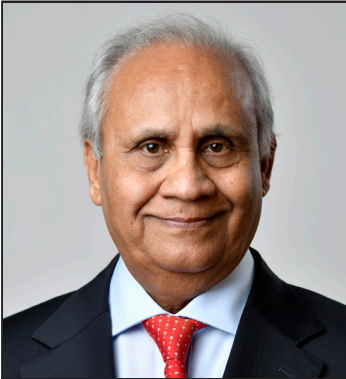


Corporate Governance and Human Resources: Distant Friends or Close Siblings?



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Corporate Governance and Human Resources (HR) are important functions that despite their seemingly very different roles, share many similarities. At a fundamental level, both functions are tasked with important responsibilities that shape a firm's foundation towards its long-term success. In practice, both functions (unfortunately) also spark a general sense of disappointment with their failures to deliver as expected. The purpose of this article is to look at the nature of these functions and reflect on how they can complement each other. This is important given that organisations of all types are likely to face radical challenges in future, which include AI transformation, social and demographic changes, political volatility, and economic uncertainties. Are our governance and HR functions fit for purpose in the emerging environments of radical uncertainty, and how can they be better siblings?

Role/ Mandate of Corporate Governance and Human Resources

Corporate Governance has a fiduciary responsibility to act in the best interests of shareholders (or owners) and to do so by providing governance oversight into how the strategic matters (whether by intent or consequence) of the firm are conducted. Corporate governance works under a set of statutory governance requirements that, with the passage of time and with each major instance of public/ corporate governance failure, whether it was Enron in 2000, or the Great Financial Crisis of 2008, have become more onerous. Following multiple iterations of new requirements and processes, its main tasks and processes are generally crystallised as governance standards, whether in law or through a general guidance set out by the relevant professional bodies. Indeed, there is an argument that such requirements and processes are excessively administrative and constrain decision-making without a corresponding benefit to show for them.

Unlike Corporate Governance, Human Resources function, at least in practice, has a fluid and less formalised mandate. Additionally, HR means different things to different stakeholders, such as business leaders, employees, HR professionals, academicians and trade unions. It is not that the HR function did not have its role and mandate scrutinised in its long history, which included attempts to evolve it from an administrative function to a personnel function and thence to HR/HRD and finally to a strategic HR function. Nor was there a lack of tools and techniques (including employee satisfaction surveys, selection methodologies, etc), dashboards and matrices. Yet, the function did not get traction for many complex and contextual reasons, including – and speaking in general terms – it lacked the accountability, visibility and risks of public failures that exist for the corporate governance function unless an extreme or systemic failure happens.

Corporate governance may have its challenges, both in theory and practice, but it is less fuzzy and less prone to “marking your own homework” and self-certification errors, particularly when failures happen.

Human Resources in Governance, and Governance in Human Resources

Organisational governance is a challenging and intense function, and its effectiveness, like any other area of business, depends on the quality of people, mainly the directors in it. There is both a demand and supply challenge when it comes to the quality of talent available for such important roles.

On the demand side, for a long time, it was not uncommon to select directors for reasons of relationship and their likelihood of not challenging questionable decisions. On the supply side, given the general state of practice, low remuneration and risks of loss of reputation, many excellent candidates are less willing to join the field. Anecdotally speaking, in the corporate governance realm, this limited supply is at a tipping point, and failure to get or attract good directors can push an organisation into a seriously fragile and governance-deficient situation. In theory, the composition of executive and non-executive membership means independent and diverse inputs, protection of minority shareholders and checks and balances that overcome partisan interests. In practice, the limited supply of good independent directors and pressures to get along thwarts the goals of having them in the first place.

HR functions for Boards, such as induction/recruitment of a board member or chair, Compensation, Board evaluation, succession and refreshment are now in the statutory purview of the Board's NRC (Nomination and Remuneration Committee), which is one of the mandatory committees along with the Audit Committee under the Indian Companies

Act 2013. It is a different matter that in most companies (especially promoter-driven companies), promoter dominance prevails in such HR matters.

Governance in Human Resources is a trickier area, because it is not always clear, beyond the rhetoric, what should and can an HR function accomplish, and therefore what should be governed. HR governance remains largely discretionary by its very nebulous nature, except for blue-collar workers whose conditions of service are governed by statutes in force. However, beyond such requirements, HR governance is “optional” and even when it does exist, it is not uncommon to be more focused on its administrative compliance rather than following the intent behind it. In a few areas of HR, such as culture building and learning & development, it is not always easy to understand how to apply the governance, except perhaps in the case of serial “culture” offenders, who produce excellent business results, in which cases, HR faces an uphill and mostly losing battle in any case. This has implications, inter alia, on the quality and motivation of talent that enters the HR field, and how the talent is used within the field. It is not a surprise that HR is not a preferred career option in most business schools, and experienced business managers do not prefer to have responsibilities for HR functions through career rotation unless this is a long-established organisational practice.

Who Keeps the Score and What is Score Anyways?

How well do the two functions (Corporate Governance and HR) work? The answer depends to a great extent on what we expect from them and on the context in which they work. Though there have been studies on their effectiveness, in the court of practitioners and public opinion, rightly or wrongly, their effectiveness is largely based on anecdotal experience, views of stakeholders, and subjective analysis.

Corporate governance, in view of the statutory oversight and requirements, has (relative to HR) specific tasks and responsibilities to which, if failures happen, a reference can be made. Both failures and successes are public (for publicly owned firms) and hard to miss, and potentially attributable to acts of commission or omission. Various (mostly external) stakeholders keep the score, the main ones being the owners, though understandably, each stakeholder would focus on their part of the score, a sub-score, so to speak. This, along with the obligations of fiduciary responsibilities and emerging practices, such as activist investors, keeps the Board members (to varying extents) accountable. It should be noted that for executive members, the scrutiny is increasing through the increased usage of “Balanced Scorecards” and other interventions (such as Senior Management Regime in financial services in the UK). It is possible to argue that for the governance function, the score could mean not having governance failures, which is a very broad term, and can be met tactically without focusing either on the real health or the long-term performance, noting that directors do not usually have a long-term tenure.

What is a score for HR is an even more difficult question to answer. In theory, HR is about ensuring that human and organisational values are adhered to, human potential is maximised and employees grow and contribute to their fullest. In reality, at least in many organisations, it is anything but that. In practice, HR mandates are mostly discretionary in nature, and, unless HR is “institutionalised in the right way”, can dramatically change with a change in the firm’s fortunes and/or in the senior leadership teams. The term “institutionalised in the right way” is the key, as it can be argued that the abundance of processes, dashboards and surveys implies that HR function is already institutionalised. It can also be argued that such scores and dashboards represent the HR score, and they are reviewed regularly by various stakeholders, and even find a mention in the Annual reports and employee forums. Though this argument is not without its merits, the presence of processes and matrices is not institutionalisation per se, it is, at best, a means towards an end (institutionalisation) and at worst, managing narratives. The real institutionalisation is the embedding of a culture in a way that the need for governance starts receding into the background, and perhaps over time similarly leads to less need for motivating and engaging employees using external motivators.

It can be argued that statistically speaking, a very few cases of corporate governance and HR failures come to light, and therefore, in general, for the large number of organisations, the two functions are effective. This argument, too, requires some reflection as it assumes that a failure exists only when it is public or the outcome of failure speaks for itself. As the saying goes, *absence of evidence is not the same thing as evidence of absence*. Systemic failures can remain hidden for a long time and usually they do not happen overnight, which is precisely why effective governance is needed ideally before they become toxic.

The way forward

The discussion above suggests that whilst the two functions have commonalities, they have been at best remote friends as opposed to being close siblings. There is a need – and opportunity - for them to embrace and leverage the intent and practices of each other more.

Two additional areas merit attention. Firstly, both functions have a common but largely unutilised performance area, namely, culture, which is key to effective governance, managing people and indeed everything that goes on in the organisation. Governance is, inter-alia, an outcome of behaviour and judgement, and that cannot be legislated. Whilst it is undeniable that culture itself cannot be mandated or legislated, it can be mindfully nudged towards outcomes geared towards better compliance and governance. Secondly, for corporate governance and HR to become better siblings, it is important that they recognise that compliance with set standards and processes enables them to meet the lowest threshold of their performance, that is, survival and maintenance, and it is merely the means to an end. The higher threshold – the end itself – is building lasting, long-term and strategically successful organisations that generate value, but also general welfare, well-being and responsible use of resources, including the trust of employees and customers.