



HUMAN RESOURCE MANAGEMENT

# People Before Strategy: A New Role for the CHRO

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**C**EOs know that they depend on their company's human resources to achieve success. Businesses don't create value; people do. But if you peel back the layers at the vast majority of companies, you find CEOs who are distanced from and often dissatisfied with their chief human resources officers (CHROs) and the HR function in general. Research by McKinsey and the Conference Board consistently finds that CEOs worldwide see human capital as a top challenge, and they rank HR as only the eighth or ninth most important function in a company. That has to change.

It's time for HR to make the same leap that the finance function has made in recent decades and become a true partner to the CEO. Just as the CFO helps the CEO lead the business by raising and allocating financial resources, the CHRO should help the CEO by building and assigning talent,

especially key people, and working to unleash the organization's energy. Managing human capital must be accorded the same priority that managing financial capital came to have in the 1980s, when the era of the "super CFO" and serious competitive restructuring began.

CEOs might complain that their CHROs are too bogged down in administrative tasks or that they don't understand the business. But let's be clear: It is up to the CEO to elevate HR and to bridge any gaps that prevent the CHRO from becoming a strategic partner. After all, it was CEOs who boosted the finance function beyond simple accounting. They were also responsible for creating the marketing function from what had been strictly sales.

Elevating HR requires totally redefining the work content of the chief human resources officer—in essence, forging a new contract with this leader—and adopting a new mechanism we call the G3—a core group comprising the CEO, the CFO, and the CHRO. The result will be a CHRO who is as much a value adder as the CFO. Rather than being seen as a supporting player brought in to implement decisions that have already been made, the CHRO will have a central part in corporate decision making and will be properly prepared for that role.

These changes will drive important shifts in career paths for HR executives—and for other leaders across the company. Moreover, the business will benefit from better management of not just its financial resources but also its human ones. We say this with confidence, based on our experience with companies such as General Electric, BlackRock, Tata Communications, and Marsh, all of which act on their commitment to the people side of their businesses.

## The CEO's New Contract with the CHRO

A CFO's job is partly defined by the investment community, the board, outside auditors, and regulators. Not so for the CHRO role—that's defined solely by the CEO. The chief executive must have a clear view of the tremendous contribution the CHRO could be making and spell out those expectations in clear, specific language. Putting things in writing ensures that the CEO and CHRO have a shared understanding of appropriate actions and desirable outputs.

To start redefining the job, the CEO should confer with his or her team and key board members, particularly the board's compensation committee (more aptly called the talent and compensation committee), and ask what they expect in an ideal CHRO. Beyond handling the usual HR

responsibilities—overseeing employee satisfaction, workforce engagement, benefits and compensation, diversity, and the like—what should an exemplary CHRO do?

Here are three activities we think are critical: predicting outcomes, diagnosing problems, and prescribing actions on the people side that will add value to the business. Some of these things may seem like the usual charter for a CHRO, but they are largely missing in practice, to the disappointment of most CEOs.

### **Predicting outcomes.**

CEOs and CFOs normally put together a three-year plan and a one-year budget. The CHRO should be able to assess the chances of meeting the business goals using his knowledge of the people side. How likely is it, for example, that a key group or leader will make timely changes in tune with rapid shifts in the external environment, or that team members will be able to coordinate their efforts? CHROs should raise such questions and offer their views.

Because a company's performance depends largely on the fit between people and jobs, the CHRO can be of enormous help by crystallizing what a particular job requires and realistically assessing whether the assigned person meets those requirements. Jobs that are high leverage require extra attention. Many HR processes tend to treat all employees the same way, but in our observation, 2% of the people in a business drive 98% of the impact. Although coaching can be helpful, particularly when it focuses on one or two things that are preventing individuals from reaching their potential, it has its limits. Nothing overcomes a poor fit. A wide gap between a leader's talents and the job requirements creates problems for the leader, her boss, her peers, and her reports. So before severe damage is done, the CHRO should take the initiative to identify gaps in behavior or skills, especially among those 2% and as job requirements change.

The CHRO, with the CFO, should also consider whether the key performance indicators, talent assignments, and budgets are the right ones to deliver desired outcomes. If necessary, the pair should develop new metrics. Financial information is the most common basis for incentivizing and assessing performance, because it is easy to measure, but the CHRO can propose alternatives. People should be paid according to how much value they contribute to the company—some combination of the importance of the job and how they handle it. Finance and HR should work together to define ahead of time the value that is expected, using qualitative as well as quantitative factors. Imagine

the leaders of those functions discussing a business unit manager and triangulating with the CEO and the group executive to better understand what the manager needs to do to outperform the competition in the heat of battle. For example, to move faster into digitization, will he have to reconstitute the team or reallocate funds? Predicting success means weighing how well-attuned the manager is to outside pressures and opportunities, how resilient he would be if the economy went south, and how quickly he could scale up into digitization. The specific metrics would be designed accordingly.

As another example, a top marketing manager might have to build capability for using predictive data in advertising. The CFO and CHRO should recognize that if the manager fails to steep herself in the fundamentals of data analytics and is slow to hire people with that expertise, new competitors could come in and destroy value for the company. Metrics should reflect how quickly the marketing head acts to reorient her department. One set of metrics would focus on the recruiting plan: What steps must the marketing manager take by when? These become milestones to be met at particular points in time. Another set of metrics might focus on budget allocations: Once the new people are hired and assimilated, is the manager reallocating the marketing budget? And is that money in fact helping to increase revenue, margins, market share in selected segments, or brand recognition? Such improvements are measurable, though with a time lag.

The CHRO should also be able to make meaningful predictions about the competition. Just as every army general learns about his counterpart on the enemy side, the CHRO should be armed with information about competitors and how their key decision makers and executors stack up against those at the CHRO's organization. Predictions should include the likely impact of any changes related to human resources at rival companies—such as modifications to their incentive systems, an increase in turnover, or new expertise they are hiring—and what those changes might signify about their market moves. In 2014, for instance, Apple began to hire medical technology people—an early warning sign that it might make a heavy push to use its watch and perhaps other Apple devices for medical purposes. Such activity could have implications for a health care business, a medical device manufacturer, or a clinic. Similarly, a competitor's organizational restructuring and reassignment of leaders might indicate a sharper focus on product lines that could give your company a tougher run.

Intelligence about competitors is often available through headhunters, the press, employees hired from other companies, suppliers, or customers' customers. Even anecdotal information, such as "The marketing VP is a numbers guy, not a people guy," or "She's a cost cutter and can't grow the business," or "The head of their new division comes from a high-growth company," can improve the power of prediction. For example, Motorola might have been able to anticipate the iPhone if the company's CHRO had alerted the CEO when Apple began trying to recruit Motorola's technical people.

The CHRO should make comparisons unit by unit, team by team, and leader by leader, looking not only at established competitors but also at nontraditional ones that could enter the market. Is the person who was promoted to run hair care at X company more experienced and higher-energy than our new division head? Does the development team in charge of wireless sensors at Y company collaborate better than we do? The answers to such questions will help predict outcomes that will show up as numbers on a financial statement sometime in the future.

### **Diagnosing problems.**

The CHRO is in a position to pinpoint precisely why an organization might not be performing well or meeting its goals. CEOs must learn to seek such analysis from their CHROs instead of defaulting to consultants.

The CHRO should work with the CEO and CFO to examine the causes of misses, because most problems are people problems. The idea is to look beyond obvious external factors, such as falling interest rates or shifting currency valuations, and to link the numbers with insights into the company's social system—how people work together. A correct diagnosis will suggest the right remedy and avoid any knee-jerk replacements of people who made good decisions but were dealt a bad hand.

If the economy slumped and performance lagged compared to the previous year, the question should be, How did the leader react? Did he get caught like a deer in the headlights or go on the offensive? How fast did he move, relative to the competition and the external change? This is where the CHRO can help make the critical distinction between a leader's misstep and any fundamental unsuitability for the job. Here too the CHRO will learn new things about the leader, such as how resilient he is—information that will be useful in considering future assignments.

But focusing on individual leaders is only half the equation. The CHRO should also be expert at diagnosing how the various parts of the social system are working, systematically looking for activities that are causing bottlenecks or unnecessary friction. When one CEO was reviewing the numbers for an important product line, he saw a decline in market share and profits for the third year in a row. The medical diagnostic product that the group was counting on to reverse the trend was still not ready to launch. As he and his CHRO dug in, they discovered that the marketing team in Milwaukee and the R&D team in France had not agreed on the specifications. On the spot, they arranged a series of face-to-face meetings to resolve the disconnect.

There is great value in having the CHRO diagnose problems and put issues on the table, but such openness is often missing. Behaviors such as withholding information, failing to express disagreement but refusing to take action, and undermining peers often go unnoticed. Some CEOs look the other way rather than tackle conflicts among their direct reports, draining energy and making the whole organization indecisive. Take, for example, problems that arise when collaboration across silos doesn't happen. In such situations, no amount of cost cutting, budget shifting, or admonition will stem the deterioration. Thus CHROs who bring dysfunctional relationships to the surface are worth their weight in gold.

At the same time, the CHRO should watch for employees who are energy creators and develop them. Whether or not they are directly charged with producing results, these are the people who get to the heart of issues, reframe ideas, create informal bonds that encourage collaboration, and in general make the organization healthier and more productive. They may be the hidden power behind the group's value creation.

### **Prescribing actions to add value.**

Agile companies know they must move capital to where the opportunities are and not succumb to the all-too-typical imperatives of budgeting inertia ("You get the same funding as last year, plus or minus 5%"). When McKinsey looked at capital allocation patterns in more than 1,600 U.S. companies over 15 years, it found that aggressive reallocators—companies that shifted more than 56% of capital across businesses during that time—had 30% higher total shareholder returns than companies that shifted far less.

Companies should be similarly flexible with their human capital, and CHROs should be prepared to recommend actions that will unlock or create value. These might include recognizing someone's hidden talent and adding that individual to the list of high potentials, moving someone from one position to another to ignite growth in a new market, or bringing in someone from the outside to develop capability in a new technology. Although capital reallocation is important, the reassignment of people along with capital reallocation is what really boosts companies.

Responding to the external environment today sometimes requires leaders with capabilities that weren't previously cultivated, such as knowledge of algorithms, or psychological comfort with digitization and rapid change. The company might have such talent buried at low levels. To have impact, those individuals might need to be lifted three organizational levels at once rather than moved incrementally up existing career ladders. The CHRO should be searching for people who could be future value creators and then thinking imaginatively about how to release their talent. Judging people must be a special skill of the CHRO, just as the CFO has a knack for making inferences from numbers.

Dow Chemical found that aggressively hiring entrepreneurial millennials was the fastest way to create more "short-cycle innovation" alongside the company's traditional long-cycle R&D processes. The share of employees under age 30 went from 9% in 2004 to 15% in 2014. To benefit from this new talent, the company also revamped its career paths to move the 20- and 30-somethings into bigger jobs relatively quickly, and it invited them to global leadership meetings relatively early.

Another way to unlock value is to recommend mechanisms to help an individual bridge a gap or enhance her capacity. These might include moving her to a different job, establishing a council to advise her, or assigning someone to help shore up a particular skill. For example, to build the technology expertise of the small start-ups he funded, the famed venture capitalist John Doerr used his huge relationship network to connect the people running those businesses with top scientists at Bell Labs. In the same vein, CHROs could make better use of their networks with other CHROs to connect people with others who could build their capacity.

CHROs should recommend ways to use human capital to unlock or create value.

The CHRO might also recommend splitting a division into subgroups to unleash growth and develop more P&L leaders. He might suggest particular skills to look for when hiring a leader to run a country unit or big division. Other prescriptions might focus on improving the social engine—the quality of relationships, the level of trust and collaboration, and decisiveness. The CHRO could, for instance, work with business divisions to conduct reviews once a month rather than annually, because reducing the time lag between actions and feedback increases motivation and improves operations.

### **What not to do.**

In addition to spelling out clearly what is expected in the way of making predictions, diagnosing problems, and prescribing beneficial actions, the CHRO's new contract should define what she is *not* required to do. This helps provide focus and free time so that she can engage at a higher level. For example, the transactional and administrative work of HR, including managing benefits, could be cordoned off and reassigned, as some companies have begun to do. One option is to give those responsibilities to the CFO. At Netflix, traditional HR processes and routines are organized under the finance function, while HR serves only as a talent scout and coach (see the “Further Reading” list). Another model we see emerging is to create a shared service function that combines the back-office activities of HR, finance, and IT. This function may or may not report to the CFO.

Compensation has traditionally been the purview of CHROs, but it may be hard for them to appreciate the specific issues business leaders face, just as it is hard for the CFO to understand the nuances of the social engine. Because compensation has such an enormous impact on behavior and on the speed and agility of the corporation, the best solution is for the CEO and CFO to also get involved. While the CHRO can be the lead dog, compensation decisions should be made jointly by the three—and, given the increasingly active role of institutional investors, with the board’s engagement.

### **The CHRO’s fit.**

With a new contract in hand, the chief executive should assess how well the CHRO meets the job specifications now and where he needs to be in three years. Most CHROs have come up through the HR pipeline. While some have had line jobs, most have not; Korn Ferry research indicates that only 40 of the CHROs at *Fortune* 100 companies had significant work experience outside HR before they came to lead that function. This might leave a gap in terms of predicting, diagnosing, and

prescribing actions that will improve business performance. However, inclusion in broader discussions will expand a CHRO's understanding of the business. CEOs should give their CHRO a chance to grow into the newly defined role, and they should assess progress quarter by quarter.

Measuring the performance of the CHRO has long been problematic. HR leaders are usually judged on accomplishments such as installing a new process under budget, recruiting a targeted number of people from the right places, or improving retention or employee engagement. Yet such efforts are not directly tied to value creation. In keeping with recasting HR as a value creator rather than a cost center, performance should be measured by outputs that are more closely linked to revenue, profit margin, brand recognition, or market share. And the closer the linkage, the better.

A CHRO can add value by, for example, moving a key person from one boss to another and improving his performance; arranging for coaching that strengthens a crucial skill; bringing a person from the outside into a pivotal position; putting two or three people together to create a new business or initiative to grow the top or bottom line; reassigning a division manager because she will not be able to meet the challenge two years out; or discovering and smoothing friction where collaboration is required. Such actions are observable, verifiable, and closely related to the company's performance and numbers.

Here's a case in point: When a promising young leader was put in charge of three divisions of a large company, replacing an executive vice president with long tenure, the divisions took off. The new EVP, who was growth-oriented and digitally savvy, seized on commonalities among the three businesses in technology and production and nearly halved the product development cycle time. In three years the divisions overtook the competition to become number one.

## **Creating a G3**

To make the CHRO a true partner, the CEO should create a triumvirate at the top of the corporation that includes both the CFO and the CHRO. Forming such a team is the single best way to link financial numbers with the people who produce them. It also signals to the organization that you are lifting HR into the inner sanctum and that the CHRO's contribution will be analogous to the CFO's. Although some companies may want the CHRO to be part of an expanded group that includes, say, a chief technology officer or chief risk officer, the G3, as we call it, is the core group that should steer the company, and it should meet apart from everyone else. The G3 will shape the destiny of the

business by looking forward and at the big picture while others bury their heads in operations, and it will ensure that the company stays on the rails by homing in on any problems in execution. It is the G3 that makes the connection between the organization and business results.

At Marsh, a global leader in insurance brokerage and risk management, CEO Peter Zaffino often has one-on-one discussions with his CFO, Courtney Leimkuhler, and his CHRO, Mary Anne Elliott. In April 2015 he held a meeting with both of them to assess the alignment of the organization with desired business outcomes. The G3 began this meeting by selecting a business in the portfolio and drawing a vertical line down the middle of a blank page on a flip chart. The right side was for the business performance (Leimkuhler's expertise); the left side for organizational design issues (Elliott's expertise). A horizontal line created boxes for the answers to two simple questions: What is going well? What is not going well?

## The CEO should form a G3—a core steering team—with the CFO and the CHRO.

“Peter could have filled in the entire two-by-two chart on his own,” Elliott says, “but doing it together really added value.” Zaffino adds, “The whole meeting took about 15 minutes. We found the exercise to be very worthwhile. We already run the business with disciplined processes. We conduct deep dives into the organization’s financial performance through quarterly operational reviews, and we conduct quarterly talent reviews, where we focus on the human capital side. So you might not think we’d want to introduce another process to evaluate how we are managing the business. But this G3 process provided us with a terrific lens into the business without adding bureaucracy.”

Working together to synthesize disparate data points into one flip chart helped the team identify items on the organizational side that would predict business performance in the next four to eight quarters. Significant value came from the dialogue as connections emerged naturally. Zaffino says, “We constantly drill down deep to understand why a business is performing the way it is. In those instances, we are drilling vertically, not horizontally, when there could be some items identified on the organizational side that are actually driving the performance.” Zaffino cited the implementation of a new sales plan, which HR was working on, as one example. His concern was making sure business results were aligned with remuneration “so we didn’t have sales compensation becoming

disconnected from the overall financial result of the business,” he explains. “We also didn’t want to drive top-line growth without knowing how to invest back in the business and increase profitability.” The CHRO was thinking it through from her perspective: Is this sales plan motivating the right behaviors so that it moves business performance to the “going well” category?

Seeing the interconnections also helped the trio identify what mattered most. “It’s easy enough to list everything we want to do better,” Leimkuhler says, “but it’s hard to know where to start. When you understand which things on the organizational side are really advancing business performance, it makes it easier to prioritize.” For example, managing the transition of regional business leaders was a big issue for HR—one that, because of its difficulty, would have been easy to push off. Seeing the extent to which inaction could be holding back business performance created a greater sense of urgency.

“In the HR world, we talk about understanding and integrating with the business,” Elliott notes. “G3 meetings are a pragmatic activity. When you’re sitting with the CEO and CFO, there’s no place for academic HR. It’s all about understanding what the organization needs to do to drive business performance and how to align those key variables.”

“There’s something to be said for peeling off into a smaller group,” Leimkuhler adds. “It would be unwieldy to have this discussion with the full executive committee, which at Marsh consists of 10 executives. In any case, it’s not one or the other; it’s additive.” Says Zaffino, “This was a streamlined way to get a holistic view of the business. Each of us left the first G3 meeting feeling comfortable that the organization and the business were aligned and that we have a very good handle on the business.”

Vinod Kumar, CEO of Tata Communications, also uses an informal G3 mechanism. Kumar’s company supplies communication, computing, and collaboration infrastructure to large global companies, including many telephone and mobile operators. In 2012 there were price drops of 15% to 20%, and disruptive technologies were par for the course. To keep pace, Tata Communications had to transform its business very quickly, which meant building critical new capabilities by hiring from the outside, at least in the short term—an effort that would hardly help the company deal with

rising costs. Something had to give, and Kumar enlisted then-CFO Sanjay Baweja and CHRO Aadesh Goyal to help chart a path forward while taking into account both financial and talent considerations.

Frequent discussions among the G3 led to a consensus: Tata Communications would restructure roles that had become redundant or were out of sync with the company's new direction, and it would move jobs to the right geographical locations. These actions would reduce staffing costs by 7%. The company would use the savings to build the necessary capabilities, mainly by making new hires, especially in sales, marketing, and technology.

The G3 next went to work on changes that would occur over a longer time. Tata Communications launched a companywide program in late 2013 aimed at continuously improving productivity. The initial objective was to reduce the cost base by \$100 million, but the overall intention was to seed a new culture. The G3 began by creating a cross-functional team that employees joined part-time. Ultimately more than 500 people participated, working on ideas in 50 categories and achieving even more cost reductions than originally targeted. In short, the project was a big success, and it continues to produce results.

Dialogue—both institutionalized and informal—between the CHRO, the CFO, and the CEO is now a way of life at Tata Communications. In time, as CHRO Goyal's grasp of the business became evident, Kumar made a bold move: He gave Goyal the additional responsibility of managing one of the company's high-growth subsidiaries and made him part of the Innovation Council, which identifies opportunities to invest in and incubate new businesses.

## **Regular G3 Meetings**

If a G3 is to be effective, the CEO has to ensure that the triumvirate meets on a regular basis.

### **Weekly temperature taking.**

The CEO, CFO, and CHRO should get together once a week to discuss any early warning signals they are picking up internally or externally about the condition of the social engine. Each of them will see things through a different lens, and pooling their thoughts will yield a more accurate picture. The

three don't have to be together physically—they can arrange a conference call or video chat—but meeting frequently is important. After about six weeks, and with discipline, such sessions could be finished in 15 to 20 minutes.

The CEO has to set the tone for these reviews, ensuring that the discussion is balanced and that intellectual honesty and integrity are absolute. It's a given that both the CFO and the CHRO must be politically neutral to build trust, and they must never sacrifice their integrity to be the CEO's henchmen. They must be willing to speak up and tell it like it is. Over time, each G3 member will have a better understanding of the others' cognitive lenses, discussions will be more fluid, and all three will learn a lot about the intricacies of the business. They will also become more comfortable correcting one another's biases, more skilled at reading people, and more likely to get the right people in the right jobs.

### **Looking forward monthly.**

The G3 should spend a couple of hours every month looking four and eight quarters ahead with these questions in mind: What people issues would prevent us from meeting our goals? Is there a problem with an individual? With collaboration? Is a senior team member unable to see how the competition is moving? Is somebody likely to leave us?

Companies do operational reviews, which are backward-looking, at least quarterly. The objective here is to be predictive and diagnostic, looking forward not just at the numbers but also at the people side, because most failures and missed opportunities are people-related. There may be organizational issues, energy drains, or conflicts among silos, particularly in the top two layers. Conflicts are inherent in matrix organizations; the G3 needs to know where they exist, whether they could affect progress on a new initiative, and how the leaders in charge are handling them. Probing such matters is not micromanagement or a witch hunt. It's a means of finding the real causes of both good and poor performance and taking corrective action promptly or preemptively.

### **Planning three years out.**

It is common practice to plan where the company needs to be in three years and to decide what new projects to fund and where to invest capital. Often missing from that process is exploration of the people questions: Will we have employees with the right skills, training, and temperament to

achieve the targets? Will our people have the flexibility to adapt to changing circumstances? In most strategic planning, there is zero consideration of the critical players in the organization—or those working for competitors.

Discussion of people should come before discussion of strategy. (This is a practice that General Electric is known for.) What are employees' capabilities, what help might they need, and are they the very best? The CEO and the CHRO of one company decided that for every high-leverage position that opened, they should have five candidates—three from inside, two from outside. Talent should always be viewed in a broad context. Consider who is excelling, being let go, or being lured away, along with any other information that could affect your competitiveness or your rivals'.

## New HR Leadership Channels

Some CEOs might be holding back on elevating their CHROs because they lack confidence in the HR leader's business judgment and people acumen. There's a fear that HR chiefs aren't prepared to discuss issues beyond hiring, firing, payroll, benefits, and the like. That reservation must be met head-on by providing rich opportunities for CHROs to learn. Give them more exposure to the business side through meetings of the G3, and provide some coaching. If knowledge or skills gaps persist, ask the CHRO how she might fill them. Some CHROs will rise to the occasion. Others won't measure up, and the supply of suitable replacements might be scarce at first. (The same issue applied in the 1980s to finding the right CFO types from the ranks of accounting.)

An enduring solution is to create new career paths for HR leaders to cultivate business smarts and for business leaders to cultivate people smarts. Every entry-level leader, whether in HR or some other job, should get rigorous training in judging, recruiting, and coaching people. And those who begin their careers in HR leadership should go through rigorous training in business analysis, along the lines of what McKinsey requires for all its new recruits. There should be no straight-line leadership promotions up the functional HR silo. Aspiring CHROs should have line jobs along the way, where they have to manage people and budgets.

All leaders headed for top jobs should alternate between positions in HR and in the rest of the business. Make it a requirement for people in the top three layers of the company to have successfully worked as an HR leader, and the function will soon become a talent magnet. Be sure

that it isn't just ticket punching. Those who have no feel for the people side are unlikely to succeed for long in high-level jobs.

## The Transition to the New HR

Any CEO who is sold on the idea that people are the ultimate source of sustainable competitive differentiation must take the rejuvenation and elevation of the HR function very seriously. Creating a mechanism that knits the CFO and the CHRO together will improve the business and expand the CEO's personal capability. It won't happen overnight—three years seems to us the minimum time required to achieve a shift of this magnitude. Stating the new expectations for the CHRO and the human resources function is a good place to begin. Creating ways to blend business and people acumen should follow. And redesigning career tracks and talent reviews will take the company further still. But none of this will happen unless the CEO personally embraces the challenge, makes a three-year commitment, and starts executing.

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G3 concept recommended has been in practice with Mars Inc. Mars refers to the People function as People & Organization (P&O). Unit GM and Co-pilots (that how Finance and P&O Leads are referred to within Mars) have a unique role in governance of every business unit within Mars. This creates a positive balance in people decisions vs business decisions.

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