

FOUR KEY TOPICS HIGH-PERFORMING BOARDS ARE ADDRESSING IN HUMAN CAPITAL MANAGEMENT

By Greg Arnold and Blair Jones

BOARDS STARTED TREATING human capital management as a critical subject a few years ago, mostly in compensation committees. But Covid-19 and social justice concerns have now pushed the topic to the forefront of board discussions. Several organizations and institutional investors have pressed for stronger human capital management in light of pandemic-driven salary cuts, furloughs and layoffs. The SEC has responded with a statement of intention to focus disclosure on human capital as an essential driver of performance, requiring oversight at the board level. Boards and companies must now work together to build long-term reputational, cultural and operational value through human capital.

The best boards think holistically about human capital management topics to determine the degree to which they want to engage and where responsibility should lie within the board. An important first step is to agree on which topics to review, what the board's accountability is for these topics, where within the board structure the topics should be reviewed and how frequently to review them. Most human capital management topics fall naturally to the compensation committee and/or the nominating and governance committee.

After determining the appropriate responsibilities, boards are asking questions across four main areas:

Culture: How do employees perceive the culture? Is the company culture a differentiator in talent attraction or achieving the business objectives? How does the culture support employee engagement? Does the perception and strength of the culture differ across the organization? What events, processes and other methods does the company use to communicate its cultural priorities? Do employees feel empowered to share bad news to senior management?

A strong company culture can create sustainable competitive advantage. A weak culture creates risk and impedes performance. Pulse surveys can help boards get a gauge on company culture, understand opportunity areas in comparison to benchmarks, and monitor changes over time. Glassdoor and other external sources provide insights on how companies are perceived by their workforce and prospective employees.

Diversity & Inclusion (D&I): Boards are increasingly recognizing that strong diversity and inclusion practices drive business results. They are requesting deep dives into the makeup of talent both at leadership levels and more broadly. Is our employee population representative of our customer base? Are our senior executives representative of our broader employee base? Do we have support systems [e.g., affinity groups, mentors] and clear career paths for diverse high potentials? Do we have a culture that values different perspectives and emphasizes inclusion?

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Boards are reviewing D&I statistics by level and function and monitoring key initiatives and risks in both conventional recruiting and training, as well as opportunities such as enhanced training. Employee feedback is also an important input to measure whether employees feel included, respected and heard at various levels in the organization. Many companies have established a baseline and are measuring progress over time. We expect an increased level of accountability to demonstrate diversity initiatives lead to better inclusion in the future.

Succession & Talent Management: Many boards are expanding their succession management oversight to cover the next generation of talent. What are the relative strengths and vulnerabilities of this generation? Will the organization include enough of the skills that will be required in the future? How does this talent planning align with diversity and inclusion initiatives? Boards can create opportunities to meet high-potential leaders and ensure that compensation programs adequately support succession planning and talent management.

Pay equity: Pay equity has gained momentum as the focus on broader equality issues has gained prominence. Activist funds have pursued this issue at a number of companies. Another factor has been the UK's mandate on pay gap reporting several years ago, which has spurred many companies to

look deeply at their global pay equity. Boards can ask to review pay equity across the company to better understand any underlying inequities and ensure the company has processes in place for remediating them.

More broadly, boards can ask whether compensation decisions support the human capital strategy. Cultural impact, employment engagement and D&I are becoming important considerations in performance management and promotions. Over time, we anticipate ever more companies incorporating strategic human capital metrics into incentives. The call

to do so has become stronger and more prevalent in light of events over the last several months.

The long-term viability of business requires a strategic focus on human capital management. Investors and stakeholders today increasingly ask boards to become accountable and take ownership of these matters. High-performing boards address human capital management in a comprehensive and strategic manner, asking how these programs are implemented and how well they are incorporated into compensation and performance management processes. A high-performing board asks the right questions at the right times, which promote long-term performance and resilience.

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