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## Research report Part 2 – Measurements report

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*Creating* and  
capturing value  
at *work*:  
who benefits?

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# Creating and capturing value at work: who benefits?

Research report

Part 2 – Measurements report

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This report is the second part of two reports exploring value creation in organisations:

- *Creating and Capturing Value at Work: Who benefits? Part 1 – thematic literature review*
- *Creating and Capturing Value at Work: Who benefits? Part 2 – measurements report*



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# Introduction

In *Creating and Capturing Value at Work: Who benefits? Part 1*, we made four key arguments

- 1 Value has to be considered as an integrated process, combining creation and capture.
- 2 The relationship between value-creation and capture can be complex and varied, and cannot be 'read off' easily, located as it is in specific institutional, legal, governance and organisational contexts.
- 3 Notwithstanding the dominance of the maximising shareholder value (MSV) model, there is scope for strategic choices that mediate the relationship between value-creation and capture.
- 4 Disciplinary perspectives act as different lenses or prisms with which to view value and that reframing value from a multi-disciplinary perspective has significant potential to improve our understanding of the value process and the scope for – and challenges in – exercising strategic choice to deliver value outcomes.

In this follow-up report some of these key arguments are applied more concretely to measures or indicators of value. Measures of value can be narrow or broad. Value can also be measured at different levels. And measures of value can also appear to be – and be – inconsistent with each other. The idiom of 'what gets measured gets managed' is at one level true and yet can obscure costly, perverse and unintended consequences.

Measures or indicators of value in businesses range from a relatively small number that are required by financial regulation and the vast array of measures collected in organisations at organisational, sub-unit and individual levels. Measures of value and costs of that value (that is, externalities) also exist at an extra-organisational level, for example at the level of the national or regional economy.

There are important and contested debates about what drives increasing measurement at disaggregated levels. While regulation plays some role in this, it is arguable that IT capability facilitates measurement of more and more organisational phenomena. Furthermore, organisational decision-makers and managers choose to make use of these facilities, irrespective of whether these measures are useful or cost-effective, notwithstanding the long-standing cautions of management scholars against measurement for its own sake (Deming 2000, Mintzberg 2013). In a variety of work contexts, research reveals the perversity of measures and associated targets in complicating rather than illuminating the creation of valued outcomes (Propper et al 2008).

This cannot be a review of all possible measures of all types of value. We aim here to describe sufficient examples to build a non-exhaustive typology that contributes to understanding of value measures. We begin by considering debates on the relationships between human capital, HR practices and the

creation of business value. While this literature acknowledges and promotes recognition of the contribution of people to value-creation, it does not challenge significantly prevailing measures of financial or economic value that are predominant in the accounting and finance literature and which are the core focus of this part of the report. It is arguable that accounting perspectives have engaged more directly than the HR literature with alternative measures of, and reporting of, value, and we assess proposals for change in this area. Lastly, and drawing on wider discussions of political economy, we will consider how measures and indicators of business value sit alongside macroeconomic and social indicators, highlighting that financial value at an organisational level may not equate with macroeconomic or social value, and the tension between value indicators depends on the unit of analysis considered.

# 1 The human resources management-performance link

It is widely accepted that there is a real and positive relationship between investment in human capital and the creation of value. Such a relationship is theoretically informed and, according to the meta-analysis of 66 studies undertaken by Crook and colleagues (Crook et al 2011), supported by empirical evidence. The first half of the CIPD's (2017a) recent analysis of human capital analytics rehearses the rationale for the contribution of people-related capitals and their theoretical underpinnings, though as we noted in Section 2 in Part 1, the conventional human capital narrative seems somewhat disconnected from the reality of shareholder-driven business models.

There has also been a vibrant debate over recent decades on the relationship between approaches to human capital deployment and management on the one hand and business outcomes on the other. This has been addressed most extensively in the HRM-business performance literature. Notwithstanding methodological concerns over the reliability of some of the extant evidence base (Wall and Wood 2005), bundles of HRM practices appear to 'matter' (Boselie et al 2005) and are at least weakly related to firm performance (Paauwe 2009) as proxied by a range of financial, organisational and HR-related outcomes (Dyer and Reeves 1995).

Whatever the merits of the findings, on the HRM-business performance link, connecting human capital and HR practice

to value indicators at a firm level is fraught with challenges. As the second half of the CIPD (2017a) report on human capital analytics demonstrates, the available data and evidence is often limited, of low quality and poorly communicated both to and by HR professionals. However, the problems run deeper than representativeness and reporting. As we will outline below, measuring human capital and HR practice is immensely difficult. In addition, while conventional value indicators such as profits or market value may be more straightforward to measure, *'financial indicators can be influenced by a whole range of factors (both internal and external) which have nothing to do with employees and their related skills or with the human capital pool'* (Paauwe 2009, p135) and more to do with other business interventions and processes. Paauwe advocates the use of more proximal measures of what HR practice can actually influence, such as employee attitudes and behaviours (for example, in relation to attendance or performance) that impact on organisational productivity and quality.

## HR metrics

Turning specifically to HR measures or metrics, these attempt to say something either about HR processes, human capital investment or workers' contribution to performance/value. Lawler et al (2004) note that HR metrics are either measures of efficiency, effectiveness or impact. Efficiency measures such as cost per hire, absence levels, tenure, turnover and many others

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focus primarily on the costs of HR processes. Efficiency measures say little about value-creation and many such measures have little relevance beyond the HR function itself (CIPD 2011). Effectiveness measures focus on whether HR policies deliver intended outcomes. Impact measures examine the link between HR practice and measurable competitive advantage by illuminating bottom-line impact. For Lawler et al, effectiveness measures are related to value-creation in that business strategy should reflect what is achievable with the firms' human capital. Impact measures are, however, the most closely related to value-creation, capturing the impact of employee performance and contribution on some measure of the 'bottom line'.

Yet there is a general consensus that firms are much more likely to use efficiency measures than effectiveness or impact measures that have greater potential to affect and/or predict organisational performance (Sveiby 1997, Boudreau and Ramstad 1998, Bassi and McMurrer 2007). Lawler and colleagues' (2004) small study of 37 self-selected companies reported that around two-thirds collected efficiency data in the HR sphere, over half collected effectiveness or cost of service data, but only 34% had business impact data, a proportion that these authors argue is likely to be higher than in the wider business population.

Similarly, Bassi and McMurrer (2007) report that while employees are both an asset and a cost, prevailing HR metrics emphasise the latter, not the former, producing chronic underinvestment in HR relative to investment in other assets (consistent with the evidence on MSV metrics discussed in Part 1). Single-cost or ratio-

based HR metrics may be simple to construct but it is immensely difficult to establish a causal relationship between these metrics and business outcome measures (Sveiby 1997). Thus, organisations may collect many of the 'wrong' metrics that distract them from measures that drive value-creation.

This situation persists despite some evidence of the potential usefulness of HR impact metrics (Lawler et al 2004, Bassi and McMurrer 2007). Bassi and McMurrer (2007) report that financial services firms with higher human capital management scores in an initial assessment were more likely to experience higher stock-market returns one year on than comparable firms with lower human capital management scores. Rasmussen and Ulrich (2015) report the way in which HR impact measures illuminated the role of high-quality leadership in reducing turnover that increased overall operator competence and in so doing improved safety and customer satisfaction. Other scholars have also identified the potential for HR impact measures and analytics to enhance value in other settings (Sparrow et al 2015).

From a more practitioner-oriented perspective, Bassi and McMurrer (2007) have also attempted to develop a series of human capital measures that predict organisational performance, encompassing 'people-related best practices' identified in research as important determinants of organisational success. Using data elicited through a bespoke survey measure of 'human capital drivers' – specific leadership practices, employee engagement, knowledge accessibility, workforce optimisation and learning capacity – they derive a single human capital management (HCM) index

for firms as well as an HCM score for each 'driver' and relate this to subsequent financial performance indicators. Using data from financial services firms, they argue that HCM scores are causally related to financial performance and can predict variations in financial performance within and across organisations.

These measures are also claimed to predict non-financial performance, for example, safety rates. Bassi and McMurrer (2007) contend that repeated employee surveys can uncover areas of HR and management practice that are causally linked to performance outcomes and in so doing can address areas that are performance- or value-limiting. They contend that these measures are more useful in understanding organisational performance and value-creation than reliance on employee engagement measures. However, these authors eschew a 'one size fits all' approach and argue that the predictive power of HCM varies within and across firms.

HR impact metrics are important in highlighting the contribution people and HR practice make to business value conventionally defined. Much of the research in this area is in examining whether configurations of people and practice impact on bottom-line financial measures either through reduction in costs or enhanced revenue-generation that enhance the return on investment in human capital (Fitz-enz 2000). However, while financial and economic concepts such as return on investment can be illuminating, the CIPD (2011) argues the need to recognise intangible features of people management and development processes that produce value over a longer timeframe.

### Measuring non-financial performance and value impact

There have, of course, been efforts to develop performance-measurement tools that look beyond conventional financial metrics, such as Kaplan and Norton's balanced scorecard (BSC), perhaps the most popular and widely cited framework that attempts to capture the drivers of value and the role of HR factors therein. Referred to by Jensen (2001) as *'the managerial equivalent of stakeholder theory'*, the BSC is multidimensional in nature, comprising qualitative, quantitative, financial and non-financial measures. It uses strategy-linked leading and lagging key performance indicators to measure performance in relation to financial, customer, internal business process and learning and growth criteria (Ragab and Arisha 2013). The BSC measures are designed to reflect the organisation's strategic direction and outcomes, and managers are asked to consider the firm's vision and its strategy to implement the vision, through the BSC's four sets of performance measures – financial, customer, internal process, and learning and growth (Kaplan and Norton 1995). Kaplan and Norton also argue for future-oriented measures that capture innovation capacity as well as measures of existing performance. However, while the BSC can help managers better understand what drives value, it has been criticised for failing to distinguish sufficiently between levels of performance (Jensen 2001) and for inadequately incorporating how learning and development impact on value (Bassi and McMurrer 2007).

Clearly, using HR metrics to examine value impact is challenging for many firms. For some, data is simply not available

to connect HR metrics closely to value-creation, or is disconnected across distinct HR processes and systems, though the development of HR information systems is increasingly bringing together a wealth of 'big' employee and workplace data on qualifications, skills and competencies, training and development, pay, and soft and hard performance indicators (see for example Angrave et al 2016). Even where HR information systems are operational, these are not always linked to enterprise data platforms containing other financial and operational indicators of value.

However, as is increasingly recognised by HR scholars, what is often lacking in firms is not just data and metrics but analytical models of the links between HR inputs and value outcomes (Lawler et al 2004). As Boudreau and Ramstad (1998) note, *'for metrics to advance beyond simply a large inventory of potentially useful indices with no integrating logic or theory, they must be driven by a strategic perspective that can identify key measures, their necessary characteristics, and the linkages necessary to test and enhance their quality'* (p4). This represents both a research and a practical challenge. On the latter, HR practitioners may not possess the skills, knowledge and insight required to interrogate properly the HR data they have at their disposal (CIPD 2013, Rasmussen and Ulrich 2015). On the former, there are a range of potential theories of the firm from which a measurement system that links people and practice to organisational outcomes might be derived, in addition to real challenges in accessing the data required to test for any robust relationship between people, organisational practice and value-creation.

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*‘Single HR measures are unlikely to be illuminating, while relating multiple HR measures to value indicators creates immense challenges of interpretation.’*

#### **From operational HR metrics to HR ‘big data’**

Development of HR analytics and the increasing accessibility of ‘big data’ raises the prospect of a better understanding of the relationship between HR metrics and value-creation. There are optimistic accounts of the potential of HR analytics in addressing underinvestment in human capital, driving balanced scorecard measures and adding rigour to the HR process (Bassi and McMurrer 2007). Angrave and colleagues (2016), however, argue for caution over the prospects that HR analytics will ensure recognition of the contribution of people and HR practice to business value. Rather, they raise the risk *‘that analytics will further embed finance and engineering perspectives on people management at boardroom level in ways that will restrict the strategic influence of the HR profession. It may also damage the quality of working life and employee wellbeing, without delivering sustainable competitive advantage to the organisations that adopt it’* (Angrave et al 2016, p1). As Boudreau and Ramstad (1998) note, metrics are not neutral: they signal values and priorities to workplace and other stakeholders and have implications for influencing their behaviours, as well as reflecting organisational power and politics (Angrave et al 2016).

Measures are much more likely to be used for more conventional operational reporting than for asking serious questions about value-creation. While there may be circumstances where, for example, performance management and reward can tie individual contribution closely to value-creation (Aral et al 2012), this is likely to be the exception rather than the rule. The multi-dimensionality of human contribution in organisations

means that simple quantification is not a useful option – single HR measures are unlikely to be illuminating, while relating multiple HR measures to value indicators creates immense challenges of interpretation.

Additional challenges exist in defining the appropriate unit of analysis of HR metrics. Looking at too low a level of activity, such as an HR process, there may be no visible value proposition. Looking at too high a level, such as corporate operations, diverse and multiple value propositions aren’t capable of being identified (Boudreau and Ramstad 1998). However strong the attraction to linking HR metrics to profitability or share value, HR metrics may be more usefully linked to unit or plant level value outcomes (Chadwick and Cappelli 1998), uncovering the HR and business processes that drive value-creation at that level. With this approach, *‘clear logical and theoretical linkage is enhanced because measurement linkage is clear’* (Boudreau and Ramstad 1998, p11). This takes us back from metrics to the need for theoretically and contextually informed explanations of the relationships that metrics aim to establish an argument for ‘logic driven analytics’ (Boudreau and Ramstad 1998) rather than an overload of useless data and measures. The primary question is whether a value proposition can be articulated in terms of employee contribution and at what level. Only thereafter is it important to identify metrics that can measure whether any results being achieved will deliver on the value propositions. And only in this way will strategic and predictive analytics be developed that illuminate how value is being created, captured and leveraged (Angrave et al 2016). Such an approach might deliver interesting



insights: for example, that staffing increases boost profitability when higher-quality labour inputs drive sales increases that outweigh extra labour costs (Ton 2009, Angrave et al 2016).

Developing more effective use of metrics to relate HR input to value-creation will test the knowledge, skills, capabilities, networks and influencing skills of HR practitioners as they engage more directly with the value proposition within their organisations (Marler and Boudreau 2017). Developing confidence in evaluating 'hard' and 'soft' data is important, and while HR software might support this endeavour, software cannot substitute for the hard thinking required to relate HR measures to value outcomes in specific organisational contexts (for a broader discussion of the limits of HR software, see Angrave et al 2016). This is the most pressing challenge for HR practitioners – developing a strategic understanding of the firm's value proposition and the role of people within it, and disseminating this to

other key actors. This, of course, takes us back to what value means within the value proposition. Focusing only on financial outcomes and shareholder value risks, as Kochan and Rubinstein (2000) argue, misses key elements of the business value proposition.

To conclude this discussion of value indicators from an HR perspective, many common HR metrics do not, and are not designed to, identify value outcomes. There is, however, potential for impact metrics to highlight the contribution of labour to value-creation. Yet HR analytics focus primarily on more conventional value – and in particular financial – outcomes. In so doing, existing HR metrics focus solely on links to value-creation. As far as we can establish, value-capture does not feature in these discussions of HR metrics at organisational level, though as we will examine later, important distributive metrics exist at a macro level.

## 2 Accounting metrics

As we indicated in Part 1, there is a fundamental shift in recognition of alternative value drivers within corporations, beyond the simplistic view of economic capital as the only consideration of a business. This is driven in part by seeking opportunities to identify and measure ‘hidden value’ that is obscured by a sole focus on the market value of the organisation (Fincham and Roslender 2003, p10), as well as a wider recognition of the limitation of existing measures in the context of the growth of a service-sector economic structure (ACCA 2017, p18). This section will consider some of the value-creation reporting initiatives from the dominant ‘big four’ accounting services firms and from some of the professional accountancy bodies specifically from the perspective of human capital.

### Accounting professional bodies

ACCA has recently produced a framework for assessing a business’s value-creation potential (ACCA 2017). The impetus behind ACCA’s ‘Full Stack’ framework was

more a concern with technological advancements than a strict recognition of human capital’s involvement in value-creation. However, the framework does include the pooling of human knowledge as part of the business model. Overall, though, this ACCA framework does not include any metrics which might be capable of connecting value-creation to staff.

The Certified Institute of Management Accountants (CIMA), the American Institute of Certified Public Accountants (AICPA) and the Certified Management Accountants (CMA) sponsored a report in which there is a more explicit recognition of intellectual and human capital as value drivers (see Marr 2008). Marr’s (2008) work focuses on how to manage intellectual capital. Overall, Marr is critical of the traditional accounting techniques which fail to encompass intellectual capital; as Marr (2008, p27) explains, *“there is now widespread agreement that the current financial reporting system is incapable of explaining the value of intellectual capital”*.

Provided within this report is a five-step intellectual capital management model.

The first step, *identifying your intellectual capital*, involves considering the types of intellectual capital held. There are also suggestions about how to place numbers on some of these factors in the context of their importance to the organisation.

The second step, *mapping the key drivers*, shows management how to keep track of their intellectual capital. *Core activities* are the imperative functions carried out by a business that differentiates itself from competitors and what the organisation must focus on to achieve its objectives. The third stage of tracking intellectual capital is *measurement*. The report sets out its intellectual capital performance indicator design model. This model is heavily based on setting key performance questions (KPGs) to then decipher.

The penultimate step, *managing intellectual capital*, is largely a

**Table 1: Assessing the importance of intellectual capital**

Identified key resources examples	Relative strengths of these resources in our organisation 0 = not at all important 10 = vitally important	Relative importance of these resources to delivering our value proposition 0 = not at all important 10 = vitally important
Our specific subject knowledge	7	10
Our perceived reputation	4	9
Relationships with key partners	4	6
Our patent for X	9	2
Our brand X	8	7
Etc.	0	0

Source: Marr (2008, p9)

by-product of the measurement step. The advantage of carrying out the previous steps is to inform decision-making and allow companies to decide how to best deploy resources. It can allow companies to develop and improve human capital by knowing where to invest in training and development. As well as this, it allows the consideration of IC risks, such as the single dependence on the human capital of one individual. The final stage, *reporting intellectual capital*, has the objective of informing stakeholders about the company's IC structure. However, information needs between stakeholders will differ, with shareholders wanting to assess investment decisions based on the HC of the organisation and analysts wanting to understand the value drivers of the company. This is alongside differing needs for employees, society and the state.

#### **CIMA (2003), ACCA (2015) – The performance prism**

This theme of the management accounting profession providing a more meaningful input into human capital is reiterated in another CIMA publication (CIMA 2003, p20). This report discusses several well-known measurement models, such as the balanced scorecard (BSC) (set out above) and the performance prism.

As ACCA highlight on their website, the performance prism considers stakeholders beyond shareholders and customers, with a due consideration of employees as well (ACCA 2015). The performance prism is built upon balancing the needs of a business and its stakeholders. It involves analysing who the stakeholders are and what they desire, and then, what the business wants and needs from its stakeholders. After such consideration takes place, strategies can be created to

satisfy the needs of the majority. CIMA (2003) suggests that many businesses confuse strategies with goals. In the case of the performance prism (PP), strategies are how the goals are achieved. The PP considers human capital needs at the outset, effectively setting out HC needs at the beginning of the process.

#### **Summary**

Overall, it seems that despite the interest of the professional bodies in human and intellectual capital reporting, the research and reports are largely mapping and framing exercises that are more concerned to discover the current status of IC reporting in the UK than to discover new ways of doing so. A significant report from the Institute of Chartered Accounts in England and Wales (Unerman et al 2007) is not encouraging. It found that senior financial executives commonly believed that intellectual capital disclosures in the annual report did not give investors any new information but rather served a 'confirmatory' function – in other words, it might confirm the information which had previously been disclosed to capital markets. Perhaps, more importantly, the report found that the senior financial executives were intensely opposed to intellectual capital reporting, other than possibly at a very broad level (Unerman et al 2007). In the next section, we consider some of the published material from the 'big four' accounting firms.

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*‘The True Value Approach seems overall to be concerned with creating a tool to help companies deal with risky externalities and perhaps to be able to build business opportunities from risks.’*

### **The ‘big four’ professional service firms**

#### **KPMG – true value**

The KPMG True Value Approach is one which *‘focuses on linking societal value with corporate value’* (KPMG 2014, p4). Thus, at first sight it seems that it is concerned with ‘society’ or, at least, broad stakeholder groups. It sets out a vision of society as one which is becoming increasingly risky. KPMG (2014) states that challenges such as overpopulation and climate change increase external pressures on companies. These pressures can result in new regulations introduced by governments, unrest among workers, or changing climatic environmental requirements, and, if not managed properly, will have a negative impact upon shareholder value. The True Value Approach seems overall to be concerned with creating a tool to help companies deal with risky externalities and perhaps to be able to build business opportunities from risks.

The *KPMG True Value* (KPMG 2014) framework outlines a three-step process for this: recognise a company’s net effect on society in financial terms; analyse how this will impact future earnings; and lastly, create a viable business case for building future shareholder value through increasing societal gain. This model is not specifically driven towards accounting for human capital; rather it considers environmental, social, earnings and economic factors to then derive a figure of ‘true earnings’. The model is said to link societal value with that of shareholders, perhaps suggesting that accounting firms are more focused on the shareholder value derived from human capital, rather than societal benefits. Furthermore, this model does not consider how value is created inside the organisation.

#### **PricewaterhouseCoopers (PwC) – *The Power to Perform: Human capital 2020 and beyond***

Making human capital considerations appealing to shareholders is also a concern of the future-oriented work of PricewaterhouseCoopers (PwC) (2017): *The Power to Perform: Human capital 2020 and beyond*. This report is specifically concerned with financial services. It is also perhaps motivated by external ‘threats’ since recruitment into the finance sector may become less appealing to graduates in the wake of financial crises and scandals. It also embraces the growing appreciation that value is derived from intellectual capabilities. The purpose behind this publication is to assist in the regeneration of confidence in the financial services sector, rather than strictly the appreciation of employee well-being and value. The prompt for action by service sector organisations is the threat from ‘socially conscious’ organisations which is making recruitment for financial services businesses more challenging. The report sets out six ‘priorities’ (for example, ‘Rebuild trust and redefine employer brand to attract and retain tomorrow’s workforce’ and ‘Influence redesign of academic curricula and modernise corporate learning and development to build an adaptive workforce’) rather than develop specific performance metrics.

#### **Deloitte – *Social Purpose and Value-creation: The business returns and social impact***

The dominant concern with shareholders is further reflected in Deloitte’s (2017) *Social Purpose and Value-creation: The business returns and social impact*. This document recognises talent, attraction, engagement, and retention combined as key drivers

of value-creation. It provides statistical evidence to support the notion that a workforce with superior morale will have a lower employee turnover and improved operating performance, which can have 'dramatic implications for company financials' (Deloitte 2017, p5). Without developing any real forms of human capital indicators, there is an illustration that 'high engagement' companies have superior changes in net income and improved earnings per share.

### **Ernst & Young – Value-creation: Background paper**

Ernst & Young (2013) produced a report, *Value-creation: Background paper*, that predominantly focuses on what it describes as the most advanced measurement system used to report human capital (and five other key capitals) – Integrated Reporting. Integrated Reporting will be covered in more depth below, but it offers possibly the most viable alternative (or supplement) to the current financial accounting system. The majority of the information set out in this document is simply extracted from the work of the International Integrated Reporting Council (IIRC). Representative of all the literature produced by the 'big four' accounting firms, it acknowledges that value is derived from other sources beyond financial capital, but there is a lack of any meaningful indicators to drive forward change. A concern expressed in this document is to assist shareholders, since it claims that it is important for financial providers to receive accurate and full information to make adequate investment choices.

### **Summary**

It appears from their literature that the big four accounting firms have produced varying reports which broadly reflect contemporary concerns about stakeholder groups and human capital inputs into the value-creation process. These documents seem to remain at a 'conceptual' rather than detailed practical level. One possibility is that any resulting reports will, in the absence of regulation, be akin to other social and environmental reports – unaudited, unregulated and open to (ab)use as public relations documents. Nonetheless, in adopting some of these initiatives (or others), there is some opportunity for firms to genuinely innovate and to move beyond narrow MSV models relating work to value-creation.

### **Integrated Reporting**

The International Integrated Reporting Council (IIRC) self-describes as 'a global coalition of regulators, investors, companies, standard-setters, accounting professions and NGOs. The coalition is promoting communication about value-creation as the next step in the evolution of corporate reporting'.<sup>1</sup> Integrated Reporting is deemed to be a reporting system which aims to instil sustainability as the principal focus of a company's aims. To achieve sustainability, companies must adopt a long-term perspective that is more encompassing of the factors which affect the legitimacy of the entity as a going concern, as opposed to pursuing short-term financial reward.

The IIRC argue that Integrated Reporting overhauls our understanding of the capitals required to create value by proposing that capitals should be ranked equally rather than in a hierarchy in which economic capital always ranks first.

### **The six capitals of Integrated Reporting**

Integrated Reporting, as put forward by the IIRC, is structured to guide entities to report all information in relation to six capitals (set out below) – however, they do stress such categorisation is optional. The six capitals outlined in the International Integrated Reporting Framework are financial, manufactured, intellectual, natural, social and human capital.

**The stock of capitals:** Each capital is a stock that increases, decreases, or is transformed depending on the activities of the organisation. For example, in the event of redundancy, the quality of the firm's human capital would decrease. On the other hand, when employees successfully complete training, the quantity of human capital is increased.

**The flow of capitals:** The different capitals can be transformed into each other. The example given by the IIRC depicts a firm which expends financial capital on employee training, thereby improving their human capital.

**Financial capital:** Traditional forms of reporting, such as annual reports, are based on the understanding that financial capital is the fundamental capital concerning value-creation. The IIRC define financial capital as 'the funds available to an organization for use in the production of goods or the provision of services'.

**Manufactured capital:** This is constituted by manmade physical objects, separate from natural physical objects, that are available to an organisation for use in the production of goods or the provision of services. Examples of manufactured capital include infrastructure, property, equipment, and manufactured goods for sale or use.

<sup>1</sup> See <https://integratedreporting.org/the-iirc-2/> [accessed 6 August 2017].

*‘Aside from the legalities, the political, social and economic changes required for the implementation of IR should not be underestimated.’*

**Intellectual capital:** This comprises organisational, knowledge-based intangibles. This includes intellectual property such as patents, copyrights, software, brands, and so on. Less documentable intellectual capital can originate from experience or expertise in an area. ‘Organisational capital’ such as tacit knowledge, developed systems, practised procedures and protocols add value to any organisation.

**Natural capital:** It includes all renewable and non-renewable environmental resources and processes that provide goods or services that support the success of an organisation. Natural capital includes resources such as air, water, land, and minerals. Furthermore, it includes processes and balances that aid in prosperity such as a forest’s biodiversity or an effective ecosystem for health.

**Social and relationship capital:** This is defined as the relationships that exist between institutions and their communities, and also the relationship between and within communities themselves. Stakeholder groups and other networks are also considered here along with the ability to share information to improve both individual and collective welfare. Social licence to operate is deemed to be part of its social and relationship capital. Research carried out by CIMA et al (2014) argues that there is a gap in understanding how relationships contribute to sustainable business success and there is a dearth of work which considers relationships more holistically and how to develop effective relationships. This report is a practical resource to help senior management map the relationships of their business, understand how and why they are important and plan for the future.

**Human capital:** The IIRC accepts the ‘breadth’ of the term ‘human capital’ and suggests an array of locations from which human capital can arise. They explain that human capital comes in the form of people’s abilities, skills and experiences which collectively allow them to be valued as a factor of production.

#### **Conflicts arising from implementation of IR**

There are significant disparities between current reporting forms and Integrated Reporting. For example, a conflict could arise from implementation of IR as the focus shifts from profit maximisation to sustainability. Current corporate governance codes mean directors legally must fulfil their duty of care and fiduciary responsibilities. However, unlike the current regulation of accounting practice which favours the interests of shareholders, all stakeholders are the focus of attention in Integrated Reporting. It has, perhaps incorrectly, been argued that under current corporate governance legislation, full and successful implementation of Integrated Reporting is impossible (CIMA et al 2014).

Aside from the legalities, the political, social and economic changes required for the implementation of IR should not be underestimated. It has been argued that it would require specific reforms: a long-term as opposed to short-term focus and a change from designing organisational aims which serve the interests of shareholders only to instead developing aims which serve all stakeholders. This inclusive perspective maximises corporate value in the long term.



### Integrated Reporting in practice: South Africa focus

Since 2010 all companies listed on the Johannesburg Stock Exchange (JSE) have been required to produce an integrated report in line with the requirements of the third King Report on Corporate Governance in South Africa (King III). There are currently four revisions of the original King Report. For the past five years, Ernst & Young have commissioned a survey of the top 100 listed JSE companies and top ten state-owned companies' integrated reports (EY 2015, 2016). One issue of concern is the extent to which the interests of wider stakeholder groups are addressed.

One of the supposed benefits of Integrated Reporting is that wider stakeholder groups' interests are given genuine consideration. However, as shown above, the majority of reports analysed did not address the needs and concerns of stakeholder groups. This raises the question as to whether Zappettini and Unerman (2016) were correct in their concern that IR could be used more as a public relations tool rather than a serious reporting one.

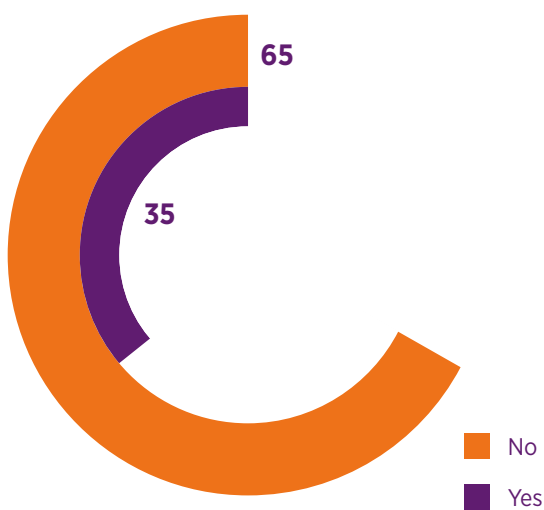
Given the emphasis on the importance of capitals throughout the IR framework, it is reasonable to expect that it would be integral in the formation of any successful integrated report. However, as shown in Figure 2 (EY 2016), the capitals were in fact rarely used to structure the integrated report. This diminishes the implied influence that the IIRC has over Integrated Reporting.

Zappettini and Unerman (2016) write that Integrated Reporting could be a useful tool in retaining shareholders and attracting new potential investors. This analysis serves as evidence of the crucial flaw with implementation of Integrated Reporting: the central focus has not fully shifted from the 'shareholder'.

In summary, the EY excellence in Integrated Reporting document (EY 2016) provides some evidence, albeit in the rather unique context of South Africa, that Integrated Reporting could be widely produced. While South Africa has adopted a 'comply or explain' approach, perhaps mandatory compliance would lead to greater consistency and comparability between integrated reports.

Figure 1: Matters addressed (%)

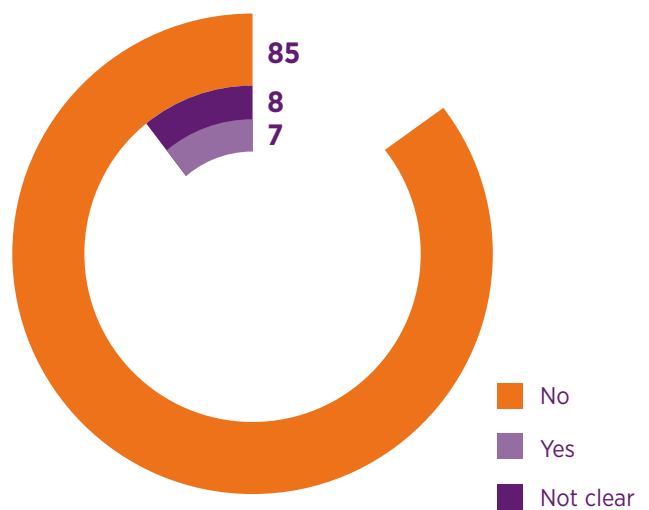
Are stakeholder needs and concerns addressed?



Source: EY (2016, p17)

Figure 2: IIRC influence (%)

Are the capitals used as a basis for report structure?



Source: EY (2016, p17)



### **Current evaluations of Integrated Reporting by professional accounting bodies and standard-setters**

Throughout the accounting profession there are different perspectives on value-creation and Integrated Reporting. We now turn to briefly consider the views of a number of the key players.

#### **International accounting standard-setters – IASB**

The International Accounting Standards Board (IASB) produce International Financial Reporting Standards (IFRS) to govern accounting practice throughout the world. It is therefore unsurprising that the IASB take an interest in the progression of Integrated Reporting. A recent speech given by the chairman of the IASB (IFRS 2017), Hans Hoogervorst, outlined their current position on the matter. The IASB demonstrate an understanding that the IIRC and UK Financial Reporting Council have developed important frameworks for evolving Integrated Reporting. Because of this, the IASB stated that it is currently looking at the question of whether it should update its Practice Statement to make Integrated Reporting mandatory (IFRS 2017). However, at the end of their statement it was argued that: *'We have a history of biting off more than we can chew so we are being very careful about adding anything to our work plan'* (IFRS 2017, pp3–4).

#### **CIMA**

Tomorrow's Company (2014) produced a report jointly with CIMA as a guide for Integrated Reporting called *Tomorrow's Business Success: Using integrated reporting to help create value and effectively tell the full story*. The report was commissioned and co-funded by CIMA and the IIRC, and designed to help chairmen, CEOs and CFOs understand how

to report the full picture of a company's value-creation process (Tomorrow's Company 2014). Throughout the document there is overwhelming support for Integrated Reporting and how it can aid companies, as well as all stakeholder groups, in the future. Although the focus is primarily on how Integrated Reporting will benefit all stakeholders, there is also a significant emphasis on how IR will aid investors and creditors specifically. Four-fifths of the executives interviewed within the context of the report stated that the IR aims are consistent with the objectives of their organisation.

With regards to human capital specifically, the report makes clear that employees are a crucial stakeholder group for consideration in value-creation, as 68% of surveyed executives believed the value-creation discussion was important to employees, second only to investors: *'A company's ability to compete and create value is totally dependent on its people'* (Tomorrow's Company 2014, p22).

While it appears that CIMA are proponents of the widespread implementation of Integrated Reporting and the centrality of human capital to value-creation, there is no suggestion of how the latter might be quantified. Rather there is a focus on the flow of non-financial information and the benefit of bilateral continuous improvement resulting from implementation of Integrated Reporting.

#### **ICAEW**

The ICAEW make their opinion on Integrated Reporting clear in their open response to the IIRC's consultation paper on Integrated Reporting (ICAEW 2014). The response also gives insight regarding how widespread

implementation of Integrated Reporting will affect audit practice. The report argues that the main proponents of Integrated Reporting are regulators and practitioners, and Integrated Reporting cannot successfully be implemented until there is a market demand for it.

Cost is a key issue. Integrated reports would gain legitimacy through external assurance, but this would be costly. Furthermore, the costs of integrated reports will be high because of the current universal lack of preparedness to implement IR. The ICAEW suggest that implementation may occur in a piecemeal fashion, starting with the areas identified as most important to stakeholders. In turn, costs associated with Integrated Reporting could be controlled and accurately predicted. Companies who implement Integrated Reporting would have to have effective internal controls for their reports to be cost-effective. They believe that, in the long term, there is a possibility that the costs associated with assurance of integrated reports may exceed their worth as the stakeholder groups' needs have been met.

#### **ICAS**

Like ACCA, ICAS (Fincham and Roslender 2003) recognises that business models should be concerned with other factors (capitals) aside from simply financial capital. ICAS outline their thoughts on Integrated Reporting adoption within the UK on their website (Robertson 2015). Robertson's research of a sample of 22 FTSE 100 UK listed companies found that less than a third succeeded in establishing high connectivity between their annual and sustainability reports, limiting their usefulness. In conjunction with results obtained in a similar study conducted by

PwC, it was noted that most of the sample companies are already beginning to address the key issues encompassed by Integrated Reporting in their strategic reports.

The document also highlights regulation as one of the key issues that must be addressed for successful implementation of Integrated Reporting. Regulatory bodies must fully comprehend how IR will work in conjunction with other reporting frameworks. The perspective of the IASB was discussed earlier; however, it is clear that regardless of whether they wish to be involved in Integrated Reporting or not, for successful implementation to occur there must be consensus on how IR will complement financial reporting.

**Summary**

Integrated Reporting is one of the most advanced initiatives to broaden the scope of contemporary accounting practice, and it is not simply ‘conceptual’ because it is being used in practice in South Africa. Nonetheless, Zappettini and Unerman (2016) suggest that an integrated report can serve as a

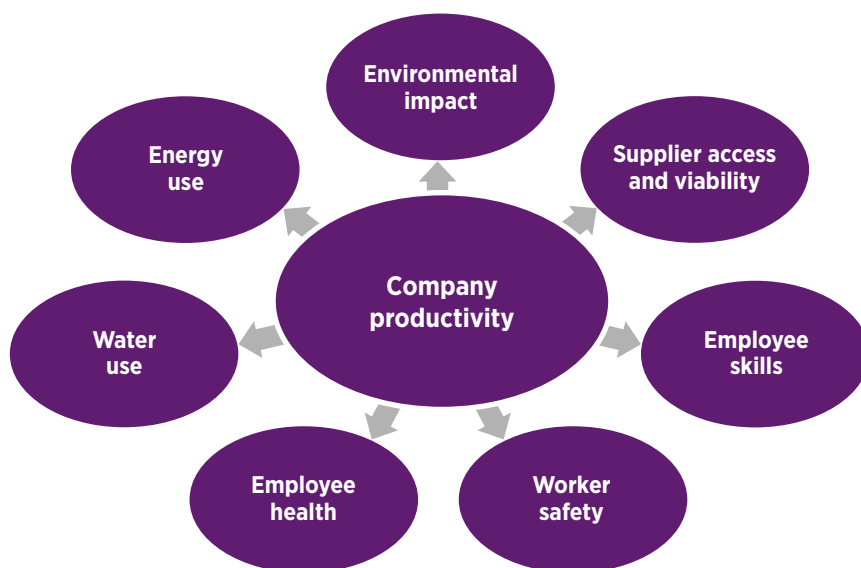
public relations tool, as well as a legal and financial document. As Integrated Reporting provides a large scope of information for a wide range of stakeholders, such a report would reach and influence a significant number of people. In practice, different stakeholder groups could be interested in many different types of information, perhaps leading to ‘information overload’ (Neumann et al 2012), or ‘generic’ but not ‘better’ information (Laud and Schepers 2009). Furthermore, Zappettini and Unerman (2016) write that Integrated Reporting could be a useful tool in retaining shareholders and attracting new potential investors. This analysis serves as evidence of the crucial flaw with implementation of Integrated Reporting: the central focus has not fully shifted from the ‘shareholder’.

**Other indicators and initiatives for valuing human capital**

Although Integrated Reporting is the most documented alternative to understanding value-creation and human capital, other indicators have been proposed by both the accounting profession and outside initiatives.

*‘Integrated Reporting is one of the most advanced initiatives to broaden the scope of contemporary accounting practice, and it is not simply “conceptual” because it is being used in practice in South Africa.’*

**Figure 3: The connection between competitive advantage and social issues**



Source: Porter and Kramer (2011)

*‘Differing from Integrated Reporting, the shared value initiative aims more to provide a link between sustainable business operations and superior performance.’*

**Shared value initiative**

One initiative which has received considerable attention within Australia is the shared value initiative (SVI). As highlighted in an article by Porter and Kramer (2011), on behalf of the SVI, this system of ‘creating value’ aims to maximise the wealth of shareholders through maximising the wealth of other stakeholders. As such, the system is about wealth expansion rather than distribution of wealth per se. Unlike Integrated Reporting, this system wants to harness and shape capitalism into a new *shared value* form (Porter and Kramer 2011).

The key factors fall under three broad areas that Porter and Kramer (2011) feel create shared value. These are summarised in Table 2. Some of the first indicators of employee human capital benefits are shown within Porter and Kramer’s (2011) discussion of a case study organisation, Johnson & Johnson. They state that by helping employees stop smoking as well as other health programmes, the company has saved \$250 million on health care costs. This was broken down to a return of \$2.71 for every \$1 spent on employee health initiatives between 2002 and 2008.

Differing from Integrated Reporting, the shared value initiative aims more to provide a link between sustainable business operations and superior performance.

A key message resonating from Porter and Kramer (2011) is that

indicators will differ depending first on the company/industry in question, and then the specific social issues confronted. While the shared value initiative might be considered to be an innovative form of reporting, like many of the initiatives considered here, it is more concerned with reporting on ‘externalities’, and widening the target groups of the reporting, than focusing on the employees of the organisation and what they do to create value.

**Total impact measurement and management (TIMM)**

A measurement system outside of the traditional financial reporting system has been proposed by one of the leading global accounting firms, PwC (see PricewaterhouseCoopers 2013). TIMM aims to monetise the impact of an organisation through the consideration of four key business dimensions: social impact, environment impact, tax impact and economic impact. The model partially considers human capital through the social impact of operations on employees. This social impact includes employee livelihood, health, education, empowerment and community cohesion. The model is said to move beyond traditional financial reporting techniques that focus on inputs and outputs, usually through the amount of resources used and the quantity generated, focusing on the specific achievement of a company. The implications (risks) on the inputs and outputs is usually expressed in financial terms.

**Table 2: Sources of shared value-creation**

Source	Explanation
Reconceiving products and markets	Using a company’s products/services to create value through targeting unfulfilled needs. This can be realised through environmental, social or economic benefits being diverted to customers.
Redefining productivity in the value chain	Focuses on internal improvements in terms of operations. This can be realised through changes such as employee enhancements or supplier reform.
Enabling local cluster development	This source of value-creation is derived from enhancing the external environment to an organisation through developing investment in communities.

Source: Porter and Kramer (2011)

**Scottish and Southern Energy (SSE) and Axa Group human capital reports**

One of the most significant examples of human capital reporting, both from an internal and external perspective, seems to be the human capital annual report produced by energy giant Scottish and Southern Energy (SSE), in conjunction with professional services firm PwC (PricewaterhouseCoopers 2015). The report considers human capital to have two components which combine to form the value of the employee: *innate ability and talent and learned knowledge, skills and other attributes*. In order to value HC, SSE utilises a measurement system bespoke to them (see Figure 4). The *sum of the expected future labour earnings* takes into consideration the expected duration of employment, changes in wage over the respective years and other assumptions around the employee’s wage over time. The *discount factor* applied is simply an adjustment to the future earnings as the future time value of money differs from the present value. The discount rate applied is bespoke to SSE and, if a company wants to mimic this approach, it would need to use its own discount rate.

As Scottish and Southern Energy set out, the HC value of the

organisation can operate as inflows and outflows, similar to a traditional cash flow statement in many respects. Several factors can create changes to a company’s ‘stock’ of human capital value, including numerical changes in staff levels, the levels of training received by employees and demographical changes which cause employees to work longer.

The PwC attempt to develop a method to account for human capital is driven, at least in part, by the IIRC. Importantly for our analysis, PwC make clear that human capital accounting is supplementary to traditional financial statements. PwC argues that since human capital is not an asset owned by SSE, the results of their analysis are not meant to be incorporated in SSE’s financial accounts. Perhaps more importantly, the form of human capital accounting developed by PwC is concerned with the impact of investments in training on the *economic* well-being of the firm, rather than any ‘social outcomes’.

Labour is assumed to be paid according to its marginal productivity and the economic measure of human capital is simply discounted future wage payments. Staff training is deemed to result in increases in future wage payments and so to increase the amount of human capital.

*‘In short, the SSE/PwC approach to human capital accounting can be considered to be entirely consistent with the shareholder value maximisation approach to accounting and as a business model. The whole method takes an aggregate approach which assumes the labour is an asset to be exploited and that training will yield economic returns (to shareholders).’*

**Axa**

Although this is not a widespread form of reporting and measuring human capital, a major global insurance and investment company, Axa Group (2015), also reports their human capital externally in their *Social Data Report 2015*. Differing from the publication of SSE, the French insurer does not put a so-called ‘value’ on their workforce. Rather, the company documents the composition of their workforce using several variables. The ‘Workforce Dynamic’ statement is based upon incoming and outgoing staff, as well as turnover of staff. Moreover, the insurer also assesses other variables such as salaried and non-salaried workers, age demographics and the gender balance of the organisation. In addition to the numerical employee analysis, Axa also track

**Figure 4: Bespoke SSE valuation methodology**



Source: PricewaterhouseCoopers (2013)

compensation costs year on year and analyse how much of the compensation structure is fixed and variable for staff.

A similar analysis is also conducted on working time and absenteeism which, it argues, will provide a clear indication to the health and well-being aspects of their human capital. The indicators under time and absenteeism include: the average hours worked for full- and part-time staff; proportion of absenteeism attributable to sickness, work-related incidences and maternity/paternity leave; and average number of working days per year for salaried workers. The Axa report basically provides comprehensive data on its staff. While the report has an English version, it basically complies with the provisions of articles L.225-102-1 and R.225-104 of the French Commercial Code.

### **Summary and commentary**

This section has discussed a variety of accounting industry initiatives and other company-specific measurement systems that encompass human capital inputs and broader stakeholder or business model approaches to accounting. These models reflect a broad consensus that human/ intellectual capital is an important creator of value alongside a recognition that there are other stakeholder groups aside from shareholders.

Arguably, despite being built upon stakeholder approaches, these models are insufficiently labour-centred. The types of suggested information relating to 'human capital' in these initiatives remains at the rather mundane level of such things as training and/or health and safety. Arguably, the use of the term human capital could be considered to be problematic, since a conviction underpinning

the various reporting initiatives appears to be that human capital is akin to any other form of capital. It should make a return for the providers of financial capital. So, for example, the SSE/PwC model, by assuming that staff are paid according to their marginal productivity and applying the weighted average cost of capital as the discount rate to their estimated future salaries, in effect, means that staff are treated as any other business asset which is expected to produce a future income stream. The major difference being that, it is an accounting principle that the workforce cannot be included as an asset on the balance sheet or statement of affairs because it does not meet the generally accepted recognition criteria. The models and frameworks do not appear to make a robust attempt to consider how people create value. This may be because the accounting industry initiatives are directed towards external stakeholder groups and so are concerned with output metrics rather than a more detailed concern with the human activities that create value.

The most developed and coherent of all of the accounting initiatives appears to be the IIRC's (2013) Integrated Reporting framework. Indeed, many of the accounting industry initiatives set out here are based upon the principles of IR. However, for integrated reports to become 'mainstream', it would be helpful for them to have the legitimacy endowed by an international accounting standard on Integrated Reporting. At present, this seems a fairly remote possibility, and until there is such a standard, Integrated Reporting will remain unaudited, open to variance in its application (and so incomparable across companies) and voluntary. As set out above, it seems that some

professional accountancy bodies (ACCA and CIMA) appear to be more favourable towards IR than others who argue that IR would be expensive, difficult to audit and offer little information that is not already encapsulated into traditional financial statements. Perhaps this is the key point. One way of understanding the initiatives set out here is that they are intended to supplement the legitimate and audited traditional financial statements which are directed towards the needs of the long-term providers of financial capital.

Overall, the accounting industry initiatives set out here are appealing in that they offer the hope of 'doing something' and 'moving in the right direction' (Milne et al 2009, Cooper and Senkl 2016). This creates the perception of being active but without having to define a specific destination and without having to be radical in terms of dramatically changing business practices. The majority of the accounting industry initiatives tell a value-creation story. They provide a business case which claims to create a win-win situation for business and society (Banerjee 2002, Livesey 2002, Milne et al 2009). The various initiatives imply that they have developed a new way of thinking about environmental and social problems (although perhaps not about employees) and could be referred to as a paradigm shift (Colby 1991, p193, Banerjee 2002, p178, Milne et al 2009, p1214). But, in practice, they do not in any way dislodge the hegemony of the extant financial reporting statements.



### 3 Discussion and policy implications: the workplace and beyond

This review has addressed the issue of how value is best created in work organisations and for whom. In the first report (*Creating and Capturing Value at Work: Who benefits? Part 1*) we have discussed how value-creation is crucial for society, firms and people, and significant public and private resources are invested in supporting it. Given this, it is crucial to find better ways to sustain and enhance value-creation. But value-capture processes and who captures value also matter, since the distribution of value to some (shareholders and senior executives) not only influences the distribution of value to others (especially employees), but may in turn limit the creation of value. There is, therefore, a business, economic and normative case for critiquing MSV as a value proposition. In this report we have highlighted the resilience of measurement approaches and reporting built around MSV, and the limitations of – and lack of real commitment to – any proposed alternatives. Measurement approaches reflect, but are unlikely to drive, value propositions.

Key questions emerge as to who has the locus to influence value-creation, capture and measurement to give due regard to other stakeholders, and what interventions in what domains might be influential. Metrics and measures both reflect and embed conceptions of value in the wider economy and in firms and production networks. As Clelland (2014) argues, ‘bright value’ (what is officially counted and costed) is only the visible part of the

economic iceberg. There are also extensive sources of hidden or ‘dark’ value which are integral to business models. Earlier discussion in this report has highlighted some aspects of hidden value and hidden costs – from intangibles to externalities – that new actual or proposed metrics seek to make visible.

Expanding the value window – the scope of what is measured – is useful but insufficient. We have already outlined some of the limitations of human capital and accounting measures (see CIPD 2017a). There is an equally pertinent problem. Adding new measures without challenging and changing those measures of the MSV model that are destructive of human capital and shared value may have limited efficacy. It is increasingly observed that HRM is ‘behind the curve’ in adequately grasping the contexts such as financialisation that are driving much in contemporary business models (Delbridge et al 2011, Thompson 2011a, Wilkinson and Wood 2014, Clark and Macey 2015). The role of the HR community in supporting more productive and equitable stakeholder relations has been ambiguous and uneven. Yet many in the profession are strongly oriented towards more stakeholder-based relationships and could have an important voice in outlining their value.

Unfortunately, the strategy of choice in recent decades has often been to engage with the debate on value on accountants’ terms by relating human capital and HR practice to profits and share prices.

*‘The distribution of value to some (shareholders and senior executives) not only influences the distribution of value to others (especially employees), but may in turn limit the creation of value.’*

Yet one (often unacknowledged) problem with comparing value concepts is that they are not comparing like with like. In part this is because whatever the narrative position (and HC concepts are still hegemonic in the HR community), MSV is hegemonic in practice, with deeply embedded metrics and mechanisms that exist as a global, macro-level 'currency'. Its 'rivals' are weakly and unevenly established, often playing more of a legitimising than a practical role.

In addition, MSV is concerned with what to do with value already created. It is only concerned with value-creation through mechanisms to boost market (share) value, which is a form of fictitious capital. In contrast 'people-related capitals' are largely concerned with establishing recognition of contributions to value-creation, which can then be captured somehow in the book value (that is, accounting and reporting systems) of firms.

### Connecting to the bigger picture

Any proposed correctives to practices destructive of the relation between work and value should be connected to the larger institutional picture. Since the global financial crash of 2008 there has been considerable debate about how to rebalance the economy. As Mazzucato and Shipman (2014) point out, that includes issues of measure – including whether GDP and national income accounts accurately capture the presence of intangible capital or certain types of R&D in aggregate production while overstating purely speculative and redistributive financial activities. This is beyond our scope, but issues of work and value cannot wholly escape aspects of the bigger picture. Issues such as the accumulation of balance sheet

capitalisation (debt and equity) ahead of surplus generating capacity are part of increasingly financialised national business systems (Andersson et al 2014) or growth regimes (Appelbaum et al 2013). In this sense, corporate governance, legal and regulatory systems, reporting requirements and other institutional factors enable and constrain the degree and scope of options available to managers, while framing the kinds of managerial routines for the application and extraction of resources adopted by firms (Siepel and Nightingale 2014, p30).

This is not the place to set out specific policy prescriptions, but some general observations can be made about policy issues and directions that can influence corporate governance and state legislation. As Lazonick and Mazzucato (2013) argue, the key is to focus on measures that can shift the risk-reward nexus in ways that encourage the expansion and retention of long-term shared value. The current, dominant MSV model embodies too many perverse incentives for value destruction. Executive remuneration is currently proving a highly contentious area. Beyond the issue of the total reward package, it is the tying of compensation to stock options or simple payments in shares that especially incentivises short-term, value-destroying behaviours. Transparency, while important, is insufficient given the power relations involved in corporate networks. The focus needs to be on the proportion and timing of rewards linked to share options.

At present, the average term of a British chief executive is less than five years, and the average time an individual share is held is four months. Consequently, there is pressure to concentrate

on activities to maximise the current share price, rather than on building a sustainable business. The incentives for senior executives to engage in self-interested behaviour that sacrifices stakeholder value have also been observed in the US (Harrison and Fiet 1999), for example, by cutting R&D investment or pension fund allocations, in order to drive short-term profitability and enhance their own position.

Wider limits to financial engineering, particularly to share buy-backs, would free up '*more funds available in companies for development of human capital*' (Lazonick and Mazzucato 2013, p1121). Constraints on buy-backs and dividend payments in more specific circumstances following takeovers of portfolio companies by private equity firms are already mandated by the European Union's Alternative Investment Fund Directive (Appelbaum and Batt 2014). On the positive side, it is possible to consider additional tax credits and other incentives for long-term investment in knowledge-based assets and human capital investment. Alternative sources of finance that can supply patient, committed capital through national or regional investment banks, as well as expansion of state-university-private collaborations on investment in innovation are also important market correctives.

As the above discussion indicates, the role of the state is crucial. Legislation and regulation in relevant spheres are, of course, core change levers, and developments in company law and employment protection have a role to play in limiting value-destructive approaches. Yet it is important to note that company law in many countries already allows, encourages or



compels company boards to take the interests of non-shareholder stakeholders such as employees, customers, creditors and investors into account (Orts 1992).

In addition, it is also worth remembering that the corporate governance framework of many countries explicitly supports stakeholder-oriented company forms such as benefit corporations and community interest companies (CICs). Looking to the US where more than 20 states have introduced facilitating legislation, benefit corporations are distinctive in having an explicit corporate purpose to make a positive material impact on society and the environment, expanded directors' duties to consider more than the financial interests of shareholders and specific social and environmental reporting requirements (Clark Jr and Babson 2011).

Taking a UK example, CICs explicitly address one aspect of value-capture through an 'asset lock' where only 35% of distributable profits per annum can be paid as dividends to shareholders, with the rest retained to support the CIC's mission. Until 2014, a double asset lock operated that precluded dividends of more than 20% of the value of shares held (Burne 2015). These business forms highlight a range of possible ways in which stakeholder interests can be supported and sustained through supportive institutional arrangements where there is political and social will to do so. In both cases, however, the role of owner/employer choice in adopting distinctive business forms is vital, a point to which we return below.

Post financial crash, extensive discussion has taken place of how corporate governance might be

amended to address some of the failings that precipitated the crisis. As we have argued above, some of this has built on long-standing debates about the role of public reporting requirements in ensuring that firms give consideration beyond shareholders by reducing information asymmetry (Hill and Jones 1992) and providing important signals to investors and other stakeholders about the importance of human capital in value-creation. But, a recent research report by the CIPD (2017b) found that investors and analysts place a lower emphasis on annual report information on human capital and its input into the value-creation process than other intangibles. And, as we argued earlier, recent developments in the UK in this regard do not provide much reason for optimism. Other developments have included, for example, proposals for public interest directors in Ireland (Spitzeck and Hansen 2010, Clarke and Henderson 2016).

### Legislative initiatives

As Gospel and colleagues' (2014) cross-national evaluation of new investment funds and employment outcomes suggests, employment protection legislation, enhanced voice mechanisms and laws on employee directors can also all have moderating effects:

*The comparative evidence shows that institutions and regulation matter. ... Variations in employment protection regulation do not inhibit fund-invested companies from undertaking large scale restructuring. However, international regulations relating to employee voice and worker representation affect the extent to which employee representatives are informed and consulted in restructuring.* (Gospel et al 2014, p43)

Yet, in a number of countries including the UK, there has been little appetite for the expansion of employment protection legislation, supporting collective employee voice (particularly through trade unions) or reshaping company law to improve stakeholder influence in corporate governance, notwithstanding the recent (and limited) dalliance of the May Government with the idea of employee representation on boards. Yet state inactivity (or active opposition) in relation to these matters can leave governments (in liberal market economies) on the wrong side of the many externalities produced by MSV models and burdened with the costs of remedial action in response to low pay, insecure work, increasing inequality, skills underutilisation, lower productivity and lower tax revenues consequent on constrained value-creation and growth.

Within such economies alternative perspectives have been gaining significance. From a US legal perspective, Jacobs (2011) has delivered a swingeing critique of the 'the impatient capital problem' and its role in declining US competitiveness, and offered some proposals for reform. His argument is steeped in the need to support innovation as a national competitive strategy and the role of company/corporate law in enabling this, arguing that:

*the innovation of new ideas and their translation into products that can be sold competitively worldwide requires capital – patient capital. And for patient capital to thrive, corporate law needs to be altered to create a more nurturing environment.* (Jacobs 2011, p1649)

Two issues lie at the core of Jacobs' analysis. The first and pre-eminent issue relates to

*‘While facilitating legislation is important, the extent of variation in “stakeholder activism” across countries and institutional settings points to the role of factors other than legislation (Young and Thyl 2008).’*

our shareholder/stakeholder dichotomy. Property models of corporate law see the purpose of corporations as to advance the interests of stock/shareholders, whatever the length of their stock/shareholding. Entity models of corporate law see the purpose of the corporation as longer-term wealth maximisation for a broader group of stakeholders.

How corporate or company law is framed around these competing conceptions also shapes the second issue of managerial incentives and disincentives. Jacobs (2011) argues that the current environment does not reward senior management for managing for the long term and that aspects of corporate law (such as annual meetings and reporting) tie them to the short-term agendas of large institutional investors. Yet these are not immovable and Jacobs offers a series of options for change – for example, that companies elect directors every five years rather than annually. He also outlines the challenges in implementing these, including the listing rules of national securities exchanges, and points to the role that the state could play in creating tax incentives to reward investors for deferring returns on their investment.

Also from a US legal perspective, Jacobs (2011) commends Strine’s (2010) analysis of the need to address the misalignment between end-user investors (for example, those saving for college/university tuition and retirement) and institutional investors, through regulatory reform. This might include pricing and tax measures to discourage churn by institutional investors and fund-hopping by end-user investors; rules that align management compensation with the time horizons of end-user investors;

leveraging limitations and broader disclosure requirements in relation to high-risk investments; and requiring greater and more timely disclosure by institutional investors of their financial interests, including derivative ownership and short positions. These measures would, of course, require federal legislation which would face considerable obstacles.

While facilitating legislation is important, the extent of variation in ‘stakeholder activism’ across countries and institutional settings points to the role of factors other than legislation (Young and Thyl 2008). Legislation is often a blunt sword, and policy priorities and policy levers, backed by appropriate incentives and sanctions, might also be harnessed to shape value-creation and capture. Much of this policy-focused debate remains myopic around supporting value-creation, but in some of its more developed and thoughtful versions, implications for value-capture are incorporated both as a ‘good’ in itself and, more commonly, as an aid to maintaining or enhancing value-creation. This has developed from policy exhortation towards high-performance working, through debates at national and international level on good, decent (ILO 2015, OECD 2017), high-quality (CIPD 2017d) or fair work (Fair Work Convention 2016) towards a more recent appreciation of the potential of mutual gains-based workplace innovation to enhance value-creation and capture (Findlay et al 2016).

These debates and practices focus on the potential to align the efforts and motivations of workers with organisational and managerial changes that improve efficiency and create value through more effective deployment of (often

skilled) human capital (Ichniowski et al 1996). Workplace innovation research has expanded in light of the increasing complexity of technical innovation issues and the human and organisational factors that are needed to make these innovations successful (Oeij et al 2014), and a body of research is emerging that workplace innovation contributes positively to company performance (Pot and Koningsveld 2009, Ramstad 2009, Eeckelaert et al 2012, Oeij et al 2012).

In many of these analyses, workers' co-operation with innovative practice to enhance value-creation is taken for granted, yet workers may share little in the benefits of improved workplace performance at a micro level, leading to an increasing disconnect between productivity improvements and labour's share in value-capture. There is a pressing need to analyse whether, and if so how and where, workplace innovation can deliver for workers as well as for employers and thus deliver shared value through high job quality work that harnesses the human, social and intellectual capital of the workforce. While there are useful early policy and research developments taking place in this regard in parts of the UK (for example Working Together Review 2014, Findlay et al 2015, 2016, Fair Work Convention 2016), emerging policy pursuit of high-value, innovative and high job quality business models are backed only by soft policy measures to support (voluntary) responsible business approaches.

More broadly, while aspects of value-creation have garnered more public and policy approval in recent years, efforts to address problems of value-capture have lagged significantly behind. There

have been some worthwhile legislative and policy measures to address low pay, for example, through the National Living Wage measures in the UK and through support for Living Wage accreditation by devolved governments (for example Scottish Government 2015, 2017) and selected employers. Concerns over executive pay and the gender pay gap are widely discussed but effective measures to address this are thin on the ground, as are ways of challenging increasing inequality in company pay ratios. Meanwhile the labour share – the proportion of national income made up of labour compensation – long believed to be stable in growing economies, has deteriorated in many advanced and emerging economies since the 1980s (ILO and OECD 2015), with negative consequences for income inequality and constraints on consumption (Cingano 2014, OECD 2015).

While explanations of this phenomenon have explored the influence of sectoral shifts, within-sector changes, technological changes, product market and financial regulation as well as changes in labour market institutions, on the latter dimension, empirical evidence suggests that the role of factors that affect the bargaining power of workers is largest (ILO and OECD 2015). A declining labour share has not, however, resulted in increased investment by firms: the capital share in advanced G20 countries rose by 2% between 2000 and 2007, while investment remained stable at 22.8% and had fallen to 20% by 2012 (ILO and OECD 2015, OECD 2015).

Employers themselves can choose different value propositions, business models and forms, aligned with or independently

*‘While aspects of value-creation have garnered more public and policy approval in recent years, efforts to address problems of value-capture have lagged significantly behind.’*

of policy influences. Employee-owned businesses have grown in number and in the UK appear to have weathered better the impact of the global financial crisis. More (though in relative terms a tiny proportion) companies are seeking BCorp accreditation (Clark Jr and Babson 2011), and discussions of ‘purposeful’ companies have emerged more prominently (Big Innovation Centre 2017). Family firms and other small businesses have the potential to choose more stakeholder-oriented approaches built around greater sharing of value. But addressing the implications of particular business models is fundamental to any realignment of the value process at work, since these reflect *‘the concrete choices made by management about how the organization must operate, and the consequences of these choices’* (Casadesus-Masanell and Ricart 2010, p98).

As Donaldson and Preston note, *‘the ultimate success of stakeholder-agency theory would require a fundamental shift in managerial objectives away from shareowners and toward the interests of all stakeholders; such a shift would necessarily involve normative, rather than purely instrumental, considerations’* (1995, p80). Instrumental considerations are important and better insight as to the business or economic merits of alternative value propositions and the organisational arrangements that can support them is needed. As Bottenberg and colleagues (2017) argue in the German context, stable trust-based stakeholder relations improve access to valuable resources, support organisational learning and innovation, and help manage change. Investing in the quality of these relationships is crucial. As these authors note, *‘whereas stakeholder relationships*

*characterised by mutual trust and commitment toward the success of the firm can serve to benefit the firm, relationships that lack these criteria can detract value’* (Bottenberg et al 2017, p175).

Both employer choice and policy priorities are often stimulated by stakeholder influence and the activities of employees, unions, consumers and campaigning organisations. This highlights the potentially important role of multiple stakeholder co-ordination to address issues of value-creation and its capture (Freeman and Evan 1990, Findlay et al 2016). In these ways and others, the ramifications of the value process beyond firms reinforces the need to consider the holistic nature of the value process at individual, firm and societal level. This report has aimed to contribute to a wider and deeper conversation about value at work, in the economy and society, and to reflect on what the HR profession might usefully bring to that conversation.

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