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At the outset of the pandemic, employees were the top priority of boards, second only to continued liquidity. That focus intensified during the social unrest following the death of George Floyd. Now, the SEC's new disclosure rules on human capital management (HCM) could further reinforce the focus on workers — at least temporarily.

Boards will soon face a choice, however, when it comes to their role in HCM. They can ensure that the company satisfies the new SEC reporting requirements but return to the traditional approach of providing general oversight and being deeply engaged on workforce issues on a *periodic* basis — as they did in response to the #MeToo movement or company-specific events such as mergers and scandals that highlighted weaknesses in corporate culture. Or they can view recent events as a catalyst to make the workforce a sustained *strategic* focus of the board.

Boards are struggling with how deeply to be involved in HCM, and there are risks in overstepping into a managerial role. But if companies achieve the appropriate level of board engagement and disclosure on HCM (focusing on strategy and key drivers, rather than day-to-day activity), they will not only drive long-term value, but also provide a template for how boards can tackle other ESG areas.

We offer five practical steps to help boards make HCM a strategic business advantage based on a recent report by The Conference Board, *Brave New World: Creating Long-term Value through Human Capital Management and Disclosure*. This report represents the collective wisdom of more than 100 practitioners and thought leaders who participated in a working group convened by The Conference Board to address the topic.

The link between human capital and company performance

For boards hesitant to dive into the deep end of the pool (let's be honest, it can be intimidating), it is worth remembering why the phrase "people are our most important asset" is often quite literally true.

From 1985 to 2020, the share of the S&P 500's market value comprising intangible assets increased from 32% to 90%. Given that human capital makes up a large share of a firm's intangible assets, a firm's workforce is a fundamental component of its economic value.

There is also considerable research showing a strong link between an organization's performance in employee diversity, health and safety on the one hand, and shareholder returns on the other. Indeed, effective HCM disclosure itself can also drive shareholder value.

Moreover, HCM matters to shareholders and other stakeholders. Support for shareholder proposals relating to HCM is rising: In 2020, support for proposals on workforce diversity averaged 38.2%, up from 28.6% in 2017; on board diversity, support averaged 36.8%, up from 18.3% in 2018. Moreover, a recent report by The Conference Board — based on the views of investors representing $12 trillion in assets under management — places human capital at the very center of the areas that shareholders expect companies to focus on in addressing the triple-pronged racial, economic and health crises the U.S. faces.

Likewise, surveys of American workers consistently find that the health, wellbeing and safety of workers should be one of corporate America's top priorities. And while not as important to consumers as price and quality, how companies treat their workforce can have a notable impact on how consumers across the globe view that company's brand.

The importance of HCM to regulators is underscored not only by the new SEC disclosure rules, but also by state and local laws focused on diversity. And, of course, there is a whole alphabet soup of ESG reporting frameworks — such as GRI (Global Reporting Initiative) and SASB (Sustainability Accounting Standards Board) — that focus on HCM.

So, for financial and a host of other reasons, boards should pay close and continued attention to HCM.

How to get HCM right

Boards can use HCM to drive long-term value. Here are five suggestions:

1. Develop a human capital strategy linked to your business strategy.
Adopting a more strategic approach to HCM requires — no surprise — a strategy. Boards should ask management to develop a strategy that sets forth a plan for taking the company from the workforce it currently has to one that it will need in, say, five years. Developing the strategy should involve identifying the key areas where the company's workforce drives the firm's business success; evaluating the firm's current capabilities in those key areas; assessing the broader trends and competitive environment for talent; and then setting clear goals and choosing metrics to report progress.

2. Clarify, codify and coordinate your board's roles.
Boards should also work with management to clearly define the board's role with respect to HCM. As a threshold matter, directors should achieve consensus on how much, and in what ways, they can add value through their engagement in HCM. That should be reflected in governance guidelines, committee charters and policies. Some companies may choose to centralize responsibility in a "human capital and compensation committee;" others may disperse responsibilities among various committees. There is no single right answer, but it is critical to be clear.

The task does not end with updating committee charters. Boards have multiple levers with respect to HCM — often more than they realize. These include the selection, promotion and compensation of management; approval of workforce policies; review of key disclosures; and general oversight and advisory powers. Indeed, the way directors themselves interact with management can have a significant knock-on effect on the company's culture. With all these powers at the board's disposal, it is vital that boards deploy them in a coordinated matter so that, for example, the board can use multiple means to address diversity, equity and inclusion.

The degree of engagement — and the areas for board focus — will vary by company and over time. Generally speaking, it is important for the board to focus on the strategic picture, to ensure that management has the policies, programs and processes systems in place to carry out the strategy and to receive candid and timely reports. Beyond choosing the CEO, boards should focus on the succession and compensation for senior executives. But it is very risky for the board to substitute its judgment for management's when it comes to personnel decisions beyond the C-suite. That can spread the board's attention too thinly, reduce management's accountability for personnel decisions, and lead to members of management trying to cultivate "friends" on the board , which can lead to a lot of palace intrigue.

3. Confirm that the board has the right information it needs to fulfill its role.
Companies have an abundance of HCM data at their disposal. The key is working with management to figure out what matters and how it is best presented to the board. Generally speaking, boards should look for both qualitative and quantitative information. Qualitative measures provide proper context and a clear link to the larger business strategy; quantitative indicators allow for greater accountability.

In addition to information on the company's human capital capabilities, the board shouldn't be shy about understanding the company's culture — the often-unwritten rules about how things get done at a company. Boards should consider not just the results of employee surveys, but also more in-depth audits (sometimes done through focus groups) on what behaviors are actually rewarded, punished or tolerated at the firm.

4. Ensure that boards have the correct composition and resources.
In recent years, boards have sought to expand their own capabilities through attracting directors with expertise in key areas such as technology and finance. Similarly, when evaluating a board's makeup, companies should consider adding HCM expertise. Simply having a director with a strong HCM background is not enough — it is important that any individual recruited for their expertise can also serve as a broad-gauge contributor to the board's deliberations. Other directors must also be conversant, if not fluent, in the topic. As they do with executive compensation consultants, companies may also consider retaining outside expertise in HCM to help supplement the board's and management's own knowledge.

5. Double down on the company's HCM story to ensure it is communicated consistently and effectively.
One of the most daunting challenges is determining what HCM information should be provided to multiple stakeholders and how it is communicated. To be successful, the board should ensure that management has determined not only which messages are aligned with the firm's corporate strategy, but also that such messaging is consistent across different audiences.

HCM as a sign of more to come

Some people see the new SEC rules on HCM disclosures as a harbinger of additional mandatory ESG disclosures — and associated board responsibilities — to come. Given the new administration's priorities, including its focus on climate, that is probably a fair bet. But, regardless of the nature of future regulatory mandates, experience with HCM can provide a few lessons for future disclosures and board engagement on ESG issues.

- **Don't rush it.** No matter how well-informed or well-meaning, boards will inevitably have less comprehensive and nuanced information than management about the workforce and many other non-financial areas. Boards must be sensitive to this and assume responsibilities carefully and with clarity.
- **ESG disclosures in financial statements are just a small part of the overall picture**. Indeed, they are just part of the disclosure tail, and it shouldn't wag the business dog. As we begin to dive into this new era of disclosure, don't lose sight of your organization's business objectives and their execution; instead, focus on tailoring these ESG disclosures to your firm's specific business and strategy.
- **Company disclosures should evolve.** Placing the appropriate emphasis on non-financial ESG topics, such as human capital, requires a lot of work by the board and management. As more companies make HCM and other ESG disclosures, best practices will evolve. Set expectations at the beginning of your rollout of HCM disclosures that this is an evolving area to allow for improvement and refinement.
- **While it is important to be conscious of the various external ESG reporting frameworks and rating agencies, boards should focus on what works best for their company in both internal and external communications.** It can be easy to get lost in the multiplicity of (sometimes conflicting) metrics suggested by reporting frameworks. While they are a helpful guide, each company should decide what standards it wants to adhere to, and to what extent.

With the vast disruption brought about by the COVID-19 pandemic, boards have an opportunity to take a fresh look at their company's workforce, how it fits into the company's future business success, and the board's role in ensuring that the firm's workforce is a key driver and beneficiary of that success. If done well, a board's approach to HCM can also serve as a model for other ESG areas that are important to the wellbeing of the firm, its stakeholders and society at large. The opportunity is there; the question for boards is whether they seize it.

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