

## Board comp committees' needs keep HR leaders in the spotlight

By Richard F. Stolz

Corporate board compensation committees are feeling the heat like never before from shareholders, regulators and the press, thanks to the troubled economy and the enduring impact of financial scandals earlier in the decade.

In addition, the scope of comp committees' oversight responsibility, once typically confined primarily to senior executive compensation, at many public companies has been expanded to encompass a wide range of human capital issues, including leadership development, succession planning, diversity, overall compensation and benefits strategy, to name a few. As a result, HR leaders are playing a more pivotal and, at times, politically delicate role in helping comp committees to fulfill their duties.

While HR's vital role in supporting comp committees carries career-threatening hazards, it also keeps human resource leaders at the center of corporate strategy development – particularly if they earn the trust of board members.

### **Comp Committee Expectations**

So what do comp committees want and expect from HR leaders? And how can they successfully navigate the pitfalls associated with becoming trusted advisors to committee members? The answer begins with a window into committee members' psyches. "They want positive outcomes, high confidence in what they're doing, and low exposure to risk," says Robin A. Ferracone, executive chair of Farent Advisors in San Marino, Calif. Ferracone, an advisor to corporate comp committees, serves on several boards herself.

"They worry about whether there are things," such as CEO severance packages, "that could come back to bite them.

"What keeps them up at night," she adds, "is if pay and performance are pretty significantly out of whack."

Adds Fred Foulkes, director of the Human Resources Policy Institute at Boston University and a member of several comp committees: "They want good data to make decisions they can defend, with activist groups or in the media."

"It's a high-stakes game" for HR leaders, he adds.

And the key for HR leaders to avoid being wiped out in that high-stakes game, comp committee chairs stress, is acting on the basis that their real master is not the CEO, but shareholders, and the board members who represent them.

Jill Kanin-Lovers, a former HR chief for Avon who now chairs four corporate comp committees, compares the HR leader's role to that of the head of internal audit. Under Sarbanes-Oxley, that executive has dual reporting responsibility to the CEO and the board's audit committee. Although the HR leader lacks the official solid-line reporting relationship to the comp committee, "it's not dissimilar," she says.

And William Kerr, chairman of the board of Meredith Publishing in Des Moines, Iowa, who serves on four other corporations' comp committees and chairs two of them, compares the HR leaders' role to that of the general counsel. "The general counsel has to have an ability to advise the board in ways that may be at variance with what the CEO wants," he says.

### **Focus on Shareholders**

What Kerr expects in his dealings with HR leaders, he says, "is someone who is doing things which he truly believes are on behalf of shareholders."

Shareholders care about many things – particularly the market value of their stock. Thus on the issue of stock-based CEO compensation, comp committees representing shareholders are keenly attuned to share availability and dilution. Therefore, so too should be HR leaders, according to Irv Becker, the Hay Group's national practice leader for executive compensation.

When authorized shares are exhausted, boards need ask shareholders to authorize the issuance of additional shares; such requests are not always a popular move. Becker makes the point to illustrate a comp committee hot button issue which, he says, HR leaders are not always as focused upon as core HR issues.

Becker urges HR leaders, in their efforts to embrace the shareholder perspective, to be mindful of their growing activism on all forms of executive pay, increasingly expressed in "say-on-pay" proposals which give shareholders an advisory vote on executive comp plans.

However, simply heeding a comp committee desire that they work as if they had a reporting line directly to shareholders does not yield a blueprint of HR policies, programs or plan designs. Rather, what comp committee chairs want most from HR leaders, they say, is neutrality in their analyses of the issues the committee is grappling with. Of particular focus, naturally, is CEO (and other senior executives') pay.

"The HR person is responsible for bringing in objective work," says Ursula O. Fairbairn, CEO of New York City-based Fairbairn Group, a consulting firm. Fairbairn retired from the top HR post at American Express in 2005, and today chairs the board comp committees for Sunoco, Centex and VF Corporation.

She and other comp committee chairs are keenly aware of the awkward position HR leaders are in when presenting analysis and proposals regarding executive compensation. Highlighting the obvious, Foulkes notes that "the CEO's pay is of great importance to the CEO."

### **Overruled on CEO Bonus**

He recalls the fate of a courageous HR leader of a struggling company who argued against a proposal by some comp committee members to override the CEO's bonus formula and reinstate a bonus when profitability targets had not been met. Committee members who favored the bonus award believed it would have discouraged the CEO to adhere to his comp plan's bonus formula.

But the HR leader argued that making such an exception "would send the wrong message," Foulkes recalls. Still, the committee ultimately awarded the bonus anyway. At the HR leader's request, his position was recorded in the committee's meeting minutes. "Three or four weeks later, we heard that the head of HR was leaving the company."

An example of the other extreme – capitulation to a CEO's desires and acting as his advocate at a comp committee meeting – is recalled by Ferracone. While this particular committee was satisfied with most of a management golden parachute plan, one element was considered "too liberal."

"The head of HR was advocating too heavily for the executive. Basically, his credibility was called into question," Ferracone says. Earlier, the HR leader had quietly opposed that "liberal" provision, thus undermining his subsequent public support for it. "He totally did a 180 on that one. That's the kind of problem HR people can run into, just carrying the executive's water."

Fortunately, comp committee chairs say there is usually a middle ground between falling on one's sword, and becoming a water-carrier for the CEO, when conflicts arise. The key, they say, is the development, over time, of a relationship of mutual trust, involving a sense of shared responsibility between the committee and HR leadership.

"Collaboration" is the term favored by J. Barry Griswell, Chairman and CEO of Principal Financial, who chairs the comp committee for Zeeland, Mich.-based furniture manufacturer Herman Miller Inc., in describing his relationship with HR leadership.

"There are so many areas where the committee has responsibility, and the company has responsibility, and they have to come together and execute those responsibilities," Griswell explains. For example, Herman Miller's comp committee's charter's duties include "review and advise on the compensation philosophy and strategy of the corporation," and "review and approve compensation and benefit plans."

Such a charter could hardly be fulfilled by a comp committee operating in a vacuum. Griswell says he's in regular contact with Andy Lock, Herman Miller's chief administrative officer whose responsibilities include HR. "When I have an issue, I call Andy. When he has an issue, he calls me."

Such strong relationships generally allow HR leaders to successfully navigate politically sensitive issues. Although Griswell and other comp committee chairs say they are happier when HR and CEOs see eye-to-eye on matters brought to the committee, they also recognize that isn't always possible. In that case, management (whether represented by the HR leader, or someone else) recommendations to the committee should "delineate where there were differences, and where the committee ought to be aware that there was a debate.

“Exactly how it comes to you, I’m not quite as concerned about, as knowing I can easily discern where there was disagreement.”

### **Discerning Disagreement**

“The worst of all worlds,” Griswell adds, “is when you get a recommendation, and it appears as if everybody’s in agreement, when in fact they’re not.”

It isn’t always necessary for HR to go on record explicitly with reservations about an initiative supported by the CEO, however. For example, Kanin-Lovers suggests the use of a pro/con analysis to help HR leaders who need some political cover to give comp committees a sense of the potential downside of a given initiative. Indeed, even when HR and the CEO are in harmony, she even prefers seeing such analyses. “I want to know they’ve also thought about the potential negatives.”

Yet another approach HR leaders might take to avoid being the naysayer on a delicate compensation issue, particularly one with potential shareholder ramifications, is to invite an attorney to brief committee members. Of course, compensation consultants retained by comp committees generally already contribute another perspective on potentially controversial issues. “Often,” says Kerr, “we encourage the HR people to have a dialog with the committee’s consultants so they understand where management’s coming from.”

Much of what comp committees expect HR to offer input on lacks the sensitivity of executive comp. When a committee is monitoring a broader range of human capital issues, committee chairs expect HR not only to have the expertise and skills needed to lead the company in those areas, but the willingness to support the committee’s efforts to stay on top of them.

For example, Coleman Peterson, the former HR chief for Wal-Mart Stores, Inc., says expects the HR leaders of the two companies he now serves as a comp committee member to keep him briefed on diversity and employee turnover metrics. And Fairbairn wants HR leaders to keep her fully briefed on executive development and succession planning. “The HR view might be a little less political, a little more competency-based” than that of other executives, she says.

But HR leaders themselves, in fulfilling comp committees’ desire that they keep shareholders’ interests in mind, may need to lead the comp committee to address a different set of issues from those they’re focusing on, notes Kathryn A. DCamp, the former SVP of HR for Yahoo who currently serves on two corporate boards. That’s not always easy, she acknowledges.

“But if your comp committee is a bunch of dead fish, don’t be afraid to ask the CEO whether there is anybody on the board who has a passion [for HR issues] who could be rotated on to the comp committee in the future,” she suggests.

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SIDEBAR:

## Ten keys to keeping the comp committees happy

Maintaining the comp committee's confidence requires satisfying some basic needs which, surprisingly, often go unmet. Other committee expectations may be less concrete. Fulfilling the following can help keep HR on a solid footing with the comp committee:

- **Get the numbers right:** Sloppy errors, such as in bonus formula illustrations in pre-meeting briefings materials, are surprisingly common. "There's nothing more frustrating than sitting in a board meeting trying to make a decision, and finding out the data is not right," says William Kerr.
- **Provide information of interest:** Naturally, committees consider some topics more useful or important than others. "Find out what their concerns are" *before* inundating them with unsolicited information, says Kathryn DCamp.
- **Don't rush the committee:** Committee members say they hate receiving briefing materials on the eve of scheduled meeting. Complex issues may require "several weeks" of mulling time, notes William Kerr.
- **Avoid the "peacekeeper" role:** Comp committees often need to wrestle with tough issues. HR leaders shouldn't "just try to broker a solution instead of coming up with their own points of view and value-added perspective," says Robin Ferracone.
- **Respect the committee's authority:** The HR leader should not be a "control freak" and try to shape all committee decisions, says Ferracone. Rather, they should strive to maximize the quality of the committee's deliberations, so that it can make the best decisions.
- **Illustrate extreme compensation scenarios:** Kathryn DCamp suggests making explicit what an executive's incentive comp payout would total "if we achieved some [performance] number we can't imagine we'd do. They need to understand it. Do an unrealistic chart" to bring the point home.
- **Remember the goal:** Comp committees don't want HR leaders to "fall in love with their benchmark data" at the expense seeing the big picture, DCamp warns. Industry norms, no matter how painstakingly analyzed, are irrelevant for a particular executive pay plan if it's designed to address a goal other than that which the committee considers most urgent.
- **Don't be an "order-taker":** Comp committees expect HR *leaders* to live up to the "leader" role, and take heat when necessary. "Having a weak backbone is the biggest way to blow it with the comp committee," says Fairbairn.
- **Do not assume detailed knowledge:** Most comp committee members serve on multiple boards. Thus pre-meeting briefing materials should include, in the appendices, details of relevant existing programs so that committee members won't be forced to request a refresher course during a meeting.
- **Keep the committee on track:** With limited meetings and lots to accomplish over the course of a year, committees want HR leadership to help establish the agendas, map out, in detail, all that must get done, and keep the committee on task.

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