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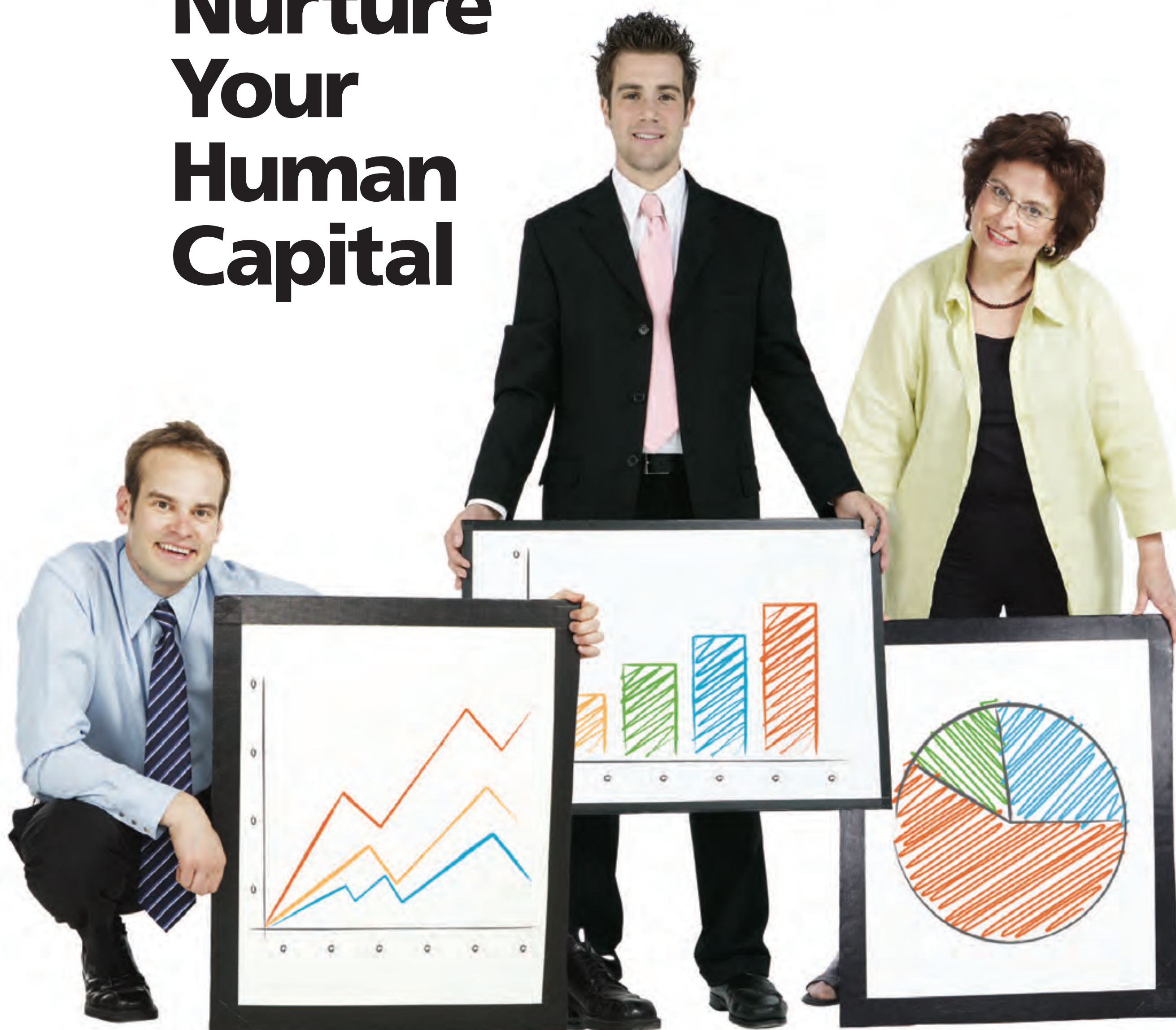
financialexecutive

www.financialexecutivemag.com July/August 2008

CFO LEADERSHIP

Nurture Your Human Capital



■ **AUDIT COMMITTEES**
New challenges involve complying with the "spirit" of regulations and worrying about being "second-guessed"

■ **PRIVATE COMPANIES**
Captive insurance programs provide many advantages, but be careful to review all the details

Nurturing A New

Kind Of Capital

While it may be common knowledge that the CFO's mission is to ensure that all the assets of the organization produce the maximum return on investment, there is one key asset on which many CFOs seem to stumble and fall. That asset is human capital.

And it's common sense that in a global business world, dominated by massive labor movements and talent shortages, the best financial management skills are useless unless organizations have the right people in the right place at the right time and use them wisely.

The effective use of an organization's human capital isn't just a leadership problem for CFOs, trained in measuring and counting complex financial data; the other denizens of the C-Suite are just as culpable for often only following their line of functional expertise:

It's the responsibility of senior managers — particularly CFOs — to be knowledgeable and proactive about investing in and developing their human assets, argue two global business consultants.

By Mike Johnson and Chris Roebuck

Marketing VPs *position brands*
R&D VPs *innovate and develop*
Sales VPs *push product and service*
The CFO *counts the cash*
The CEO *sweats strategy*

Putting their hard-earned expertise aside, all the individuals in the roles listed above have one thing in common: they are all senior managers charged with leading their organization to be the very best it can be. In today's global environment, that very best includes knowing how to invest and develop human capital — the asset that doesn't sit on the company's books at night, but goes home and has the option of whether it comes back the next day.

The stark reality is that many organizations still leave the strategic management of human capital to the human resources (HR) department and operationally to mid- or low-level HR and line managers.

COVER STORY

Unfortunately, professional training as a finance executive will probably not have included understanding the potential of human capital returns and how to release them.

Often, the presence of a few visible strategic HR initiatives lulls the CEO and other senior executives into assuming, incorrectly, that the business is working hard at maximizing the human capital return. But that is rarely the case.

There needs to be a proactive human capital strategy to turn the potential into bottom-line results. Such a strategy doesn't begin in HR, but rather, it begins at the top, with the CEO, CFO and the rest of senior management.

Human Capital Strategy

The objective of a human capital strategy is the maximization of the return on investment (ROI) on the human capital of the organization to impact the bottom line in the best way possible. And, that's easier said than done.

It can be accomplished, however, by making sure that all your people are better motivated, more engaged, supported, skilled, customer-focused and more qualified than your competitors, and in a way that can be measured. Such a task requires a hands-on, proactive CEO and CFO, other senior management and HR, all acting together.

In such a scenario, the CFO and his or her top management team is deeply involved — and not just cheering from the sidelines. In this hands-on leadership approach, this human capital strategy gets turned into an agenda that is driven by the business but delivered by line managers and ultimately, every employee.

There are a number of factors why CFOs have not traditionally been involved in the development of human capital returns, but primarily because their early professional training tends to make them more likely to focus on numbers than on people — a natural focus to reduce costs and maximize income and profit. Unfortunately, professional training as a finance executive will probably not have included understanding the potential of human capital returns and how to release them. As a consequence, many CFOs feel that it is not their place to work on this type of people-centric agenda.

More than that, human capital investment — and the time lag to deliver returns — are often not in line with the traditional cycles of annual financial and corporate planning processes and are often perceived as a distraction (a "nice-but-not-necessary") to real business activity.

Additionally, visible, concrete benefits from human capital initiatives are difficult to attribute to specific financial results using traditional financial measures, so they seem to fall outside the comfort zone of tried-and-true areas of measurement. When viewed from such a lens, it's not surprising that most CFOs feel it safer to leave these "esoteric" projects alone.

But no true professional CFO can afford to leave this human hot potato alone for very long, especially now. Now the business case for driving the people agenda cannot be ignored, as it links directly to share price and other key financial measures.

Indeed, corporate researchers like Wayne Brockbank and Dave Ulrich (co-authors of *The HR Value Proposition*) estimate that up to a staggering 70 percent of share price is derived from intangibles. This is made up of brand, strategy, current and future leadership capability, bench strength and so on. Day-to-day, the success of all of these measures is determined by the quality of strategic activity to maximize human capital performance in a business.

The highly regarded Roffey Park Institute in the United Kingdom has closely studied attitudes toward work for more than a decade. Its 2008 findings are a real eye-opener to those who think that human capital doesn't match up to financial capital in the "how really profitable is your business?" argument.

Roffey Park's latest findings show that far too many senior managers are disconnected from reality. They may measure, measure, measure when it comes to people, but they don't pay attention to what they are reading in the results.

Indeed, according to Roffey Park, 82 percent of board directors felt that the leadership enjoyed by their organization was "good" or "excellent." But only 52 percent of middle managers felt they could describe their business leadership in such a positive way. Worse still, while 37 percent of board directors said morale in their organization was high, only nine percent of middle managers thought so as well. It gets worse. Only 26 percent of board directors thought there was a mismatch between the "espoused values" of their firm and what actually went on; a stunning 75 percent of junior managers said that there was such a gap!

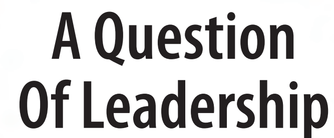
Imagine the impact if you can turn these all-too-real attitudes around. The real key, however, comes down to people — not just the employees, but those at the top, too. The CFO must take part of the responsibility for pushing the people performance just as much as those dollars and cents.

A Corporate Leadership Council study showed that 54 percent of those questioned thought it was vital for managers to develop people on the job, but only 24 percent said that senior managers do this well. However, they emphasized something more important: "The example senior management sets influences everyone else." That includes the CFO.

Five Areas of Organizational Performance

Any strategy to release the potential returns of a successful human capital strategy should focus on five key areas of organizational performance. All of these should be on the leadership agenda of any people-centric CFO or CEO and HR department.

- **Risk Minimization.** Ensure that the loss of key personnel, revenue (due to error), damage to reputation, potential regulatory or legal risk is minimized. Increasing engagement can reduce the risk of loss of key people by up to 87 percent, reports the Corporate Leadership Council.
- **Cost Control.** Costs are minimized by efficient delivery of business objectives where employees are constantly thinking about helping the organization save costs. Recent studies point out that over two-thirds of highly engaged employees think they can make a positive impact on their organization's costs and efficiencies, while just 19 percent of disengaged staff feel the same.
- **Performance Improvement.** People perform at their best to deliver more output at a better quality in the same time. The lesson? Good leadership by line managers can increase discretionary performance by over 40 percent, according to research by the Corporate Leadership Council.
- **Customer Service.** All activity is focused on delivering the best possible service to customers. This means that staff is trained as customer relationship experts, not just sales staff; customers are involved in the organization's decisions about products and services and give feedback on performance.
- **Innovation.** Constantly be looking for better ways of working across different parts of the business and opportunities in the market for new offerings or disruptive offerings that change the base dynamics of the market. The value of innovative action — particularly in difficult economic times — was made clear in a report on innovative companies in *Business Week*, which concluded it brought better bottom-line results, greater market share and with so-called



Undeniably, one of the year's juiciest business stories has been the calamitous events surrounding Société Générale's (SocGen) Jerome Kerviel's ability to run up a trading loss in excess of €5 billion. Was it simply that the systems and controls didn't work? As more facts and theories have emerged, each new revelation clearly points not to a failure of control but a failure of leadership. This is so, for the following reasons.

- First, it's clear that this isn't a story about SocGen; it's much bigger than that. And it isn't confined to the financial services industry. Basically, it's about how we manage and lead, or rather, *don't* manage and lead our businesses in the 21st century.

There's far too much of a disconnect between those at the very top of our businesses and the rest. As this story seems to illustrate so well, there is a vacuum between top managers and the rest (see the Roffey Park Institute's findings in main story). If you look back at similar trading fiasco stories over the years (Sumitomo, Barings, Daiwa, Allied Irish, Bank of Montreal), you'll find that subsequent investigations blamed the failures on poor management or failed leadership.

This has also been the core cause of the current subprime crisis where, in the search for a quick profit, many top financial organizations threw out their leadership values. They then dropped basic deferred compensation and risk principles and demonstrated poor communication between operational staff and senior management.

To understand that, look at today's big business model and compare it with 40 or 50 years ago. In the 1960s and early '70s, most businesses were led by engineers, bankers and chemists. They all had one thing in common: they knew stuff! They had become leaders by accident. Employees worked for them because the boss "knew what he was doing."

Now, most of business is so complex that we rely on people with finely honed, niche skills. This is especially so in the larger, faster-moving and more global business world, where those in top management often have but the slightest idea of what their employees are really up to.

- Second is the culture, the climate, of the organization. Jerome Kerviel has made it clear in interviews that all he wanted to do was be a big suc-

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cess, make lots of money for his bosses and earn a big bonus. If that is the only culture there is, and if that is all he was judged by, then all the controls in the world won't stop it from going wrong. When you have a culture based on profit and little else, you're in trouble from day one.

■ Third, Kerviel's bosses quickly distanced themselves from him. There was not the merest hint of support. Then, as it became clear that others may have been involved — and even that there had been three suicides in recent years caused by apparent stress to succeed — the leadership moved further away.

The message was clear: "We're cutting you loose; we don't want to even begin to understand your problems." By doing that, they have *de facto* told the rest of the firm, "We don't want to understand anyone else's problems, either." Such management lives in a bubble, disconnected from the rest. Survey after survey says that senior management gets quickly disconnected unless they get involved.

What's needed is to reconnect senior managers with the people in the business — and not through some human resources initiative, either, no matter how well-intentioned — through a real connection that pierces the bubble, implodes the vacuum and puts the organization together again. It *must* come from the leadership and be maintained by them day after day. This is not something for human resources. Senior management must follow these three approaches:

1. Senior management *must* spend real time with those who make the money — leaders and future leaders at all levels — those who generate the ideas and interact with the customers. The new power elite, the traders, information technology engineers and biochemists, have to be able to talk openly with those at the top. Smart companies already do this, as part of their leadership culture.

2. There's more to a business than "profit at any price." These recent events show that this model is not only bad, it's very expensive, too! Change the model, change the culture and you'll be more profitable, long-term.

3. Take responsibility. Real leaders (at all levels) don't run away. In the complex world of big business, a blame culture is just as poisonous as a profit-above-anything culture. Talk, support, take responsibility: that's real leadership, and something many big businesses need today.

The moral: A company with poor leadership and a culture based on profit will pay the price. What's better? A well-led, open culture where effective leadership is the only control that is needed. And to please the CFO, you can measure it, too.

— Mike Johnson and Chris Roebuck

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disruptive offerings, 100 percent share of a new untapped market.

When organizations get these five factors wrong — or even two or three of them — the consequences can be extremely costly. That's when not paying attention to human capital issues turns into something else — a real failure of leadership (see sidebar, beginning on page 35). When that happens, the CFO is as much a part of the problem as any other senior manager.

Study after study shows that getting these basics right has a huge effect that, if nurtured and allowed to become "the way we do business around here," leads to ongoing world-class performance. A senior management team that shows true, on-the-ground, day-to-day leadership creates the potential to improve employee engagement and productivity by huge amounts.

In a Towers Perrin study of major companies, the 50 companies with the highest levels of employee engagement (defined as those where 70 percent or more of staff say they are engaged) showed operating income improvements of almost 20 percent over a year. Conversely, in firms with low engagement (under 70 percent), operating income fell by a third. But such financial success will only come if the CEO, CFO and other senior managers lead this process and drive it forward as a key, non-negotiable business requirement.

This means setting an example in their own areas with their own teams. If this agenda is passed over to HR and treated as an HR issue and not a strategic business issue, everyone

below senior management level will draw the conclusion that it's not important and the benefits will never be realized. This "people focus" can be improved by coaching, mentoring, development programs, appraisal systems and on-the-job feedback by line managers. The only rule is that everything, from the content of initiatives to communication from senior management and what people are rewarded on, must align to deliver on the five key areas and be directly linked to the corporate objectives, vision and values.

The CFO Role in Driving Engagement and Performance

In all this, the CFO can play a crucial role, linking with human resources to develop and review the five critical areas and create a strategy and objectives to deliver improvement, making a business case for the CEO to champion the human capital strategy into the business as the "people and performance strategy."

Additionally, the CFO should also ensure that the HR department has sufficient resources to facilitate the human capital strategy program — particularly in headcount of business-facing relationship managers per employee. This will, of course, depend on the degree to which a business has outsourced its HR transactional services. However, it should not drop below a ratio of about 1 to 75 or 1 to 100, excluding experts operating from the corporate center.

The CFO's role in providing management data to the senior management in conjunction with the HR department to monitor and fine-tune the implementation of the human capital strategy is also vital. Indeed, the CFO's involvement underscores both the viability and the legitimacy of the process.

Above all, a CFO is the leader of the financial team in the organization. As such, he or she sets an example. And, in this "new territory," the CFO has to bring to bear all the skills from the world of balance sheets. However, often CFOs who have followed a traditional career path haven't had much opportunity (or need) to develop people skills and leadership skills.

But in creating, leading and being an active part of the process, CFOs need to develop excellent leadership skills. To achieve these skills, CFOs will need to devise a personal strategy to enable them to develop their leadership skills further. This is best based on 360-degree feedback from boss, peers, clients and their immediate team. Additionally, a mentor or executive coach would be of value. There are many quick, simple and effective ways that even the toughest "bean counter" can be helped to become an excellent leader.

Seeing a return on this type of investment, and using some or all the activities suggested, could result in a positive upswing within six months of implementation, while others will take longer. For example, a mentoring program for a key group of people or good leadership development programs for line managers certainly should produce positive data within six months and further improvement from there.

Some of this return may not be demonstrated by specific, measurable financial data, but by data that will show business performance improvement. However, with some activities, such as the development of new business projects, there may be an attributable financial benefit.

Examples of data that could be useful are key group retention figures, promotion rates of developed groups versus controls groups not yet developed, 360-degree feedback, level of new business ideas and their outcomes, employee engagement figures, employee focus groups, attitude surveys and brand perceptions (both from customers and clients and potential employees).

In the final analysis, if an organization wants to be the best in its market, it has to release the full potential of its human capital. There simply is no other way to achieve this other than engaging everyone, from the top down, rolling up their sleeves and being determined. This is not the product of a magic potion; it takes hard work.

And the CFO plays a crucial role in the entire process — working with HR and the CEO, leading the finance function and demonstrating a positive example representing senior management in the organization. It will take hard work and it will take some time, but the returns on an organization's human capital will be seen on the bottom line. More than that, the CFO will have made a real difference to the organization and grown as a finance professional and a business leader as well.

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TAKEAWAYS

>> While the CFOs' mission is to focus on the assets of an organization, they're falling short on manging their human capital assets. In the global economy, financial management skills are useless unless organizations have the right people in the right place at the right time and use them wisely.

>> C-level and senior managers follow their line of functional expertise: Marketing VPs position brands; R&D VPs innovate and develop; Sales VPs push product and service; the CFO counts the cash; and the CEO sweats strategy.,

>> A strategy to release the potential returns of a successful human capital strategy should focus on five areas of organizational performance: risk minimization, cost control, performance improvement, customer service and innovation.

>> Among the CFO responsibilities in driving employee engagement and performance is to ensure that the HR department has sufficient resources to facilitate the program, set an example and link with HR. In order to create, lead and be an active part of the process, CFOs need to develop their own leadership skills.