

C

E



Center for
Effective
Organizations

**PAY AT THE TOP: WHEN DOES HR MAKE A
DIFFERENCE?**

**CEO PUBLICATION
G 08-17 (553)**

EDWARD E. LAWLER III

*Center for Effective Organizations
Marshall School of Business
University of Southern California*

JOHN W. BOUDREAU

*Center for Effective Organizations
Marshall School of Business
University of Southern California*

Pay at the Top: When does HR Make a Difference?

Edward E. Lawler III and John W. Boudreau

Executive compensation, board compensation, and management succession are among the most important issues confronting corporate boards. Decisions in these areas should be informed by valid information and expert knowledge. An obvious source of information and knowledge is the HR function. HR leaders bring unique professional expertise and perspective to these areas. HR information systems can potentially provide unique and relevant data and boards can benefit from an HR contribution that goes well beyond administration and program implementation.

In most corporations, the chief human resource officer is not on the board so there may not be a connection between the HR function and board decisions on compensation and succession management. Unlike such disciplines as finance and marketing, in many cases, HR must be explicitly invited to participate in board and committee meetings that deal with topics that involve its area of expertise.

There are a number of factors that may influence the degree to which HR is invited to work with corporate boards on compensation and succession. It may occur because HR is involved in decisions concerning change management, business strategy and succession planning; all of these have implications for compensation and succession. In addition, the way the HR function is structured, the competence of HR leaders, and the information and knowledge available in HR systems may play a major role in determining the role HR plays in these decisions.

Research Study

Despite its importance, we know relatively little about what influences the role HR plays in board decision making concerning executive and board compensation and executive succession. In order to learn more about HR's role we surveyed managers and HR executives in Fortune 1000 firms. The full report of the results of the survey can be found in Lawler & Boudreau (2009).

Completed surveys were obtained from 106 companies. This survey was the fifth in a series conducted by the Center for Effective Organizations that began in 1995. Surveys have been conducted every three years. In this article, we focus on the most recent data, collected in 2007. It is the first survey to examine HR's role in executive and succession decisions.

Where do Boards Request Help from HR?

Table 1 presents the answers to a question about the extent to which corporate boards request help from HR in the areas of executive compensation, executive succession and board compensation. The greatest help is requested in executive compensation. Over 80% of HR executives report that their boards request help to a great or very great extent in this area. Executive succession is the area of second greatest requested help. Board compensation is the area where HR is asked for the least amount of help. Only 44% of respondents report that HR is asked for a great or very great amount of help. This is a much lower level of help than for executive compensation and succession ($p < .01$). It may reflect the fact that board compensation tends to be an area where compensation consulting firms are the major providers of board compensation information and consulting, not the internal HR staff.

The amount of help the HR function gives with respect to executive compensation is strongly related to the amount of help it gives with respect to executive succession ($r = .48, p < .001$). The level of requested help with board compensation correlates very highly with executive compensation help ($r = .61, p < .001$) and somewhat less highly with succession help ($r = .40, p < .001$). Overall executive compensation and board compensation seem to go together, while requested help with board and executive compensation are less strongly related to help with executive succession.

Talent Sophistication of Business Leaders

Does the expertise of business leaders regarding the principles underlying human behavior at work, human capital markets and organization design determine the degree to which boards request help from HR in compensation and succession decisions? Table 2 explores this question by reporting the correlations between measures of business leader and organizational expertise regarding talent, with requested help in the three areas.

In the first three columns are questions that deal with how the organization competes for talent overall, whether business leaders outside of HR understand where human capital makes the biggest difference to organization success, and whether their decisions about human capital are as rigorous as decisions about other resources. Board requests for help in all three areas are uniformly and significantly associated with higher business leader expertise and organizational excellence in decisions about talent.

The next four columns in Table 2 focus on traditional management areas: business strategy, finance, marketing and technology. The results suggest that business leader savvy even in traditional and non-HR areas is related to requests for help from HR in the three areas. This is true with respect to all four areas for executive compensation

and succession, while only expertise in marketing and technology are related to requests for HR help with board compensation.

It is interesting that HR help requests are positively associated with business leader expertise in non-HR areas. This suggests that organizations that generally value and emphasize sound decision making principles produce leaders who respect and value specialized functional assistance in all areas. Of course, this also sets a high bar for HR. If expert leaders are the ones asking for help, for HR to remain at the table once invited, their help must be rigorous and consistently based on sound and logical principles,

The final four columns show the association between board help requests and business leader sophistication in several specific areas of human capital management: motivation, development and learning, labor markets, culture, and organization design. The pattern is similar to the traditional management areas; business leader expertise in these areas is consistently related to requests for help with executive succession and compensation and often related to requests for help with board compensation as well. The relationships are somewhat stronger for executive succession help than for executive compensation help, with culture expertise notably strongly correlated with help with executive succession but not with help in the other two areas.

It appears that the more sophisticated and knowledgeable business leaders are in human capital management, the more corporate boards request HR help in compensation and succession. This is in contrast to the view that when business leaders are good at a discipline, they request less functional help in that area. This is good news for HR, as it suggests that as the decision science for talent and organization effectiveness becomes pervasive beyond the HR profession, top leaders may be even more inclined to request

HR help in key areas. It may be that greater business leader sophistication leads to a stronger appreciation for the value that HR perspectives can provide, and respect for the power that the understanding of human behavior can provide.

It may also be that as HR plays a greater role in these three areas, business leaders become more sophisticated regarding the principles of the discipline and expect their HR function to be more knowledgeable. This in turn may lead to the function having more expertise and being able to provide more help with respect to compensation and succession.

How HR Creates Strategic Decision Value

The finding that more sophisticated business leaders request more help leads to the question of whether the way HR contributes to better talent and organization decisions affects the sort of help that is requested by boards. Table 3 shows the association between board help requests and specific ways that HR contributes to more rigorous decisions. The first two columns show that help requests in all three areas are significantly and positively related to the degree to which HR leaders identify unique strategic connections between human capital and business strategy, and have a good understanding of how and why those human capital connections create strategic differences. The relationships are stronger for executive compensation and succession, but they are significant for board compensation as well.

The next two columns show low, mostly non-significant associations, suggesting that the degree to which HR educates business leaders about their talent decisions, and the degree to which HR adds value through compliance do not relate to board help requests. With regard to educating business leaders, we suspect that at present this is an

under-appreciated HR role by business leaders and boards. Notably, it is significantly related to executive succession help requests, suggesting that in at least this area, HR's ability to educate business leaders has some effect on how boards use the HR function. With regard to compliance, the finding of no relationship is logical; compliance with rules, regulations and laws is very important, but only gets board attention when something goes wrong.

The HR compliance results are in contrast to the final two columns. They show uniformly strong associations between help requests in all three areas, and the degree to which HR adds value through high-quality program delivery and through improving talent decision making inside and outside the HR function. This suggests that even at the board level, HR benefits from increased quality in its more traditional role of delivering services. Unlike compliance, it appears that the service-delivery value paradigm is not simply a minimal expectation.

The results for HR adding value through improving decisions are encouraging. They suggest that as HR evolves the decision-support elements of its value proposition, the effects on its involvement in succession and compensation may be positive not only at lower levels of the organization, but at the board level as well.

HR's Role in Strategy

The role of the HR function in the formation and implementation of corporate strategy can and does vary significantly from essentially no role in some firms to a full partnership in others. Table 4 shows the relationship between how involved HR is in strategy and how much of a role HR plays in executive compensation, board compensation and executive succession. The correlations are particularly high for

executive compensation and executive succession. There is also a statistically significant relationship with board compensation, but the relationship is relatively weak.

HR potentially has the information and the expertise needed to be sure that there is a fit between business strategy and how executive positions are filled and compensated. (Lawler, 2008). Thus, finding strong relationships with executive compensation and succession is not surprising. The relationship probably reflects causation that goes in both directions. That is, when HR has achieved a stronger role in strategy, it is likely to have both the presence in the strategy process, and the understanding of strategy decisions, such that it is invited to give input on how to structure executive compensation and succession. It may also be the case that when HR is requested to be involved in executive succession and compensation at the board level, that role opens the door to a stronger role in strategy formation.

The correlation between the extent of help requested for board compensation and HR's role in strategy is lower than the correlation for executive succession and compensation. It is still positive and significant, but lower. This may reflect the fact that the connection between board compensation and strategy is likely to be less direct than the connection between executive compensation and strategy and the one between executive succession and strategy. HR's role in board compensation may reflect more the degree to which it has attained the position of a trusted advisor to the board on many matters, than a specific need for help in structuring and designing executive rewards that align executive interests and strategy.

Having found that there are positive relationships between HR's overall role in strategy, and the extent to which it is asked for help in the three areas, it is important to

explore how help with these three areas is related to HR involvement in specific business strategy activities. Table 5 shows the relationship between the degree to which HR engages in five important business strategy activities and the degree to which it is asked for help with executive compensation, board compensation and executive succession.

The results show consistently significant relationships across all the strategy activities for executive compensation and executive succession, but only one significant relationship for board compensation. The one significant correlation for board compensation concerns HR engaging in “work with the corporate board on business strategy,” and thus may reflect our earlier observation that when HR is present in board deliberations, it is also asked for input on board compensation. Still, the overall conclusion is that HR is providing less help with board compensation, and that the extent that HR’s help is requested with this issue is not strongly related to its broader role in strategy.

The correlations related to executive succession and executive compensation show positive relationships to all the strategy activities, whether the role is to assess organization readiness, implement strategy, help decide on options already identified, or identify the options themselves. There are somewhat stronger relationships with assessing readiness and working with the board. This may reflect the fact that executive succession and compensation decisions are closely tied to creating organizational strategic readiness, perhaps even more than implementing or shaping strategy. It may also reflect the fact that when HR has a presence in working with the board, its presence enhances HR’s role in helping with executive succession and compensation as well.

HR Strategic Contribution

How HR contributes to the strategy of a corporation is strongly related to the extent of help requested in: executive compensation, board compensation and executive succession. Table 6 presents data on the relationship between four characteristics of the HR contribution to strategy and the help requested from HR by the corporate board.

The more HR is a partner with the line in developing the business strategy, and the more the human capital strategy is integrated with the business strategy, the more the board asks HR for help with executive compensation, board compensation and executive succession. The highest correlations are with executive succession. The most likely explanation for these relationships is that as a result of working on business strategy development and tying it to the HR strategy, HR is very well positioned to help design and implement compensation and succession plans. HR is not only likely to know what the plans need to do; it has the visibility and relationship that it needs to help with getting it done.

The degree to which HR drives change management is also highly correlated with whether or not corporate boards ask for HR help. This too is not surprising since in order for change management to be successful the right reward and succession practices need to be in place. Finally, HR making rigorous data based decisions about human capital management is strongly correlated with executive compensation, board compensation and executive succession. Again, the fact that the human resource strategy is tied to the business strategy and tied to rigorous data based decisions puts HR in a well-informed and knowledgeable role about how executives and board members should be

compensated. It also potentially puts them in a knowledgeable position with respect to executive succession.

Across the board, the greater the extent to which HR contributes in all of these arenas, the more help is requested. It is interesting that this is true not only for executive succession and compensation. Unlike some of the results above, the pattern is also strong for board compensation. This suggests that a wide variety of avenues toward strategic contribution may either enhance HR's desirability as a partner in board deliberations about compensation and succession, or that when HR is requested for help in all of these areas, their capability to contribute in each of these ways increases. It is probably some of both, but we believe in this case that the logic is more compelling to suggest that if HR can contribute to strategy in these ways, that creates a demand for their help at the board level with respect to succession and compensation.

Type of HR Contribution to the Board

It is quite possible that the type of help that HR provides to boards in other areas is related to the help it provides with compensation and succession planning. The type of contribution HR makes to a board might include addressing strategic readiness, change consulting, developing board effectiveness/ corporate governance, and providing information about the condition/capability of the work force. One possibility is that requests for help with compensation and succession issues are associated only with HR contributions that directly relate to these decisions, such as providing information about the capability of the workforce. Another possibility is that all of these contributions relate to requests for board help with compensation and succession. This would suggest that requests for board help in these areas is more a function of HR's general presence

and active engagement with the board, than because of HR expertise in compensation and succession planning decisions.

Table 7 shows the correlations, which are all significant, and generally high. They argue strongly for the conclusion that board requests for HR help are related to a wide variety of HR contributions to board activities, rather than being related only to compensation and succession. This suggests that when HR is asked to do compensation and succession work with the board, it is also asked to provide help in other areas. It looks like there may be a general tendency for boards either to request or help from HR or to forgo it.

Structure of HR

During the last several decades organizations have increasingly moved toward organizing HR functions with service centers and centers of excellence. These centers provide expertise and administrative support and usually are complemented by placing HR executives in the various business units or departments of the organization. The argument for this design is that it provides subject matter expertise in key HR areas as well as providing responsive, efficient and effective HR services. If they are indeed effective in creating a more responsive and efficient HR function, that should lead boards to rely more on HR expertise. It may also be that once HR is organized in this way, there is more professional time for HR to attend to strategic considerations.

Table 8 shows the relationship between the existence of centers of excellence and HR's role help with executive compensation, board compensation and executive succession. All the correlations are statistically significant and support the argument that centers at the corporate level are a powerful way to insure that HR has the expertise it

needs to deal with corporate strategy and the decisions that must be made at the corporate level. Issues of executive compensation and succession span organizational units, so one would expect that creating corporate centers that have expertise would provide the opportunity for HR to have the cross-unit perspective necessary to such deliberations.

Two other features of the HR organization shown in Table 8 are not significantly correlated with HR providing help with executive compensation, board compensation and executive succession. The efficiency with which the HR organization is run is not nor is the degree to which information technology is used by the organization. The result for resource efficiency is not surprising since it is not directly related to the issues that come up with executive compensation, board compensation and executive succession.

The result with respect to information technology is surprising since HR IT can be a vehicle for providing information needed to make sound compensation and succession decisions. We believe this result reflects the reality that HR IT systems can be used for a wide variety of purposes, and contain and generate information spanning the range from HR processes to workforce attributes to connections to business outcomes. Thus, the mere presence of HR technology does not necessarily imply information aimed at assisting with these board-level decisions.

HR Skills

There is increasing attention to developing the skills of HR executives (Boudreau and Ramstad, 2007; Ulrich, Brockbank, Johnson, Sandholtz, and Younger, 2008). One can divide its skills into three major categories: Technical skills reflecting the professional knowledge required to design and deliver key HR programs and practices; business skills that reflect HR's understanding of business disciplines and the specific

business issues and initiatives in their organization; and consulting skills that reflect capability to advise, coach and provide useful diagnosis and perspectives (Lawler, Boudreau and Mohrman, 2007). Table 9 shows the relationship between board requested help and the satisfaction of the HR leaders with the skill level in the HR function in each of these skill categories.

Interestingly, satisfaction with HR technical and consultation skills is not significantly correlated with board requests for HR help with compensation and succession decisions. Satisfaction with business understanding is related to requests for help with board compensation and executive succession, but not executive compensation. If HR satisfaction with these skills indicates the level of the skills themselves, then this pattern may reflect the fact that HR's technical skills and consultation skills reflect a broad capability that is applied at many levels of the organization and, to many issues, but it is not critical to dealing with the board on these issues. We do not believe this implies that boards don't value such skills, but they may not feel they are related to help they need. The level and quality of business understanding, on the other hand, may be more directly related to the issues that boards confront and should affect compensation and succession decisions.

Conclusion

What aspects of HR's strategic role associate with board requests for assistance with executive and board compensation and executive succession? Our results suggest that the most strongly associated HR elements are those that relate directly to HR's role in strategy formulation, presence in board processes, and contributions to general manager decision sophistication regarding talent and organization issues. Less associated

with board help requests are the more function-specific elements of HR such as efficiency with resources, use of information technology, technical and consultation skills, and value added through compliance.

As we have noted, our results are correlational results, which means that we can't be certain about the direction of causation that underlies the relationships we found. It may be that HR presence and involvement in board-level decisions leads to the visibility and respect necessary to build a broader role in contributing to strategy, or it may be that when HR organizations successfully build their capability to contribute to strategic decisions they are invited to help with board-level decisions. It is likely both, occur. Regardless of whether it starts with presence at the board level, or with a stronger strategic and decision-support role more generally, it is clear that HR organizations that can achieve a stronger strategic and decision-support role are more likely to be invited to assist boards in these important areas.

Also, while most HR strategy and decision-support elements are associated with all three board help request arenas, clearly HR help is requested more often in the areas of executive succession and compensation as compared to board compensation, and the associations between HR strategy and decision support is stronger in the former two areas than in the latter. We speculate that this is because executive succession and compensation decisions are more clearly tied to HR's success in improving organization processes, while board compensation is often distinct from those processes. Still, our results suggest that it is common for HR to be asked for help with board compensation issues, and that even here; greater strategic capability and decision-support contributions by HR improve the chance that boards will look to HR for assistance in this area.

Implications for HR

What should HR organizations do in light of these findings? First, they should create structures at the corporate-level that support board-level decision processes and they should develop expertise in business strategy. Excellence in the more administrative and function-specific aspects of HR may add great value to the organization, but it appears that board involvement with HR depends more on those HR elements that create a specific presence in corporate decision processes (such as having corporate-level centers of expertise and a specific role in ongoing corporate and board strategy processes).

HR needs to enhance the talent and organization decision science sophistication of business leaders. HR organizations would also do well to incorporate board-level experience into the career paths of HR leaders, accelerate the progression of the HR function from a strictly compliance-based paradigm toward more decision support, and generally enhance HR's role in strategy formulation and design.

We believe that HR has much to contribute by bringing principles of human behavior, organization effectiveness and labor markets to the deliberations of boards regarding executive and board compensation and succession. In order to tap that potential contribution, boards must more frequently request HR's help, and HR must evolve to be prepared to deliver on those requests through a stronger presence and capability in delivering strategic insights, decision support and unique value.

HR can certainly achieve a strategic partnership in many ways besides contributing to board decisions concerning succession and compensation, but we would argue that HR's role with the board in these areas is very important to HR's overall role.

It represents an important business area and is a symbolic indicator of HR's status. As a result it deserves attention and continuing scrutiny by HR executives.

References

- Boudreau, J. W., & Ramstad, P. M. (2007). *Beyond HR: The New Science of Human Capital*. Boston: Harvard Business School Press.
- Lawler, E. E. (2008). *Talent: Making People Your Competitive Advantage*. San Francisco: Jossey-Bass.
- Lawler, E. E., & Boudreau, J.W. (2009). *Achieving Excellence in Human Resources Management: An Assessment of Human Resources Functions*. Stanford, CA: Stanford University Press.
- Lawler, E. E., Boudreau, J.W., & Mohrman, S. A. (2006). *Achieving Strategic Excellence: An Assessment of Human Resource Organizations*. Stanford, CA: Stanford University Press.
- Ulrich, D. , Brockbank, W., Johnson, D., Sandholtz, K., & Younger, J. (2008). *HR Competencies: Mastery at the Intersection of People and Business*. Alexandria, VA: Society for Human Resource Management.

TABLE 1. WHERE BOARDS REQUEST HR HELP

	Percentages					
How much does your Corporation's Board call on HR for help with ...	Little or No Extent	Some Extent	Moderate Extent	Great Extent	Very Great Extent	Mean
Executive compensation	5.2	5.2	6.2	40.2	43.3	4.1
Board compensation	21.3	11.7	23.4	28.7	14.9	3.0
Executive succession	10.3	6.2	18.6	23.7	41.2	3.8

TABLE 2. RELATIONSHIP BETWEEN BUSINESS LEADER TALENT SOPHISTICATION AND BOARD HELP

DECISION MAKING											
How much does your Corporation's Board call on HR for help with ...	We excel at competing for and with talent where it matters most to our strategic success	Business leaders have a good understanding about where and why human capital makes the biggest difference in their business	Business leaders' decisions that depend upon or affect human capital (e.g. layoffs, rewards, etc.) are as rigorous, logical and strategically relevant as their decisions about resources such as money, technology and customers	Business leaders understand and use sound principles when making decisions about:							
				Business Strategy	Finance	Marketing	Technology	Motivation	Develop-men & Learning	Culture	Organiza-tion Design
Executive compensation	.35***	.31**	.31**	.24*	.26*	.37***	.28**	.26*	.23*	.18	.22*
Board compensation	.33***	.30**	.35***	.17	.12	.27**	.24*	.23*	.26*	.16	.18
Executive succession	.25*	.29**	.29**	.34***	.24*	.30**	.31**	.38***	.41***	.39***	.36***

Significance Level: * $p \leq .05$ ** $p \leq .01$ *** $p \leq .001$

TABLE 3. RELATIONSHIP BETWEEN HR DECISION BOARD HELP

DECISION MAKING							
How much does your Corporation's Board call on HR for help with ...	HR leaders identify unique strategy insights by connecting human capital issues to business strategy	HR leaders have a good understanding about where and why human capital makes the biggest difference in their business	Business leaders have a good understanding about where and why human capital makes the biggest difference in their business	HR systems educate business leaders about their talent decisions	HR adds value by insuring compliance with rules, laws and guidelines	HR adds value by delivering high quality professional practices and services	HR adds value by improving talent decisions inside and outside the HR function
Executive compensation	.37***	.44***	.31**	.16	.02	.29**	.39***
Board compensation	.28**	.23*	.30**	.18	.04	.28**	.28**
Executive succession	.44***	.45***	.29**	.25*	.01	.30**	.49***

Significance Level: * $p \leq .05$ ** $p \leq .01$ *** $p \leq .001$

TABLE 4. RELATIONSHIP BETWEEN HR'S ROLE IN STRATEGY AND BOARD HELP

How much does your Corporation's Board call on HR for help with ...	HR'S ROLE IN STRATEGY [±]
Executive compensation	.46***
Board compensation	.21*
Executive succession	.46***

Significance Level: * $p \leq .05$ ** $p \leq .01$ *** $p \leq .001$

[±]Response Scale: 1 = No Role to 4 = Full Partner

TABLE 5. RELATIONSHIP BETWEEN BUSINESS STRATEGY ACTIVITIES AND BOARD HELP

How much does your Corporation's Board call on HR for help with ...	BUSINESS STRATEGY ACTIVITIES				
	Help identify or design strategy options	Help decide among the best strategy options	Help plan the implementation of strategy	Assess the organization's readiness to implement strategies	Work with the corporate board on business strategy
Executive compensation	.30**	.30**	.23*	.43***	.41***
Board compensation	.10	.14	.13	.17	.21*
Executive succession	.38***	.37***	.34***	.43***	.49***

Significance Level: * $p \leq .05$ ** $p \leq .01$ *** $p \leq .001$

TABLE 6. RELATIONSHIP BETWEEN HR STRATEGIC CONTRIBUTION WITH BOARD HELP

How much does your Corporation's Board call on HR for help with ...	HR STRATEGIC CONTRIBUTION			
	Partner with line in developing business strategy	A human capital strategy that is integrated with business strategy	HR drives change management	Makes rigorous data based decisions about human capital management
Executive compensation	.40***	.42***	.46***	.38***
Board compensation	.25*	.31**	.28**	.28**
Executive succession	.54***	.57***	.48***	.44***

Significance Level: * $p \leq .05$ ** $p \leq .01$ *** $p \leq .001$

TABLE 7. RELATIONSHIP BETWEEN HR CONTRIBUTION TO BOARD ISSUES AND BOARD HELP

How much does your Corporation's Board call on HR for help with ...	HR CONTRIBUTION TO BOARD ISSUES			
	Addressing strategic readiness	Change consulting	Developing board effectiveness/ corporate governance	Information about the condition/ capability of the work force
Executive compensation	.43***	.37***	.36***	.42***
Board compensation	.27**	.31**	.48***	.37***
Executive succession	.58***	.49***	.40***	.56***

Significance Level: * $p \leq .05$ ** $p \leq .01$ *** $p \leq .001$

TABLE 8. RELATIONSHIP BETWEEN HR ORGANIZATION AND BOARD HELP

	HR ORGANIZATION		
How much does your Corporation's Board call on HR for help with ...	HR Centers	Resource Efficiency	Information Technology
Executive compensation	.39***	-.02	.16
Board compensation	.27**	-.06	.13
Executive succession	.32***	-.02	.20

Significance Level: * $p \leq .05$ ** $p \leq .01$ *** $p \leq .001$

TABLE 9. RELATIONSHIP BETWEEN HR STAFF SKILLS SATISFACTION AND BOARD HELP

How much does your Corporation's Board call on HR for help with ...	HR STAFF SKILL SATISFACTION		
	HR Technical Skills	Business Understanding	Consultation Skills
Executive compensation	.03	.11	.03
Board compensation	.05	.26*	.06
Executive succession	.08	.21*	.06

Significance Level: * $p \leq .05$ ** $p \leq .01$ *** $p \leq .001$