough decisions that affect employees, it is even more important that they have a committee. This committee should not micromanage the HR side of the organization, but it should monitor the condition of the organization's human capital and influence the human capital management practices of the company. As with any corporate board committee, it needs to determine what issues go to the board and what data are needed to monitor the activities of the company. It should call attention to potential liabilities and weak points in the company's management processes and reactions to business issues.

In the absence of a human capital committee it is hard to get the kind of attention from senior management that human capital warrants, but perhaps most importantly it is hard to get the board's attention. There simply is not enough time in most board meetings to have the kind of in-depth discussion and analysis that is needed to do an adequate job of monitoring an organization's human capital in today's challenging economic environment, thus it is particularly important to have a human capital committee at this time.

Potential competitive advantage

In order for boards to be effective in dealing with human capital issues, major changes are needed in most boards. They need to greatly increase the information they have, the knowledge they have, and the focus they have on human capital. This is not an easy change, since many board members don't have a history of focusing on human capital management and may not be particularly receptive to looking more closely at this area. It is also a tough time to get the attention of boards because the economy has put so many companies in a financial crisis.

Nevertheless, it is critical that during the recession, boards improve their oversight and performance when it comes to human capital issues. It is not only a matter of avoiding legal liabilities and damage to an organization's ability to hire and retain human capital; it is also a matter of creating a potential competitive advantage by being a better organizer and manager of human capital than other companies during the recession. In addition, the recession has created an opportunity for firms to gain a long-term competitive advantage by improving their human capital. They can come out of the recession leaner, with a higher level of talent and a better employer brand if they make the right moves in dealing with it. But, this is unlikely to happen if the board is not supportive and knowledgeable with respect to human capital management. ■

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Boards need to know the ROI

By Frank DiBernardino

As Ed Lawler argues, the time has come for boards to form human capital committees (with a charge far broader than that of compensation committees). Investment in human capital — people and programs — is usually an organization's largest investment in driving business performance, yet the return on that investment has been left virtually unstudied. Given the stakes involved and what we have seen in how the economic crisis is affecting human capital, the status quo of not attending to that investment in a comprehensive manner is unacceptable.

The survey conducted by Heidrick & Struggles/Center for Effective Organizations cited by Lawler highlights missed opportunities to leverage people investments to drive revenue, profits, and shareholder value. These missed opportunities are due, in part, to the board not having a comprehensive strategy for the human capital investment or the metrics to measure the effectiveness of the investment.

What is a human capital strategy, and can its financial performance be measured? A comprehensive human capital strategy is aligned to advance the business strategy and consists of four dimensions: Talent, Rewards, Culture, and HR Services. *Talent* relates to organizational structure, staffing plan, professional development, succession planning, and performance management. *Rewards* include all compensation and benefits programs. *Culture* involves the oversight of corporate values, behaviors and employee engagement. And the *HR Services* dimension defines the services provided by HR and how they are delivered, internally or externally.

A new generation of metrics now offers boards the ability to isolate and measure the ROI of the human capital investment. By tracking key performance indicators such as human capital ROI, productivity, and liquidity across business units and over time, a human capital committee can pinpoint the major drivers of business performance and modify its human capital strategy to maximize returns on the investment.

So, yes … the evidence is in, and the time has arrived for boards to form human capital committees to monitor and assess the full scope of the people strategy, measure its financial performance, and provide guidance accordingly.

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