

Features of Human Capital Governance

- What we can learn from the research on Japanese and US companies -

March 2024

BoardHR Initiative

World Intellectual Capital /Assets Initiative

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1 Executive Summary

Our study showed that boards in both Japan and North America are taking an increased interest in human capital. This is appropriate, human capital is one of the main drivers of organizational value.

While Boards in Japan and North America have similar goals: leverage human capital opportunity and mitigate human capital risk, the context is quite different. The following two findings from our study illustrate the differences:

- Average time head of HR has been in their current organization
 - Japan: 30+ years
 - North America: 4 years
- Degree of specialization the head of HR has in the field of HR
 - Japan: limited specialist expertise, heads of HR have typically worked in many functions in their career.
 - North America: high specialist expertise, heads of HR have typically worked for decades in HR roles.

More generally, board governance of HR in North America is quite mature. Practices across different organizations are similar. The primary focus is on executive compensation with a secondary focus on succession.

On the other hand, the style of human capital governance in Japan is less standardized than in North America. This suggests that there is more room in Japan than in North America to explore a style of human capital governance that meets the needs of individual companies. However, since there is no standard approach, there is a risk of poor governance. The above-mentioned differences in the backgrounds of human resources leaders between Japanese and American companies suggest that the board of directors plays an extremely important role in human capital management in Japanese companies.

In both geographies, HR leaders value the input of the board, especially when they raise thoughtful questions and share insights based on their experiences with other organizations. However, there was also some frustration with Board members who appeared to lack the expertise to add value and may even create an unwanted distraction by asking scattered or irrelevant questions.

1-1 Key Recommendations for Japanese Boards

- **Define the roles.** In Japan, organizations need to define the roles of the board of directors and human resources leaders in appropriately supervising and supporting human capital management. Although the level of appropriate intervention and supervision by the board in human capital governance differs from company to company, we must reaffirm the importance of "discussion" as well as "approval/decision" in the board's role. Additionally, top management needs to discuss how HR leaders should be creating corporate value through human capital, drawing on ideas that go beyond traditional HR functions. (Please refer to Appendix 5.)

- **Create the right platform for oversight.** Organize an appropriate platform for having strategic human capital discussions at the board level by establishing a board committee whose members have expertise relevant to human capital.
- **Set aside sufficient time.** Set the agenda for the HR committee and realistically assess the time required for a value-added discussion. Additionally, ensure there is time for board members to visit locations, customers, and suppliers as part of their preparation for the human capital discussions.
- **Make more sophisticated use of HR analytics.** The board should ask for a variety of HR information, not limiting themselves to standard metrics such as turnover and engagement. HR analytics should provide insight into human capital matters that are key to value creation, risk mitigation, and business success.

1-2 Key Recommendations for North American Boards

- **Have more HR committee meetings.** Consider having more HR Committee meetings so that there is time to adequately cover topics beyond executive compensation and succession.
- **Be clear about where the HR Committee is likely to be able to add value.** In particular, the committee can work on ensuring HR strategy aligns with the business strategy, identifying human capital risk, ensuring there isn't an unduly short-term focus, and ensuring that the nature of financial reporting doesn't lead the organization to undervalue human capital.
- **Make more sophisticated use of HR analytics.** Take advantage of the organization's people analytics capability to get evidence-based answers to strategic questions (e.g. which jobs are pivotal, see Appendix 4).

2 Introduction

2-1 Background

Human capital is one of the key drivers of an organization's value.

- Management should understand how the company's human capital connects to value creation, and create mechanisms to facilitate more effective use of human capital to enhance value creation and motivate employees.¹
- The board should play a role in ensuring the organization is making wise strategic decisions about human capital and mitigating human capital risk.

Are boards doing this in Japan or North America? How could they do it better?

2-2 Purpose

The purpose of this study is to gain insight into what is currently happening with respect to board oversight of human capital in Japan and North America. Following those comparative insights, we suggest what boards and HR leaders might do differently in both Japan and North America.

2-3 Methodology

This study focused primarily on qualitative insights based on interviews with HR leaders and board members in Japan and North America. The interviews were supplemented with several Likert-scale questions to gather a small amount of quantitative data.

In Japan, we interviewed six HR function leaders in the food, retailing, non-iron metal, finance, heavy machinery, and fiber product sectors. Most of the companies had between 10-40k employees. (One was smaller with fewer than 2k employees.)

In North America, we interviewed four HR function leaders and two board members in the finance, health care, car rental, and distribution sectors. Most of the companies had between 1k and 25k employees. (One was smaller with fewer than 1k employees).

¹ WICI Human Capital Sub-Committee Report

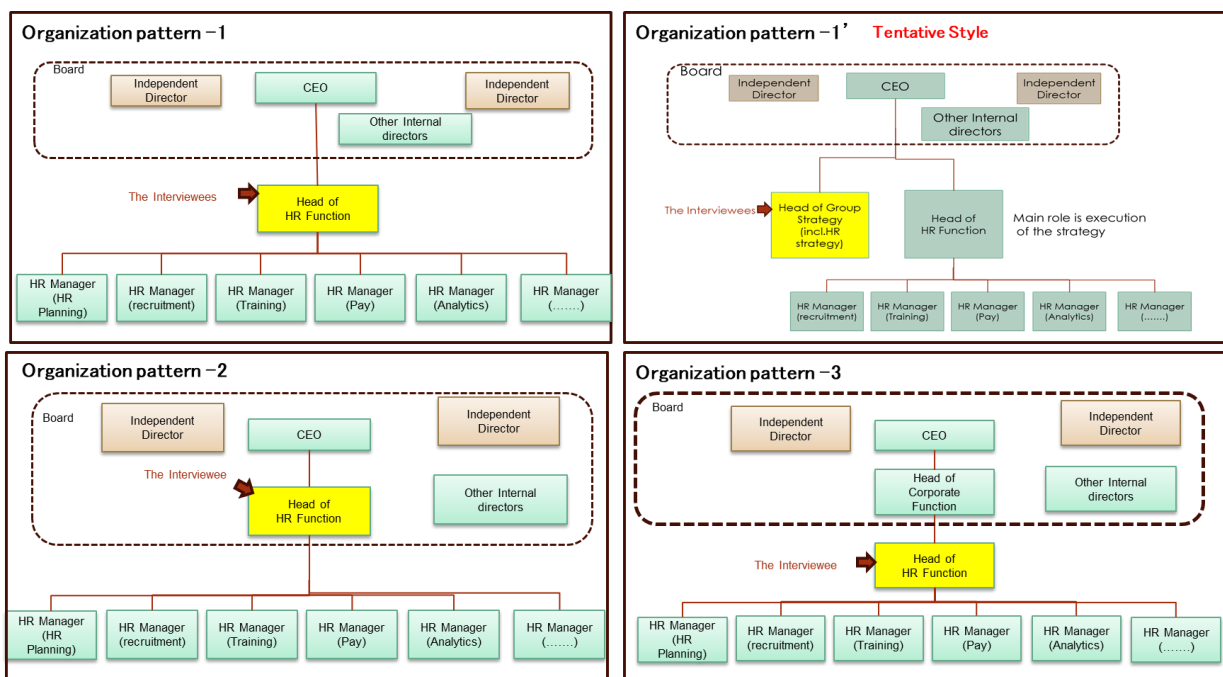
3 The Situation in Japan

3-1 The organizational context

The relationship between the board and HR will be affected by the organization's structure. There were some important differences among the companies interviewed; the various structures are shown in the figure below. The most common structure has the head of HR reporting to the President but is not on the board (pattern 1); in one case the head of HR is on the board (pattern 2), in another case the head of HR is further down in the organization and does not report directly to the President (pattern 3), and there was one unusual structure (pattern 1') where HR strategy was managed by the head of group strategy rather than the head of HR.

Irrespective of the structure, there needs to be good communication between HR and the Board on human capital strategy and risks; if the head of HR is several layers removed from the board then it's up to the board to ensure those layers are not barriers to a good flow of communication.

Figure 1: Organizational patterns in Japan



3-2 Interview results and insights

Key Finding: There is no consistent approach to human capital governance

There is no universally accepted best practice for board oversight of human capital in Japanese organizations. Some companies engage in strategic discussions at the board level, addressing issues such as the connection between long-term company growth and HR strategies, the investment in and return on human capital, and shifts in company culture. However, other companies have yet to bring these strategic matters to the board level.

HR leaders in these organizations have multiple points of contact with board members beyond formal Board of Directors (BOD) meetings. These include HR strategy committees, compensation and nomination committees, sustainability committees, pre-reporting sessions prior to official BOD meetings, BOD member participation in executive officer meetings, and off-site meetings. On average, HR leaders interact with BOD members over eight times annually.

Our observations indicate a positive correlation: the more frequent the contact between HR leaders and BOD members, the more strategic discussions about human capital occur at the board level.

Takeaway: The absence of a standardized approach to human capital governance presents a significant opportunity. Leaders have the freedom to tailor governance processes to align with their organizational culture and the importance of human capital in driving organizational value. Crucial decisions include determining the frequency of meetings, who sets the agenda, and typical agenda items.

Key Finding: The lack of good governance troubles some heads of HR

Several HR leaders have expressed difficulty in discussing serious HR challenges with their Boards of Directors, citing the lack of established platforms for such strategic conversations. Some of these leaders face critical issues in acquiring the top talent necessary for executing company strategies. They are eager to engage with their boards on topics such as recruiting strategies, employee compensation policies, and the promotion of gender diversity in role assignments.

Takeaway: It is essential for boards to proactively inquire about strategic HR issues that need addressing. In cases where the board does not initiate these discussions, it falls upon the head of HR to devise an approach for bringing these matters to the board's attention in a manner that aligns with the board's interests and time constraints.

Key Finding: Some boards take an active role in guiding communication about human capital to investors

Some company boards guide decisions about reporting on human capital to investors (such as a unique definition of human capital investment and return, and a unique analysis of the engagement survey). In other companies, boards are not much involved in human capital reporting.

Takeaway: While it's not essential that the Board directly comment on how to communicate about human capital to investors, they should at least be fully aligned with the approach investor relations is taking.

3-3 Notable comments from interviews

There were a number of specific comments from interviewees that shed light on how the board was working with HR on human capital issues.

Comments about the agenda

The engagement survey is the starting point for the BOD discussion; *“In the annual BOD agenda, we have a report on engagement survey results, and from there overall HR strategy is set.”*

The nomination committee covers broad human capital issues; *“In the Nomination committee meeting, the D&I objectives and targets are discussed. Succession planning is also discussed.”*

Requests and questions from the BOD are not organized; *“Requests and questions from BOD members range from small details to big topics”*

There are issues about the lack of clarity in the BOD’s viewpoint on human capital; *“The BOD members’ views are not organized at all, each individual has different interests in human capital. So, we need to prepare an appropriate platform for an organized discussion”*

HR leaders struggle in reporting to BOD members; *“Since BOD members don’t necessarily have HR experiences, I sometimes wonder how detailed reports should be.”*

Takeaway: Much like North America, engagement, diversity, talent development, and succession will likely be key agenda items. However, there will likely be some unique agenda items for Japanese companies such as the linkage between business strategy and HR strategy, and organizational culture change. Because many traditional major Japanese companies still keep a seniority-based HR system, this kind of issue should not be discussed just as a change of HR practices but should be discussed as a long-term company-wide transformation, and should be a key agenda item at the board level. Note that there may be times when the board asks poor (e.g. unnecessarily detailed) questions, so not all board interest in human capital is helpful. This suggests HR has a role in guiding board members on where they should focus their attention.

The standard BOD meetings are not enough to address all the important issues

Interviewees mentioned their organization has created opportunities for discussions besides the official BOD meetings; *“The HR strategy committee was established for deep discussions.”* *“Broad issues about human capital (such as HR strategy) are discussed in the sustainability committee.”* *“Pre-reporting to the outside BOD members before the official BOD meeting is a good place for open discussion, rather than in the official BOD meetings.”*

Takeaway: Board meetings are often taken up with reporting and approvals rather than free-flowing discussions. Since these discussions are valuable, the board needs to create other opportunities for deeper conversations.

The Board adds value by providing insights from outside the company

HR leaders welcome outside viewpoints from the BOD; *“Outside BOD members pointed out the communication gap between headquarters and production sites, It’s valuable for us to hear this, since internal members are unaware of the issue.”* *“The BOD is concerned about the shortage of human capital investment in Japan, and they see our company from this viewpoint.”* *“The BOD thinks in terms of human capital investment and return, rather than in terms of the HR function itself.”*

Takeaway: Board members should recognize the value they can provide to HR simply by sharing their insights based on their experiences with other organizations; what may be obvious to a board member may not be obvious to someone within the company.

The board has an interest in high-level HR topics, HR would like to see additional topics discussed

There is a need for a platform for HR-related strategic discussion; *“We (top management) need to have deep discussions about the company’s long-term direction and HR strategy at the board level, but we have not yet prepared the discussion platform (such as creating an appropriate agenda). For such a strategic discussion, we may have to form a focus team that consists of a selected small number of executives.”*

HR leaders observe that the BOD is interested in a variety of high-level topics; *“Whether current HR practices align with the long-term company growth strategy” “The BOD’s consider issues in terms of human capital investment and return”, “The BOD is concerned about the linkage between business strategy and HR strategy”, “The BOD asks how we should change company culture”*

There are some topics that HR leaders would like the BOD to be interested in; *“ I would like to have BOD much more interest in issues such as recruiting and employee pay policy.” “From an executive perspective, one issue I want to share with the board is the need to be more ambitious in utilizing women, beyond our medium-term goals.”*

Takeaway: HR leaders should have an opportunity to raise issues where they believe board input would be valuable.

4 The Situation in North America

4-1 The organizational context

Whereas we saw a variety of organizational structures in Japan, in North America our interviewees all had a common structure. The head of HR, usually called the CHRO, reported to the CEO and was not on the board. Even though the CHRO was not on the board, they had a significant amount of contact with the board and in particular with the HR committee of the board.

4-2 Interview results and insights

Key Finding: There is consistency in the approach to governance

Overall there was a great deal of consistency between all the organizations we spoke to. The approach to governance of human capital is well-established in North America.

Takeaway: In North America, the question isn't so much how to approach the Board's role in overseeing human capital, it's more a matter of ensuring the people on the HR committee are qualified and disciplined in handling their responsibilities, in other words, a focus on execution, not design.

Key Finding: Boards have limited time and executive compensation issues take up much of that time

Most organizations have an HR Committee of the Board but in a few cases, it is combined with the Governance Committee. It typically meets 4 times a year for 2-3 hours in addition to the 4 full board meetings. Additional meetings are held if required. An executive compensation consultant we spoke to estimates that 65% of the HR committee's time is spent on matters relating to compensation, limiting the time available to consider other topics.

Unlike Japan, none of the companies scored 1, *Strongly disagree*, in Q2: *The Board is mainly concerned about executive compensation and succession, not broader human capital issues*. The average score was 3.7 (between *Neutral* and *Agree*). This aligns with the conversations that indicated that executive compensation and succession planning weigh heavily on the minds of US/Canadian boards.

There is flexibility in how often the HR Committee meets and what it focuses on. The HR Committee will have special meetings in response to significant events such as a major restructuring

Takeaway: If Boards want to take a broader role in providing oversight of human capital and its role in driving organizational value, then they will have to have more meetings since there simply isn't time to take on much more in the current set of meetings.

Key Finding: Boards tend to avoid digging too deeply into HR matters

HR Committees usually only look at basic HR metrics. Most HR committees keep an eye on engagement and turnover metrics but do not look more deeply than that and typically do not ask the people analytics team for special research.

The Board wants an overview of HR, not too much detail. Usually, the CHRO prepares a summary of key HR initiatives that is presented to the HR Committee and/or full Board.

Takeaway: There may be a missed opportunity for the Board to dig deeper, and help uncover strategic opportunities and risks.

4-3 Notable comments from interviews

Insight: Boards need to make an effort to ensure they are getting good insights about human capital, they cannot take this for granted.

- **Boards need to trust leadership is being open:** An HR leader admitted, “I can use the metrics to tell any story I want; the board depends on me telling it straight.” A board member lamented, “We only know what management decides to tell us, so they need to be open about the business situation.”
- **Good board members do their own research:** “Board members visit customers, partners, and branches...and are very curious when they do.”
- **Hotlines provide a way for employees to get information directly to the board:** “We pay attention to hotline complaints that present a risk of litigation, a failure to comply with regulations or reputation risk.” The hotline provides an important source of information to the board.
- **In the US, leaders are reluctant to share any more detail than they are required to.** “Reporting human capital information to investors is a risk to the company.”

Insight: Boards can theoretically add value by having a long-term focus but in practice, they focus on tangible short-term issues

- **The HR Committee has a short-term focus:** “The HR committee looks at what HR needs to do in 3, 6, and 12 months. There is not much point in looking beyond that because the world changes so quickly.”

Insight: HR leaders have a role to play in adapting to the styles and strengths of their board members

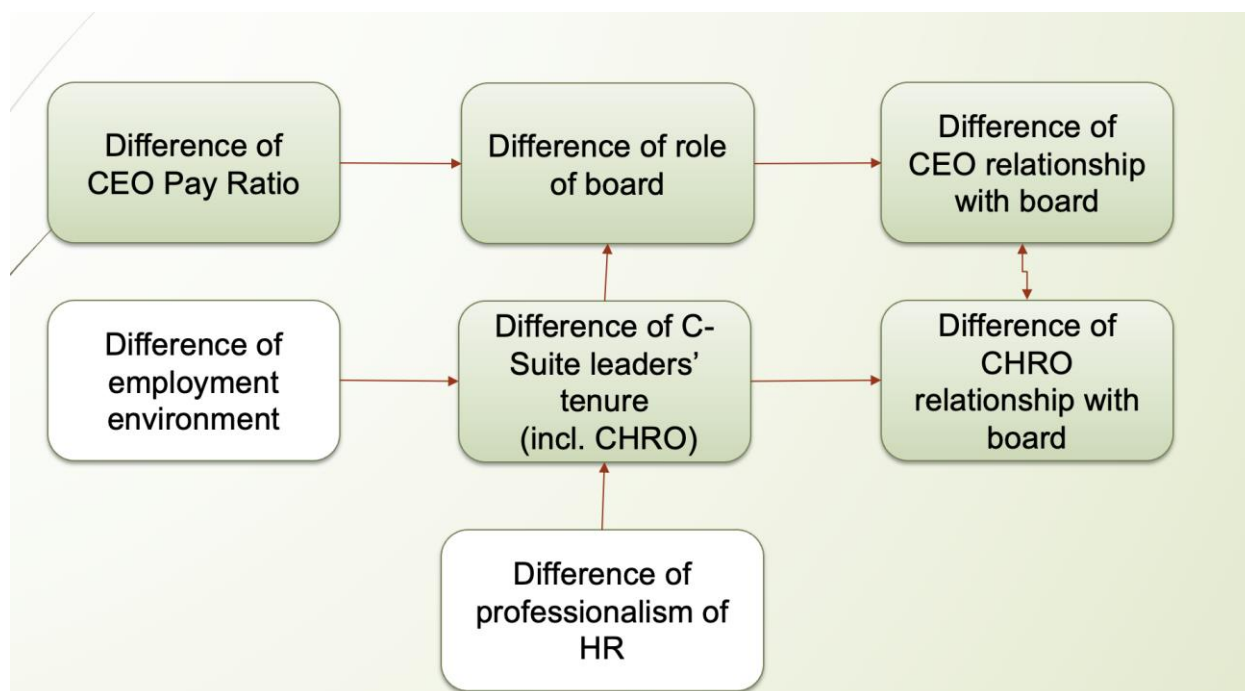
- **Different boards have different styles.** “Some boards are much more aggressive than others in influencing how the business is running. The CHRO needs to understand the personality of the board.”
- **Some board members are very effective, but not all.** “Some board members ask interesting and challenging questions, some do not.”

- HR leaders in North America observe that their boards show interest in meeting with high-potential mid-level managers. This differs from the situation in Japan. We hypothesize that this difference may be due to the varying tenure of HR leaders in Japan and North America.

6 The Important Differences between Japan and North America

There are many important differences between Japanese and North American organizations that affect board-HR relations. We summarize some of the issues to be considered in the figure below:

Figure 2: Differences between Japanese and North American organizations



- **Average CEO Pay Ratios are entirely different between Japan and the US**

According to Mercer Japan, while the CEO Pay Ratio in the US is 100-400, it in Japan is 20-30 <https://www.mercer.com/ja-jp/insights/consultant-column/888/>. Furthermore, most of the pay of US CEOs is in the form of a variety of short and long-term incentives that need to be carefully designed. The size and complexity of US CEO pay schemes mean that the HR committees of US boards need to devote the majority of their time to executive pay issues.

- **C-suite leaders in North America are more likely to leave for another company than in Japan.**

In the US, it's common for C-suite leaders to have a short tenure, which means NA boards need to pay extra attention to succession planning. (Please see the differential of the score between Japan and NA in Q4 of the questionnaire.)

- **NA boards generally strongly adhere to the principle of “oversee but don’t meddle in management”.**

In Japan, there is an opportunity to be more flexible in finding the appropriate level of intervention by boards.

- **Our dataset, while small, suggests the NA HR leaders have had far, far less time in the company on average than Japanese HR leaders.**

This means the NA HR leaders likely won't have the same depth of understanding of their organization.

- **NA HR leaders are HR specialists, while Japan HR leaders are generalists.**

This reflects the relationship between boards and HR leaders from the viewpoint of which has deeper professionalism. (Please see the differential of the score between JP and NA in Q9 of the questionnaire. Japanese HR leaders respect the HR-related experiences outside the company of the board members.)

7 Summary & Recommendations

Boards in Japan and North America have the same goal with respect to human capital: create value and mitigate risk. However, the organizational context is sufficiently different such that we see substantial differences in how boards work with HR. Those differences are summarized in the table below:

Comparison of HR Governance in Japan and North America

| Topic | Findings | Implication |
|-----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Governance Style | <ul style="list-style-type: none"> ✓ Japanese organizations have various approaches to human capital governance ✓ The US –approach to human capital governance is fairly standard | <ul style="list-style-type: none"> ✓ Japanese boards have the opportunity to tune the governance approach to their own situation, but if they fail to do so then there could be mistakes and missed opportunities. |
| CEO Pay Ratio | <ul style="list-style-type: none"> ✓ The Japan – CEO Pay Ratio is small ✓ The US – CEO Pay Ratio is high and pay is largely based on incentives | <ul style="list-style-type: none"> ✓ Japanese boards have time to focus on a range of HR issues. ✓ US boards have to spend a lot of time determining CEO compensation. |
| HR Leaders Tenure | <ul style="list-style-type: none"> ✓ Japan –HR leaders have spent a long time in their company ✓ US – HR leaders have spent a short time in their company | <ul style="list-style-type: none"> ✓ Japanese HR leaders know the company very well but do not have other perspectives. The board should complement the HR leader by providing outside views. ✓ US CHROs have an outside perspective because they have typically worked in several organizations but may not know the company as deeply as Japanese leaders. They may import ideas that worked elsewhere but are not appropriate in the current organization. Boards should be alert to a CHRO who over-relies on what worked elsewhere. |
| Professionalism of HR | <ul style="list-style-type: none"> ✓ Japan – HR leaders are business generalists | <ul style="list-style-type: none"> ✓ Japanese boards should support HR leaders by sharing HR expertise. |

| | | |
|--|--------------------------------------|-----------------------------------------------------------------------------------------------------------|
| | ✓ US – HR leaders are HR specialists | ✓ US boards should support HR leaders by ensuring HR activities are aligned with the business priorities. |
|--|--------------------------------------|-----------------------------------------------------------------------------------------------------------|

While human capital governance in North America is more mature, which can be an advantage, there is less flexibility than in Japan. In particular, the need to devote so much time to executive compensation in North America limits the time spent on other human capital issues. It's also the case that boards in North America are generally careful to avoid “meddling” in management. This can be a good thing, however, there may be times when more active board involvement would help overcome short-term thinking. Hence, in Japan, there is an opportunity for the board to have a greater impact on human capital management, which is a good thing if it is handled well.

Japanese boards have a potential advantage over North American ones in that their HR leaders likely have spent decades in the organization and know it inside out. One of the disadvantages of Japanese companies is that HR leaders who have been in their organizations for a long time often play a coordinating role within the organization, making it difficult to make changes on their own. In situations where fundamental organizational change is required, it may be necessary for the board of directors to invite a transformational HR leader from outside. Secondly, in Japan HR leaders are not necessarily specialists in the HR field. Boards cannot rely on HR leaders to have years of experience in HR. The Japanese HR leaders targeted in this research hope that board members will offer different perspectives based on their experience in the HR field and that they will participate in discussions about whether human capital strategies are on track.

Based on the above considerations, it may be safe to assume that the board of directors has an opportunity to play a greater role in human capital management in Japanese companies than in North American companies.

7-1 Best practices & issues observed in Japan

The table below summarizes some of the best practices observed in Japan, along with some common issues. At a high level, the best practices can be summarized as a highly engaged board that spends plenty of time discussing human capital management. At a high level, the issues relate to boards not having those discussions, or not having an effective collaboration with HR.

| Best Practice | Issues |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ✓ In some Japanese companies, HR leaders felt that their board of directors was effectively governing human capital from a broad perspective. These companies had multiple platforms for strategic discussions between HR leaders and | ✓ Some HR leaders feel that strategic discussion at the board level is necessary, but they have no appropriate opportunity for such a discussion. (HR leaders feel the full Board meeting isn't a |

| | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>board members. Some specific practices included:</p> <ul style="list-style-type: none"> ◆ Annual agenda setting for the board of directors and discussions before and after ◆ An HR strategy committee as an advisory committee to the board of directors ◆ Retreats involving board members and executive officers ◆ Collaboration between HR department leaders and external HR experts ◆ Disclosure of human capital information at the sustainability committee ◆ Discussions on D&I in the nomination committee. ✓ Some companies create opportunities for outside board members to meet high-potential middle managers. | <p>good fit for such strategic discussions).</p> <ul style="list-style-type: none"> ✓ Some HR leaders mentioned serious HR risks (especially in the area of recruiting and employee pay design), but they cannot share such risks with the board. ✓ Through the interviews, it appeared that some HR leaders were trapped in the mindset that the main role of the board is to approve rather than discuss. ✓ Some HR leaders struggled with deciding how much detailed HR-related data was necessary to report to the board, while others were challenged by the wide range of data requests from the board. |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

7-2 Key Recommendations for Japanese Boards

- **Define the roles.** In Japan, organizations need to define the roles of the board of directors and human resources leaders in appropriately supervising and supporting human capital management. Although the level of appropriate intervention and supervision by the board in human capital governance differs from company to company, we must reaffirm the importance of "discussion" as well as "approval/decision" in the board's role. Additionally, top management needs to discuss how HR leaders should be creating corporate value through human capital, drawing on ideas that go beyond traditional HR functions. (Please refer to Appendix 5.)
- **Create the right platform for oversight.** Organize an appropriate platform for having strategic human capital discussions at the board level by establishing a board committee whose members have expertise relevant to human capital.
- **Set aside sufficient time.** Set the agenda for the HR committee and realistically assess the time required for a value-added discussion. Additionally, ensure there is time for

board members to visit locations, customers, and suppliers as part of their preparation for the human capital discussions.

- **Make more sophisticated use of HR analytics.** The board should ask for a variety of HR information, not limiting themselves to standard metrics such as turnover and engagement. HR analytics should provide insight into human capital matters that are key to value creation, risk mitigation, and business success.

7-3 Key Recommendations for North America Boards

- **Have more HR committee meetings.** Consider having more HR Committee meetings so that there is time to adequately cover topics beyond executive compensation and succession.
- **Be clear about where the HR Committee is likely to be able to add value.** In particular, the committee can work on ensuring HR strategy aligns with the business strategy, identifying human capital risk, ensuring there isn't an undue short-term focus, and ensuring that the nature of financial reporting doesn't lead the organization to undervalue human capital.
- **Make more sophisticated use of HR analytics.** Take advantage of the organization's people analytics capability to get evidence-based answers to strategic questions (e.g. which jobs are pivotal, see Appendix 4).

8 Appendices

Appendix 1: Human Capital Topics of Interest to the Board

Observed from interviews

- Executive compensation
- Succession planning
- Core HR metrics: e.g. engagement, turnover (incl. disclosure of the metrics)
- Human capital investment and return
- Alignment of HR strategy and business strategy
- Organization culture change

Additionally Recommended by BI

- Discussion on any significant human capital risks
- Review of employee complaints, 'whistleblower' communications
- People analytics that provide insight on specific issues of concern to the board
- Review of 'pivotal role' and 'pivotal talent' essential for success, not just top jobs
(see Appendix 4)
- Overall compensation strategy (see Appendix 2)
- Discussion on how AI impacts human capital management (see Appendix 3)
- Restructuring of the role of HR leaders (please refer to Appendix 5)

Appendix 2: Investor Critiques of Alphabet HR

What happened

A major investor, TCI Fund Management, wrote a strongly worded public letter to the CEO of Alphabet criticizing their overall compensation policy, saying it was far too high.

Why this is interesting

It's unusual that the investor felt they needed to go public to make their point. It's unusual to address an HR issue like average compensation, not just executive compensation.

What does this tell us about the Board?

HR decisions have a material impact on results. It's not enough for the board to focus on executive compensation and succession. TCI Fund's letter chastised the CEO; however, it should also be seen as a critique of the Board for not keeping an eye on overall compensation levels.

Source:

<https://www.tcifund.com/files/corporateengagement/alphabet/15th%20November%202022.pdf>

Appendix 3: Are Boards Ready for AI?

When we asked CHROs to react to the statement: *“The Board has shown concern about the impact of AI on employees”* the average answer in the US was between neutral and disagree (2.6).

This is understandable given how unexpected the quick advances in AI have been. Nonetheless given the potentially disruptive impact AI could have on the organization and its employees, AI should be on the board’s agenda.

AI experts are worried that advances in AI in 2024 may be even more revolutionary than what we saw in 2023; that concern should be reflected at the board level.

Appendix 4: Role of the board in “pivotal roles”

Pivotal roles are critical jobs that may be overlooked because their importance is not always obvious. As such the Board can play a useful role in probing to ensure HR has identified these roles and is acting accordingly. The Board may even have fresh insights on what roles are pivotal based on their experience with other organizations. This activity, discussing pivotal roles, is a good example of how a Board can add value by focusing on human capital.

Background

The definition of pivotal roles, from Dr John Boudreau, is “Roles where an increase in the quantity or quality of talent will have a significant impact on the execution of strategy.”

One example of where the quantity of talent was critical came from a telecoms company that was counting on the successful launch of a new product. However, each sale required a relatively low-level technician to install the product. Without enough of these technicians, sales could not be finalized. In this case, the easy-to-overlook low-level technicians were crucial to the execution of the strategy.

An example of how critical the quality of talent is can be found at Apple. For their strategy they needed something other than good designers, they needed the best designers in the industry. Having the best design gave a big advantage over the second-best design, and hence the best designer was far more valuable than the really good, but second best, designer.

Understanding which roles are pivotal will affect who you hire, how much you pay, and how you manage talent.

Appendix 5: Redefining the Role of HR Leaders

If organizations change the role of the board in overseeing human capital, that will inevitably have an impact on the role of HR leaders. One model of an enhanced role for HR can be found in the book *The CMO of People: Manage Employees Like Customers* by Peter Navin (Chief People Officer, US Olympic Committee) and David Creelman (CEO of Creelman Research and co-author of this study on boards). The theme of the book is that there are useful parallels between the Chief Marketing Officer (CMO) and the head of HR who can be seen as a kind of “CMO of People”.

Here are four elements of the CMO of People model that may be relevant to HR leaders both in Japan and North America:

- **Intensely close connection between the head of HR and other C-suite leaders.** In the CMO of People model the head of HR is very much a part of a core leadership team; it’s not a support function that sits off to the side. In a case where the organization faced a financial crisis the CEO-CFO-Head of HR “linked arms” so that every decision about strategy, finance, and people was aligned to get the company through the crisis quickly and effectively. In less stressful times, the CMO said he met with the head of HR for at least half a day per week—so it was a close collaboration, not two functions working on their own.
- **A strategic view of HR.** While HR has significant administrative and compliance responsibilities; the conversation among C-suite and board members is not about these, the conversation is about HR’s strategic impact. One strategic concept taken from marketing is the “total lifetime value of an employee” (in marketing it is the “total lifetime value of a customer”). Instead of seeing an employee as a cost, HR frames employees as generating value over the course of their time with the organization; and HR’s role is to maximize that value over all the years.
- **An emphasis on data and analytics.** Every important function comes to the C-suite and board with data. HR needs to be able to do the same. Notably, marketing made the transition from emphasizing opinion to emphasizing data. HR needs to make that same transition.
- **The “End-to-End Employee Experience” as an organizing principle.** Just as marketers have developed the concept of the customer experience, so too HR needs to develop the concept of the employee experience. The employee experience focuses on specific, tangible events. For example, “What is it like for an employee on the first day of their job?” and “What is it like for the employee when they need to use a meeting room?” The question is does the experience align with the company brand/culture and does it enable productivity? The concept of employee experience takes HR from the level of abstract concepts to specific areas where they can make improvements that ultimately will increase the lifetime value of an employee.

There are different models for HR and the CMO of People is only one such model. However, the broader point is clear: if the board is going to drive more value-creation through human capital then the role of the HR leader must be re-designed to support that.

This research was conducted and reported by Ms. Kuniko Takahashi and Mr. David Creelman of BoardHR Initiative with support by WICI (The world intellectual Capital/Assets Initiative).

About BoardHR Initiative and the authors, please refer to the following website;

<https://www.boardhr-int.com/>