REHUMANISING

THE FIRM

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Rehumanising the firm

It's ironic that it has taken an ongoing global financial crisis (GFC) for the empty rhetoric behind 'People are our greatest asset' to be fleshed out by an admission that 'People are also our greatest risk'.

"Fred the Shred". Bernard Madoff. Kweku Adoboli. Deepwater Horizon. Enron. Lehman Brothers. Credit swaps. These individuals, brands and mathematical chicanery have become reference points for everything wrong with greed-is-good, ethics-lite capitalism.

In fact, capitalism is now seen as a risk. As JC Spender calls it, we need to 'humanise the firm'.

Of course, this call to make the firm more diversely populated, ethically run and socially ended, smacks of irony too. In the last 'decade from hell' as Time calls it, the only lone voice repeatedly calling for business to take all this 'soft people stuff' seriously is now the one whose expertise is being called upon to save the day. It's a good job top-table-lite HR was busy with more than just payroll:

1. Taking on board analytics and quantitative analysis
2. Putting a strategic competitive value on workplace culture
3. Flattening hierarchies, connecting networks and empowering leaders to cope with change as the norm

Busy creating a forward-looking, data-rich people picture of an organisation not lost on the next generation of brands - Google, Tesco, IBM, Starbucks – who not only want to create the best workplaces to think in, but *invest* in too. And post GFC, the appetite for the 'S' in ESG integrated reporting is growing.

So what do we mean by Human Capital Risk, whose new insights are furnishing businesses – and investors - with so much awareness about its ability to compete?

Human Capital Risk (HCR) can be considered as risk comprised from both the individual employee (People Risks) and the organisations attempts to manage (or perhaps allow) counterproductive behaviours (Organisational Risks).

How well an organisation employs techniques to manage People Risks will affect the likelihood of that behaviour occurring, and ultimately influence the organisation's culture.

The following paper is split into 2 sections – People Risks and Organisational Risks. The learning here, from psychology, science, and business, with practical examples of value to HR, risk professionals, management and the entire board, is as risk free as we can make it.

(Please note we are not concerned with location risks. Nor are we concerned with legal or compliance risks, acts of God, cyberwarfare, or terrorism - employee sabotage – or 'internal terrorism' - is of course a risk we take seriously).

What do we mean by 'People Risks'?

People Risks include behaviours considered counterproductive, or even destructive, to an organisation's objectives. Things like unethical behaviour. Fraud. Dishonesty. Internet misuse. Gambling or addiction. Financial distress. Unhealthy lifestyles. Poor performance. Absence. Unwanted turnover. Conflict. Stress. Lack of innovation.

But People Risks change. Three years ago, 'Cyberslacking' was considered a major problem. But after clumsy attempts at putting the social genie back in the bottle, most have come around to our belief that they should turn a perceived negative to their advantage: instead of encouraging less non-work related work-time 'lost' networking on Facebook or booking holidays (the amusing term used to describe employees doing two non-work activities at once is 'Multishirking'), most businesses should be asking for more:

- More of their talent connecting with other talent on networks - a pool they can tap into to join the business/ project, in a more cost effective way
- More dealing with work/life issues during work time in recognition that an employee panicking about missing their daughter's birthday is hardly focused on the job

We prefer to use the Roman trick and ask: 'Cui Bono', 'Who Benefits'?

> *Who benefits from saying this is a problem? Who in turn is benefiting by seizing this as an opportunity (taking a risk)? Who benefits in the long term, and from both sides, if we look at this differently?*

This takes a lot of mythdebunking research, some of which is only backed by hindsight. Our advice for anyone who still thinks internet misuse is a problem: start by weaning your employees off thinking a clean inbox is a box well-ticked.

In the next few pages, we'll focus on some of the main People Risks and show how to turn negative behaviours into opportunities.

We'll also look at an area of risk – idea generation – having profound consequences for the organic way we think of a business.

Money, money, money

Over £85 billion is lost to fraudsters in the UK each year. More: on average, 6.1% of expenditure across the private and public sectors is lost to fraudulent activities in areas such as payroll, procurement, insurance, social security and healthcare. Now throw in not just the fact that fraud is more prevalent in a recession most businesses are sitting up and taking notice. Or should be.

But how should you tackle it? You should:

- Make fraud a board as well as management level priority
- Run an audit to provide evidence that fraud behaviours exist
- Proactively look for and remove temptations to commit
- Change the culture so fraud is seen as an unethical and unlawful
- Build this into your employment and recruitment policies
- Monitor, measure and review progress

Raising financial literacy

All these activities will raise awareness and tighten up fraud prevention. But with pay rises postponed, the cost of living escalating, none of this is addressing the financial problems employees are facing.

You can of course argue that this is not your responsibility.

But financial distress is the number one cause of stress and has been linked to physical and mental distress – leading to other Risks like conflict. All of which could add to financial distress to the business.

Our approach is simple: offer free education and training that teach employees money and debt management skills.

This in turn will:

- Help them help themselves, even if the issues are not of your making
- Provide life skills that they will have learnt from you
- Not just increase brand loyalty, but also raise productivity and lower absence caused by financial stress

The key is to get at the root causes of risk behaviours where everyone else would only deal with the outcomes. To make it a visible and active commitment on the part of your business to help.

Work can make you ill

Second only to money worries, employees worry about their health. Here again if we follow the advice prescribed by internet censors we'd ban the Ben and Jerry's website, stop serving chips in the canteen, subsidise gym membership, or install EAP counselling lines.

While we condone the latter options and confess to loving Chunky Monkey, many of the causes of these health issues are work related. Unreasonable deadlines, toxic Managers, bullying colleagues - can make you ill. Taking a long hard look at the health of the relationship between your business and its employees is critical - but in a new way.

Helping the fit get fitter

Marks and Spencer is a great example here. Instead of M&S's occupational health team's traditional devotion of 95% of its resources on the 5% of staff who were sick, they now focus 95% of those resources on the staff who are well.

M&S has cottoned on to the fact that collaboratively adding value to their employee's lives in ever more relevant and personal ways makes them more productive. Productivity that is measurable.

Healthy minds, healthy bodies, healthy profits. But what if your businesses biggest risk is a lack of new and healthy ideas?

A war for the talent with the next big idea

Some people go to sleep thinking about a problem and literally dream up the solutions (the science backs this up). Paul McCartney woke up one morning humming Yesterday. Shelley's Frankenstein was born out of a dream (or nightmare). Of course, McCartney is a talented musician, and Shelley could write. And both were in tune with the ideas around them, ideas which gave rise to such imaginative leaps.

> *But how do you mitigate the risk of ideas drying up?*
> *How do you ensure you have an idea pipeline?*

Google famously give their employees 20% of work time as think time. They do this for a very good reason: Google itself was a bright idea once, but indexed search has a shelf life, so they want – it's a risk not to – their employees to dream up the next Google before someone else does. Google are also buying up ideas from others too.

Few companies are as flush as Google. But in every company ideas are constantly being generated: how to improve manufacturing methods; how to connect the business with local communities. Leaving the thinking to the boardroom is a risky idea in itself.

With simple and effective use of knowledge boards or employee blogs, companies can ensure these ideas aren't lost.

Of course, we're soon back to the world of who owns the big ideas. Or who owns the money those ideas make: there's no such thing as a free hunch. But there is more to it than that. And Design has its place.

Serendipity as a driver of wealth creation

Not the film - though the premise is similar.

> *Think of the ideas you've had in your life that turned into new businesses, new products or services. How many of the chance encounters in a bar or networking event - even lift - led to those ideas? How many were sparked by a casual conversation?*

Nobel prize-winning University of Chicago economist Robert Lucas noticed that human capital density in cities was the main reason why they continued to create wealth.

You can have 1,000 PhDs spread out across your state, but if in my little principality I have 100 living one on top of another, chances are my human capital density will lead to greater economic development.

What does this mean for business?

- It's as important to accrue the best and brightest as it is to put them into a room together
- Forget the idea of the lone 'engaged' individual and think more about the engaged and diverse group, where ideas clash, collide, challenge, converge and compete
- Design into the business's architecture, group selection processes, the objective of increasing chance encounters

Of course, you may counter that the idea of creating workspaces that 'promoted encounters and unplanned collaborations' is the preserve of creative industries. Steve Jobs certainly made that a reality when he took it upon himself (obsessing over every detail) to design Pixar's HQ.

It worked too: As John Lasseter, Pixar's Chief Creative Officer, recalled to biographer Walter Isaacson:

> *"…I've never seen a building that promoted collaboration and creativity as well as this one."*

But Jobs was onto something. As we spend a huge percentage of our time in these environments, and as they greatly impact our lives, it is important the design of the building has to meet both our personal and business needs.

This has not been lost for example in education, where studies have shown that something as simple as improving natural light in classrooms can impact the health and wellbeing of students – as well as boost pass rates (by up to 25%).

Positive deviants

In almost every conversation we have about people risks, most ask:

> *Why don't we just weed out all the non-conformists and black sheep? Let's just hire nice sane rational people, who keep their head down and do what they're told. People like us.*

Indeed, most companies – even those founded by risk-taking rebels – once they get to a certain size do this naturally.

Slowly but surely, size brings with it a flabby, suffocating layer of rules and bureaucracy, a settled cultural expectation of 'how things are done around here', and the emergence of the employee archetype – often ambitious grads from the same schools who all took the same MBA courses or tried-and-trusted star names from competitors that you feel would most likely 'fit in'. But this kind of complacency is a big risk.

Course, you could follow Google and encourage everyone to let their hair down for 20% of the week. Google also eschew academic achievement in favour of initiative. Making diversity the rule is beneficial and should be encouraged not just as window dressing, and not just in terms of gender and ethnicity: background, experience, nationality and age richness can help keep a healthy balance between saying "This is the way things are done around here" and asking, "How would you do it differently?"

But silence is also a risk. And businesses are increasingly encouraging whistleblowers and positive deviants to speak up when they see their business (and individual employees in the form of risks like conflict) making wrong moves (or not moving at all).

> *Would The News of the World still be around now if its criminal activities had been leaked to their media rivals or brought to the attention of the police when they first began? "Told you so", is not an option.*

Let's end this section with a link to the Edge article, 'Why Cities Keep Growing, Corporations and People Always Die, and Life Gets Faster', by Geoffrey West.

If you can't always follow the science and the analogies between the growth and vibrancy of cities with the growth and inevitable demise of companies, what this scientist has cottoned onto is a very simple but also profound idea:

Unlike cities, whose margins suck in crazies with the next big ideas to replenish themselves, companies, often started by crazies, all eventually end up positively discriminating against them. They push them away into early retirement, fire them and lock them out and become one-dimensional. For this reason, they always fail and die. Is there a bigger risk?

What are 'Organisational Risks'?

While this paper started at the individual employee grassroots level, we also need to assess risk at the wider organisational level.

Organisational risks include: talent and succession planning; policies and procedures; corporate governance; knowledge management; vision and values; diversity; organisational structure; communication and leadership/board behaviour.

Organisational Risks are increasingly important, not only from an internal perspective but also in the context of UK financial regulation, as they could have a detrimental impact on the effective management and/or governance of your firm.

For example: Attrition of key individuals without a contingency plan in place; Board behaviour and dynamics; a shortage of high-calibre individuals on your senior management team; adequacy of HR processes which could lead to gaps in training and competence-checking, or the wrong organisational structure.

In this section we will look at the broader Organisational Risks which need to be factored internally alongside People Risks and will shed light on the practical ways that Organisational Risks can and should be properly addressed at the top level.

But we start with the emerging relationship – and all the risks that entails – between HR and risk professionals.

Laying everything out on the table

In 2007, the Economist Intelligence Unit (EIU) asked Risk Managers to rank risks - regulatory, reputational, IT, and market risks etc – in order of business impact. Human Capital Risk topped the list.

The problem though was that when the same respondents were asked to rank how effectively their companies managed these risks, human capital almost fell off the chart. Only climate change and terrorism were managed less effectively. The EIU drew the obvious conclusion: there needs to be much closer integration between the risk function and the Human Resources function.

Years later, integration is still a way off. Here we summarise six reasons why, even in large firms where HR and ERM functions have a mature take on Human Capital Risks and business success, a unified front is still not being presented:

1. Silo risks: Here the two functions are not operating or communicating together
2. Cultural risks: With different backgrounds/world views here the two functions are drawn from different cultures
3. Language risks: Here the two functions are effectively speaking different 'risk' languages
4. Incentive risks: Here the two functions are not being incentivised or directed to work together
5. Priority risks: Here the two functions are interpreting and ranking key risks based on different and ingrained perceptions
6. Ego risks: Here one function (risk) is unwilling to share the CEO's ear

We could also add gender issues: only 14% of FTSE boardrooms are made up of female Directors, and 75.8% of the UK HR profession is female. This is a diversity risk to both sides, though things are changing. But how do you speed things up?

The human capital risk panel (HCRP)

In the wake of the financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 mandated that U.S. financial services firms must have a Board-level risk management committee.

We think most businesses would do well to have a Board committee or a panel of experts that regularly and systematically assess the company's overall risk picture.

The panel will help:

- Provide a Human Capital Risk Framework setting the joint (HR and ERM) language, policies, and processes to think about risk in the context of your own organisation for the long term
- Review Human Capital Risk Audits to measure the costs/benefits of the aggregated risk picture
- Analyse the risks particularly as they apply to large or more frequent business transformations, including for example mergers and acquisitions
- Ensure the Human Capital Risk Strategy, as part of the wider HR Strategy, becomes a visible and informative part of the wider Risk Strategy: and is not lost in translation in the overall Business Strategy too
- Ensure the aggregate risk picture engages business leaders by showing clearly all the current challenges, limitations and opportunities they face
- React quickly to deal with any unplanned-for risk scenarios (loss of the CEO for example)
- Both sides – HR and risk professionals – refine their working relationship and minimise the risks their relationship (or lack of) poses to the business
- Act as an education and communication base not just for raising board-level awareness of the business's approach, activities and maturity in dealing with risks, but all the way down through the organisation (line managers and employees) and beyond (suppliers, customers, shareholders and investors)

Including business leaders, risk professionals, HR, line managers, as well as experts in areas such as legal, finance and corporate social responsibility, it is suggested that a company-wide view is ascertained at least quarterly.

If the business is new to this way of looking at itself, has an imbalance between the competencies of risk and HR, has undertaken an audit and shown itself to be suffering widespread risks (at shop floor and Board-level), or needs to monitor People and Organisational Risks on a more regular basis (such as in financial institutions) then the frequency can be increased.

We also urge the panel to look externally to get the right information and support they need from professional bodies or business intelligence providers. We also urge them to focus on the future.

Future gazing

One of the core responsibilities of Risk Managers is to second guess the future, to flesh out hunches and intuitions, to slim down the choices available to ensure the options are sound, and any decisions taken are as rational as possible (admitting rationality is bounded).

Risk intelligence can fit in here, especially as it is based on data-backed analysis that measures important variables and trends. For example, changes in the multi-cultural and age mix of the workforce over time that can be used to forecast shortages and opportunities.

The historical picture – that we needed to do X at point Y – can be modelled to make predictions based on future business needs – we need to do X again. Knowing what the business needs in order to compete (provided HR are central in the development of the business strategy), is an invaluable source of intelligence not just for the board but also to help lower level Managers cope with and be more resilient to increasingly changing demands.

With the internet and specialist services that provide best practice and business environment knowledge, HR can also proactively look at new ways to do more with less, raising the level of talent needed as well as removing barriers to productivity that in themselves are often causes of risk (such as toxic leaders or cultural issues).

Getting into the cultural space between a firm and its employees and turning it from a risk into an asset is becoming increasingly strategically vital. Of course, this depends on the business acumen of HR. It also depends on the HR acumen of boards.

HR Governance and the self-aware business

Given a better working relationship between HR and risk professionals, and with the activities of a panel or committee in place, it is much easier for the Board to hold a mirror to itself.

And sure enough, human capital risk savvy companies are actively beginning to subject Directors, Board sub-committees and audit committees to the same 360-degree performance assessments and reviews employees regularly undertake. They are also questioning the makeup and structure of Boards themselves.

This is not easy. Boards are not used to being questioned, and will not take kindly to 'softening up'. At the same time, HR have grown accustomed to leaving their people skills, conscience, and ability to spot poor performance when they see it outside the boardroom too.

There are also many free agents and non-exec Directors on Boards who operate above the scrutiny and reproach of company shareholders and other stakeholders. But if we take Human Capital Risks seriously as business risks, then HR practitioners must not only be allowed to use their unique knowledge, skills and experience to help business leaders tackle governance, risk and compliance issues throughout the organisation, but encouraged to do so.

A study by Creelman-Lambert, "The Board and HR, How Board Oversight of Human Capital Works", has also uncovered a growing interest within boards to up their game in HR Governance: how well the board is governing (in the hands-on sense of managing too) how well HR is performing in its new role as Owner/Manager of Human Capital Risk across (and beyond) the organisation.

This in turn is having a profound impact on the makeup of boards, beyond the need for greater diversity. As Creelman-Lambert point out, even the Chairman, whose worth has traditionally been reflected in the illustriousness of his/her career background, is now being measured against an ability to build and manage a cohesive and diverse team of strong willed and independent minded (risk-taking) individuals.

As HR has hardened up; boards have by necessity softened up. But this is a two-way partnership.

Letting the world know

With this degree of self-awareness, the opportunity arises – long overdue – for businesses to take seriously the concept of human capital reporting: communicating with the world how sophisticated and mature your businesses awareness of people (biggest risks, assets and costs) is. And especially how sophisticated and mature this self-awareness is against that of your competitors.

Without going over the convoluted and largely frustrating history of this concept, it must be pointed out that more concrete steps appear to be in place, with the Society for Human Resource Management (SHRM) in the US developing an ANSI standard for reporting human capital information to investors. Even if this does not become mandatory, or a global requirement, the idea is gaining legitimacy within the financial world.

Whilst we would argue that any business should prepare for – even pre-empt – the emerging appetite from investors for this information, we also argue that they build a strategy for communicating this information in more pioneering, systematic, and multifaceted ways. The bland annual report is not the best place to lump HCM analysis

Three better ways to make a business's sophistication and maturity in dealing with Human Capital Risks explicit include:

1. Board charters - outlining the board's responsibility for governing risk
2. Risk management pledges – outlining the board's and employees joint responsibility for mitigating risks together
3. Dedicated public and private employee-only websites/intranets – to help with interactive tools, education and training, and other resources to make that collaborative effort a reality

Brand reputation

But what if things still go wrong? When despite all your best efforts, one of your employees or a supplier does something out of the ordinary and a media and customer tweeting frenzy tears into your reputation?

And reputation matters: Ernst and Young suggest it makes up as much as 50% of a company's share price.

Of course, the standard move is to lay the finger of blame at the door of one 'rogue' man or woman. But what is immediately striking about the high profile UBS case for example, is not that the 31 year old 'rogue trader' Kweku Adoboli could 'lose' over $2 billion without anyone noticing (incidentally, he first alerted UBS to the losses). But that this was not the first time this had happened within UBS itself.

Which has led many to question who is really to blame here. Financial Times blogger and chief business commentator John Gapper maintains that, "given the recent history of UBS, it is fair to ask if Kweku Adoboli is a rogue trader or his employer is a rogue bank."

Nick Leeson, Brian Hunter, Jerome Kerviel, Kweku Adoboli: it's a convenient tactic to lay all the blame on one or a few individuals.

But risk cause analysis always shows that they are usually the products and symptoms of a more fundamental business problem:

Businesses don't hire bad people, they make them bad.

There are other lessons to be learned here though:

- Risks can have knock-on effects: in the Gulf of Mexico oil spill, inferior quality cement in the underwater oil rig, systemic inattention to process safety, inadequate training, and decisions to ignore safety warnings all combined to cause the catastrophe
- Risks can occur outside the office: the impact of dodgy Chinese suppliers on Apple's reputation
- Customers have the power: this FedEx customer's shocking – and rather amusing - YouTube video has been watched by millions of people – all prospective customers

The rogue individual view of People Risks here does not serve the long-term interests of the businesses. It does not get to, learn from or remedy the causes of those risks.

More importantly though, it misses a trick. For many reasons, businesses jumped on the CSR bandwagon for marketing purposes: it aligned their brands with the changing values of their customers.

With the financial crisis and the openness of the internet, these values are now shifting onto broader Human Capital Risks. And as politicians, educators and others sense the need to return ethics into business life, you can expect that trend to continue, for business reasons as well as because it is morally right.

For that reason alone, a less risky strategy would be for brands to embrace the wrong doers and help them rather than look to put as many miles between them as possible. People-friendly is the next eco-friendly. Business-friendly too.

M&A due diligence: using the human capital risk lens

Without going over the historical evidence, it is safe to say that most mergers fail because of so-called 'soft' issues, like cultural and leadership incompatibility.

But as the expertise here has matured, and as the awareness of the value of this information is beginning to permeate boards, not only is caution entering the minds of those who want to take these major risks, but boards can now call on their own Human Capital Risk analytical skills to cut down the risks of merger failure.

Knowing your people helps you know your business. It also gives you the skills to know the fit between your people business and the people business of your next partner.

Conclusion: Don't risk it

- Educate away financial distress to minimise the risk of fraud
- Help the fit get fitter to improve engagement
- Make it your business to make ideas come to life
- Don't encourage whistleblowers and positive deviants, hire them

These are just a few ways to help your business work collaboratively to turn behavioural People Risks into opportunities.

These are just a few of the business benefits for doing so:

- Increased presenteeism, productivity and morale
- Better quality of product or customer service
- Decreased likelihood of conflict and tribunals
- Improved engagement and overall employee wellbeing
- More transparent and open interactions and idea exchanges between workers and leaders
- Reduced private medical insurance/risk insurance claims
- Increased brand loyalty

These are just a few ways to help the board – and the wider world - become aware of the Organisational Risks in your business:

- Recognise that People Risks include EVERYONE in the company, and beyond
- Help HR and risk professionals work together to build a total risk picture
- Run risk audits and establish a risk panel to monitor risks
- Factor future Human Capital Risks into the business strategy
- Establish HR-Board Governance as a two-way partnership
- Innovate new ways to communicate your approach to People and Organisational Human Capital Risks as a business strategy to employees, customers, shareholders and investors
- Think, react, and deal differently with increasingly public Human Capital Risks
- Put Human Capital Risks front and centre in any analysis of mergers and acquisitions

These are just a few of the business benefits for doing so:

- Helping to up ratings with the credit agencies
- Making it easier to seek finance at preferential rates
- Keeping investors happy
- Offering protection in an M&A situation
- Even helping prepare for a trade sale

However, let's not forget, these are only some of an organisation's People and Organisational Risks. Always target those risks which are most damaging to your organisation (metrics and stats can help). Once you have strategically reduced these, you can move through the wider scope of HCR management.

We must offer a note of caution. Many of HR's new powers, actively called upon by boards, are 'borrowed' from finance and audit professions. Many HR professionals have followed Dave Ulrich's advice and made statistical analysis a core part of their activity. But these insights – these new ways to humanise the firm – should not be seen as a way to make everything go back to normal.

The opportunity here is not to subsume HCR into a simplified numbers based offshoot of the medieval audit profession far removed from business reality. The opportunity is quite the opposite: to drag those professions and the board's perception of the value of those insights kicking and screaming into a new, sustainable 21st Century way of thinking about and doing business.

Sticking with what you know and what has always worked in the past is the real human capital risk.

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We are brother and sister at mine the gap! and help brands bridge the gap to their customers and employees.

We'd be happy to research any area of HC for your business.

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We look forward to hearing from you.