DIRECTOR DIALOGUE SERIES

Board Oversight of Talent Strategy

Introduction

Human capital is simultaneously one of the most critical risks and one of the greatest sources of opportunity for organizations of all sizes and sectors.[1] According to a survey of equity analysts, management team strength is the most important driver of investment decisions, outranking "earnings performance" and even "future growth potential."[2] Other research suggests that the positive financial impact of hiring a top performer can range anywhere from 10 to 100 times the individual's compensation.[3] Yet many organizations are facing a talent shortage—"in the United States alone, the 2020 job market will have 1.5 million fewer college graduates than are needed"—and these potential employers are "still battl[ing] entrenched issues such as workplace diversity and the 'glass ceiling' for women."[4] According to Protiviti Managing Director Jim DeLoach, "Succession challenges, the ability to attract and retain top talent, and organizational culture issues such as resistance to change—which is closely tied to employee engagement—are all significant areas of enterprise risk for companies."

Talent strategy is an integral component of a company's overall business strategy. It is no coincidence, therefore, that boards are expanding their oversight of management's activities related to talent acquisition, development, retention, and employee engagement throughout the organization. For the past three years, respondents to NACD's governance surveys have ranked "executive talent management and leadership development" among their boards' top five priorities, reflecting the fact that many directors see it as a full-board responsibility.

In 2015, NACD and Protiviti hosted a series of roundtables that brought together more than 65 directors of public and private companies to discuss current challenges and effective practices in board-level oversight of talent strategy. The sessions highlighted three imperatives for board members:

- Set clear expectations about the board's requirements for a human-capital strategy.
- Use incentives to reinforce management's focus on talent development.
- Seek opportunities for directors to participate in talent-development efforts beyond the C-suite.

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[1] National Association of Corporate Directors (NACD), *Report of the NACD Blue Ribbon Commission on Talent Development: A Boardroom Imperative* (Washington, DC: NACD, 2013), p. 7 (hereafter, *BRC Report on Talent Development*).
[2] Id., p. 7.
[3] Oracle Human Capital Management, *Modern HR in the Cloud: Best Practices for Recruiting the Best Talent* (Redwood Shores, CA: Oracle Corp., 2013), p. 2.
[4] Rebecca L. Ray et al., *The State of Human Capital 2012: False Summit—Why the Human Capital Function Still Has Far to Go* (Washington, DC: The Conference Board Inc. and McKinsey & Co. Inc., 2012), p. 4.

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Set clear expectations about the board's requirements for a human-capital strategy.

Many participants reported that the quality and sophistication of their organization's approaches to talent development have improved considerably in recent years, although there is still work to be done. One director described the evolution at his company this way:

> *Our board asked for a presentation from the head of HR on three things: What's our human-capital strategy? What are the key milestones in the plan, and how do we measure them? How are we doing? The first year, it was obvious that there wasn't much of a strategy. The second year, it was much better but still a work in progress. This year, it's finally starting to come together.*[5]

Participants agreed that it is essential for the board to *"set and demonstrate tone at the top about the importance of a robust talent strategy."* They suggested three areas of emphasis:

- **Take an organization-wide view.** The *BRC Report on Talent Development* recommends that boards ensure their companies maintain "multi-year, multi-level internal pipelines of talent."[6] Directors should understand the organization's overall human capital strategy and also ask questions about the company's "executive bench strength," as one participating director referred to it, two and three levels below the C-suite. As one director observed, *"We all have a tendency to focus on high-potentials, however they are defined. But the board needs to know more: how well are we doing at keeping the seasoned players who are good at what they do; how diverse is the pool of incoming employees; and so on."*

- **Use a long-term horizon.** *"What made the difference to [our company's] human-capital plan was one director who kept asking questions,"* said one participant. *"The board saw the succession plan on a regular basis. This director pushed [the issue], saying 'There are a lot of baby boomers on the succession list. What's our long-term plan?' It sent a clear message to management about what we were looking for."*

- **Make human capital a recurring topic on the board's meeting agenda.** Several participants agreed with the director who commented: *"At every board meeting we discuss one or more issues related to human capital, as these connect with the different topics on our agenda."* At another director's company, *"a practice had developed over time where two of the longest-tenured board members would meet privately with the CEO to review the top 25 leaders. Several of us who joined the board as new directors expressed some concerns about this. Now the CHRO does a full talent review with the entire board each year, and we receive interim updates as needed."* Increasingly, compensation committees are taking on a greater level of responsibility for talent development oversight, and a number of directors reported that on their boards the "deep-dive" work happens in compensation committee meetings, with the full board receiving updates on a periodic

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[5] Roundtable discussions were conducted under the Chatham House Rule. Italicized quotations are from participating directors.

[6] *BRC Report on Talent Development*, p. 8.

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basis. The *BRC Report on Talent Development* recommends that "the full board should view human capital through the lens of strategy and risk, with committees providing input to the board on talent development in their respective areas of oversight as appropriate."[7]

Roundtable participants discussed two additional reasons why increasing management's focus on talent development is critical. First, there is a generational imperative: as baby boomers retire and more millennials join the workforce, companies must find ways to capture and transfer vital institutional knowledge. Second, directors of global companies need to recognize that employees at facilities located outside the United States may have concerns that differ substantially from those of their U.S. counterparts. Company leaders must be sensitive to cultural diversity and its impact on behavior even as they reinforce consistent corporate values across the organization.

Use incentives to reinforce management's focus on talent development.

Examples of Talent Development Metrics

- Number of designated successors for key positions who are considered to be "ready now" and "ready in 2 to 3 years"
- Number and percentage of employees in high-growth-potential and high-performance categories, along with their rates of retention
- Changes in employee turnover (including regretted and unregretted departures), vacancy rates, and median recruitment time for key positions
- Changes in demographic profile of current workforce and candidate pool
- Changes in results of employee engagement surveys, particularly during periods of transition (e.g., following major strategy changes, acquisitions/divestitures, and so on)

SOURCE: NACD, *The NACD Blue Ribbon Commission Report on the Board and Long-Term Value Creation* (Washington, DC: NACD, 2015), pp. 28–29.

Another common theme of the roundtable discussions was the role of incentives in reinforcing the board's view that talent should be a top priority for the organization—and accelerating behavioral change on the part of senior management when necessary. As one director noted, *"Over time, we began to realize that our CEO was like a pine tree—very tall and strong, but nothing was growing underneath. We added specific people-development metrics to his [goals]: diversity, churn rate, retention of new hires and high-potentials. That made a difference."* Another participant reported, *"Ten percent of our senior management's long-term incentive plan is connected to succession planning—we want to see a successful cascade two levels deep."*

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7 *BRC Report on Talent Development*, p. 9.

When discussing management's responsibility for talent development, directors underscored the importance of identifying high-performing employees and engaging them in meaningful ways. One director expressed concern that his company "*did not provide enough opportunity to its [up-and-coming] top performers*." Another offered this observation: "*Invest in people's careers and they will notice.*" The notion of a learning environment in which successful employees are encouraged to experiment, seek new opportunities, test new ideas, and contribute to innovating products and processes was a key topic at one dinner session. Participants emphasized that employees must know "*it is OK to fail and learn from failures and what went wrong.*"

Seek opportunities for directors to participate in talent-development efforts beyond the C-suite.

Many boards have established practices that enable directors to interact informally with members of the C-suite (e.g., breakfasts or dinners scheduled in conjunction with board meetings) as part of, or in addition to, the board's CEO succession-planning activities. Attendees at the roundtables agreed that it is also important for directors to interface with leaders at lower levels of the organization so they can, in essence, serve as "[senior advisors] to the executive team on people issues." Many participants reported that they routinely meet with regional, functional, and/or business executives two or even three levels below the C-suite at different sites and facilities. At one company with significant operations in India, the full board spends a week in-country every year: their itinerary includes townhalls and smaller-scale meetings with employees at various levels, including new hires. These forums provide a platform to "get people talking" about issues germane to the company. They enhance employee engagement and provide an opportunity for the board of directors to interact with high-potential employees. For additional examples of roundtable participants' current practices, see "Talent Strategy Oversight in Action" on page 6.

According to participants, these interactions *"serve multiple purposes. The board gets exposure to future leaders and vice versa. But these exchanges also offer a chance for directors to get a firsthand sense of the company culture and employees' views on topics of interest to the board. We ask such questions as, 'How can we be more effective with training programs and technology? What resources do you need?' It brings a different perspective into our capital allocation and budget discussions."*

Conclusion

Nearly 20 years after publication of a landmark research study by the same name,[8] the "war for talent" shows no signs of abating. Directors at leading companies intend to stay actively engaged in discussions with management about the alignment of the organization's strategy with its approach to human capital—at the CEO and C-suite level, and beyond: *"In order for*

[8] The eponymous 1997 study by Elizabeth G. Chambers et al. for McKinsey & Co. is discussed in Ed Michaels, Helen Handfield-Jones, and Beth Axelrod, *The War for Talent* (Boston, MA: Harvard Business School Press, 2001).

our companies to experience sustained growth and profitability in a highly connected world, we need a multi-generational, multi-ethnic, and multi-skilled workforce. The board needs to hold management accountable for making sure that talent never becomes a barrier to the execution of our strategy."

Related Resources

NACD, *Report of the Blue Ribbon Commission on the Board and Long-Term Value Creation* (Washington, DC: NACD, 2015)

NACD, *Report of the Blue Ribbon Commission on Talent Development: A Boardroom Imperative* (Washington, DC: NACD, 2013)

NACD, *Report of the Blue Ribbon Commission on Strategy Development* (Washington, DC: NACD, 2014)

Talent Strategy Oversight In Action: Practice Capsules From Directors

1. *After I retired as CEO, the board asked me to stay involved as the head of our executive development program, as a senior mentor. I meet with 8 to 10 future leaders once per quarter. The current CEO and I get together for discussions before and after, and I report to the board as well.*

2. *We created cross-functional teams of high-potential employees who work together on a real project—instead of the company hiring outside consultants. These teams spend 50% of their time on their day jobs and 50% on their assigned project. As a result, they have to delegate quite a bit; so they need to have a strong team of their own. The teams report to the board over the course of the projects, which gives us direct exposure to them. Some of the projects have resulted in truly innovative thinking.*

3. *One of my companies is a small, high-growth organization. It runs very lean, so bench strength could easily become a significant challenge. We took every senior role and divided it into four parts. Executives have to identify a backup or successor for each 25%. It has allowed responsibilities to be distributed more effectively, and leaders aren't just grooming one person as a successor—they are grooming four.*

4. *Our board asks management to report on future candidates for top roles in multiple time frames: 1 year, 2-to-3 years, and 3-to-5 years. That enables us to identify gaps quickly. Where do we have a lack of successors? Where do we have the same individual showing up multiple times? We can then discuss how to resolve those issues.*

5. *Because ours is a global company, the board reviews our human-capital strategy and talent pipeline from an international perspective. We set the expectation that if you want to move into the senior leadership, you will need extensive international experience. And you can't get your direct supervisor's job. That one simple policy has really encouraged collaboration on staff development among the members of the executive team. Everyone knows their star players will go elsewhere, but they'll get someone else's top performer in return.*

Source: NACD–Protiviti Director Roundtables, 2015.

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