

# Human capital management:

The role of the Board and Management  
and how HR can lead





In the current tight labor market, companies continue to face challenges in recruiting and managing an engaged, diverse workforce with the necessary skills to drive business success and enhance investor returns. Investors recognize that how well an organization manages this critical asset — its human capital — can play a significant role in enabling or derailing a company's business strategy.

In making investment decisions, shareholders are looking for more information on whether a company's human capital management (HCM) programs and processes create risk or provide a competitive advantage that could enhance a company's value. To assess this risk (or possible advantage), investors are scrutinizing how the company discloses and measures the effectiveness of its HCM and whether the organization's management and board are properly engaged in and overseeing this process.

Investors have noted there is significant room for improvement — for both management teams and boards — when it comes to HCM disclosure and oversight, and they have asked regulators to mandate more disclosure. However, companies don't have to wait for new mandates, they can immediately respond to investor concerns through enhanced disclosure and improved HCM processes and measurement. Taking these steps now could be a competitive advantage for the company and yield increased returns to shareholders down the road.

**This article provides:**

- An overview of SEC disclosure requirements related to HCM and companies' current disclosure practices
- A perspective on what good HCM looks like so companies can assess where they are on their HCM journey
- Action steps management and boards can take to enhance HCM oversight and implement best practices



### What is human capital and what is the role of HCM?

While there is no common definition of HCM, we define human capital and HCM as follows:

- Human capital** is the accumulated skills, experience and knowledge that resides in an organization’s workforce and drives productive labor. Since human capital is an asset, it follows that HCM is a form of asset management.
- HCM** is a system of processes designed to: align critical human capital priorities and governance; gather and analyze data on current state; define measures, goals and reporting; and align on points of communication to integrate social media, change management and marketing into an organization’s strategy.

HCM is sometimes conflated with ESG and/or diversity, equity and inclusion (DEI). However, HCM (including DEI) is typically considered part of the social bucket of ESG or at the intersection of social and governance, as noted in the graphic below.





## What is the current state of HCM disclosure?

Since 2020, a Securities and Exchange Commission (SEC) rule has required that public company annual reports on Form 10-K and registration statements disclose the HCM measures or objectives that “management focuses on in managing the business” that are material to investors, so investors can understand the company’s people risk. The rule is “principles-based” and not prescriptive, so companies don’t have to disclose specific metrics beyond the company’s total number of employees. Our 2021 analysis of Form 10-K disclosures indicates that the most common topics covered are employee development and training; diversity and DEI initiatives; a company’s culture, mission, values and ethics; and pay and benefits, as noted in the graphic below.

### Prevalence of HCM disclosure rule topics



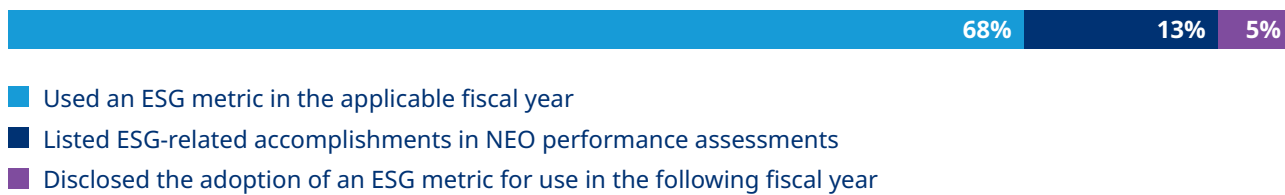
Data from S&P 500 companies that filed 10-Ks with an HCM section between 11/9/20 and 9/13/21

## How are companies holding management accountable for HCM?

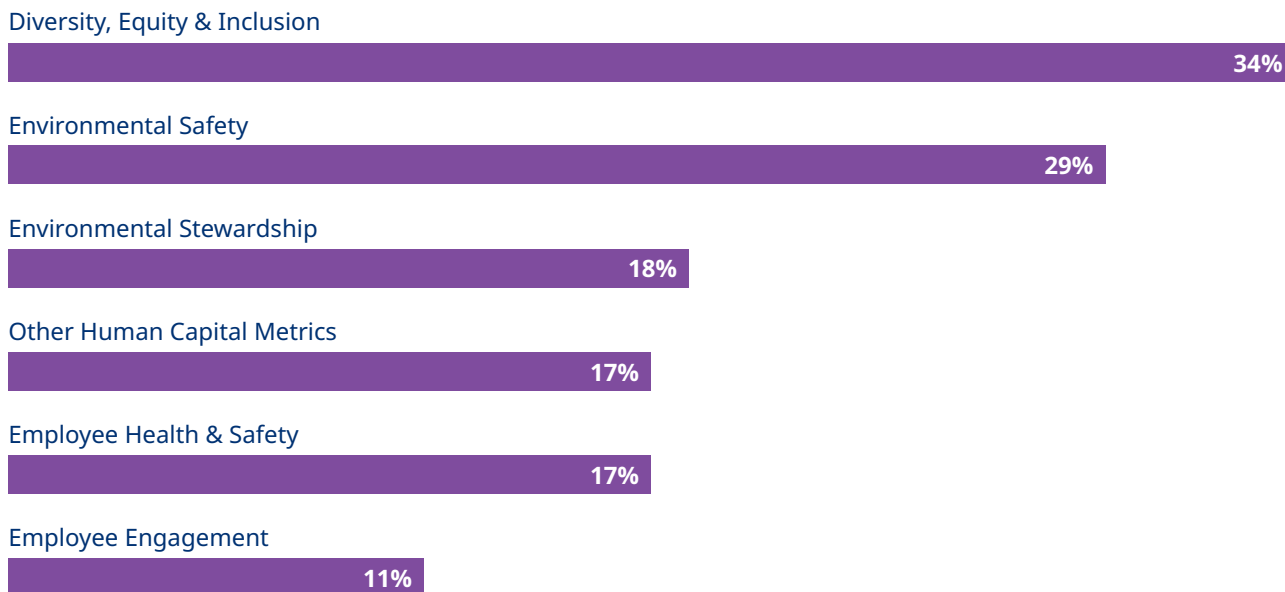
In addition to disclosure, another way in which companies have responded to pressure from investors for more insight into and accountability for HCM is by including HCM metrics in their executive incentive compensation plans. Our 2022 review of company proxy disclosures shows that 68% of companies used at least one ESG metric in their executive incentive plans in 2021 and an additional 5% disclosed their intention to adopt an ESG metric in 2022. A further 13% listed an ESG-related accomplishment in their performance assessment of proxy named executive officers (NEOs), as noted in the first graphic below.

HCM metrics related to DEI made up 34% of ESG metrics. Employee health and safety, engagement, and other human capital metrics were also common, as noted in the second graphic below.

### Prevalence of ESG metrics in executive incentive plans\*



### ESG metrics — overall prevalence by type\*



\* Based on a review of proxy statements of S&P 500 companies with June 2021 to May 2022 fiscal year ends



## What does mature HCM governance look like?

**Boards need to be engaged in the HCM conversation and take an active oversight role in influencing the most critical people-related priorities. It's no longer enough to treat HCM as a compliance activity.**

Most companies are having regular dialogue around HCM topics such as succession planning, DEI, pay equity, pay transparency, turnover and engagement. However, in our experience, there is insufficient attention given to:

- Defining the critical HCM business drivers and risk factors and determining who will be responsible for overseeing them
- Determining how to measure, and potentially reward, action steps and progress toward these critical HCM objectives

Board engagement and dialogue with management on HCM risks and opportunities is the first place to start on a company's HCM journey. However, companies should work progressively toward a more mature HCM governance model that includes alignment on priorities, sophisticated data gathering and analysis, and measuring and monitoring progress toward agreed-upon goals.

**A company with a mature HCM governance model would have:**

- Alignment across the board and management on the HCM priorities that are critical to an organization's strategy and mission
- Human capital data showing emerging challenges and opportunities
- The full capture of data in a human resource information system and ability to use the data to conduct sophisticated DEI, pay equity, turnover and engagement analysis

Typically, both oversight and disclosure of human capital falls under the purview of the board's compensation committee. In fact, the 2020 SEC disclosure rule accelerated a trend that was already underway for several years: compensation committees expanding their charters to encompass broader human capital issues. Changes to the name of the committee signaled this trend, for example, a switch from "compensation committee" to "compensation and human resources committee."

- Detailed information on employee engagement and associated action plans
- Market data with an adequate amount of detail on all working populations and detailed information on relevant labor markets
- Predictive or prescriptive analytics to assess drivers of behavior
- Regular reviews of HCM dashboards to measure and monitor progress on key metrics
- Alignment of management's interests with HCM priorities by including HCM metrics in executive incentive plans

## Establishing an HCM governance model — an opportunity for HR to lead

**To fulfill the boards' oversight responsibilities, directors are increasingly demanding that senior management and HR keep them abreast of critical HCM-related issues. Without a well-defined HCM governance framework, this often takes the form of ad hoc questions or urgent requests related to how the company is addressing the latest HCM trend or concern.**

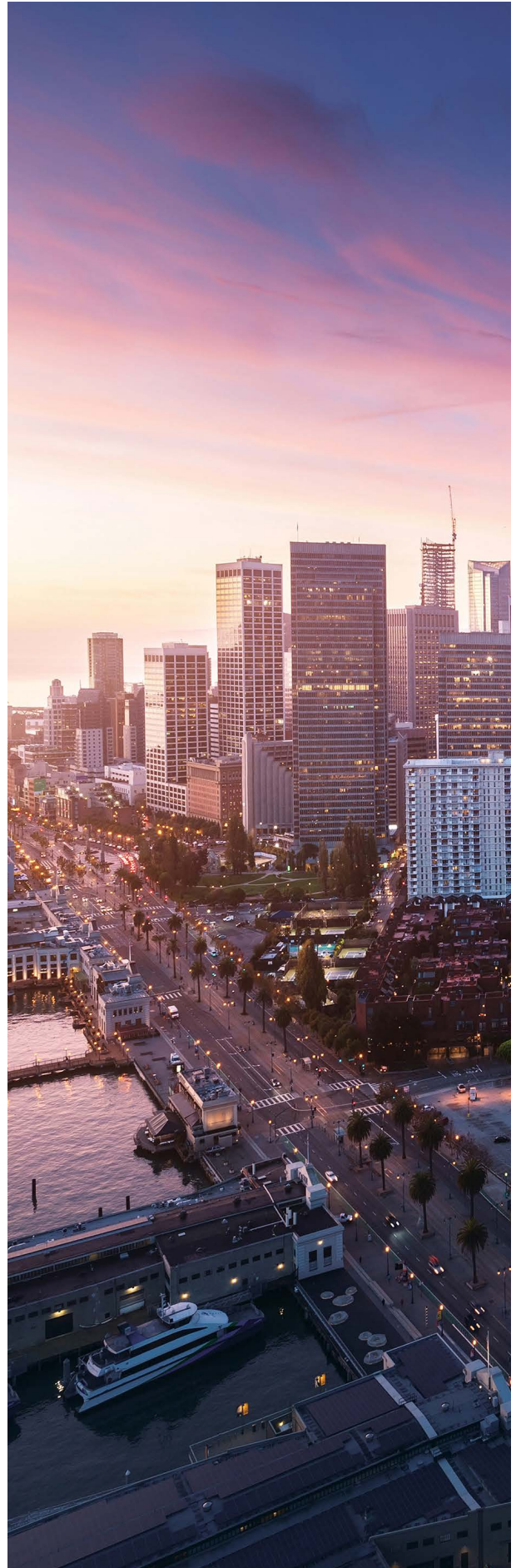
As a result, management may be gathering data that is misaligned with the board's expectations or the organization's most critical HCM priorities. To avoid this misalignment, senior management, preferably senior HR leadership, should engage with the board to seek feedback on HCM priorities and what data the board needs to fulfill its oversight responsibilities.

HR plays a critical role in supporting the board as it oversees the organization's HCM journey—a role that goes beyond HR's customary role of supporting the compensation committee in overseeing the design of compensation programs and making compensation decisions. HCM covers a broader range of priorities than the traditional compensation committee mandate—how to measure progress toward achieving HCM goals can be complex and may not be readily apparent. That's where HR can have a critical impact.

HR can play a significant role in designing an effective governance framework because it understands the company's HR context. The type of HCM governance framework a company adopts will depend on cultural factors such as: how prevalent employee voices are in the governance model, how reactive management or the board is to changing social tides, and how attuned HR is to these particular factors.

In some cases, the chief HR officer may be responsible for designing and adopting the company's HCM agenda or play a significant role in assisting the board in creating a governance framework to address HCM issues. In others, HR business partners or centers of excellence take a leadership role—much as the compensation function may support the compensation committee agenda.

Boards and HR departments may be at different levels of maturity as they learn to navigate the creation or enhancement of their governance model for HCM and endeavor to avoid missteps. We propose the following framework for the board and HR to tackle the basics of HCM and build a more sophisticated model to address HCM issues as they continue to evolve.





## Helping the board and management take action on HCM

	 Embark	 Discover	 Shape	 Drive
<b>Objectives</b>	<b>Align on critical HCM priorities and governance</b>	<b>Gather and analyze data on current state</b>	<b>Define measures, goals and reporting</b>	<b>Activate through a roadmap for operationalizing and communicating</b>
<b>Key questions</b>	<ul style="list-style-type: none"> <li>Does the company have an explicit workforce strategy to secure and manage talent?</li> <li>What elements of the people strategy are most critical to enabling the business strategy and what HCM problems might derail it?</li> <li>Does oversight rest with a sub-committee (e.g., compensation/HR committee) or the full board?</li> </ul>	<ul style="list-style-type: none"> <li>What types of quantitative and qualitative information is currently used to make workforce decisions?</li> <li>How are employee perspectives captured?</li> <li>Is there data on drivers of behavior—predictive analytics?</li> </ul>	<ul style="list-style-type: none"> <li>What's the cadence of reporting/ discussion/ decision?</li> <li>What measures can be used to assess progress?</li> <li>What reports can be used to provide insight to the board?</li> <li>Should goals focus on improvement or minimum standards?</li> <li>Should goals be tied to management incentives?</li> </ul>	<ul style="list-style-type: none"> <li>What interventions and stakeholder groups are most critical to affect change?</li> <li>Should communication be focused on compliance or telling the organization's story?</li> <li>What mediums (e.g., 10-k, proxy, website, ESG/ sustainability reports) should be used to communicate to various stakeholders?</li> </ul>
<b>Board's role</b>	<ul style="list-style-type: none"> <li>Provide feedback on HCM priorities</li> </ul>	<ul style="list-style-type: none"> <li>Review insights from data analysis to guide/evolve HCM priorities, measures and goals</li> </ul>	<ul style="list-style-type: none"> <li>Define the governance model, desired reporting and cadence for the board</li> </ul>	<ul style="list-style-type: none"> <li>Agree/sign-off on HCM goals, especially those tied to executive incentives</li> <li>Review communication for accuracy and consistency of messaging</li> </ul>
<b>HR's role</b>	<ul style="list-style-type: none"> <li>Determine/define most critical HCM priorities</li> <li>Seek feedback from board on HCM priorities to ensure alignment</li> </ul>	<ul style="list-style-type: none"> <li>Gather, consolidate, and present data to provide insight and create HCM narrative</li> </ul>	<ul style="list-style-type: none"> <li>Develop and execute HCM action plans</li> <li>Develop and support measurement and reporting</li> <li>Track and report progress against goals</li> </ul>	<ul style="list-style-type: none"> <li>Develop communication and ensure it is compliant with SEC rules and effectively tells the organization's HCM story</li> </ul>
<b>Work steps for HR</b>	<ul style="list-style-type: none"> <li>Conduct HCM education and data-gathering session with board or sub-committee, if needed</li> <li>Define/refine elements of people strategy that enable or create most risk to business strategy</li> <li>Test what has worked and not worked with board on prior HCM activity</li> </ul>	<ul style="list-style-type: none"> <li>Inventory all components of the current HCM maturity model and data that currently exists to support the board on HCM</li> <li>Define existing support model for management and determine gaps and opportunities</li> </ul>	<ul style="list-style-type: none"> <li>Use workshops to create a blueprint for HCM governance, including:</li> <li>Detailed HCM strategy tailored to the organization</li> <li>Ongoing schedule of metrics to be gathered and reported</li> <li>Structure for HR's support (who will support the strategy)</li> <li>Schedule for board/ committee involvement, including oversight roles</li> </ul>	<ul style="list-style-type: none"> <li>Create a roadmap for operationalizing HCM, including:</li> <li>Detailed stakeholder analysis and mapping</li> <li>Communication calendar to ensure the organization is integrating social media, change management and marketing into HCM strategy</li> </ul>
<b>Outputs</b>	<ul style="list-style-type: none"> <li>Initial HCM priorities or hypotheses to refine or test</li> <li>Initial view of oversight responsibility</li> </ul>	<ul style="list-style-type: none"> <li>Current State HCM Interaction Model</li> <li>Data Inventory to support HCM</li> <li>Draft HCM Dashboard and analytics roadmap</li> </ul>	<ul style="list-style-type: none"> <li>HCM Dashboard</li> <li>Future State HCM Interaction Model</li> <li>Go-forward HCM strategy</li> </ul>	<ul style="list-style-type: none"> <li>HCM Communication Strategy</li> <li>Ongoing Reporting Package</li> </ul>





## Case study “The Board’s oversight in action”

The board of a leading global financial services firm with a large hourly workforce developed a specific goal to increase the representation of women and underrepresented minorities in its workforce and in senior roles, by the year 2025. The goal was established after careful review and consideration of analysis and perspective from both internal and external stakeholders, including Mercer. The company also established a roadmap for how to achieve the objective. For example, the plan included outreach efforts to identify early-career diverse talent in non-traditional colleges and high schools as well as training and development efforts targeting business leaders, people managers and hiring managers. The company’s ultimate objective was to make systemic change to employees’ sense of inclusion and belonging, and increase organizational literacy around DEI topics. To hold the organization accountable, the company implemented a metrics-based approach to evaluating progress. The company also implemented a multi-year communication strategy that incorporated substantial discussion of HCM efforts in its ESG report, with the objective of greater external transparency to DEI statistics by 2025.

## Mercer's work in action with Management

The firm was facing challenges with lack of diverse representation across the firm, particularly in leadership roles, and diverging employee experiences for majority groups vs. underrepresented minorities (URMs). There was an existing DEI strategy & roadmap in place, but there was concern about potential bias in key talent management processes, potentially hindering the organization's ability to achieve its DEI-focused goals.

Mercer conducted a deep dive analysis on the employee lifecycle to identify and address potential biases in the client's talent management systems and processes including: a rigorous discovery process, including focus groups and interviews with key business leaders and employees. Our workshop-based approach included process reviews to identify areas of opportunity in talent acquisition, promotions, succession planning, and performance management. In addition, we conducted robust analysis using our Internal Labor Market Analysis methodology (see chart below for illustrative data) using candidate and employee data to understand impact/outcome of key talent processes on various employee segments including gender, race/ethnicity, age, etc. Mercer made specific recommendations for change, including defining metrics and their tracking and reporting as well as a detailed communication plan for engaging key stakeholders across the firm.

## Summary of Illustrative Internal Labor Market Analysis Results

For example, the analysis below shows female employees were 20% more likely than male employees to receive a high performance rating, but they were 12% less likely to receive a promotion. Likewise, employees older than 40 were 22% less likely to exit the organization than their younger peers.

Demographic Group	First Round Interview	Job Offer	High Performance Rating	Promotion	Voluntary Exit
<b>Older than 40</b> (vs. Younger than 40)	-7%			-5%	-22%
<b>Women</b> (vs. Men)	12%	6%	20%	-12%	
<b>Asian</b> (vs. White)	-12%			-18%	8%
<b>Black/African American</b> (vs. younger than 40)	-46%	-23%	-26%	-44%	18%
<b>Hispanic/Latino</b> (vs. White)	-30%	-6%	-35%		
<b>White Women</b> (vs. White Men)	22%	5%	16%	-5%	
<b>POC Women</b> (vs. White Men)	-34%	-6%	-14%	-28%	
<b>POC Men</b> (vs. White Men)	-38%			-20%	14%
<b>Disabled</b> (vs. Not disabled)	-14%	-44%			-10%

■ Statistically significant positive driver of the outcome (or statistically significant negative driver of Voluntary Exit) at the 1% significance level

■ Statistically significant negative driver of the outcome (or statistically significant positive driver of Voluntary Exit) at the 1% significance level

■ Statistically significant negative driver of the outcome (or statistically significant positive driver of Voluntary Exit) at the 5% significance level

■ Statistically significant negative driver of the outcome (or statistically significant positive driver of Voluntary Exit) at the 10% significance level

■ Does not have a statistically significant effect

Another framework that boards and management teams may find helpful in determining HCM priorities, goals and measures is the Good Work Framework, published by the World Economic Forum in collaboration with Mercer in May 2022. The objectives and core goals of the Good Work Framework are shown in the table below. There are also recommended metrics and reporting guidelines to help organizations when setting public, time-bound commitments. [Good Work Alliance](#)



**Objectives**



**Core Goals**

<p><b>1</b> Promote fairness on wages and technology</p>	<p>Ensure at least a living wage for all</p>
<p><b>2</b> Provide flexibility and protection</p>	<p>Enable all workers to benefit from flexibility, where possible and appropriate</p>
<p><b>3</b> Deliver on health and well-being</p>	<p>Safeguard total well-being at work</p>
<p><b>4</b> Drive diversity, equity and inclusion</p>	<p>Ensure that the workforce profile reflects the operating market</p>
<p><b>5</b> Foster employability and learning culture</p>	<p>Provide accessible upskilling and reskilling for the entire workforce</p>

**It’s critical that boards take an active role in overseeing their organization’s HCM strategy. It’s equally critical that HR rises to the challenge of ensuring their organization has a robust HCM strategy and supporting processes, programs and objectives. This is not a compliance exercise, but rather investors and employees alike know an HCM strategy is foundational for an organization to sustainably thrive.**



**Mercer can meet you where you are on your HCM journey and help your management and board progress toward best-in-class HCM oversight.**