The board's role in talent and culture

Visionary boards go beyond simply setting compensation policies – they seek to understand and assess the health of a company's culture

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It is well-accepted that boards play a critical role in shaping a company's business strategy. The senior management team may be the architects of the strategy – and the builders as well – but the board is expected to play a central role in ensuring the soundness of the plan.

Boards routinely require management teams to present three to five-year business strategies, complete with detailed financial projections, competitive analyses and the like.

But what about the board's responsibility for leadership strategy? If business strategy defines what a company plans to do, then leadership strategy governs how a company will do it. Shouldn't an active board be equally concerned with both?

Boards have long acknowledged their responsibility for CEO succession, but leadership strategy is more than the mere identification of a collective group of current and future executives. It is the development and stewardship of a company's priorities and values – that is, its culture.

Historically, many boards have been loathe to interfere in the talent and leadership arena – beyond hiring and firing of the CEO and other C-suite executives. A firm's talent management and corporate culture have largely been viewed as the purview of senior management and boards are reluctant to be seen as micro-managing or second-guessing their executive team.

Recently, however, we've seen a shift in that regard. A Pearl Meyer review of 1,400 US public companies shows that nearly 20 per cent have formally expanded the purview of their board compensation committees to incorporate some aspect of leadership and talent (e.g. compensation and management development committee, leadership and compensation committee, management performance committee, people resources committee, etc). This finding is consistent with our in-boardroom experience, where committee members are increasingly engaging in discussions with management that go beyond the traditional focus on the compensation and benefits packages for a handful of senior executives.

So, what should 'visionary' boards be thinking about?

Succession planning and leadership development

Visionary boards think beyond basic CEO succession planning. Boards should receive (at least) annual debriefs on ready-now/ready-soon successors for all key senior positions. These debriefs should provide an overview of each executive's position history and their most recent performance reviews. The CEO should also be prepared to discuss his/her assessment of everyone's strengths and weaknesses, as well as plans to address any developmental needs through rotational assignments, coaching, etc. For ready-now candidates, the overview should include the succession plan for that person's replacement. The discussion of ready-now candidates also needs to touch upon potential retention risks and mitigation strategies – if you think someone is ready for a promotion, chances are at least one of your competitors agrees. Boards should have opportunities to observe and interact with candidates for key C-suite positions in formal presentations and informal gatherings. Beyond scheduled meetings, we see many board members actively involved in the leadership development process throughout the year by volunteering to provide one-on-one mentoring of high-potential executives.

The succession planning and leadership discussion should also include a high-level, comprehensive review of the overall team dynamics. In the same way that boards have begun to assess their own skills and diversity, boards should consider the composition of the company's overall leadership team. Many of the techniques boards are using to assess

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CULTURE AT THE CORE Boards must engage with employees to gauge if 'tone at the top' trickles down

their own effectiveness can be readily applied to the company's leadership team.

For example, consider reviewing a skills matrix, like that used by many boards in their self-assessment process. Does the leadership team have the combination of skills and expertise necessary to successfully deliver the company's business strategy? Have recent or anticipated changes in business strategy changed the skills/expertise required – and have those changes created any skills 'gaps' in the current leadership team? Similarly, boards should also look at the demographics of the leadership team. Is the team appropriately diverse? Is it reflective of the employee population and/or the company's customer base? Is there a mix of tenure among the leadership team? Has there been strategic consideration of which positions are best suited to internal versus external candidates?

Culture at the core

In the same way that boards have historically limited their compensation focus to the pay programmes for senior executives, their corporate culture concerns have tended to focus on the 'tone at the top'. And yet, time and again we see companies dealing with scandals that are the result of actions taken by employees much lower in the corporate hierarchy. Of course, a strong argument can be made that it is indeed tone at the top that creates a corporate culture that allows (or encourages) lower level employees to act in ways that maximise short-term results but are contrary to the long-term health of the company. On the other hand, is it possible that there is a disconnect between the company's tone at the top and the day-to-day culture at the core of the organisation? Boards need to identify ways to assess the health of the company from top to bottom – both 'tone at the top' and 'culture at the core'.

Many companies routinely take advantage of board meeting dates to provide opportunities for board members to spend time formally and informally with senior management. Likewise, many companies rotate meeting locations to provide time for site visits. But such planned, scripted interactions may not provide board members with much insight into the 'real' working culture of the organisation. So how do boards understand and audit company culture?

Our discussions with board members suggest multiple approaches that combine formal and informal avenues. For example, while board members should be debriefed on the results of company-conducted employee engagement and customer satisfaction surveys, they can 'validate' those findings through other sources, such as Glassdoor (for employee comments) and customer chat sites. Obviously, employees are on their best behaviour for scheduled on-site visits, but board members can augment these interactions by looking for opportunities to engage. »

For consumer-facing companies, there are a myriad of opportunities for board members to interact with and observe employees at various levels in the organisation. For other companies, activities, such as attending trade shows, can afford board members an opportunity to meet with employees, customers and competitors to gain a deeper understanding of the company's competitive positioning and reputation in the industry.

Pay equity

In the US, pending regulatory action has created increased interest in broad-based pay issues among the rank-and-file employee population. The CEO pay ratio is due to be reported by public companies for the first time in 2018 proxy statements. Obviously, the board has long been responsible for setting CEO pay. With the advent of the CEO pay ratio disclosure, the board will need to be equally concerned with the pay of the median employee. Additionally, there is a pending regulation in the US that would require all companies with more than 100 employees to annually report gender and race pay equity statistics to the Equal Employment Opportunity Commission. Likewise, several states have enacted, or are considering, legislation that requires companies to prove gender pay equality (e.g. California's Fair Pay Act).

Obviously, the recent US presidential election results have raised the possibility that these and many other pending regulations will be delayed in implementation or potentially rescinded. Still, we suggest that, considering the overwhelming and uncertain agenda proffered by the prospective administration, companies need to be prepared to comply with these pending regulations as they are currently constituted.

We further believe that issues of pay equality and fairness will continue to increase in importance, regardless of regulatory mandates and oversight. Even absent the pending CEO pay ratio disclosure, there will continue to be public scrutiny over the levels of CEO pay and the disparity of CEO pay levels and increases compared to rank-and-file US workers. On the gender equity front, we have recently seen several examples of prominent companies in the US (including Amazon, Apple and Facebook) voluntarily disclose gender pay ratios.

As a matter of good governance, boards need to ensure that management is prepared to comply with CEO pay ratio and gender/race pay equality reporting requirements. Further, boards need to help senior management consider the implications of the analyses and devise an appropriate communications strategy for all interested constituencies – media, shareholders, customers and employees.

SKILLS MATRIX
Do changes in strategy affect the senior management experience required?

A dis-ARMing human resources philosophy

While this article's focus has been to highlight the role boards can play in shaping a company's leadership and talent strategies beyond simply setting compensation policies, the importance of pay cannot be ignored. In fact, pay is a powerful tool that boards and senior management can use to reinforce and communicate company priorities, values and culture.

The ubiquitous phrase found in nearly all proxy statements contends that the primary goal of compensation and benefits programmes is to 'attract, retain and motivate' (i.e. ARM) executives. And while companies obviously need programmes that are competitive, we think leading companies are shifting from a mindset of 'attract and retain' to one of 'engage and align'. The traditional 'attract and retain' approach to compensation and benefits suggests a defensive posture that is externally focussed – i.e. we're playing not to lose. In contrast, an 'engage and align' philosophy suggests a proactive posture focussed on internal goals – i.e. we're playing to win. This shift in positioning can impact how programmes are designed and how they are communicated to employees and the marketplace.

> *Management guru Peter Drucker states that 'culture eats strategy for breakfast'. If that is indeed true, then boards have a responsibility to understand and assess the health of a company's culture as a critical component of the company's ability to deliver on its business strategy*

An engagement-centred programme design focusses on:

- Developing a holistic view of 'compensation' that draws on an organisation's unique culture and incorporates both monetary and recognition-based awards
- Realising that internal factors (business strategy and culture) carry more import than external factors (market data and advisory firm policies)
- Addressing the evolving needs of future leaders or high-performing employees as they advance within an organisation (via age or position)
- Incorporating a true long-term view of compensation that extends beyond three-year incentive plan timeframes

An alignment-centred programme design focusses on:

- Balancing individual accountability and rewards with the responsibility that all employees have for the overall results of the total organisation
- Adopting a compensation pay mix that encourages necessary risk while delivering pay-outs that equitably share in the upside/downside
- Using compensation elements that are engineered to unlock long-term shareholder value creation in an efficient manner (e.g. large annual equity awards to major internal stock holders are not an efficient use of equity)
- Accepting that shareholders have a rightful say in how compensation should be structured

A famous business maxim attributed to management guru Peter Drucker states that 'culture eats strategy for breakfast'. If that is indeed true, then boards have a responsibility to understand and assess the health of a company's culture as a critical component of the company's ability to deliver on its business strategy.