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COMPANY BOARDS INCREASE CULTURAL OVERSIGHT

Reconstituted Comp Committee Charters Point to Change

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CULTURAL OVERSIGHT

Companies recently have found themselves in trouble because of breakdowns in corporate culture that have been well covered in the news: Overly aggressive selling (Wells Fargo). Sexual harassment and a macho culture (Uber). Cheating (Volkswagen). Gender discrimination (Nike). Racial bias (Starbucks).

Is there a common thread? Hidden flaws have been embedded in the culture of these otherwise high-performance companies. In too many cases, executives have run operations with best practices, but bad cultural habits have started to grow, and no one stepped in to bring forward or raise the red flag. All of a sudden, a scandal erupts that highlights the cultural flaws. The once-lauded companies then suffer severe blows to their reputations among customers, in addition to damaging the relationship with a key asset: employees.

As this scenario plays out again and again, similar questions arise: Where was the board? Shouldn't board members have known? How could these internal cultural issues have persisted for so long? As a result, many boards of directors are taking steps to proactively monitor and influence corporate culture and broader HR risks, and their partner in doing so is the chief human resources officer (CHRO).

Because compensation committees already handle pay, performance and executive hiring and succession, the responsibility for a broader role in HR and cultural oversight is likely to fall to compensation committee members. Caterpillar, Cisco, JP Morgan Chase & Co., The Home Depot, Walmart and other leading companies currently have broader HR oversight in their compensation committee charters. (See "Chartered Oversight.")

As with other oversight responsibilities, directors who take on more cultural and HR oversight will demand performance reports in a digestible format. They will need enough detail with enough hard numbers to feel reassured that HR leaders — and the people in the HR function — are nurturing a high-performance culture with world-class HR practices that give the company a strategic edge.

The logical next step for many boards is to reconstitute their compensation committees as human resources committees (HRCs) or human resources and compensation committees (HRCCs). (See "What's in a Name?") Such committees, pressed to respond to new issues, will divide their new responsibilities into four focus areas, each of which will give CHROs the opportunity — if not requirement — to collaborate with directors to assure the new level of HR risk oversight the public and shareholders demand.

Organizational Ethics

An HRC or HRCC needs information to monitor the health and strength of the company's culture and its internal and external reputation. These committees will need to:

Chartered Oversight

Caterpillar's Compensation and Human Resources Committee charter reads, "The committee shall provide general oversight over the company's policies and initiatives related to immigration, equal employment and equal opportunity, diversity and inclusion, and labor relations."

General Electric's Management Development and Compensation Committee's charter charges directors "to assist the board in developing and evaluating potential candidates for executive positions, including the chief executive officer, and to oversee the development of executive succession plans."

JP Morgan Chase & Co.'s Compensation and Management Development Committee's charter includes, "Receive reports from management regarding significant conduct issues and any related employee actions, including compensation actions."

Mastercard's Human Resources and Compensation Committee charter reads, "Periodically review key diversity initiatives and human resources policies and practices, including those related to organizational engagement and effectiveness and employee development programs."

Orbital ATK's Compensation and Human Resources Committee charter reads, "The committee will periodically review employee 'culture,' talent management, learning and development, and other key human resources metrics (including workforce numbers, hiring rates, attrition rate and trend, labor matters and employee helpline issues)."

Wells Fargo's Human Resources Committee charter provides that, "The HRC shall oversee the company's culture, including management's efforts to foster a culture of ethics throughout the company."

Leading boards understand that a talent mindset must be part of the culture.

- Review with directors the results and trends from employee engagement surveys, including questions that are specific to the company's culture, ethics and handling of bad acts.
- Provide a report of logs from hotline calls, including some verbatim.
- Inform directors of issues raised in Glassdoor.com and social media outlets.
- Provide a summary of violations of the company's code of conduct, including data on where the violations occurred and how (and how quickly) they were resolved.
- Include in individual performance appraisals of C-suite executives assessments of their leadership with respect to culture, values and behavior.

Diversity and Inclusion

CHROs already are busy with issues of diversity and inclusion, and they will need to detail for directors an authentic and visible corporate commitment to both. The HR team can help by:

- Updating directors at least twice per year on the company's inclusion and diversity goals and efforts, including detail on results and progress and how that compares to peers
- Reporting to the committee on pulse or other survey results regarding employee perception of inclusiveness
- Detailing relative pay equity across groups of employees
- Describing pay levels and structure for different groups and levels of employees within the organization.

Workforce Planning

CHROs also can expect a reconstituted compensation committee to ask them how the company is competing in the ever more rigorous war for talent below the executive level. This will require help with understanding workforce capabilities, monitoring goals for developing critical workforce skills, monitoring union or labor relations, and monitoring outsourcing and the use of contingent workers. That means they will ask CHROs to provide:

- Detail on employee turnover history, including how that compares to peers and how it varies in different parts of the business
- Summary of findings from exit interviews
- Data on new recruits: where they come from, their backgrounds, their ethnic and gender makeup and how that compares to the existing workforce
- Information on workforce training programs, especially those aimed at developing critical skills and certifications
- Updates on union and labor-relations issues.

Talent Development and Executive Succession Planning

Succession planning for the CEO and the executive team is a task often assigned to the full board. However, succession planning often does not get much time and attention, other than once a year on the board agenda. Leading boards understand that a talent mindset must be part of the culture. By assigning this responsibility to the compensation committee, it allows a dedicated group of directors

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CULTURAL OVERSIGHT

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to oversee the process and receive updates between board presentations. Committees that view talent as a significant strategic priority make this a permanent topic on the committee agenda. Evolving practices a compensation committee may adopt include:

- Understanding top leaders' retirement timeframes and advancement ambitions
- Understanding the depth of talent within various areas of the business and what their leaders are (or are not) doing to develop and nurture a deeper bench
- Reviewing performance evaluations of CEO successor candidates and plans for addressing developmental areas
- Annually reviewing skill matrix/skill development of individuals identified in the talent pipeline
- Providing input on the approach to talent identification, retention and development
- Exposing up-and-coming executives to the board, both in formal and informal settings.

Getting into such culture-related issues takes many directors onto new terrain. But mastering that terrain may well be necessary to sustaining a positive corporate culture and preventing new scandals from brewing.

By preparing HR staff to provide directors with these four kinds of support, CHROs will not be inventing new systems. They will instead crystallize available information in fresh, succinct formats tailored to the needs of their external board — namely the independent directors who are responsible for approving executive pay.

On some boards, changing the compensation committee into an HRC or HRCC may amount to a simple rebranding. After all, many boards have — albeit not systematically — overseen cultural and HR performance all along. But shareholders and the public have made it clear that accountability for cultural and human-capital health should not be left to management alone. Independent directors need a hand in oversight.

What's in a Name?

Two-thirds of Dow 30 companies have a committee focused solely on compensation and benefits.

One-third of Dow 30 companies have a board committee focused on leadership development and/or other HR areas in addition to compensation.

Many committees reflect broader responsibility in their name, including:

- Compensation & Benefits Committee
- Compensation & Human Resources Committee
- Leadership Development & Compensation Committee
- Compensation & Management Development Committee
- Executive Compensation & Management Resources Committee
- Human Resources Committee.

When shareholder heavyweights such as Blackrock, Vanguard and State Street demand data on gender pay equity, when lawmakers summon CEOs to testify before Congress on ethical issues, when the media highlight the suffering by women from predatory male behavior, when boards in Europe, Canada and elsewhere role-model HR oversight with rigor not seen in the United States — when all these events are taken together, the signal becomes clear that CHROs are a strategic partner in helping directors raise their game.

The risks of not doing so are substantial, as company stock prices take a dive when unsavory revelations come out. Only the directors — the independent ones on today's compensation committees — are in a position with the credibility and clout to respond to reassure shareholders. And only with a chief of HR as a collaborator can they effectively monitor and vouch for the appropriate pay, performance, treatment, development and well-being of all employees. **WS**

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