

A strengthening nexus: Boards and the CHRO

Look for a company's chief human resources officer to become a much closer and more highly valued counselor to the board of directors. The times, and the board, will demand it.

IF YOU'RE EYEING THE LANDSCAPE for developing trends, here is one that's going to break big. The complexity and sweeping scope of compensation and leadership development issues will drive an ever-closer connection between the HR function and the board of directors. The board will need this. Just look at what's happening now and what's ahead: the intricacy of crafting and disclosing compensation plans; the implications of "say on pay"; the greater rigor being brought to performance appraisal; the intense pressure on the board to ensure CEO as well as senior team succession; and the movement toward proxy access, which would drive HR's heightened involvement in board composition. These are just a few of the forces that will cause directors to require more and better input from the chief human resources officer (CHRO) to fulfill their oversight responsibilities.

To more fully grasp how HR officers can be vital counselors to the board, *DIRECTORS & BOARDS* visited with the CHRO Board Academy at its meeting in June 2009 at the Wharton School of the University of Pennsylvania. Formed by Dennis Carey, senior client partner of Korn/Ferry International, the CHRO Board Academy is an organization that specializes in preparing human resources executives to work with their boards as well as to serve on outside boards. (A companion

trend of senior HR officers becoming a more involved resource for the board is for boards to recruit top HROs as members so as to boost the board's expertise on pay and performance, much as boards have done by adding financial experts.) What follows are excerpts from presentations made by three of the participants at the Academy's June meeting:

- **Kathy J. Herbert**, board member of Covidien PLC and the former EVP of human resources of Albertson's Inc. She is a preeminent example of the HR expert who has been recruited as an outside director. (Covidien is the former Tyco Healthcare Group, a \$10 billion manufacturer of medical devices and other products that was spun out of Tyco International in June 2007, at which time she joined the board.) She serves on Covidien's compensation and human resources committee.

- **Angela S. Lalor**, senior vice president of human resources of 3M Co. She joined the company in 1990 and was named to her current position in 2006.

- **Ian V. Ziskin**, corporate vice president and chief human resources and administrative officer of Northrop Grumman Corp. He co-chairs the CHRO Board Academy with Daniel J. Phelan, chief of staff of GlaxoSmithKline.

Read on for the developing opportunities for HR's "voice" to be heard in boardrooms in the era ahead.

— James Kristie

What the board needs from the HR chief

BY KATHY J. HERBERT

THE HR POSITION is one the most exciting in a company because it influences most areas of the business. Here is my Top 10 list that addresses how to become a chief human resources officer (CHRO) who is a trusted adviser to the board. And for board members, this is a list of what you should be looking for from your CHRO.

1. Understand your people

Know your pipeline. Understand your talent up and

down. If you are building depth charts, focus on leadership risk management — assessing the criticalness of each role and the flight risk of its incumbent. Show the board how you plan to deal with anticipated vacancies. Make sure your succession plan ties in with the strategic plan, and make sure your board knows that it does. As a board director, it is important that we know your high-talent people. You always hear — "people, people, people." People are the most important assets and your

board should know the current and future leaders of your organization. But there are many issues that compete for the board's attention. Many HR executives develop talent presentations and profiles, but that just gives us faces and names. We still don't know the people. Whether at lunch, dinner or other scheduled events, you need to figure out ways to get your talent in front of the board.

2. Understand your costs

You need to understand how every dime is spent — not just in your function but throughout the company. And you need to be ruthless on cost management, in good times and in bad. If you become a daily champion of effective cost management, you will gain credibility. Directors will appreciate your strong partnership with the CFO and your ability to work cross-functionally on the cost structure. Further, when a real need emerges and you come to the board for capital, you'll have an easier time justifying your requests.

3. Understand the business of business

Speak P&L! The board wants you to have a deep understanding of the business. An HR executive should be a business professional first. I found that the less you engage in what I call HR “psycho-babble” and the more you speak the language of the P&L and finance, the better equipped you are to help the board. In many organizations the HR chief is all about rules, regulations, programs, and mounds of paperwork. While it is clearly important that you possess and demonstrate expertise in your field, the board expects you have a deep understanding of business. If necessary, determine your needs and seek professional development to increase your knowledge and business acumen.

4. Understand your CEO and executive team

The HR chief should coach, advise, and provide the confidential leadership support that the CEO and members of the executive team need. You should know what makes the CEO tick. The board expects you to fill this role. Know the leaders and be ready to offer your point of view, if asked. This is especially important with businesses having gone through so much M&A and restructuring activity. A board member may come to you specifically and ask your opinion about executive A, B, or C or about how they are thinking about a certain issue. For example, when I was an HR exec, the head of the compensation committee would phone me and say, “I know what the CEO's opinion is on this. I want yours.” A call like that requires you to know where the executive team stands on the issue. You



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have to have the confidence to be able to state your opinion but also put it in context with the rest of the executive team. The other dimension of this point is that you should provide an understanding ear. The executive team needs to feel that you are there to hear them and listen to them, and that you can offer sound counsel and advice.

5. Understand your company culture

One of the key lessons I can offer to HR chiefs is that the best way to improve, align and advance your company culture is by learning it, living it and working from within it. What is the primary culture? What and where are the subcultures that

affect executions and outcomes? This is important to me, as a board member, because with each of these cultures come people issues that can impact the leadership of the organization in the filling of executive appointments and succession planning. Whether you are growing acquisitively or organically, you must be mindful of how the culture is formed and how cultural determinations can

bubble up to the board. Ultimately, you want to eliminate succession and leadership decisions that are based on poor cultural norms.

6. Understand your profession

Obvious? Maybe. The outside world has made this even harder today; everyone has a say in how you do your job — new information and government

HR as a driver of new thinking

Angela Lalor spoke at the CHRO Board Academy on HR's role at 3M in helping the company transform itself in a number of ways over the past five years — everything from reorienting its strategic focus to overhauling its compensation system to revamping its leadership development. A few of her key pointers:

On Driving a New Strategic Focus: “3M is a 107-year-old company, which for 98 of those years had CEOs who came from the inside. The culture was one of R&D excellence that generated products for which we then went out and found markets to buy them. Our challenge was to transition to a much more outside-in focus — in essence, dragging the company into the new competitive world. The first big break from this inwardly focused culture came when Jim McNerney joined us from GE. That was a big culture shock to the organization. He tightened us up as a global organization. When Jim left to go to Boeing and George Buckley became CEO, his focus was to take the operational efficiencies that Jim achieved to then drive top-line growth. That meant much more increased accountability and line of sight in this complex matrix organization that is in 90 countries. George’s position to the unit heads was this: ‘You all run different businesses. I can’t decide on the strategy for each of your businesses. You need to decide on that — and that means you have to be much stronger and more holistic business leaders.’ By busting the insular mindset to get the leadership team much more in tune with the competitive landscape, he created an environment where it was okay to have conversations about strategy and people that were uncomfortable. That was hard for the organization to get used to, and HR had to help drive that into the organization — to tell people that it is okay to have the

tough conversations. This has been a heavy responsibility on HR to work with our business leaders to bring more rigorous thinking to their strategic and operational planning.”

On Revamping the Compensation Structure: “We basically changed every program that



we had. For example, our short-term incentive comp plan had been in place relatively unchanged for over 50 years. We threw it away and instituted a much stronger pay for performance plan, one that pushed accountability into the business units. Because the program is much more variable now, it initially created some fear. We realized we didn’t do enough upfront selling of the business case for the changes. Your senior leaders and the level below that have to be on board to get a major change like this accepted. The compensation committee of the board agreed that

change was in order. In fact, the compensation overhaul was a byproduct of the CEO change, a comp committee chair change, and an HR leader change.”

On Enhancing the Leadership Development Program: “To match the new strategy, we needed to redefine what it means to be a leader in the organization. A fundamental element of our approach was to identify six leadership attributes that would be ‘owned’ by the senior leadership team and driven through every aspect of HR — from selection to assessment to pay. For example, ‘Thinks from the outside in’ is one of our leadership attributes that didn’t exist before but is now one that we are trying to live by. What we’ve also done, which has been tied in with our CEO succession planning, is to do an in-depth leadership assessment of the senior team” (see next point).

On Honing the CEO Succession Plan: “When George came in we had a very open dialogue with the board on succession, emphasizing that we wanted the next CEO to be from the inside. It is much harder for an organization to bring in an outsider because of the education that goes along with that. The board’s direction to George and me was to determine if that leader is here, and, if not, to get candidates into leadership roles so that they are ready when George leaves. What we then did was put the entire operating committee through an in-depth assessment process. The benefit of it was twofold. One, it gave information to George and to me on the team that we were able to share with the board. We were able to lay that assessment up against our own assessment to see where it matched and where it didn’t. It gave the board some validation of our own perceptions of talent.

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regulations are everywhere. This means you need to be a constant student of your trade. Because the complexion of the HR world has changed so dramatically, the board expects that you have current knowledge about the latest trends, legal changes, and external environment in all matters related to human resources. For example, if you come to the board with a compensation program, which typi-

cally is multifaceted, we are going to assume that you've thoroughly vetted the details with all of the appropriate constituents, i.e., legal, finance, and outside consultants.

7. Understand your industry

It's also important to be a student of your industry. Changes that impact trends in your industry

HR's responsiveness to the comp committee

Ian Ziskin was asked by the CHRO Board Academy participants to address the Northrop Grumman board's selection and use of an independent compensation consultant. A few key pointers from his presentation:

On Having an Independent Compensation Consultant: "For those companies that don't yet have one, get ready. The best advice I can give is to get in front of the decision rather than have the board ask you to do it. Northrop Grumman had a long history of using one firm to serve management as well as the board, an arrangement that was seamless in many ways. But our board, as with many boards, began wrestling with the question of having their own independent comp consultant, and that debate led the board to select one."

On Selecting the Independent Consultant: "The board asked me to help them identify a broad universe of consultants first, which we then narrowed down. The board was very clear that they were going to make the final selection. The directors ended up interviewing three firms before making their final selection."

On Interacting with the Consultant: "One of the rules that we had when we began this process was 'no surprises.' We didn't want a situation where we would have a ping-pong match between management and the independent consultant. Overall that has worked out well. We have a good sense of where the independent consultant stands on an issue so that when we get into the compensation committee meeting we can have a good debate. What often happens is we will go into the comp committee meeting and present on those items on which the board's consultant agrees with management's position and the consultant will then cover those items where

it has concerns. Sometimes the directors will agree with the consultant if the consultant suggests we should go in a different direction, but more often than not the committee will end up agreeing with management. I think it's fair and reasonable that the committee has access to this independent viewpoint."



On When Disputes Arise: "I would not say we get disputes often. What we find is that management's adviser and the board's consultant tend to agree on the data, but where they may differ is on the interpretation of the data. I put it in terms of market prevalence versus business relevance. Here's an example. The independent consultant might see defined benefit pension plans, including at the executive level, as a benefit that is quickly dissipating throughout industry, which is true. However, within the aerospace and defense business, where we compete for talent, these plans are

not quickly dissipating at all. That has led to quite a bit of debate about the impact on our hiring of any changes we might make to our compensation programs, and requires a lot more due diligence, analysis and debate to make sure everyone sees the world the same way. But, in the end, I think we end up agreeing more often than not."

On the 'Independence' of the Independent Consultant: "You will find that compensation committees increasingly are insisting that the independent consultants they retain are, in fact, independent — meaning that they are not doing any other work on behalf of the company. Well, good luck! The universe of comp consultants is small and most of them have been 'tainted,' if I can put it that way, by doing lots of work on behalf of management. As more and more companies decide to go down this path of retaining an independent consultant, my concern is whether there will be enough qualified firms out there to actually take on the work. There are a lot of people who would be happy to jump into the game but there are few who are really knowledgeable and experienced enough to operate at that level with the board."

On Retargeting the Compensation Strategy: "A few years ago we began a debate with the comp committee and the full board on bringing some of our compensation practices more in line with how the company is performing relative to its peers. The board charged us to completely rethink the degree of difficulty of our goals. Our tendency had been to focus on specific metrics that we pay for — return on assets or whatever the metrics we all have and use. The board was more interested in how hard it is to get to target and how hard it is to get to maximum performance. The board's

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And secondly, the assessment gave important development clarity to everybody on the senior leadership team. While there may have been some initial reluctance to go through this process, the team was so appreciative of the approach and what it taught them about themselves that we are now rolling the assessment out to all of our 110 senior division leaders and their operating committees. So this has been very successful from a development planning standpoint and shows the investment we are making in them, as well.”

On Creating Board Opportunities: “Another key component of our development program is to have our senior business leaders participate on outside boards. This was not encouraged before, but George was very open to us educating our leaders on what being on an outside board means and then working with some firms to get them placed on outside boards. Especially these days, getting

a better grasp on the relationship of a CEO with a board and with governance matters and thinking through the enterprise-wide issues that come with being a CEO . . . it is hard to get that in any other way than serving on a board. There are advantages and there are risks to doing this. One risk is you unveil your leaders to the outside world, and may

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make it more likely that they leave for other opportunities. But if we are not developing people that other companies want, shame on us. If other companies don’t want our top people, why should we? On the plus side, we have seen lots of advantages in the maturity of their thinking on operational issues inside the company.”

On Other Development Initiatives: “With 65% of our business being international and growing much more rapidly than our U.S. businesses, we also have been focusing on local leadership development. We have been on a mission to make sure that we take any ceilings off within the countries where we have operations. Moving away from the notion that a German can’t run Germany has put talent on the radar screen that was just hidden under a rock before. That has been very beneficial for us. The other key change that we have made is to focus more on the quality of assignments rather than quantity of assignments. Keeping a business leader in a job long enough to confront challenging situations, make tough choices, and then live with the consequences of their decisions can be as powerful or more powerful than having somebody experience lots of different businesses. We are keeping people in their roles longer to try to get that kind of learning.” ■

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perception was that no matter what the metrics were we always ended up achieving near-maximum performance. One of the most important things we have done is to prove to the board that we have made our goals harder to achieve. We have gone through a process of changing 15-20 major elements that we have in place in the company. This included shifting to value-based guidelines for long-term incentive from share-based guidelines, eliminating some perks, rethinking our whole pension and benefit structure at the executive level and below, substantially changing the mix between base pay and bonus and long-term incentive and how each of those is determined. We raised the bar on how difficult it is to achieve each of those components of the program. The two most difficult things we implemented this year were the elimination of the CEO’s employment agreement and eliminating gross-ups from change in control agreements, as well as significantly reducing the number of people who are covered by the change in control agreements. These were

emotionally charged moves, but it was worth doing to get in front of the shareholder voting on say on pay issues. What I’ve learned going through this change process over the past two years is that these concerns about

‘It’s fair and reasonable that the compensation committee has access to an independent viewpoint.’

our pay program had been floating around the comp committee, and as we addressed them any tension between the board and management on these issues has lessened substantially.”

On Improving Communications with the Board: “I will share a story that we have been

through recently with our board. Northrop Grumman, as an engineering and technology company, is a Power Point culture. We speak to each other at meetings through Power Point, and we presented to the board that way too. Well, after three years of the board trying to tell us in polite ways, we discovered that they hated Power Point. Directors felt the presentations were a little too polished — that maybe all they were being told was what was going right with the company. So we have moved to a format that provides for much more dialogue and discussion. We’ll use a couple of charts to make a point or two and our presenters will speak for relatively short bursts, and then we open it up for questions. The information that is shared is exactly the same as it would have been shared in Power Point form but the board feels much better about the level of interaction and that they are getting a more balanced picture. For us, that was a real epiphany in terms of how your company culture can get in the way of interacting effectively with your board.” ■

may impact your stock, decisions by your executive team — and maybe even the mood of your CEO. If you understand industry dynamics, you can better partner with business leaders around tactical plans, strategic change, and talent movement decisions. You'll know where and when to mine talent and how to best advise other human resources professionals. For example, when the industry announces some devastating development that tanks the whole sector, it is probably not a good time to make a major capital request for your department.

8. Understand what you do well

The board has to trust you. Be honest with us and with yourself about what you know and what you don't. Surround yourself with people on your team who are experts in the areas where you are not. We're expecting you to provide complete information and solid recommendations. Be error free to the board. HR credibility has a lot to do with the accuracy of your data, so make sure it's right. This also means getting processes and systems in place to give you accurate, timely and error-free data. Scrub it before we get it . . . and when there are errors, limit the number of times you have come to us with corrected data. If there is a mistake made, we don't want you to bury it. We want you to tell us and fix it. But constant problems may signal a broken process. Be mindful of that when you're bringing in something for approval. The final key dimension on this point is that board members need continuity of your data from meeting to meeting. Sometimes this will require a bit more explaining than what might be necessary for a monthly executive staff meeting. A board typically meets six to eight times a year. That means there are time gaps between meetings — and things happen. For example, at one board meeting you are praising "Pete" as a rising star and how he is going to run the company some day, and two board meetings later he is gone. Well, what happened? We're not there every day, and we sometimes sit on more than one board. By making sure you communicate regularly and clearly, you won't have us wondering, "What kind of thought process are they using? Do

they even have a plan?"

9. Understand and live the company values

The tone is set at the top. Be mindful of the decisions you make, and those that you don't. Remind others that values are demonstrated over time, not just at scheduled company events. Coach others to be keenly aware of that and expect the same of your team. The board is going to look to you as a kind of litmus test on the "hygiene" of the company, so know what is going on around you and how people are feeling.

10. Understand how to leverage the board to maximize your results

In the past the board of directors was hands off. The only person who talked to the board was the CEO. Other executives didn't have much to do with the directors except to see them when doing pitches at a board meeting. This is not as true today. It is not uncommon for business leaders to invite board members to sit in on a meeting with their team leaders. This is a great opportunity to meet talent in the organization and better understand how they think about their business. Every director I know on a board is more than happy to offer guidance whenever needed. If you've got a "stumper issue," chances are someone on the board may have dealt with it in the past and can offer some helpful insight. I view my role on a board as a privilege. For me, it's a way to give back. It's a way to help and work to increase shareholder value. I think most directors feel the same way.

In my experience, and taken individually, each of these points is not revolutionary. But when collectively executed, I believe they are transformational for your board . . . and, most importantly, for you as the CHRO ■

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