Innovation in human capital management

A new, risk-based approach to HCM allows global financial services companies to achieve long-term business advantage by better assessing future risks, and aligning them with current people management activities within the overall strategic direction

“People risk management improves an organisation’s reputation internally and externally, influences shareholder value positively and enhances business advantage.”

Director, People Risk
Lloyds Banking Group

Financial services firms rely heavily on their people to enable them to succeed. Achieving strategic change and a sustainable return to growth depends on attracting, retaining and developing the right staff. Companies are increasingly appreciating the importance of helping their people realise their potential.

At the same time, firms need to cut costs, and are challenging Human Resources (HR), along with other front and back office functions, on their operating model and contribution to the business. Instead of simply reporting and managing lagging indicators like attrition, leaders want HR to help them understand the wider people risks and impact of macro-economic change, and the causal relationships involved.

Views of risk management are changing too, as a result of both technological drivers and (particularly in the aftermath of the financial crisis) regulatory ones.

All these factors add up to a strong case for a more strategic approach to people risk management. Pioneers of this approach are finding that it:

- Helps HR and business heads maximise the return on their investment in people through an understanding of current and future risks and impacts of a programme or change
- Provides a “sense check” for regulatory and legislative change so that leadership can develop risk-based responses and seize HR and people change opportunities

The people aspects of transformation need better handling

Over the past two years, financial institutions have needed to review every aspect of their operation fundamentally in order to weather the global financial storm. Often, this process has been nothing less than a complete rethink of their core purpose.

Simultaneously, attention from regulators and the public has made areas like reward packages, staff conduct and accountability into focus areas for significant change. All this is happening against a background of workforce instability and economic unrest, with recent research showing almost 25% of the UK workforce looking for new jobs[1].

At the same time, financial services firms are needing every ounce of energy to re-balance their workforce and emerge from the crises with their people intact to drive growth.

The answer, we believe, is to ensure there is a formal approach to strategic risk management within the 3 lines of defence risk model; acting as a bridge between HR and Risk to support business transformation and identify areas for HR and People innovation.

The solution: strategic people risk management

Strategic people risk management creates a clear line of sight between the goals of the organisation, the people required to deliver those goals and the operational HR and people levers that must be pulled to effect change.

It helps HR mature its position as a strategic partner to the business. Identification and evaluation of people risk moves away from being the sole responsibility of HR. Instead, a partner model emerges, in which short, medium and long term risks are developed into a structured portfolio to mitigate risks and manage opportunities.

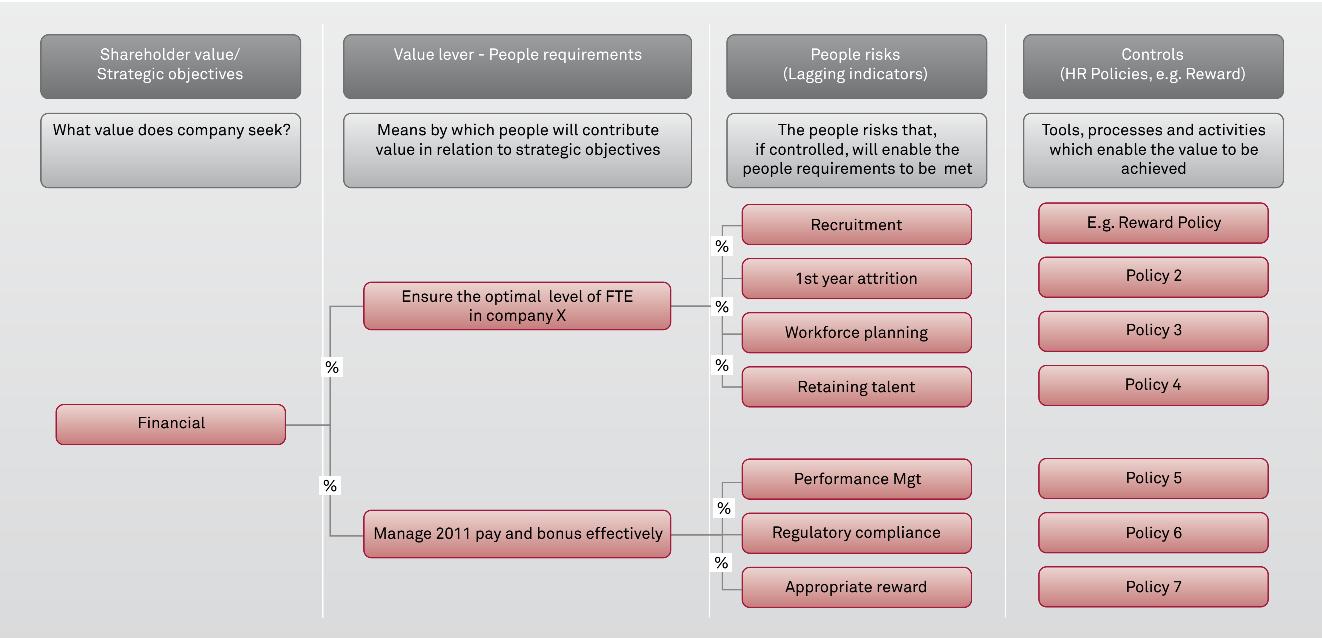
HR and risk functions must lead this agenda, working together to understand emerging risks and engineer long-term responses that reflect strategic intent. Their collaboration creates a tangible link between risk on the one hand and HR strategy and execution on the other.

Benefits of people risk management

Strategic people risk management brings enormous financial and human capital benefits. It:

- Allows the firm to maximise the potential of its people through targeted investment
- Challenges people risk appetites across the company, reviewing them constantly against a macro-economic and business driver framework
- Integrates HR with risk management, enabling the HR function to add value through effective policy-making
- Brings a comprehensive understanding of, and a culture of responsibility for, people risk to the business as a whole
- Improves people and HR change management, shifting the focus of HR away from the purely operational towards enablement of strategic change
- Provides a "one stop shop" to help HR directors and programme leads to handle people risk impacts of regulatory and mandatory change

Figure 1. Mapping KRIs to value levers and major risk types to define appropriate controls and investment decisions



[1] Claire Churchard, "Employee satisfaction hits record low in downturn", People Management, 05 May 2011 http://www.peoplemanagement.co.uk/pm/articles/2011/05/employee-satisfaction-reaches-record-low-in-downturn.htm

- Significantly reduces the risks inherent in major change programmes, allowing their ROI to be realised sooner
- Identifies the most significant risks and enables effective mitigation strategies which, potentially, cover multiple risks

How to implement strategic risk management

Step 1. Define your risk appetite

Virtually all financial institutions have sufficient internal analysis and external empirical data to start defining their people risk appetite. This involves developing a comprehensive mapping of lagging key risk indicators (KRIs) to business value levers and major risk types (to divisional and functional level), and then defining controls to allow the value to be achieved. See figure 1 for example. Stakeholders such as business unit heads will ultimately own the agreed appetite statement and reporting approach; therefore it is important to ensure that they have confidence in the empirical data and benchmarks that underpin them. It is also important to create cross-functional working groups that continuously review and refine the choice of KRIs and value levers, and the assumed relationships between them, based on the data that accumulates from using the model. Once a people risk agenda is in place and the causal elements understood, HR policies themselves become a risk management tool, linking standard controls and procedures to the risks they are seeking to mitigate in day-to-day operations. Newly identified risks and opportunities can be tackled through coordinated projects that design and diffuse business-wide solutions.

Step 2. Define the strategic risk management role

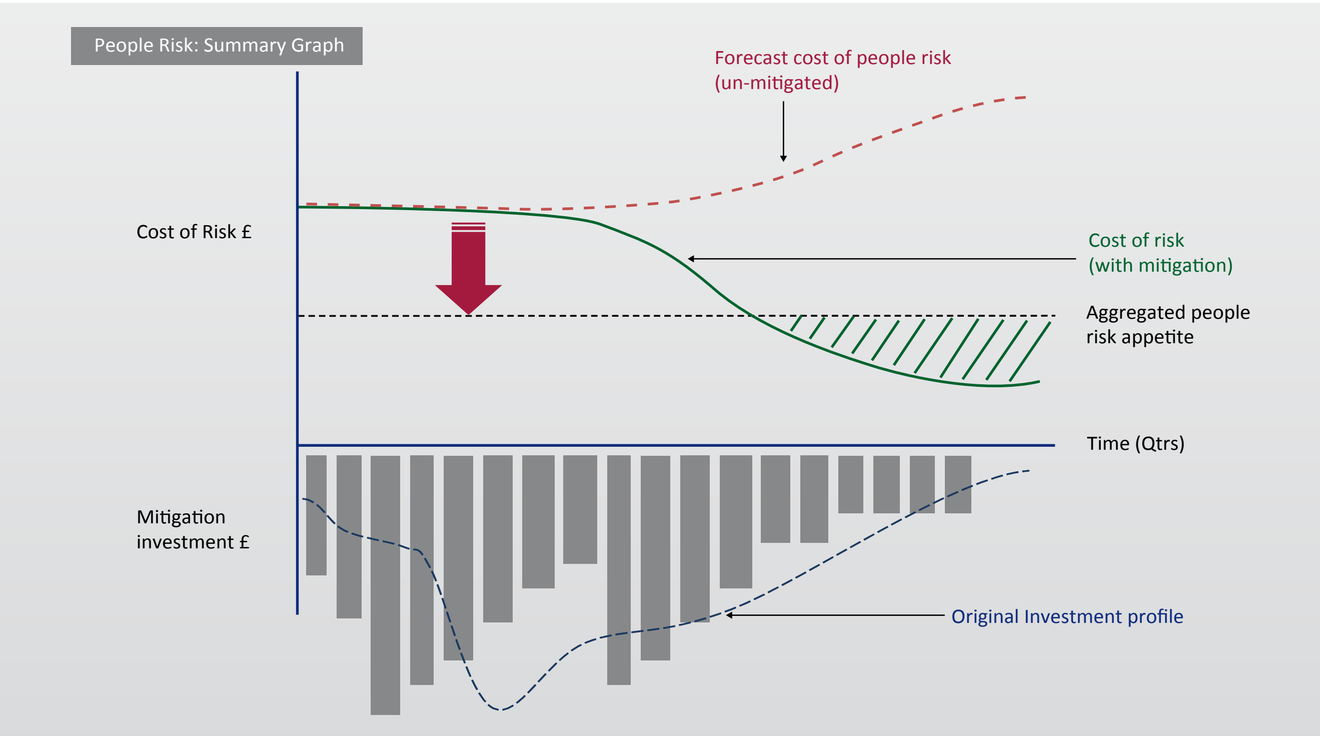
People risk management needs a clear mandate from the top. In our experience with working with Group Risk functions, it should be a central business advisory function that supports, and also challenges, decision-making at both tactical and strategic levels; with a direct reporting line into group risk, but integrated into group HR and its leadership.

We believe the function should have three main roles:

- Definition of people risk appetite – coordinating overall appetite and managing the reporting and impact of people risks
- Risk audit, identification and mitigation – developing robust processes and approaches for risk evaluation (e.g. horizon scanning) and implementing controls and improvements via cross-functional working groups and line heads
- Portfolio management – working with HR to manage and track people risks inherent in both day-to-day operations and business change; working with HR and group risk to focus investment

Although we argue for a central people risk function (as a second line of defence), the function must ensure that business units themselves take responsibility for identifying and mitigating risks at the front line (i.e. the first line of defence). Therefore, people risk functions must provide quantitative data to ensure that both HR and business unit heads are implementing the right projects

Figure 2. Risk-based analysis for Human Capital transformation



and controls, and must constantly review their performance against appetite criteria.

This includes embedding individual and functional measures into scorecards to drive the right behaviours.

Step 3. Implement appropriate measures and management tools
One of the key tools for the people risk function is a digital risk dashboard which:

- Tracks measures against agreed Business Unit risk appetite statements
- Models current and future exposure to people risk across the business
- Runs scenarios based on causal relationships between lagging and leading indicators to test the impact of risk probability on strategic goals
- Models mitigating strategies to ensure that they are proportionate to risk and deliver optimal ROI

This approach provides an opportunity to bring forward the ROI of projects by targeting investment on the basis of an understanding of the inherent people risks.

Conclusion: linking HR and risk for the benefit of the enterprise

Virtually all leading financial institutions are already recognising the advantages that intelligent risk management can bring. With people at the heart of the strategic change agenda, it makes sense to put them at the heart of risk management too.

Adopting a formal, integrated risk-based approach as outlined here gets HR a seat at some very important tables. And, once HR and risk functions become close collaborators, the company can implement change with increased confidence, since it now has a comprehensive picture of the possible people implications.

The whole business, and its people, will be the winners.

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