HR ValueCurve
International Consulting

Why do some companies have a central Reward & Governance function?

By Desirée Klein-Wagner (LinkedIn article, 23 May 2019)

A small center is surely beautiful! Central functions increase corporate overhead and cost. So why would the C-suite consider to create a central HR sub function to coordinate and oversee Reward activities?

There is no simple answer. I will occasionally refer to practices in financial services as a "guide" here, though many conclusions will apply to other sectors as well.

Depending on the nature of a business and how it generates value for its shareholders, some companies are run in a more decentralized, others in a more centralized manner. Decentralized organizations and smaller companies often operate based on "guiding principles", with no or an often rather slim set of corporate policies, particularly in HR. In contrast, global and fully integrated financial services providers tend to manage based on "strict rules, policies and procedures".

Most companies today will have "some" central governance functions, usually with a limited scope of clearly defined company-wide responsibilities. These functions may initiate, coordinate and/or oversee certain processes from the center, e.g., to assure legal compliance, meet general audit, risk or corporate reporting requirements. This can be a reflection of applicable regulations and the company's delegation of authority.

For example, over the last decade, with the more demanding oversight and reporting requirements introduced by regulators in the aftermath of the financial crisis, many larger insurers have implemented group-wide functions to oversee key people-related risks and manage certain reward and governance aspects.

Other contributing factors can be:

- The higher demands to company directors, with threat of prosecution and imprisonment in case of substantial control failures;
- The significant public and media interest in and scrutiny of executive pay, with potential for considerable reputational damage;
- The less predictable political, economic and business reality, with frequent disruption, increased market volatility and slashed interest rates.

The latter two issues, high market volatility and low interest rates, has also fueled a surge in defined benefit employee pension liabilities, which in an "increased risk / reduced return" investor environment has brought many companies financially to the brink of bankruptcy.

To be sure to effectively manage key people-related risks like, e.g., pensions and executive pay, in such challenging environment, many companies have moved these under global surveillance. This can be through a financially versed internal expert, or by outsourcing some aspects to a 3rd party supplier.

Companies that have managed certain reward aspects centrally for some time, have usually expanded the initial scope, recognizing the business impact an effective central reward & governance function can have.

When deciding upon the delegation of authority in the HR/Reward area, companies will typically consider:

- Organizational aspects, i.e., reporting lines, roles & responsibilities, particularly, who participates in or decides on material pay aspects and who needs to be informed;
- Operational aspects, i.e., how to best manage top executive changes and their pay implications, design, maintain and oversee related policies and their application.

Looking at how companies are organized, it is not easy to determine from the outside whether a bundling of responsibilities and expertise was driven by a desire to enhance governance or by a need to move to a more cost effective HR delivery model. As regards the acceptance, power and effectiveness of such central units (e.g., Corporate Executive Affairs, Group Reward, Group C&B, Global Pensions, etc.), any regulatory requirements supporting their existence and a clear cut of roles and responsibilities usually helps. Where not the case, their impact may sometimes depend on how they fit into the company's hierarchy or reporting structure. Job titling, giving more or less organizational weight to the function's head, can be important in some markets. Equally, the company's culture and how any such central function is supported (or, at times, defended) by executive management, particularly, the CEO/CFO/CHRO and the Chairman, or the Remuneration Committee Chair. They will significantly influence how governance is 'lived' versus just published in a shelved document or displayed on the company's website.

Notably, any central reward and governance function can only add value and make a meaningful contribution if its resources are well qualified for their roles, i.e., they have the requisite skills, knowledge, experience and standing to deliver the expected results, and sustainably.

When determining how to best manage and govern reward, the following aspects should be considered:

- Business model, organizational set-up and legislative requirements;
- Key stakeholders, governance bodies, delegation of authority, culture and values;
- Key management controls and their supervision or enforcement;
- Types of HR/Reward decisions to be prepared, taken or governed, their potential impact and inherent risks (including consideration of low probability, yet, high impact "tail risks");
- Potential gains from scale effects or from a bundling of expertise;
- Processes, operational procedures, timing and ownership.

While it may be useful to understand how similar other businesses are organized, each company ultimately needs to develop its own model, decide what is right for its business, people-related risks and needs. Any changes being implemented should be well thought through from a stakeholder management, implementation and follow-up perspective to achieve lasting success.

Feel free to share your thoughts or comments. We are happy to support you if you wish to discuss your reward structure with us to optimally support and protect your business.

The author of this article (link: https://www.linkedin.com/pulse/why-do-some-companies-have-central-reward-governance-klein-wagner), Desirée Klein-Wagner, is Managing Director of HR ValueCurve in Munich/Germany, where she advises Remuneration Committees, Chief HR Officers and Global Reward Heads. Desirée has over 25 years of Corporate HR experience. She was the Global Compensation & Benefits Head in market leading multinational companies in the Germany, Switzerland and the UK, served seven years on WorldatWork's Board of Directors and one year on the Board of Directors of the Global Equity Organisation (GEO). She can be reached at desiree@hrvaluecurve.com.

HR ValueCurve