Human Capital Governance:
The beginning of a new era

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The era of human capital has arrived in the boardroom and, with it, the need for more thorough board oversight and governance of this mission-critical investment.

As evidence, consider three current paradigm-shifting items:

• Institutional investors are demanding that the companies they invest in pay more attention to environmental, social and governance issues (ESG); and are increasingly focused on the topic of human capital management, a large component of the "S" in ESG. In fact, some claim that 2020 will be "The year of the S," while others believe 2020 will be just the start of an era of social focus and opportunity.

• The Business Roundtable (BRT) issued an updated purpose statement for corporations in August 2019 describing how a company's purpose is to serve the interests of all stakeholders including employees, customers, vendors and suppliers, the community and environment, and shareholders/owners. This is a dramatic change from the BRT's decade-long stance that a corporation's sole purpose is to serve the interests of shareholders. It acknowledges that employees, as human capital, are key stakeholders in the long-term success of a business and suggests that shareholder interests are aligned with having healthy, engaged, hard-working and productive employees.

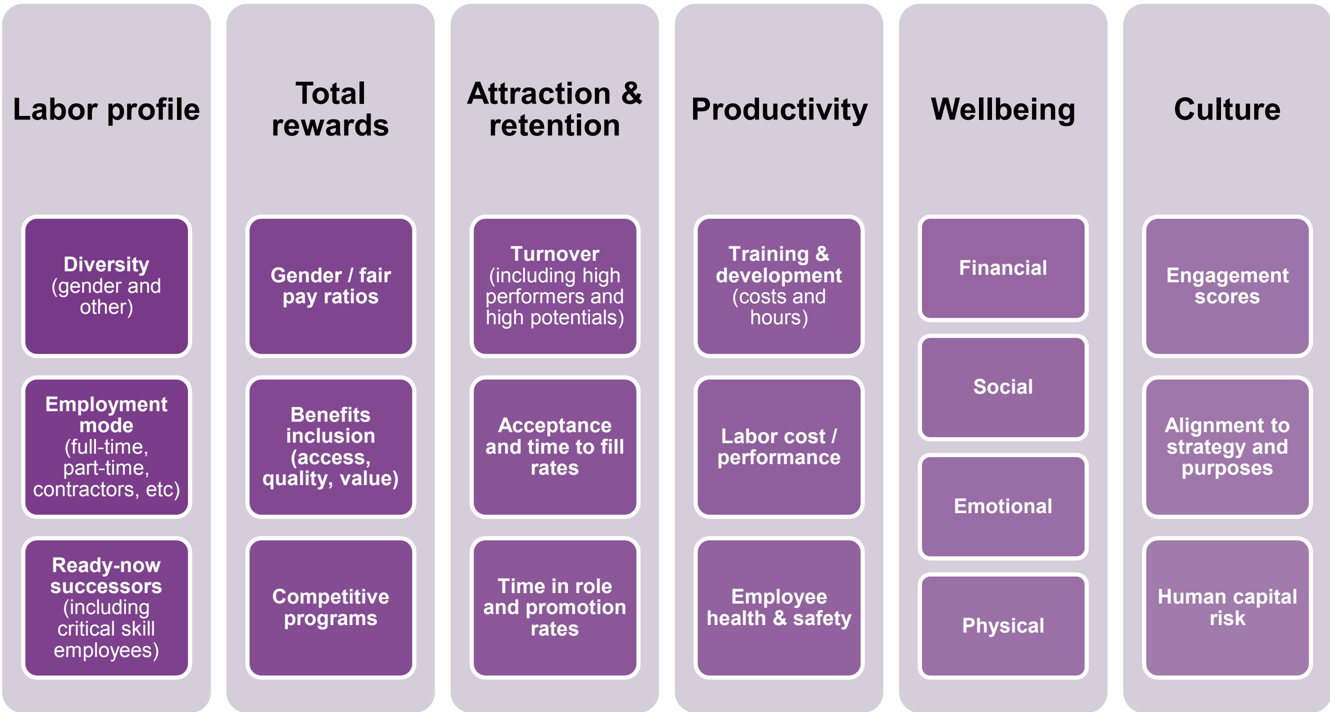
• The U.S. Securities and Exchange Commission (SEC) has proposed that because human capital is such an important and material part of the economic value of enterprises, companies should consider disclosing key human capital metrics in their public filings. SEC chairman Jay Clayton indicated that up to 70% of the value of corporations is embodied in intangibles and human capital, and not captured in traditional financial statements.

The following are suggested approaches boards can take to provide oversight of human capital management in the new era.

Tapping human potential

The increased focus on human capital is neither a random confluence of events nor a "perfect storm." Rather, it reflects the result of decades of evolution in technology, how humans relate to that technology to get work done, and, in turn, how this creates value for society. Technology has greatly enhanced, not diminished, the value of human labor. While technology has catalyzed the automation of work and eliminated certain jobs, it also has allowed industries and organizations to re-

WTW Human Capital Measurement Framework



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think how work gets done and how to redeploy human capital to create new jobs and deliver value. This evolution has accelerated to a tipping point where human effort and ingenuity can be at least as valuable as physical and financial capital.

Boards recognize this relevance as both a performance and shareholder imperative (independent of any social imperatives) based on the types of actions from investors, business leaders and regulators described above.

For example, the Business Roundtable statement highlighted the commitment of nearly 200 CEOs to invest in their employees. This pledge included providing fair compensation and important benefits, and skill-sharpening training and education that enhances employees' value in a rapidly changing world. The commitment to employees also includes fostering inclusion and diversity, and dignity.

This is consistent with trends by companies to increasingly complement investments in technology with training, culture and total rewards (pay, benefits, careers, wellbeing) that maximize their human capital investments.

Training

Unfortunately, the benefits of human capital evolution are uneven. The divide between technologically enabled employees with advanced skills and those without those skills is growing larger, and attention is needed to reskill workforces to close this gap in order to ensure companies have the talent they need to succeed in the future.

Culture

Increasingly, boards have been considering broader governance in areas such as employee engagement, purpose, inclusion, diversity, dignity (defined as respect and self-worth) and sustainability. Data support connections between healthy company culture, reduced risk and positive business outcomes and financial performance.

Total Rewards

Beyond their traditional focus on executive compensation and pay equity, boards increasingly are taking a broader view of company "Total Rewards."

• Pay: Aggregate reviews of compensation often include factors surrounding pay clarity, differentiation of incentives, incentive metrics, incentive cost and sharing ratios, and fairness.

• Benefits: Aggregate reviews of company health, retirement and voluntary benefit programs, including factors related to access, quality, value, inclusion and risk.

• Wellbeing: Integrated employee wellbeing has become an essential human capital topic for many companies as they assess the physical, emotional, social and financial wellbeing of their employees, and the correlation to employee engagement, productivity and business performance. Despite some progress on the tough issues regarding job stress, health care affordability, retirement readiness, access to flexible work arrangements and reskilling opportunities, more work is required.

• Careers: Connecting careers to reskilling and continuous learning efforts, reviewing career and skill development/learning programs that ensure companies will have the qualified workforces they need to execute their strategies and operations today and in the future.

What this means for boards

The era of human capital requires *human capital governance*. Investors realize that people are a big part of their investments, and the value of those investments. Boards, which represent those investors, will need to be more deeply interested in the overall wellbeing of employees who create value for the enterprise and its owners.

In the last two to three years, boards and their compensation and human resources committees have become increasingly concerned with the broader talent pool of the organization, and now receive regular updates on the key HR topics and metrics described above.

Principles for measurement, oversight and reporting

Human capital metrics should be selected carefully, according to a set of principles that have been used over time for measuring physical and financial capital, including:

Materiality: Does this measure something that is material to our company?

Relevance and meaning: Does this measure something that is relevant and meaningful to running our business?

Measurability: Is it actually measurable? And does it actually measure what it's supposed to measure?

Reliability: Can it be reliably measured on an ongoing basis?

Comparability: Can it be compared over time, across business units and to other companies?

Timeliness: Can it be measured on a timely basis or is there a long lag?

Auditability: Can it be verified as accurate?

Cost vs. benefit: Are the costs of measuring it worth the benefits?

Our proposal

Much of human capital governance historically has been piecemeal and reactive. We propose that boards act more holistically, providing effective oversight of the enterprise's entire human capital asset. Their objective should be straightforward: Maximize the value of this asset and the return delivered.

To accomplish this, boards need a new system of metrics that allow management and boards to measure multiple, relevant dimensions of a company's human capital. We propose starting with a framework and some guiding principles (see sidebars).

How to think about human capital and human potential

Boards are finding they need to develop a more expansive language and terminology for governing human capital. We suggest a "hierarchy of needs" approach, expanding on American psychologist Abraham Maslow's theory about the hierarchy of human needs, along with elements of self-determination theory as developed by contemporary psychologists Edward Deci and Richard Ryan. Here are some important questions to consider.

• Security: Do our employees feel safe and reasonably secure? Do they have what they need to thrive?

• Healthy company culture: Are people treated with respect and dignity? Is the culture inclusive and does it promote diversity? Is there an appropriate balance between performance expectations and developmental opportunities? Does the culture promote excessive risk taking or other behaviors detrimental to the company and its employees? In balance, does the culture support the right balance of risk tolerance for innovation?

• Physical and emotional wellbeing: What is the physical and emotional wellbeing of our employees? Do they have access to and can afford quality health care for themselves and their dependents? How are they managing stress in the workplace?

• Financial wellbeing: Do our employees feel confident in their ability to provide for themselves and their dependents, now and in the future? Are they accumulating savings wealth at a reasonable rate? Do we have employees that are living below the poverty line? Can our employees expect to retire at an acceptable age?

• Competence: Do we provide people with the ability and accessibility to learn and master new skills, talents, capabilities and to perform in their current roles, grow in their careers and remain employable despite changes in work?

• Purpose and autonomy: Are employees able to find meaning in their work? Do people feel that their personal purpose and mission aligns with the purpose and mission of the company?

• Motivation and rewards: Do our employees believe they are paid fairly? Are we effectively using monetary and other rewards to foster alignment and drive exceptional performance? Do we properly differentiate rewards based on individual or team performance? Is our compensation package competitive and fair? Are our pay practices transparent?

• Leadership: Do our leaders lead with integrity, act ethically and inspire our employees to do the same? Are we transparent in our communications and intended purpose, values and culture in which we aspire?

• Empowerment and enablement: Do we provide the tools, training, technology and opportunities that allow and enable all employees to unlock and harness their potential? Can we demonstrate this?

• Return on investment: What is the payoff? Can we demonstrate greater productivity, collaboration, creativity, sales, innovation, new product development or lower turnover? What is the impact on financial performance, value creation and shareholder return?

This is just one possible set of topics and questions for the oversight and assessment of human capital. But these are the types of issues and questions we believe boards will be asking in the era of human capital governance.

A starting point

A framework such as this one, along with principles for human capital management, measurement and governance, are a productive way to start thinking more broadly and holistically about an organization's most valuable asset — its people. Increasingly, it is clear that human capital offers the most profound potential for the future of business with limitless acuity, creativity and curiosity driving constant, positive and sustainable change. ■

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