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MANY LEADERS delved into human capital management (HCM) when the economy was booming, just before the Great Resignation. Boards and compensation committees worked to understand talent issues and make their companies more attractive, inclusive, and engaging. Now that the labor market is shifting, HCM has become even more critical as companies navigate new market-related challenges. The issues are not abating, just evolving, as stakeholders press for more attention on employees. While many companies worked diligently on the symptoms, they may have missed some underlying nuances driving core HCM issues. Compensation committees now have an opportunity, if not an imperative, to step up oversight and partner with management on these complex talent issues.

Compensation committees partnering with management is important for companies that are still settling on an HCM strategy. In the technology industry, for example, many companies are shifting from a "growth at all costs" mind-set to a focus on profitability. They hired aggressively in 2020 and 2021 to ensure they had the resources to pursue new product development and customer groups. It seemed the COVID-19 pandemic had permanently accelerated demand for their products, so they paid heavily to recruit and retain people at all levels of the organization.

When demand receded in 2022, investors raised concerns about profitability, and stock prices fell. Tech companies lost an important part of their employee value proposition and a retention hook. Many also found themselves with bloated organizations and carried out layoffs as well as restructuring efforts. They now require thoughtful consideration to develop an HCM approach so that they have the people to thrive during the transition ahead.

The opposite dynamic happened in the medical devices industry, where some companies dried up as hospitals stopped elective surgeries during the pandemic. As restrictions lifted, surgeries came back slowly, but now business is booming as hospitals address pent-up demand on the way to normalcy. These companies must expand their workforces to ensure products are available and doctors have support—without over-hiring.

Almost all companies find themselves in a new world of post-pandemic work. HCM strategies must address the balance of office-based work and people working from home. How can companies maintain engagement and collaborative cultures with a dispersed workforce that is increasingly concerned about work-life balance?

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The Compensation Committee's Evolving Role in Human Capital Management

What Directors Can Do

Boards, and especially compensation committees, represent investors in overseeing management on issues relevant to overall performance. In the past, boards focused on executives, but the rising importance of nonmanagerial talent has broadened directors' responsibilities regarding HCM generally.

In a review of fiscal year 2022 proxies, we found that half of Fortune 100 company boards and 40 percent of S&P 500 boards have altered the title of their compensation committees to include HCM topics (e.g., compensation and leadership and management development). Even more have broadened their charters to include HCM issues (see Figure 1). Many of them now explicitly oversee broad-based pay and total rewards programs. As with most governance trends, large companies are likely to be first movers here.

Expanding the compensation committee's charter to include HCM is not a stretch. Executive hiring, promotions, and terminations, with associated changes to compensation, give the committee a way to promote diversity, build inclusive cultures, encourage engagement, and foster collaboration and creativity. As executives plan for promotions, compensation committees can encourage them to reward high-potential managers—especially those that foster HCM in their own teams—with faster pay trajectories and appropriate retention bonuses. They can oversee changes to organizational structures that expand career opportunities while following strategic priorities. Executive compensation and benefits packages should complement the broader strategy, with learning and development rounding out a robust employee value proposition. HCM involves treating employees as scarce assets worthy of investment for strategic returns to the company.

Boards and committees can work with chief human resources officers to raise their game in HCM. Whether dealing with layoffs in the technology industry, a surge of growth in the medical devices industry, or simply determining talent priorities and practices post-pandemic, HCM is now front and center for compensation committees. In this guide, we sketch out key areas where directors can make discussions with management more substantive. Following an extensive internal diagnostic, companies can focus on key HCM areas including, but not limited to, performance management; succession planning; diversity, equity, and inclusion (DE&I); and culture.

Sample Expanded Committee Charter Language

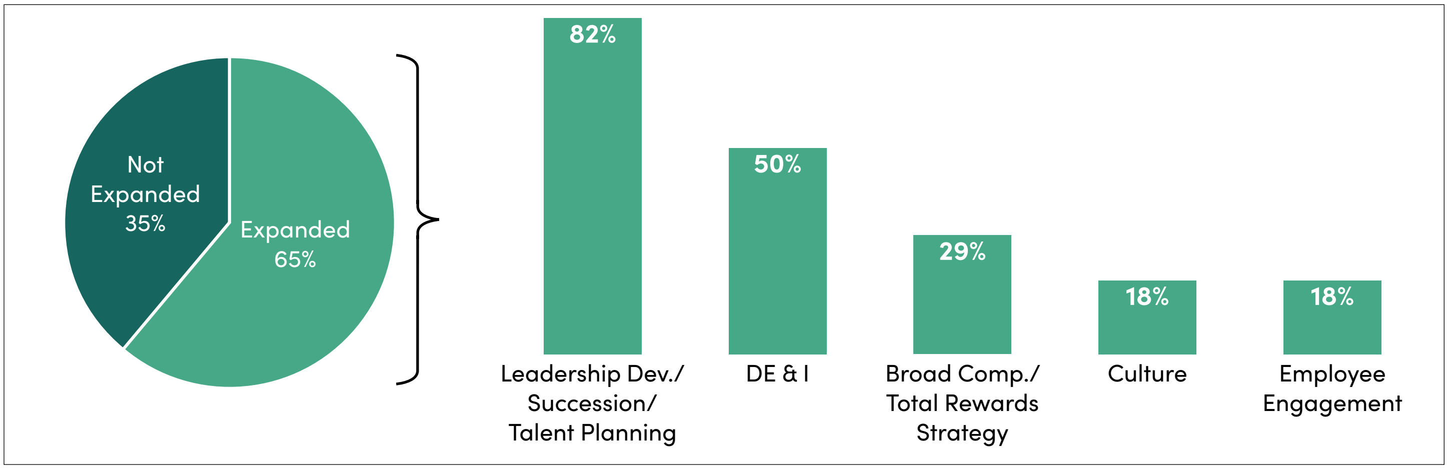
"The committee oversees and monitors the company's strategies and policies related to human capital management within the company's workforce, including with respect to policies on diversity and inclusion, workplace environment and safety, and corporate culture."

—Amazon.com leadership development and compensation committee

"The board shall review management succession plans annually. This shall include review by the board of organization strength and management development and succession plans for each member of the company's executive team."

—The Hershey Co. compensation and human capital committee

Figure 1: S&P 500 Compensation Committee Charter Responsibilities



A Road Map to Elevating HCM

As HCM gains momentum, committees can lead robust discussions with executives on current and future talent priorities. Unlike those for executive compensation, HCM discussions require fewer approvals. Instead, directors can work with management as thought partners while fulfilling their fiduciary responsibility for oversight of a key business risk.

This work involves multiple steps:

1. Clarify the HCM connection.

Directors need to understand how HCM practices support the strategy. That clarity should in turn determine the critical facets of HCM that management must tackle. Talent planning and culture will likely take priority for companies undergoing a strategic change. Automobile original equipment manufacturers, for example, need people with different skill sets as they transition to electric vehicles. Their cultures must evolve to build for the future while acknowledging current practices. To support these moves, committees must elevate performance management and leadership development among executives. In contrast, consumer products companies expanding to local markets across the world need to build an understanding of their broadened customer base. Their talent planning must involve developing a pipeline of diverse leaders.

2. Understand the current state.

Take an inventory of current publicly disclosed measures and internally communicated HCM goals, as applicable. Robust discussions require reliable data on what's happening now. Many companies still have rudimentary or fragmented ways of collecting data on the broad organization; committees should work with human resources to boost this data collection. Even companies that have focused on HCM for years may discover gaps in the collected data.

Directors are not responsible for carrying out the data-gathering process; however, they can ask challenging questions to ensure the data are meaningful and tied to company priorities. They can make sure the objectives support a serious exploration, rather than decisions already made.

Meanwhile, directors should assess what information they need at the committee or board level to carry out effective oversight. How will they gain the familiarity or background expertise to provide that oversight? What information should human resources (HR) provide, and how often? Along with the data, the committee can ask how well these goals align with the current strategy, messaging, and external comparisons—including the employer brand. If unaligned, how should the company adjust its efforts?

3. Define success.

Working with management, directors should decide what metrics matter the most for strategic alignment, rather than simply taking what's already tracked. A separate, perhaps sensitive, matter is deciding whether management has the proper talent in place to drive progress.

Once the overall goals and metrics are in place, HR can draw on HCM best practices and lay out realistic near-, mid-, and long-term milestones. What are the company's strengths and weaknesses, and how well do the strengths align with the critical milestones? If alignment is poor, is HR moving aggressively enough to drive results?

It may be helpful to compare these efforts with those of peers or close competitors. HCM policies should match the company's efforts to attract and retain the talent needed to thrive. More broadly, HR should assess the external influences on HCM, from investors to local communities to regulators to news media. What are their expectations? Directors also need to determine whether to bring in relevant executives, such as the chief diversity officer or business unit heads, to provide context for the data. Directors should use this as an opportunity to demonstrate that accountability and progress are priorities.

Many companies are developing HCM dashboards to share regularly with the compensation committee. The dashboards reinforce priorities and focus management and directors on the crucial progress over time.

4. Determine responsibilities.

The next step for the board, in consultation with management, is to determine responsibilities for overseeing HCM. What are the compensation committee's decision rights vis-à-vis the executives'?

Committees set their responsibilities across a spectrum, from simply monitoring progress to directly approving the key elements of HCM (see Figure 2). There's no right answer to what level of engagement committees should have on particular topics, but it's essential that they clarify their involvement in advance and prepare to follow through. For example, a compensation committee might ask for periodic updates to monitor pay equity while others might want to directly oversee management's actions for pay equity improvement. When considering adding environmental, social, and governance (ESG) metrics to executive incentives, management may recommend a design, and the committee would have approval rights.

Multiple committees can share an HCM challenge; boards should determine whether some facets of HCM belong to committees other than the compensation committee. Some boards assign all compliance matters to the audit committee, including leadership

Figure 2: The Compensation Committee's Responsibilities for Oversight of HCM

(Illustrative Sample of Topics)
ESG and HCM Oversight Responsibility by Governing Group

	Carbon Footprint/ Renewable Energy	Community Engagement/ Charitable Contributions	Product Quality/ Customer Satisfaction	Ethics/ Compliance	Diversity and Inclusion	Company Culture	CSR/ESG in Incentives	Compensation /Pay Equity	Succession/ Talent Planning/ Leadershp Development
Board of Directors	Monitor	Monitor	Monitor		Review & Discuss	Review & Discuss			Review & Discuss
Compensation Committee						Monitor	Oversight (ESG in Incentives	Oversight	Oversight
Nominating & Governance Committee	Oversight	Monitor	Oversight				Review & Discuss CSR		
Audit Committee				Oversight					

violations of codes of conduct such as sexual harassment and discrimination. The nominating and governance committee will sometimes oversee all DE&I efforts, not just board diversity.

Many boards have elected to set up a sustainability committee, which may share DE&I and ESG oversight with the compensation and audit committees. What matters is the upfront clarity on decision rights. Clear alignment brings greater transparency, along with better communication and oversight. The board's responsibilities can grow over time, adding value as directors gain experience and connections in this area.

5. Update the calendar and expand the charter.

To reinforce the importance of HCM, committee agendas should carve out time for relevant discussions. Each compensation committee meeting could start with an update from the CEO (or the chief human resources officer) on the state of talent, perhaps walking through highlights from the dashboard.

As the committee adds HCM responsibilities, directors will likely have valid concerns about lengthening the meetings. In most cases, committees will need to extend their meetings by 30 minutes to an hour to provide sufficient time for discussion. Committee chairs can also evaluate their standard agendas and use approaches such as consent approvals to review more transactional items on an as-read basis, allowing for questions and clarifications but combining this with approvals, thereby minimizing time spent.

Management and committee chairs often find it helpful to have an annual discussion that provides a high-level overview of HCM and then dive deeper into identified HCM focus areas at subsequent meetings. For deep dives to be meaningful, it is important to ensure that the discussion does not compete with denser agenda items, such as annual approval of executive pay decisions.

Committees new to HCM may prefer a "crawl, walk, run" orientation. Early discussions would involve report-outs and establishing the baseline (crawl). Then, committees would move on to having HR teams update the progress of initiatives underway (walk). Once they grasp the fundamentals, directors could hear from business unit leaders about how they are developing diverse organizations and inclusive cultures (run). At that point, the committee would be ready to ask challenging questions to drive HCM forward.

As for the charter, compensation committees can add HCM discussions to their agendas without added authority, but as seen in the expanded charters above, boards are preferring to be explicit about accountability. Charters are also beginning to incorporate purpose statements with the addition of HCM oversight, as well as specific responsibilities as mentioned in Figure 1.

6. Share oversight and metrics with investors.

Investors are increasingly interested in what boards are doing to oversee and support HCM initiatives. Most companies already provide an overview of their HCM practices, objectives, and priorities that are material to understanding the company's business in the 10-K, but some also describe HCM goals in their sustainability reports, on their websites, or in their proxy statements.

Boards can start with the 10-K requirements and then consider expanding based on industry norms and shareholder questions in outreach discussions. It's important to understand the risks of disclosure, especially the pressure to reduce disclosure when progress isn't made. Are directors comfortable disclosing when the numbers

Figure 3: Committee Agenda with HCM

	Q1 Committee Meeting	Q2 Committee Meeting	Q3 Committee Meeting	Q4 Committee Meeting
Ongoing Compensation Committee items	• Approve go-forward executive target pay • Approve prior year AIP funding and PSU payout • Approve go-forward AIP and LTI plan design and goal setting	• Review CD&A/proxy materials • Review consultant independence	• Peer group review • Compensation planning: current year review, next year preview • Trends in executive pay	• Executive compensation benchmarking review • Annual compensation risk assessment • Compensation philosophy/ strategy update • Dilution and burn rate • Assess CEO and Compensation Committee performance • Assess charter
Human Capital Management Topics				
Crawl (Introductory)		• Additional human capital management topics (*DEI Evaluation current stats and future plans)*		• Discuss engagement survey results and plan to address issues
Walk (Introductory)	**Dashbord on DEI by Business Unit shared at each meeting, including DEI, engagement, and other key HCM topics**			
		• Leadership development overview		• Review progress on issues through spot survey results • Pay equity update
Run (Proficient)		• Business Unit Leaders speak about their talent	• Succession planning below C-suite • Discuss plans for Top 100 Talent	• Leaders attend meetings to share plans and progress against plans

aren't to the company's advantage?

Key HCM Areas

Committees and boards also need to consider the following four key HCM areas: performance management, succession planning, DE&I, and culture.

Performance Management

This is where the company translates corporate objectives into employee goals, monitors individual progress, gives feedback, evaluates results, and adjusts compensation accordingly. Performance management sets expectations between managers and employees so everyone works toward the same goals and understands how their contributions align with the strategic priorities. It doesn't just motivate actions and decisions; it also differentiates high-performers. As companies make strategic decisions about staffing and need to differentiate rewards to manage costs, strong performance management enables the appropriate decision-making.

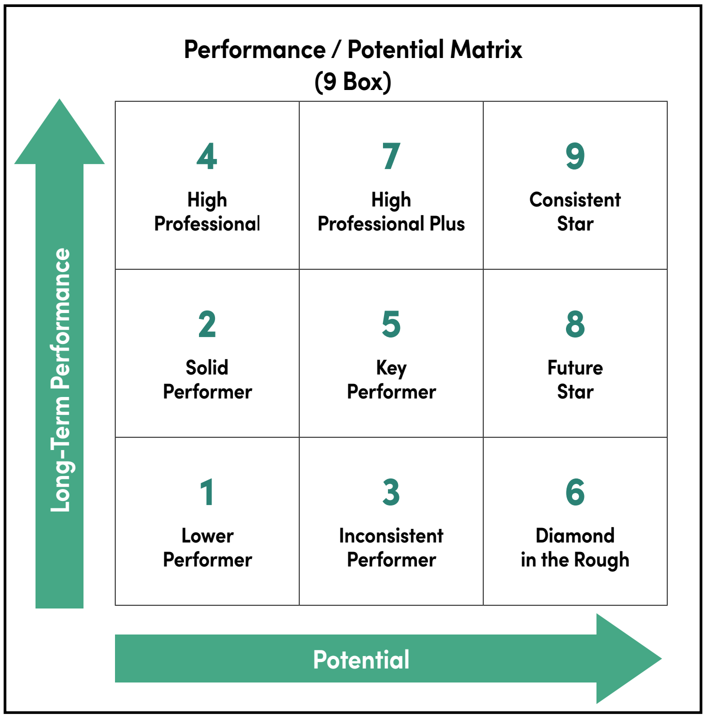
Compensation committees have direct influence only over executives—but this work sends a message about HCM generally. Diligence here not only reinforces accountability, but also conveys the seriousness with which directors take HCM and models what managers should be doing regularly with all employees.

The committee starts by reviewing and adjusting the CEO's goals. The purpose here is to ensure alignment with corporate objectives and agree on priorities, including areas of special interest to investors, such as investor day commitments. Once those goals are in place, the committee can discuss how the CEO might translate them into goals for the leadership team. From there, the committee should review progress against goals at mid-year, and in some cases quarterly, to give time for providing feedback and to consider any adjustments or additions.

On top of the usual concerns about executive oversight, committees need to see the performance management process influence HCM broadly. For example, at a hospital management company, the compensation committee wanted to understand how quality goals cascaded throughout the organization, including to the managers of facilities. Directors also sought end-of-year analyses that showed goal attainment variation at different levels of the organization, in different organizational units, and across gender and ethnic diversity. Where the distribution is skewed or inconsistent, directors can discuss with management how to strengthen the underlying processes.

Finally, boards can ask management teams to analyze performance management outcomes for high-potentials versus others, particularly whether pay outcomes are differentiated for those individuals over time. HR may need to adjust pay guidelines to make this differentiation visible without alienating the broader organization.

Figure 4: Nine Box Matrix for Assessing High-Potential Employees



Succession Planning

Performance management feeds directly into succession planning, as it spotlights strong performers with high potential who might be considered in the future for promotions. Boards already "own" the planning for CEO succession, but they can expand this effort to clarify overall strategic priorities (tied to the actual CEO in place), assess succession planning for the rest of the C-suite, and thereby influence HCM throughout the organization. Directors are increasingly assessing whether the company has a strong bench for growth and expansion, including strategic pivots. They can also identify emergency successors and emergency succession protocols for key roles.

Boards need a robust process with clear oversight of transition timelines across the executive team. Directors must regularly review the slate of internal candidates to understand the strength of upcoming talent and at the right times test the waters on external talent. Sometimes this work starts in the compensation committee, which acts as a working group before sharing the conclusions with the full board. Other times, the board oversees CEO succession and succession for other C-suite executives, with the compensation committee focusing on future high-potential talent.

In carrying out their responsibilities here, directors can influence HCM by asking the following:

1. **What's needed now?** Extending the work in performance management, directors can identify skills that the likely strategy direction will require in future leaders. They can also review pending hires, promotions, and departures, and validate retirement horizons.
2. **What's the bench?** Aside from looking at a slate of candidates, committees can go a level down and ensure that management supports, retains, and develops future high-potential candidates. The most common tool here is the nine-box matrix, which assesses an employee on current performance and future potential. The matrix catalyzes conversations with executives on the organization's talent prospects, while improving the consistency of talent criteria and expectations (see Figure 4).
3. **How are we reassuring the losers?** Promotions always risk disenfranchising those not selected. Committees must not saddle a new leader with out-of-sync or disengaged colleagues, but some talented people are worth retaining somewhere.

Diversity, Equity, and Inclusion

Research continues to show a payoff from DE&I at most companies. These efforts benefit companies directly by expanding both the outside pool and the internal pipeline for talent, with better recruitment and retention. While DE&I has gained momentum since 2020, many companies are still early in their journeys. Committees can help keep those journeys on track with diligent oversight, best carried out by asking challenging questions:

1. **Where does DE&I matter most for the company?** As with other efforts, directors need to define what DE&I means for their company and identify goals. These goals can come not just from the strategy and the needs of current employees, but also from outside stakeholders including investors, customers, and the wider society. Committees can take an inventory of these goals and brainstorm new goals with management. For any goal, boards must make sure the organization has a clear baseline or current state against which to measure progress. But with finite resources, companies should concentrate on the areas that matter most.
2. **How well are we doing so far?** Here, directors can learn about the data that is currently tracked and available, review other common DE&I metrics, and determine whether management should be tracking anything else. Management can also make the committee aware of ongoing initiatives such as employee resource groups, expanding sources of talent (e.g., to historically Black colleges and universities), and unconscious bias trainings. At some companies, investors are asking boards to consider external civil rights or racial equity audits in order to take a deep dive into the current state and potential areas of improvement.
3. **What's our progress over time?** Directors can rely on HR data

to monitor changes, but they should also take the time to understand the reasons for progress, stasis, or decline. As with the other areas, a dashboard of statistics against goals can help directors regularly engage with management on trends and discuss improvements. These statistics could focus on the following:

- Representation of new hires, those who are promoted, and those who are terminated
- Diverse candidate slates for roles across the company
- Representation by organizational unit, function, and employee level
- Participation in key initiatives and their impact
- Community participation with diverse organizations

In addition, boards should have an annual review of pay equity to ensure that pay outcomes are equitable for individuals with comparable skills conducting comparable work.

4. **What should we disclose?** Investors and other stakeholders are increasingly asking for more disclosure of DE&I metrics and goals. Investors have already influenced companies' disclosure of EEO-1 data, and the US Securities and Exchange Commission is likely to require HCM reporting that highlights employee diversity, among other topics. At a minimum, directors should understand what the analyses might show in order to prepare for future disclosure, but they might also work with management on voluntary disclosures to build investor goodwill.

Culture

As companies rely increasingly on autonomous knowledge workers, often operating remotely, organizational culture rises in importance. The culture sets expectations for how employees interact with each other away from supervisors, and can drive or discourage engagement. Employees often cite the culture in deciding whether to join or stay at a company. More than other areas of HCM, culture is subtle and hard to change. Committees need patience and perspective as they learn the prevailing culture or cultures. Yet even here, directors can ask management tough questions:

1. **How does the culture touch employees?** Depending on the answers, follow-up questions might include, Who are the key cultural leaders? How well are they articulating and communicating that culture throughout the organization? Is the messaging specific to the company and authentic or generic to many organizations? What visible signs exist to promote and reinforce the culture? And how does the culture spread?
2. **What are the potential challenges with the culture?** A culture that supported the company's initial strategy may now hold it back from a new strategic direction. How is the culture evolving to fit the future strategy?
3. **What do the employee engagement surveys say?** These surveys usually include questions about culture and the strength of leadership messaging and employee belonging. (Some management teams go further with periodic organizational culture assessments, which fuel good conversations with directors.) Directors can engage with management to analyze where the company is falling short, and whether the culture is either weak or no longer aligned with the strategy. What does the company require for long-term success? Some areas of the culture might need only reinforcement, while other areas may require active adjustment.

One of the strongest actions that executives take is hiring and firing managers, who are central to any cultural implementation. Cultural discussions are thus intertwined with the talent pipelines in succession planning.

Aside from tracking progress through regular surveys, directors can visit company sites in coordination with management, attend major company meetings or town halls, and meet with small groups of employees in sessions arranged by management. For large, multinational organizations, directors should expect cultural differences by region. Subcultures may be appropriate as long as these don't hamper working across regions. And for all companies, organizational cultures will need to change with the wider society.

Boards, and especially compensation committees, have more influence than they think over HCM. We've written this article as a guide for directors looking to raise their company's game. What matters is not the specific choices that any committee makes, but the seriousness with which it takes oversight of this increasingly vital corporate activity.

In any scenario, directors and executives need to work together to build a strong employee value proposition that attracts and retains the talent most needed to carry out the current strategy. A company can establish a smart strategy, with appropriate structures and resources, and still fall short because it lacks the relevant human capital. With prodding from directors, companies can develop people to move the strategy forward and gain traction in the marketplace.

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