

Measuring human capital disclosure

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ABSTRACT

Disclosure of human capital in annual reports enable HR Professionals with information to improve their investment decisions on a broad range of people-related issues. When contrasted against the other dimensions of intellectual capital, namely, structural and customer capital, disclosed human capital information provides useful insights on how people contribute towards organisational performance. This study applied a self-constructed disclosure index with four constructs to assess the extent of human capital disclosure in the 2015 annual reports of the Top 40 Johannesburg Stock Exchange (JSE) listed companies in South Africa. A Cronbach's alpha of 0.872 was attained confirming the internal consistency of this instrument. Overall, 26% of human capital information was disclosed qualitatively, quantitatively and in monetary value compared to 33% for both structural and customer capital.

INTRODUCTION

Empirical studies on human capital disclosure investigate the extent to which corporate annual reports share people related information. Annual reports are considered the most valuable source of information for shareholders to improve investment decision-making [1] [2]. In the interest of enhancing corporate governance, disclosure of information is asserted mandatorily as a professional accounting regulation, legislation and listing requirement [3]. Alongside statutory requirements is the increasing expectation for organisations to disclose voluntary information which is considered critical towards sound investor decision making. In response, organisations are becoming proactive by disclosing voluntary information, particularly in human capital [4]. [5] confirm that the hidden market value of companies can be addressed through voluntary human capital disclosure. A variety of disclosure indexes which include the key intellectual capital (IC) constructs, namely, structural, human and customer capital are used to assess the extent of information shared by organisations. As such, the main aim of this study was to apply a self-constructed index to measure human capital disclosure relative to the other three constructs including human resource (HR) risk.

LITERATURE REVIEW

Substantial research in measuring human capital focuses on establishing the relationship between this intangible asset and organisational performance. Most of these studies present profound results on how information disclosure can leverage investor confidence [1] [2] [4] [5] [6].

Human capital measurement and reporting is considered a key driver of productive and innovative organisations. The theory of human capital illustrates that the disclosure of people-related information in annual reports is recognised as a significant determinant of corporate value. Although most of this information is not a mandatory requirement in terms of the International Financial Reporting Standards IFRS and the General Accepted Accounting Practices (GAAP), voluntary disclosure is encouraged to reduce information asymmetry and enhance investor decision making [6]. Voluntarily reporting choices on human capital disclosure confirm the extent to which companies share information on people-related investments to highlight the overall impact on the financial success. To assess the extent of disclosure in this regard, measurement indexes containing a variety of items are used empirically. Accordingly, a disclosure index can be defined as a measurement instrument with different constructs used to evaluate the extent of information disclosed in the annual reports [1]. The construction of disclosure indexes must be well-grounded on literature review. Previous studies have demonstrated the effect of information disclosure on the company's expected market value by using self-constructed disclosure indexes [1].

Nature of information disclosure

Annual reports contain financial and non-financial information expressed qualitatively, quantitatively and in monetary terms. Qualitative information are narratives or words explaining the state of affairs in the organisation at the end of the financial period. Quantitative expressions reflect the numerical content disclosed in annual reports while the financial data is represented in monetary values [2]. Human capital disclosure include items such as employee training, number of employees, compensation plans, benefits, incentives programs, rate of staff turnover and employee value form part of the annual corporate disclosure [7].

Structural capital reporting contains information on patents, trademarks, subsidiaries, ownership, business processes, culture, management structure, computer equipment, internal control and systems. Information regarding the organisation's customer capital is concerned with marketing, media communication and interaction with stakeholders such as the government, banks, communities and suppliers [5]. Additionally to the traditional components of IC, HR risk including measures such as absenteeism, strikes, resignations, deaths and ill-health affect the contribution of human capital towards organisational performance.

HR risk must be identified and effectively managed for improving decisions on people embodied assets [8].

Disclosure measurement

Measuring information disclosure has become more significant for organisations. [4] [6] emphasise the use of disclosure indexes as measurements instruments to assess the extent of information disclosed in annual reports. The construction of disclosure indexes can have items ranging from 35 to 224 [9] with a scale of 1 to 2 where the value of 2 means that information is disclosed quantitatively, 1 indicates qualitative reporting and 0 demonstrates non-disclosure in annual reports. When testing for internal consistency, the disclosure index can yield a Cronbach's alpha of any value within the range of 0.7 and more [10], although in certain instances these can be acceptable at less than 0.7.

This study used a self-constructed disclosure index to evaluate the extent of human capital information disclosed in the annual reports.

RESEARCH DESIGN

Research method

A content analysis of the corporate annual reports was carried out by using a disclosure index to measure human capital disclosure. According to [9] content analysis methods with applied disclosure indexes facilitate the information gathering process for improved measurement practices.

Sampling strategy

A sample of the Top 40 (JSE) listed companies was drawn for the 2015 financial year. Listed companies are selected for disclosing audited information in annual reports [11]. The Top 40 JSE constituents are the largest companies by market capitalisation in South Africa and spread across the various sectors such as the financial services, mining, retail, telecommunications and petroleum. Listed companies are making progress in disclosing information on structural, customer and human capital [12].

Measuring instrument

A self-constructed disclosure index including the structural capital, customer capital, human capital and HR risk was developed. Self-constructed disclosure indexes depend on the research question under investigation and can be categorised according to a set of constructs [9]. Existing literature was used as a guide to identify, and score the measurement items. This led to the retrieval of 129 items which were distributed across a total of 16 sub-categories within the four constructs. The structural capital construct produced 44 items; human capital included 28, customer capital 39 and HR Risk 18. To assess the disclosure content, the index was administered by using a score of 0, 1, 2 and 3.

In this case, 0 means items not disclosed (ND); 1 disclosed qualitatively (DQL); 2 disclosed quantitatively (DQNT) and 3 disclosed in monetary value (DMV). Scoring of items represents the measurement scale of disclosure indexes [9].

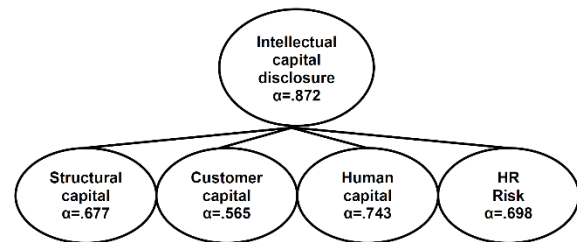
Data analysis

SPSS was used to analyse data in terms the internal consistency of the disclosure index and descriptive frequencies to indicate the extent of HC disclosure.

RESULTS

The self-constructed disclosure index yielded an overall Cronbach's alpha of 0.872 and confirms reliability. Figure 1 below presents the complete results with a reliability score of 0.743 for human capital relative to the other constructs.

Figure 1: Reliability test



A factor analysis was performed to clarify the underlying constructs of the disclosure index with the following summary of results in Table 1:

Table 1: Factor correlation matrix

Disclosure	SC	CC	HC	HRR
SC				
IP	0.325			
Structure	0.372			
Culture	0.397			
Philosophy	0.229			
Processes	0.140			
IT	0.232			
Infrastructure	0.353			
CC				
Relationships		0.360		
Distribution		0.246		
Marketing		0.166		
Partnering		0.126		
Reputation		0.210		
HC				
Employees			0.160	
Earnings			0.294	
Training			0.312	
HRR				
Risk profile				0.156

Disclosure frequencies in Table 2 below indicates the extent of human capital disclosure relative to the other constructs.

Table 2: Disclosure frequencies

Constructs	Frequencies				
	ND	DQL	DQNT	DMV	%
SC	508	867	26	284	33
CC	461	863	40	256	33
HC	239	642	81	207	26
HRR	492	240	21	3	7

The extent of human capital information signifies a growing move towards voluntary disclosure.

DISCUSSION

Managerial implications

HC disclosure practices apply the intellectual capital framework which include the structural, customer and human capital dimensions. This study added the HR risk category to highlight the level of information disclosed pertaining to the unfavourable consequences of human capital investment. This is important for refocusing the companies' human resource strategic plans. Specifically, the overall disclosure in human capital indicates the extent to which the JSE listed companies in South Africa make significant progress towards voluntary disclosure beyond the statutory required information. The monetary disclosure of human capital presented in the disclosure frequencies provide useful insights on the actual investments companies make in enhancing their human assets.

This information is important in establishing the relationship between human capital investment and business performance. Also, the sufficient narrative reporting on human capital can be used for understanding the valuable impact people bring to the organisations. These narratives are more insightful when read in conjunction with the related monetary expressions contained in the annual reports. As such, human capital disclosure provides HR Professionals with the opportunity to improve their business acumen by understanding the impact of people contribution to the organisations.

Possible limitations of the study

The study was limited to the Top 40 JSE listed companies in South Africa. Although these carry the highest market capitalisation, the inclusion of more constituents would improve the structure of the disclosure index and produce more disclosed information.

Suggestions for future research

The expanded version of the disclosure index applied in this study can be subjected to a broader JSE listed population. Validity tests to assess the inter-item correlation must be carried out to determine the association between items of one and more scales.

Conclusion

The paper aimed to measure the extent of human capital disclosure in the annual reports. A key finding is the growing voluntary disclosure by most constituents of the Top 40 JSE listed companies.

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