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Boards of Directors: HR's Most Challenging Frontier

ABSTRACT
Leading thinkers envision a dramatic expansion of HR's influence. But for that to happen, HR visionaries must close the gap between their aspirations and the more traditional perspectives of the boards of directors who are the ultimate organizational gatekeepers.

The magnitude of change predicted by management visionaries will have limited impact unless organizational leaders can successfully engage directors in a similar rethinking of the strategic importance of talent, culture, and workforce management. New approaches to the human capital function will necessitate new relationships with key constituents, including boards of directors.

There are enormous challenges to making this shift; nevertheless, the opportunities are real and consequential. One way to think about it is to compare HR with the dramatically evolving role of technology within corporate governance in recent decades.

For years, IT was viewed as a highly technical, back office, purely operational function. Technology rose to the level of board discussion only when time came for approval of major capital expenditures. Fast forward to the recent years.

As boards struggle to get a handle on cyber risk, the strategic use of technology and big data, and the paramount role of technology in successfully implementing strategic acquisitions and leveraging the potential synergies of mergers, more CIOs than ever—over half, according to Korn Ferry International—now report directly to the CEO. ("CIO Journal," *Wall Street Journal*, July 11, 2016.)

Recent surveys by *Agenda*, a Financial Times publication, report that experience in cyber risk, new technology and big data are at the top of the skill sets that boards are looking for in new directors ("Cyber Expertise Tops Most Wanted List," *Agenda*, May 16, 2016.)

Now consider HR. Despite all the changes in the workforce and in our organizations, HR is still generally held in the same low esteem in most board rooms. Our own survey of directors, conducted by Nadler Advisory Services in collaboration with the National Association of Corporate Directors, found that only 31 percent of directors said their CHRO had either a "great deal" or a "good deal" of influence over the board's decisions. CHROs were rated good or great by more than half the directors only in areas involving executive compensation and talent management, and received high marks from only a disappointing 12 percent in the critical area of "risk management." ("The HR Opportunity in the Boardroom," *People + Strategy*, Spring, 2015).

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Other research is just as telling. Work by Ed Lawler and his colleagues at USC has shown that 80 percent of U.S. boards lack a single member with any professional HR experience of any kind, and only 19 percent of CHROs at large U.S. companies attend their company's board meeting on a regular basis, compared with more than 90 percent of chief finance officers. The recent *Agenda* surveys asking directors to rank the most important experience they're seeking in new board members, HR experience doesn't even make the top 10, rating lower than marketing, regulatory and supply chain experience. (*Agenda*, May 16, 2016)

The bottom line is that it's crucial for HR professionals—as well as board members and CEOs—to acknowledge the large and growing gap between the aspirations of HR visionaries and the more traditional mindset of the boards who are essential to enabling so many ideas become reality. The responsibility for creating at least a semblance of alignment—for getting all the key players somewhere even close to the same page—lies with all three groups.

But the starting point is clear; another finding in the Nadler Advisory survey was that fewer than a third of the directors gave their CHRO high marks for keeping the board informed about innovations in HR. Helping boards understand where HR is headed simply must become a higher priority on the longer transformation journey.

Let's begin by understanding the changes which slowly have already taken place in terms of HR's relationship with the board, as well as where this relationship ought to be headed—and what will be required for the real change to happen.

THE THREE HORIZONS

To map out the strategy for CHRO's evolving role with the board, we introduce one of the most enduring strategic planning models, the Three Horizons Framework (*The Alchemy of Growth*, 1999.) The three horizons approach provides a structure to invest in potential opportunities for growth without neglecting performance in the present.

Here is how we see it applied to HR.

Horizon One

Horizon One is where HR gets on the board's radar. In the recent past, the boards have been focused almost exclusively on issues related to CEO pay and executive compensation. HR executives acted as staff support to the board in those efforts often working behind the scenes as sources of information for the Compensation and Audit Committees. In strongly unionized companies a committee or the full board regularly reviewed union activities and oversaw contract negotiations working closely with labor relations executives. This remains to be where the majority of companies are at this historical point.

Horizon Two

Horizon Two is where HR is getting its current foothold with the increased focus on the company's talent agenda. We see a growing number of boards beginning to broaden their thinking and include talent not only as a critical factor in executing the corporate strategy, but also as an asset, an investment and a potential risk to the company. These forward looking boards expect regular reports on the state of executive talent management in their organizations.

The list of these new critical focus areas starts at the top with board's direct involvement with the succession management for the executive team and the C-suite roles including CHROs. As constant executive turnover becomes the norm, both long-term and emergency succession plans are expected to be in place, regularly updated, and constantly in progress.

Another set of human capital questions at the board level are those of strategic business readiness in the time of discontinuity. To successfully implement the company's strategy over the next two to four years, the board might probe the gap between the current management talent they have and the talent they need, and about the plan for filling those gaps through development, reassignment and recruitment.

People analytics are beginning to influence how the boards approach organization's talent issues. Take employee engagement. Forward looking boards could request a report on the results of the engagement survey and follow up actions. Information on the recruitment, separations and retention numbers could be additionally requested by the board.

Compliance and risk are now more than ever central to the company's operations. HR is called upon to partner with the general counsel and chief risk officer on ethics and compliance training and compliance and risk-related employee issues.

Horizon Three

Horizon Three is dedicated to the emerging and aspirational issues that are not yet on the majority of boards' agendas. These issues have become a concern for the visionaries in HR and require the boards' attention and commitment. This horizon is about the broadening importance of the "human side of business" and, with it, the growing strategic mandate for HR.

To review those critical issues, we start with workforce management, which is changing rapidly with the "gig economy"—automation and the Internet of things replacing full time labor with contractors and machines. Companies need to decide where and how to invest and if workforce retraining can solve the social risks associated with skills obsolescence. Boards need to understand the full implications of these changes and be prepared to effectively address the changing skills requirements in the new labor markets.

Diversity and globalization continue to grow in strategic importance. Diversity officers in some companies are now reporting directly to the CEO, elevating the agenda to the board's level. Boards themselves are being challenged for the homogeneity of their directors. Political pressures add to the urgency for companies to demonstrate that their boards look more like their shareholders. To be credible to all stakeholders, boards increasingly are expected to include women, minorities, and global executives.

Sustainability and climate change issues are still faint blips on the radar of most boards. It remains to be a steep climb for companies to establish the robust governance of sustainability issues at the board level. Board oversight must address the critical environmental and social impact that will be facing companies in the near future. Several factors related to sustainability for the boards' agenda include trend assessment, strategy and performance, risk management, stakeholder engagement, sustainability reporting, incident management, and environmental and social impact assessment of business decisions. While most boards review and monitor cor-

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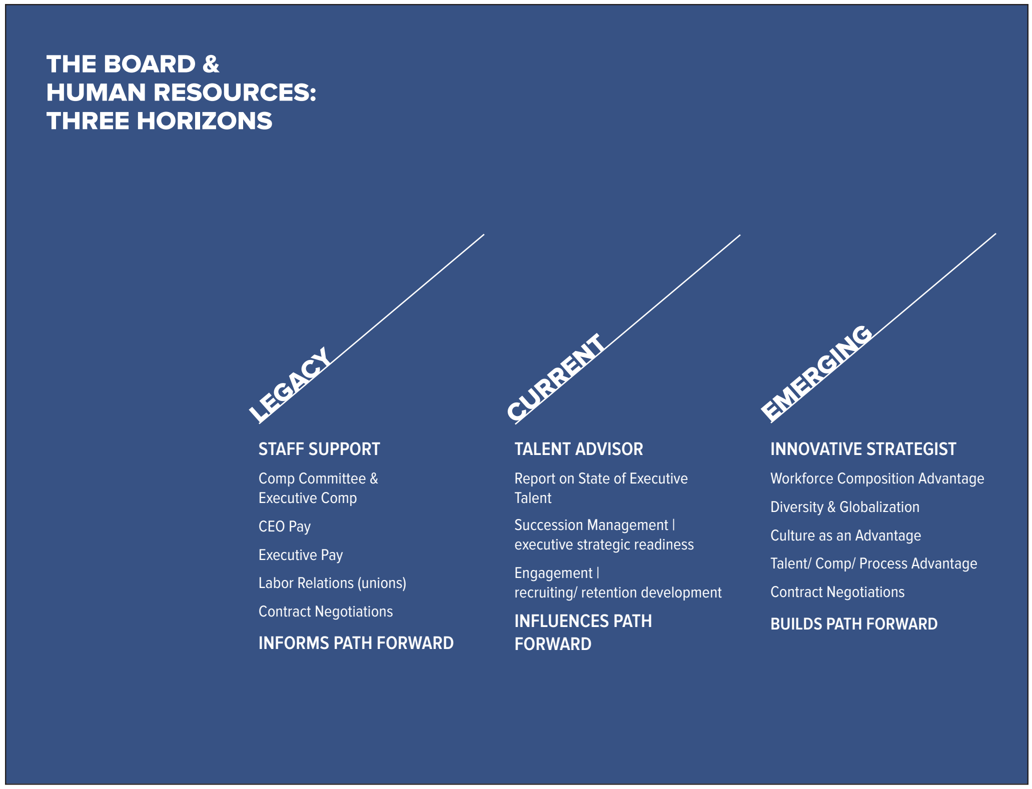
THE BOARD & HUMAN RESOURCES: THREE HORIZONS



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porate policies, less than half provide oversight in any of the other categories that are equally as vital to identifying business value and addressing risks.

Corporate culture is becoming a major area of concern among boards and audit committees. Of particular importance is the role culture plays in corporate strategy and performance. If a company wants to take a new strategic direction, then it will often have to change the culture as part of that effort. The risks of neglecting the culture are obvious; it is often reported that as many as 90 percent of mergers and acquisitions fail because of cultural incompatibility.

Regulatory oversight is what most boards have been traditionally concerned with especially in financial services but the debate about the board's actual involvement in regulating and overseeing the culture is still unresolved. Is the line between management's responsibility for culture versus the board's? In the United Kingdom, for example, the boards moved beyond the debate and implemented culture assessment as a part of the overall company audit. Clearly, HR should be at the table reporting on the results of the culture audit and recommending actions to the important culture alignment.

Reputation management should not escape the board's agenda in the current environment where social media sets the tone and employees have a significant say. To be sure, the primary responsibility for safeguarding a company's reputation lies with management. They know the environment and have the resources to address the issues. But the board plays a crucial role in managing reputational risk. Through its oversight of the company at large, boards must ensure that they work with management to explore both obvious and new or non-traditional potential sources of risk.

Values refresh from the new strategic perspective aims to align the Board directors with the evolving mission and values of the company. It is an important exercise whenever evaluations include open-ended questions designed to initiate board dialogue on the mission and values. The process is an effective meter of the board sentiment. Are these important facets of culture still relevant? Do they resonate with directors? Are they guiding decision making and strategy?

The challenge with the emerging issues is that without explicit senior executive level involvement and Board's sponsorship and investment these Horizon Three issues easily get deprioritized due to the immediate operational pressures of the moment.

When it comes to human capital issues, boards need to be better informed and better equipped to move the agenda forward. To be informing the board on the right issues, provide data and expertise and become part of the longer term solution is the primary role of HR.

SOLUTIONS

Boards should be asking their CHROs for regular updates—including data supported reports and analysis, forward-looking indicators of future challenges—regarding the comprehensive talent strategy, specifically including questions on workforce composition, diversity, and potential talent gaps. Boards need to enlist management's help in thinking holistically about the relationship between strategy, risk, talent and culture.

If the board's job is to oversee and support management's efforts to create long-term value, then it's essential for the board to become fully conversant with the emerging thinking about the effectiveness of organizations and the vitality of their talent pools.

QUESTIONS THE BOARD SHOULD ASK THEIR ORGANIZATIONS

- Is there sufficient investment in top human capital priorities to drive the culture offering optimum readiness and ability to achieve strategic objectives of the enterprise? (targeted investment in human capital aligned to business objectives)
- Are the leadership, workforce and infrastructure positioned to achieve strategic objectives challenges of the business? Is there a clearly articulated appreciation of the level of readiness required and realistic plan for success in execution? (Is there organizational capability to achieve strategic business objectives?)
- Is innovation in human capital investment offering competitive advantage to the organization? What are the human capital strategic priorities and are we excelling in these areas of focus? (Is there focus on the future needs and excelling beyond best practice to best in class where optimal for market leadership?)
- What will enable the board to better evaluate human capital readiness? (Does the board have information and capability needed to access key human capital needs? What must the organization provide to the board to achieve these goals?)
- What does this risk mean to us, what are you going to do about it, and what happens if things go wrong anyway?

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QUESTIONS BOARDS SHOULD ASK THEMSELVES

In addition to the questions the board should be asking of HR, there are also questions the board should be asking of itself regarding its approach to HR as a key component of both risk management and strategic value creation.

- Does the board's composition reflect the necessary diversity of business experience, functional skills (e.g., HR, enterprise risk, reputation management) and cultural background that are essential to understanding the importance of talent and culture? The good news is that a growing number of boards see the importance of having directors with global business experience, an attribute that is among the most highly sought in new directors. But so far, there is little evidence of similar interest in directors with specific HR experience—either as an executive, academic or consultant.
- Does the board's structure—specifically, committee responsibilities for matters related to risk and strategy—contribute to meaningful consideration of HR-related issues at the level at which most board work gets done? The traditional board structure for handling risk remains the most common—the Audit Committee is in charge. That made sense when boards were mainly concerned with financial, legal or hazard risk. Now, most directors believe that risk, like strategy, should be the responsibility of the entire board—but board committee structures have failed to keep up with expanding definitions of risk.
- Do the board's work processes, including annual schedule of regular and special meetings, effectively integrate HR into the board's ongoing consideration of strategy and risk? At many—if not most—boards, the CHRO shows up periodically for specific presentations regarding executive compensation, the talent pipeline, and a report on the annual engagement survey. All too often, the CHRO is either absent or an afterthought as the board proceeds through the annual cycle of special meetings and offsites dealing with strategy and enterprise risk.
- Does the board's own culture reflect and model the culture and values it espouses for the organization as a whole? If, for example, the values include transparency, innovation, diversity, accountability, collaboration, or whatever they might be—does the board take explicit steps to operate according to those same values? One of the most obvious disconnects involves personal accountability. Some form of formalized performance assessment is routine at most companies these days—except in the boardroom, where meaningful director evaluations with consequences for renomination to the board remain scarce.

LOOKING AHEAD

We advocate that applying a people lens to strategic business issues at the board level not only has to be done better, it also has to become second nature. When boards take on Horizon Two and Three issues, it fundamentally changes the role of the CHRO and raises the bar on the performance of the HR organization.

In Horizon Two and Three organizations, CHROs are adding value to the board and not only to the executive team. A few top CHROs are now bridging relationships between the board and executives and helping define the company's strategic agenda. Companies where HR sits on the sidelines, are running multiple human capital and organizational risks and potentially weakening the company's ability to compete in the future.

To migrate the majority of the boards to the new way of thinking about the business' profitability and success will take a significant change effort. The immediacy of concerns around horizon-one businesses can easily overwhelm other efforts, including human capital critically important to the future of a company The boards and the executives can use the three horizons model as a blueprint for balancing attention to and investments in both current performance and opportunities for growth. It will take commitment and oversight from the board and from the CEO to successfully make that leap and become a human capital focused organization.

About the Authors

Mark B. Nadler is principal and co-founder of Nadler Advisory Services, where he consults to boards of directors and CEOs on governance, leadership, executive succession, and senior team effectiveness. He has consulted to the leaders of more than 50 companies across a broad range of industries, ranging from Fortune 500 corporations to family-owned firms and private equity portfolio companies. He was a partner at of Heidrick & Struggles International, specializing in board effectiveness and CEO succession. Prior to that, he was a partner for 16 years at Delta Consulting Group (later known as Mercer Delta and Oliver Wyman Delta.) Mark's work at Delta covered a wide range of areas related to organizational change and effective leadership, and included founding and leading the firm's global Strategic Communication practice. Prior to consulting, Mark worked as a distinguished journalist and senior newspaper executive. He can be reached at mnadler@nadleradvisory.com.

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Anna has had an extensive global career in business, academia, and consulting. She has served as head of Motorola's EMEA OD function, global head of talent management for Nokia, chief learning officer with UTC, and global head of talent and organizational development for AIG Investments.

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