Investors Want More Human Capital Oversight

Time for directors to oversee "the most important asset."

BY BLAIR JONES

Directors are questioning whether they should be exercising more oversight of human resources management, and that's leading to changes in the boardroom.

At Caterpillar, the board now has a compensation and human resources committee. At Principal Financial Group, it's the human resources committee. At JP Morgan Chase, it's the compensation and management development committee. At Mastercard, it's the human resources and compensation committee.

The change is largely being prompted by investors' calling for more information on human capital risks.

So, how and how much should directors get involved in monitoring today's largest of intangible assets, human capital?

Inside boardrooms, directors have a range of views on the subject, from insisting they leave HR issues entirely up to management to fully embracing oversight as a fitting board role. Whatever your sentiment, a variety of forces are pressing for more board action. One force is competition. If the edge in business today comes through heads, not hands, the management of that resource becomes a mission-critical capability the board can't ignore.

Although intangible assets made up just over 30% of total company assets in 1985, today they make up more than 80%, according to recent studies. The care and feeding of those assets is no longer seen by many investors as a subject outside board scrutiny. The Securities and Exchange Commission's Investor Advisory Committee, for example, recently voted to urge the SEC to consider imposing human capital management disclosure requirements.

As part of an exploration of disclosure practices, SEC Chairman Jay Clayton said, "Investors would be better served by understanding the lens through which each company looks at its human capital. In this regard, I ask: what questions do boards ask their management teams about human capital and what questions do investors—those who are making investment decisions—ask about human capital?" (See related article on page??)

Microsoft, TJX, Macy's, and Salesforce to disclose more information about their workforces' pay.

Forty-eight pension funds, from the states of New York, Ohio, Connecticut, California, Illinois, and elsewhere, have also sent letters to every company in the S&P 500 asking for more HR disclosure. In the letters, the fund managers ask for data such as the median employee's job function and location; full- versus part-time employment status; use of temps and contractors; experience and tenure of the workforce; workforce education and skillsets, and a dozen other HR factors.

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Investors have launched a quest for more information. State Street, for example, is asking directors how company culture underpins performance. Pension funds are asking for basic data about company workforces. Last year, New York State Comptroller Thomas DiNapoli extracted agreements from companies including CVS, Though motives vary, a common thread unites investor concern: risk.

Companies like Google and Nike took a reputational hit after incidents related to human resource difficulties. Their boards came off looking like uninformed overseers. The upshot is that boards have been put on notice that the intangibles of human capital—culture in the cases of Nike and Google—rank as prime targets for board oversight.

An evolution in the charter of the compensation committee seems inevitable. That committee, once concerned mainly with executive pay, would logically provide oversight over the entire pipeline of people development. This new challenge is akin to those of facing the board in the past. In years gone by, providers of capital most wanted to know management was making the most of physical assets. Were executives investing financial capital for good returns? Today they also want to know that management is making the most of human assets—on the talent that drives innovation and growth.

Although the entire board needs to become more involved, the compensation committee can best ask the question, to confirm that executives have institutionalized the right policies, systems, and behaviors: Are executives getting the best return on investments in people? Are the mechanisms in place to continuously develop and reward workers at all levels to a higher plateau of corporate-wide performance?

Oversight over the human asset across the corporation still strikes many boards as going a bit far afield. Some directors believe the task belongs solely with management, or at least want to remain respectful of management's role. And that may explain why many compensation committees have only acceded slowly to outsider requests for more oversight—and why they have not dedicated more focus to a subject that has gained increasing prominence.

But change is happening.

The compensation committee at one $10 billion maker of healthcare products is setting the standard. The CEO has pressed forward to give the company an edge through diversity and inclusion, as well as a high-performance culture. The compensation committee has responded to the strengthened focus, taking on the oversight of progress not just for executive employees but for the rank and file.

The company publishes its goals, including increasing the representation of people of color to 20% of the workforce, increasing pay equity to 100%, and increasing the representation of women in management to 40%. The compensation committee receives regular updates from management on these factors.

The litmus test of a board taking on this new oversight is delivering an effective compensation plan to support it. That further explains why the compensation committee at should logically take the lead. While designing incentives on the front end and awarding rewards on the back end, the committee can oversee the host of initiatives in between. That makes the committee responsible for the people-development pipeline end to end.

Too many boards today only touch the surface of HR issues, and if necessary parcel out the responsibilities to one committee or another that's seems appropriate—whether the issue is creating a high-performance culture, recruiting top talent, nurturing high-potential employees, fostering leadership development, establishing pay equity, enhancing diversity and inclusion, assuring effective executive succession, spurring employee engagement, and so on.

Such a case-by-case approach may be sensible as the board gets up to speed on the issues and moves deliberately into the HR-oversight spotlight. Over time, however, the practice of splitting the HR oversight will split the effectiveness of the overseers. Assigning a single committee to be responsible for HR as a whole makes more sense to assure the implementation of HR initiatives and assure action that spurs improvements.

From investors' point of view, consolidated oversight over the entire pipeline would be more reassuring: The board could show it has a holistic view. Meanwhile, that would simplify the burden on HR chiefs, who will be expected to provide an accounting of all HR strategies, goals, and metrics in a consolidated fashion.

This new job may seem broad, and yet it can be guided by a simple question: Are the drivers of growth in human assets being looked at as an integrated whole that can underpin competitiveness? Can the compensation committee assure investors that this "most important" asset is steadily appreciating and not the reverse? ■

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