Human Capital Disclosures in Developing Countries: Figureheads and Value Creators

Abstract

Purpose
To explore an apparent disparity between human capital information desired by financial analysts and fund managers and actual disclosure of such information in company annual reports in the context of developing countries.

Methodology
Financial analysts and fund managers were interviewed to obtain opinions on the importance attributed to human capital information and whether their desired information is disclosed in the annual reports. Content analysis was then used to assess the extent and nature of human capital information actually provided in the annual reports of 100 listed companies in Malaysia.

Findings
The interviews reveal that financial analysts and fund managers particularly seek information on company management and key corporate decision makers that could provide firm with competitive advantage. However, the human capital information provided is limited, unquantified, non-uniform and tends to focus on directors, many of whom may be figureheads with little impact on the way companies are run and in creating value for the firm. Accordingly, analysts have to rely on alternative sources to get their desired information – a costly process for private shareholders.

Implications and value
The paper contributes to the literature on the demand for, and disclosure of, human capital information in the context of developing countries. It identifies the inadequacy, to financial analysts and fund managers, of current human capital disclosure practices in company annual reports. We theorise that, in developing countries, resource dependence, legitimacy-seeking and ‘culture’ causes companies to pay relatively more attention to figureheads than value creators.

Keyword(s): human capital disclosure, developing countries, non-exec directors
Human Capital Disclosures in Developing Countries: Figureheads and Value Creators

1. Introduction

Human capital has long been recognised as a vital asset and value creator to companies. In Roslender and Dyson (1992), ‘value’ was seen in a broad sense as “enhancing the performance of an organisation” (p.316). More recently, Swart (2006) refers to “core competence, knowledge creation and innovation … creating value over and above physical and financial resources” (p.136).

In the current business environment, human capital is regarded as a key source of competitive advantage. With the ‘knowledge agenda’, companies view their employees as an important resource and invest heavily in them. But the value of human resources, or human capital, may not be adequately reported to stakeholders partly due to strict recognition criteria for intangible assets that do not allow human resources to be shown as an asset in the balance sheet (Tayles et al., 2002). Nevertheless, information on human capital and its development is important to financial analysts and fund managers who need to assess the future direction, potential and values of companies. Human capital information is not absent from capital market intelligence (Mouritsen, 2003) but actual and potential private investors and their advisers may have to rely on disclosures in the annual report when evaluating a company’s value and prospects. As human capital disclosure is mainly at the discretion of management¹, the information that is provided may not necessarily be what is desired by users of annual reports, creating an information gap costly to both providers of information (opportunity loss) and users of information (relevance loss).
In this paper we respond to the call by Guthrie et al. (2007) for a consensus between business and researchers about the need to report, what to report and how to report it.

Our survey of the literature indicates that most previous studies tend to focus on the supply side of information, and have shown that human capital disclosures in the annual reports are mostly voluntary, diverse in content, format and extent, and often adopt the social responsibility perspective. There has been less research examining the investor demand side of human capital information, and none to our knowledge in the context of developing countries. Adequate disclosure of human capital information is an important matter since it affects not only a firm’s ability to recruit and retain the best people, but also conveys a firm’s potential to create value and thus its share price and ability to attract funding nationally and internationally.

Hence, the objective of this paper is to explore the nature of human capital information that is desired by financial analysts and fund managers and then to examine the extent to which this is met by disclosures in annual reports. Within this broad objective, we seek to answer the following specific research questions: firstly, what is the nature of human capital information that is desired by the investment community?; secondly, what information about human capital is disclosed by companies, what form does it take and what aspects does it focus on?; and thirdly, is there a disparity in human capital information desired by the investment community and what is actually disclosed by companies and if so, what are the possible explanations for it? The research context of this study is Malaysia, a developing country with strong emphasis on the nurturing of a knowledge economy.² Findings from this study may reflect the nature of the demand and supply of human capital information in other developing countries that share similar characteristics.
The remainder of the paper is organised as follows: The next section reviews the human capital disclosure literature including its origins in human resource accounting, the results of relevant empirical prior studies, and theories of accounting disclosure. Section Three presents some features of the business environment in developing countries and considers Malaysia as a particular example. Section Four provides details of the research method, followed by a section dealing with the interview findings and the results of the content analysis. The last section discusses the findings and limitations of the study.

2. Literature review

The development of human resource accounting, intellectual capital and human capital

In the 1960s and 1970s, many attempts were made to measure the value of people to their employers and to account for human resources; for instance, in 1964 Hermansson published pioneering work concerning valuation of human assets, and in 1968 Brummet et al. first used the term ‘human resource accounting’ (HRA). The American Accounting Association defined HRA as “… the process of identifying and measuring data about human resources and communicating this information to interested parties” (AAA, 1973; 169), indicating the value-relevance of such information to both internal and external users of accounting information (Flamholtz, 1985). However, it did not receive widespread acceptance, and by the end of 1970s, the interest in HRA declined as many conceptual problems and practical difficulties were yet to be overcome. There was also a lack of consensus on how human assets should be measured or valued. Pertinent to the thrust of this paper, Roslender and Dyson (1992) proposed a related concept, ‘human worth accounting’. Central to the
idea of human worth accounting is “the idea that businesses will be keen to retain the
services of those employees who are able to add significant value to the enterprise”
(Roslender and Fincham 2001, 389). Roslender and Dyson (1992) concluded that, in
the UK, HRA had failed to develop as a practical application. In Swedish companies,
Lundberg and Wiklund (1994) found human resource costing and accounting being
used by 70% of the personnel managers, and Grojer and Johanson (1998) documented
its use for management control. However, there was little progress on these matters in
the other parts of the world until the 1990s (see for example, Turner, 1996) when it
became recognised as a central component of what became known as intellectual
capital. For a greater discussion of attempts to account for the human factor prior to
the emergence of the intellectual capital concept, see Roslender et al. (2007).

In a review of the current state of financial and external reporting research,
Parker (2007) identified intellectual capital accounting as a major area for further
work. Definitions of intellectual capital (IC) vary and are inevitably broad. According
to CIMA (2001), IC is the possession of knowledge and experience, professional
knowledge and skill, good relationships, and technological capacities, which when
applied will give organisations competitive advantage. Prominent IC frameworks
tend to categorise IC into three parts (customer capital, structural capital and human
capital) with human capital being a principal component (e.g. Edvinsson and Malone,
out that IC statements are complex forms of reporting which combine numbers,
narration and visualization to produce a story line of how value is created using data
on resources, activities and effects. As argued by Roos et al. (1998), through their
competence, attitudes and intellectual agility, employees generate and encapsulate IC.
Hudson (1993) defines human capital as a combination of genetic inheritance,
education, experience and attitudes about life and business while Brooking (1996) identified the following as the elements of human capital: know-how, education, vocational qualification, work-related knowledge, occupational assessments, psychometric assessments, work-related competences, models and frameworks and cultural diversity.

It has been recognized that human capital is not only individualistic but that some skills and knowledge are formed in an organizational context and embodied only in a team of employees (Nonaka and Takeuchi, 1995; Chillemi and Gui, 2001). Two kinds of human capital can be discerned in any organization – generic and firm-specific human capital. The former refers to an explicit form of knowledge, developed outside the firm and paid for by individuals, and is highly transferable (mobile). Swart (2006) found that the most frequently used measures for generic human capital include: level of formal education, years of work experience and level and number of years of managerial experience. Firm-specific human capital refers to the knowledge and skills unique to a firm that cannot be easily transferred to other companies. The cost of its development is incurred by the firm as part of a strategy to retain key knowledge workers by setting mobility barriers (Swart et al., 2003). Measures for firm-specific human capital include: length of firms’ experience, number of unique projects, team-based solutions, and unique operating procedures (Swart, 2006). Besides nurturing the generic human capital, firms must also pay attention to firm-specific human capital to gain competitive advantage and to recruit and retain core value creators. Since relevant human capital information is an important ingredient in decision makers’ assessment of the future potential of companies, it is in the interest of companies to supply more of such information to increase their market value.
As mentioned earlier, a trained and motivated workforce is one of the most valuable intangible assets to companies. However, the criteria of IAS 38 *Intangible Assets* restrict the recognition of human capital as an intangible asset because companies do not have control over the market for managers and other employees as well as the future economic benefits expected to flow from them.\(^4\) The difficulties in recognising and measuring human capital in the financial statements have led companies to disclose data elsewhere in their annual reports or other media. The communication of human capital information to outside parties is mostly voluntary rather than mandatory.

*Previous studies of human capital*

Most previous studies have concentrated in exploring the extent of the supply of human capital information especially in companies’ annual reports. Olsson (2001) examined the annual reports of the 18 largest Swedish companies based on five elements, namely, education and development, equality of employment, recruitment, selection of employees, and CEO’s comments about personnel. It was found that none of the companies devoted more than 7% of their reporting space to human capital information. The information reported was found to be highly deficient in terms of quality and extensiveness. Her conclusion was that in the real world, there is an observable absence of transparency in human capital reporting.

A number of content analysis studies in the broader IC field have been conducted in Australia (Guthrie et al., 1999; Cuganesan, 2006), Sweden (Beaulieu et al., 2002), Canada (Bontis, 2003), New Zealand (Wong and Gardner, 2005), Spain (Oliveras et al., 2004), and the UK (Williams, 2001; Li et al., 2008). Studies conducted in developing countries include April et al. (2003) in South Africa,
Abeysekera and Guthrie (2004) and Abeysekera (2007) in Sri Lanka, and Goh and Lim (2004) in Malaysia, while studies in emerging economies include Qu and Leung (2006) in China, and Murthy and Abeysekera (2007) in India. Taken as a whole, they reveal the absence of a consistent framework for IC reporting and considerable variation in the extent of disclosure. Furthermore, disclosure has been mainly in narrative form without placing numerical or monetary value on IC. The lack of quantitative IC reporting may be due to there being no single agreed way to measure the information and that only a few people in companies have enough knowledge to quantify such data (Abeysekera, 2004, Goh and Lim, 2004). While there has been some increase in the extent of human capital disclosure (see for example Oliveras et al., 2004; Vandemaele et al., 2005; Williams, 2001; Abeysekera and Guthrie; 2005), the level and nature of disclosure is still limited.

We are not aware of prior studies in developing countries that have specifically focused on demand from finance-industry users for human capital information. There has however been considerable research on the information, including broader IC ‘data’, that is sought by the investment community in developed markets (Beattie, 1999; Vance, 2001; MORI, 2006; Campbell and Slack, 2008). Interview based studies by Holland and Doran (1998) and Holland (1998, 2003, 2005, 2006), concentrated on ‘private’ meetings at which analysts seek information about managers. The study by Holland and Doran (1998) revealed that personality characteristics of key managers as well as ‘quality of management’ were identified as “the most important ingredients in expected corporate financial performance” (p.141). Similarly, Holland (2003) found “fund managers … have learned how intangibles such as the qualities of certain key executives, and changes in top management, have affected stock prices” (p.42). In an earlier study, Holland (1998) found that most fund
managers in the UK contact companies privately to seek information on management quality and succession plans. In short, studies on the demand side in developed markets revealed that human capital information is indeed important in valuing companies’ performance and often users need to seek for such information privately.

**Corporate reporting theories**

One of the objectives of financial reporting is to provide relevant information to users to aid their decision making. Since it is costly to satisfy the demand for information of all stakeholders, companies tend to fulfil the needs of their primary stakeholders especially the investment community. However, much of the accounting information produced by the traditional historical cost accounting system has limited use for making investment decisions. Accordingly, to enhance the decision usefulness of corporate reporting, companies are increasingly supplementing mandatory financial reports with voluntary disclosures about intellectual capital, including human capital (Holland 2003). Theories explaining the decision by companies to voluntarily disclose supplementary human capital information include decision usefulness, agency, stakeholder, legitimacy, resource-based and resource dependence.

Decision usefulness theory, as theorised by Bebbington et al. (2001), explains that in order to provide useful information, companies need to identify and fulfil the demand from various stakeholders for information that will help them in assessing management efficiency and the future value of the companies. However, to avoid information overload and loss of competitive advantage, companies tend to only supply information that is perceived to be ‘useful’.

Agency theory explains how information asymmetry between principals and agent may impair the efficient allocation of capital (Diamond and Verrecchia, 1991), leading to higher costs of capital (Botosan and Plumlee, 2002). Tayles et al. (2007) in
their research find that, amongst Malaysian companies, greater information asymmetry between investors and the management in high IC companies means that there is increased scope for surprise, resulting in stock market volatility and stock price over-reaction. When information is asymmetric, investors lacking inside information such as details concerning human capital are in a disadvantaged position when judging the quality of companies. Often, principals engage intermediaries such as financial analysts and rating agencies to seek private information to uncover managers’ superior information (Healy and Palepu, 2001). The privileged position of analysts, via private meetings with company management, permits some degree of access to additional information not available to ordinary shareholders.\footnote{Stakeholder theory suggests that all stakeholders have a right to be provided with information on how organisational activities impacted them, even if they choose not to use it (Deegan, 2000). Organisations will elect to voluntarily disclose information about their human resource, over and above mandatory requirements, in order to meet real or perceived stakeholder expectations (Guthrie et al., 2006). The various groups deemed to have an interest in controlling certain aspects of an organisation can be efficiently communicated with via the annual report (Guthrie et al., 2004).}

Legitimacy theory, closely linked to stakeholder theory, views society as having implicit and explicit expectations on how organisations should conduct their operations. Hence, companies will voluntarily report on human, environmental and other social activities and responsibilities as part of their legitimating process. According to Guthrie et al. (2004), companies are more likely to report on their human capital if they specifically have a need to do this, because they can’t legitimise
their status via the hard assets that are traditionally recognised as symbolising corporate success.

Resource dependence and resource-based theories provide explanations on how firms can create value by managing their resources, including human capital, strategically. The former has an external focus while the latter has an internal focus. Resource dependence theory, originally formulated by Pfeffer and Salancik (1978), suggests that when companies lack essential resources, they will seek to establish relationships with parties upon whom they depend. Three factors deemed critical in determining dependence and power are the importance of the resource to the organisation, the alternative sources available for the resource the organisation is dependent upon, and the degree of unfettered discretion in the deployment of the resources (Medcof, 2001). For companies that are particularly dependent on employees, financiers and others for survival and growth, there is strong incentive to disclose human capital information as it will not only increase the opportunity to attract and retain human resources but also to get the necessary contacts, networking, and official sanction via important figures in society. Abhayawansa and Abeysekera (2008) link human capital to the resource based theory of the firm and the pioneering work of Penrose (1959). According to the theory, human capital resources within a firm that are valuable, unique and difficult to imitate will provide firms with competitive advantage (Barney, 1991). Hence, firms should disclose information on human capital such as experience, qualifications, training, and leadership since these help firms to create value in the capital market.

This review of the relevant literature has indicated that there are ongoing issues relating to inadequate disclosure about human capital to companies’ stakeholders. Furthermore, these issues have largely been addressed from a
normative supply-side perspective with little insight on possible reasons for disclosure of human capital information by companies in developing countries. Hence, we attempt to narrow the literature gap by assessing the demand-side. Specifically, we investigate whether the human capital information that is currently disclosed meets the needs of the investment community, whether mechanistic disclosure of readily quantifiable details places disproportionate emphasis on metrics at the expense of ‘softer’ human capital drivers of corporate performance, and how any tendency by emerging economies to focus disclosure on particular components of human capital may be explained.

3. The Business Context of Developing Countries

The envelope term ‘developing countries’ refers to those countries that lack strong industrialization, infrastructure, and sophisticated technology, but are beginning to build these capabilities (TEFO.com, 2009). All of the countries of Africa (except South Africa), Asia (except Hong Kong, Singapore, South Korea, and Taiwan), and Oceania (except Australia, Japan, and New Zealand), Latin America, and the Middle East are generally considered developing countries, as are a few European countries (Cyprus, Malta, Turkey, Poland, and Hungary, for example) (AGOA.infp, 2009). Despite their geographic dispersion and different levels of economic development, there is a wide perception from the perspective of potential investors that such countries display a number of shared characteristics: potential for rapid economic growth; relatively high volatility; less systematically enforceable contracts; less ‘efficient’ capital markets; greater ‘power distance’ with acceptance of status and inequality in society.
In many developing countries, the discretionary influence of government is often greater than in less dynamic countries and there is also greater imperative to retain and signal the support of locally significant individuals and institutions. For instance, Maidment and Mackerras (1998) described the Asia-Pacific region as an area where power tends to be concentrated within certain groups thereby maintaining a traditional order of patron-client networks.

Another feature of developing countries is that they tend to be net investee, rather than investor, countries. Accordingly, the research focus of a corporate disclosure study might be expected to concentrate on the supply of corporate information rather than on the demand for it. However, despite operating in developing country markets, the financial industries in Hong Kong, Singapore and Kuala Lumpur act as important intermediaries between the ‘ultimate’ investors (mostly in Japan, Europe, the Middle East and the USA) and investee companies in their own jurisdictions and in China and other East-Asian countries.⁶

Cultural, or societal values in developing countries inevitably influence accounting and reporting practices. Gray (1988), based on Hofstede’s (1980) societal dimensions, proposed that in high power distance, high uncertainty avoidance, less individualistic and more masculine societies, disclosure is often minimal as such societies tend to be secretive. As regards secrecy specifically, empirical studies by Hofstede (1980; 1991), Gray and Vint (1995), Salter and Niswander (1995), Gray (1996) and Zarzeski (1996) have all found tendencies in oriental countries, in particular, to be less transparent.⁷ If this is indeed the case, it is important for international investors to pay attention to societal values in understanding the nature and extent of disclosure including human capital information and the particular need to privately seek certain types of information to aid in decision making.
Another important consideration in understanding the business landscape in developing countries is ownership structure and its implications on strategic management. In such countries with less developed capital markets, businesses tend to be concentrated in a few hands or are family-owned. In view of this, companies tend not to disclose much information to avoid losing competitive advantage. However, there may be an imperative for companies to disclose certain human capital information as part of their legitimising strategy, to avoid being ridiculed by users, or possibly due to dependence on resources controlled by powerful groups in society.

We explore these issues in the context of Malaysia, a developing country that shares many of the above characteristics. We do this by conducting interviews with financial analysts to identify the nature of human capital information that they deem to be important and then comparing it against a content analysis of companies’ disclosure on human capital in the annual reports. Finally, we consider possible reasons for any information gap in the context of Malaysia and whether these may also apply in other developing countries.

4. Research methods
Two methods were employed in gathering the data for this study. First, face-to-face interviews with financial analysts and fund managers (users of information), and, secondly, content analysis of annual reports (suppliers of information). We restrict our content analysis to annual reports since in most developing countries annual reports are the only mandatory routine communication with all stakeholders.8
4.1 Interviews

Interviews were conducted with 15 financial analysts and fund managers. The subjects were obtained through contacts and by writing to prominent financial firms; there was no attempt to target specific industry specialism. The fundamental assumption of this paper is that the main purpose of external reporting of accounting and other data is to provide value-relevant information to the users. More specifically, financial analysts and fund managers need information (including human capital information) to assist them in their task of evaluating shares and preparing recommendation reports. Table 1 provides relevant details about our interviewees, their roles and specialism. In order to induce greater freedom of expression, interviewees were assured anonymity and are simply identified by the letters A to O.
Table 1. Information about interviewees and the human capital information they emphasized in the interview.

<table>
<thead>
<tr>
<th>Person</th>
<th>Position</th>
<th>Services</th>
<th>Sectoral specialism</th>
<th>Do they visit companies?</th>
<th>Aspect of HC information particularly emphasized</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Investment Manager</td>
<td>Buy-side Invests funds</td>
<td>Not industry specific</td>
<td>Yes</td>
<td>Movement of key people</td>
</tr>
<tr>
<td>B</td>
<td>Vice President</td>
<td>Sell-side Advises clients</td>
<td>Not industry specific</td>
<td>Yes</td>
<td>Expertise, management strength Capability of people</td>
</tr>
<tr>
<td>C</td>
<td>Analyst</td>
<td>Sell-side Advises clients</td>
<td>Banking</td>
<td>Yes</td>
<td>HR incentive scheme Employee satisfaction and remuneration</td>
</tr>
<tr>
<td>D</td>
<td>Vice President</td>
<td>Sell-side Supports research department</td>
<td>Everything except Banks and Financials</td>
<td>Yes</td>
<td>Employee recruitment, training, competence, expertise and motivation; Who leaves a company.</td>
</tr>
<tr>
<td>E</td>
<td>Fund Manager</td>
<td>Buy-side Invests funds</td>
<td>Not industry specific</td>
<td>Sometimes</td>
<td>Management philosophy Management expertise</td>
</tr>
<tr>
<td>F</td>
<td>Research Manager</td>
<td>Sell-side Supports brokers</td>
<td>Tele-communication</td>
<td>Yes</td>
<td>Management quality</td>
</tr>
<tr>
<td>G</td>
<td>Analyst</td>
<td>Sell-side Supports dealers</td>
<td>Banking Insurance Gaming</td>
<td>Yes</td>
<td>Key employees Quality of managers Employee remuneration and satisfaction</td>
</tr>
<tr>
<td>H</td>
<td>Analyst</td>
<td>Sell-side Supports dealers</td>
<td>Tele-communication Media Technology</td>
<td>Yes</td>
<td>Expertise Key employees and their contracts Employee remuneration and turnover</td>
</tr>
<tr>
<td>I</td>
<td>Fund Manager</td>
<td>Buy-side Invests funds</td>
<td>Not industry specific</td>
<td>Yes</td>
<td>Employee turnover Management quality and ability to carry out plans</td>
</tr>
<tr>
<td>J</td>
<td>Analyst</td>
<td>Sell-side Advises clients</td>
<td>Not industry specific</td>
<td>No</td>
<td>Nothing in particular</td>
</tr>
<tr>
<td>K</td>
<td>Research Manager</td>
<td>Sell-side Supports dealers</td>
<td>Oil &amp; gas Technology Media</td>
<td>Yes</td>
<td>Is management “genuine”? Managers’ technical skill.</td>
</tr>
<tr>
<td>L</td>
<td>Vice President Research &amp; Technology Analysis</td>
<td>Buy-side Invests funds</td>
<td>Not industry specific</td>
<td>Yes</td>
<td>Employee loyalty Management philosophy and quality.</td>
</tr>
<tr>
<td>M</td>
<td>Fund Manager</td>
<td>Buy-side Invests funds</td>
<td>Not industry specific</td>
<td>Sometimes</td>
<td>Management</td>
</tr>
<tr>
<td>N</td>
<td>Investment Manager</td>
<td>Buy-side Invests funds</td>
<td>Not industry specific</td>
<td>Yes</td>
<td>Nothing in particular</td>
</tr>
<tr>
<td>O</td>
<td>Analyst</td>
<td>Sell-side Advises clients</td>
<td>Not industry specific</td>
<td>Yes</td>
<td>Human capabilities</td>
</tr>
</tbody>
</table>
In order to guard against influencing the interviewees, the interviews were only loosely structured; we did not commence with direct enquiries about human intellectual capital information specifically, but asked more broadly about how they evaluate companies, their use of externally available information such as that in company annual reports, and the factors that they rely upon when making investment recommendations to clients. Our discussion prompts sought in an indirect way to identify and explore the intellectual capital measures, indicators or information that fund managers and financial analysts look for, or desire, when reviewing companies. Interviews were taped and later transcribed. As might be expected, their responses were broad ranging but for the purposes of this paper, we restrict ourselves to their comments on human capital. For those interviewees who volunteered particular emphases on aspects of human capital, this is shown in the final column of Table 1.

4.2 Content analysis of annual reports

A content analysis on the disclosure of human capital information in the annual reports of 100 representative companies9 listed on the main board of Bursa Malaysia for the years ended between June 2004 and June 2005 was carried out. Table 2 displays the number of companies from the respective sectors which were selected for the purpose of content analysis.

Table 2: Sectoral breakdown of companies and sample selected for content analysis

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total number of listed companies</th>
<th>Sample selected</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial products</td>
<td>152</td>
<td>29</td>
</tr>
<tr>
<td>Consumer products</td>
<td>73</td>
<td>14</td>
</tr>
<tr>
<td>Trading and services</td>
<td>129</td>
<td>25</td>
</tr>
<tr>
<td>Technology</td>
<td>16</td>
<td>3</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>Construction</td>
<td>43</td>
<td>8</td>
</tr>
<tr>
<td>Property</td>
<td>99</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>520</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
Each annual report was downloaded in PDF form from the Bursa Malaysia website. The focus of the content analysis was on the non-mandatory reports and statements in the annual reports. A checklist was developed from the literature to identify human capital information that might be disclosed in annual reports. Guthrie and Petty’s (2000) framework of human capital was used as a starting point. Additional items of human capital were subsequently added from other IC studies such as Oliveras et al. (2004), Firer and Williams (2003), Bontis et al. (2000), Van Burren (1999), Lim and Dallimore (2004), Liebowitz and Suen (2000) and Claessen (2005). The resultant list of 29 human capital disclosure items shown in Table 3 can thus be considered to be authoritative.

Key words were first searched using Adobe Reader 7.0. Where a word was found, the sentence was read carefully to check whether it was relevant and whether any further explanation or description was given. Employing this approach, each item or element of human capital information was then coded. A detailed seven type coding system adapted from Guthrie et al. (2004) was employed in conducting the content analysis. Since the focus of our study is not on the supply side, our content analysis is not as detailed as narrower disclosure studies utilising disclosure indices, wordcount etc.

5. Empirical results

5.1 Interviews

It is apparent from Table 1 that various aspects of human capital are important to financial analysts and fund managers when they review companies. For instance, D places great emphasis on the competence, expertise and motivation of the employees; he also regards levels of employee training as relevant. But information regarding
these matters is generally not available in the annual report. That is why “I attend a lot of investors’ seminars, company visits. We talk to the companies and ask questions ... I try to find out whether there is a convincing story and whether they have human capital to execute their plans” (D). Likewise G told us that “Private meeting is important because you tend to get a little bit more information than if you just rely on public information” and K maintained that “This is where you get a chance to check up, clear all doubts and you can really test the management whether it is genuine or not.” Similarly, B visits companies to “discuss the prospects and financial data with the management.” F told us that “when you meet with the management, you get a feel whether the person is very well informed about the operations of the company ... this sort of information is usually available in conversations but seldom found on paper.” According to H, private meetings give “a feel of how the management is handling the company.” As a specialist in the technology sector he considers human resources to be critical:

You have a lot of engineers contributing to the success of the companies, this is where you get the intellectual property eventually. They are the people who come out with the programmes, codes, softwares. Mostly what we look at is whether or not the employee has a contract with the company. It is important to be able to see whether or not he is sticking with the company for a long time or not.

Interviewee I stated that:

Sometimes, if you want to know more about the company, you have to actually go to see the management to get hands on information. ... You have to go and talk to the management to get hands on feel on what they are doing, whether it is viable or not, whether the company has the
potential to go forward. ... Even if you have good people, but bad management, it is useless.

As regards the importance of managerial talent, Interviewee A’s perspective was that:

When someone leaves a company, we need to work out the impact of this on the company. In servicing firms, they work in teams, if this team leaves, they bring the whole team out so there is a vacuum and the clients will also follow this team. So it is important especially in service industry. That’s why we look at the key people of the company and if there is any movement for these key people, we want to know and we want to know why.

G believes that “at the end of the day it is the management that is driving the company forward; it is important to look at what they have installed for the management.” And E echoes this by saying:

Management is very important; make sure they have enough people with expertise in the business. Management must be credible and must be transparent. You must understand the human capital side of management in any company because if human capital has no credibility, company will just go down the drain.

Finally, I told us that “When we review, we look at management most of the time.”

Turning to issues related to staff more broadly defined, G said that she investigates how well the employees are compensated and rewarded, because it is important to attract and retain the necessary talents. C, who concentrates on banks, also looks at how employees are compensated. H too looks for data on employee
turnover and key employees – especially in the technology companies where he maintains their replacement can be more problematic. K evaluates how well companies manage their human resources. In addition, he also looks at the ratio between technical and non-technical personnel. According to him, “over the years we see how the ratio changes. We also look at human to machine ratio and evaluate on the company’s dependence level on labour.” In addition to the quality of management, L looks at employees’ loyalty and what makes them stay on.

From these extracts several clear themes emerge – (i) the importance of knowledge about human capital especially human capabilities, leadership skills, firm dependence on resources, reward and turnover; (ii) the dissatisfaction with the information related to human capital disclosed in the annual report; (iii) the value that analysts attribute to their privileged private meetings, and (iv) perhaps of most relevance, that it is to meet and evaluate the managers that they go to companies. Clearly, some of the directors, such as the CEO and other executive directors, are also managers, but it is notable that not a single interviewee expressed any desire to meet ‘the directors.’ This could be because, in Malaysia, the word ‘directors’ is often used to refer principally to non-executives who are seen as having little input to the creation of value for the company. Instead, interviewees expressed the importance in getting to know the top management; those who set strategies, manage resources and create corporate value. In the analysis which follows, the nature of human capital information that companies choose to make available in their annual reports will be presented.

5.2 Human capital disclosure in annual reports

Table 3 presents the frequency of companies’ disclosure of each of the human capital items in their annual reports and an analysis of the nature of such disclosure. Of the
29 human capital items considered, 27 items were disclosed by one or more companies but only six items were disclosed in more than discursive form.\textsuperscript{10} Two items identified from the literature, viz. \textit{dependence on key employees} and \textit{post-training evaluation exercises}, were not explicitly referred to in any annual report. The fact that not a single company made any reference to \textit{dependence on key employees} was a striking finding as it contrasts markedly with what might have been expected from the interviews with annual report users. \textit{Employee turnover} and \textit{IT literacy} items were disclosed by only one company. This generally low level of human capital disclosure confirms the findings of Oliveras et al (2004) and Guthrie et al (2006).
<table>
<thead>
<tr>
<th>Human Capital Information</th>
<th>% of Cos.</th>
<th>Discursive only</th>
<th>Numerical only</th>
<th>Financial only</th>
<th>Discursive &amp; Numerical</th>
<th>Discursive &amp; Financial</th>
<th>Numerical &amp; Financial</th>
<th>All 3 forms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directors’ years of experience in business</td>
<td>100</td>
<td>3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>97</td>
</tr>
<tr>
<td>Directors’ qualifications</td>
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<td>100</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Directors’ skills</td>
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<td>85</td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Directors’ training programme</td>
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<td>80</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Directors’ education</td>
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<td>76</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Directors’ knowledge</td>
<td>65</td>
<td>65</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Directors’ expertise</td>
<td>57</td>
<td>57</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Directors’ competence</td>
<td>51</td>
<td>51</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Employee training programmes</td>
<td>42</td>
<td>35</td>
<td>2</td>
<td>4</td>
<td>1</td>
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<td></td>
<td></td>
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<tr>
<td>Succession plan</td>
<td>34</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Employees’ skills</td>
<td>23</td>
<td>23</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Work safety and health</td>
<td>23</td>
<td>23</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees’ competence</td>
<td>21</td>
<td>21</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees’ innovation/entrepreneurial spirit</td>
<td>18</td>
<td>18</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Employees’ expertise</td>
<td>15</td>
<td>13</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Leadership qualities of employees</td>
<td>14</td>
<td>14</td>
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<td></td>
<td></td>
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<td>Employees’ knowledge</td>
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<td></td>
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<tr>
<td>Recruitment policy</td>
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<td>12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Leadership qualities of directors</td>
<td>12</td>
<td>12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Employee loyalty</td>
<td>12</td>
<td>12</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td>Employee incentive scheme</td>
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<td>9</td>
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<td></td>
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<tr>
<td>Employees’ motivation</td>
<td>6</td>
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<td></td>
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<tr>
<td>Employees’ education</td>
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<td>5</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Employees’ profitability</td>
<td>2</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1</td>
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<tr>
<td>Employee satisfaction</td>
<td>2</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td>1</td>
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<tr>
<td>Employee turnover</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees’ IT literacy</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Post-training evaluation exercises</td>
<td>0</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Dependence on key employees</td>
<td>0</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

1 The list includes some items which while not directly required by law are, for listed companies, influenced by ‘best practices in corporate governance’.
In broad terms, Table 3 shows two groups of human capital information, namely that which relates to the board of directors and that which relates to managers and other employees. The top eight items disclosed are all related to board of directors: their experience (100%), qualifications (100%), skills (85%), training programmes (80%), education (76%), knowledge (65%), expertise (57%) and competence (51%). This dichotomy points to a central finding of this paper i.e. Malaysian companies disclose markedly more information about directors rather than about other employees, managerial or junior.

Looking at the employee-related information, the most frequently disclosed item was \textit{employee training programmes} (42%), 7% disclosing some financial or quantified detail.\textsuperscript{11} Information about \textit{succession plans} was disclosed by only 34% of companies. Much of this was director-related through brief comment in the internal control statement or corporate governance statement. Companies disclosing this information in other statements, such as the operation review and human resource development statement, tend to give more detailed information. For instance, Aluminium Company of Malaysia Berhad stated in its review of operations:

\begin{quote}
... a more structured approach was adopted towards successsion plan and career development. This was felt to be an important step especially in light of an increasing number of employees attaining retirement age. In the planning process we have, besides identifying the best internal candidates for each position, developed action plans for potential successors recognising current competencies and drawing up customised development plans through a structured talent-development process to yield a greater return on investment (Aluminium Company of Malaysia Berhad, Annual Report, 2004: 33).
\end{quote}
Two companies incorporated some non-financial numerical information related to employees’ expertise into the discursive content - in both cases it was simply a number of years. Tractors Malaysia states that its Heavy Equipment Division has been putting its ‘expertise in nation-building projects throughout Malaysia for more than 75 years’ (Tractors Malaysia, Annual Report, 2005: 42) while Habib Corporation states that,

Leveraging on its 46 years of experience and expertise complemented by a team of highly creative and inspired designers and the support of strategic alliances, the Group has effectively maintained its distinctive identity as a home grown jeweller of international standing (Habib Corporation Berhad, Annual Report, 2004: 3).

Turning to recruitment policy, the only disclosure was qualitative discussion by 12 companies of their recruitment programmes. For instance, Sindora Berhad mentioned that ‘Human resource recruitment and development programs … not only emphasise on developing and upgrading professionalism but also seek out to motivate and energise, to hone specific skills and talents …’ (Sindora Berhad, Annual Report, 2004: 52).

Two companies, Grand United Holdings Berhad and Malaysian Airlines System Berhad (MAS) disclosed employee profitability in their annual reports. Ranhill Utilities included non-financial numerical information in its discussion on employee satisfaction. It had embarked on a ‘Six Sigma project’ and, in assessing the perceptions of employees about the working environment, reported in the Corporate Social Responsibilities report that ‘the overall satisfaction of Ranhill Utilities’
organisational climate is 83%. The satisfaction level for eight dimensions was assessed’ (Ranhill Utilities, Annual Report, 2004: 48).

To summarise, only five issues concerning information related to employees and managers (excluding directors) were referred to by more than 20% of the companies: employee training programmes (42%); succession plans (34%); employees’ skills and work safety and health (both 23%); and employee competence (21%). There was evidence of ‘warm words’ about employees in some reports. For instance Tractors Malaysia’s mission statement (Annual Report, 2005, Cover Page) proclaims that employees are their most important asset and encourages them to realize their full potential in a caring environment which promotes participative team involvement and continuous improvement. Likewise, United Engineering had the following comment:

The group takes every effort to identify, develop and retain our human capital and create a more conducive environment for the intellectual assets to grow by putting in the right infrastructure and to ensure the right framework is in place. The group believes that an organisation’s success in business is based on the effectiveness of its people and that strategic investments in human capital will add value to any organisation in the long run (United Engineering Berhad, Annual Report, 2004: 36).

But this sort of general, unsubstantiated and unquantified blandishment, rather than information on key decision makers, is unlikely to be helpful to those who use the annual report to make decisions about the value of a company. Taken as a whole, the content analysis evidence supports the view expressed by Olsson (2001) that human capital information in annual reports is deficient in both quality and extent. Since
intangible resources including human resources are vital for future growth, companies would do well to voluntarily disclose more information on this aspect.

5.3 Comparative analysis of users’ desired information and actual disclosure

One of the areas about which analysts and fund managers most desired information is employee turnover - especially the movement of, and dependence on, key people. Interviewee A stressed the importance of monitoring the movement of key people, particularly where they were components of teams in the companies under review. But as shown in Table 3 (bottom row), dependence on key employees is not disclosed by any company in the annual reports.

Interviewees C, H and I stated that they look for employee turnover information. According to H, key employees in the technology companies are more difficult to replace. Interviewee D also commented that it is important to know who the people are and why they leave a company. In the annual report survey, however, only one company (in the infrastructure sector) out of 100 disclosed information regarding employee turnover; no turnover rate is given but merely a mention that it has a low level of staff turnover.

Other desired information concerns compensation and employees’ satisfaction. We were told by interviewees C, G and H that employee remuneration and reward systems are relevant when reviewing companies. However, only 9% of companies disclosed such information, mainly in discursive form; an example is Sindora Berhad which states that it promotes the well-being of its entire staff through competitive remunerative packages and fringe benefits (Sindora Berhad, Annual Report, 2004: 4). In the users’ view, employees’ satisfaction is usually related to the remuneration scheme. When the company pays its staff well, there is strong incentive
for them to stay on. In other words, if they are satisfied with the company’s compensation scheme they tend to stay on.

As mentioned by interviewee C, “Staff satisfaction indicates whether people are happy with the company and this is partly related with how the staff is remunerated. I look into this stuff.” However, employee satisfaction is sparsely reported in the 100 annual reports reviewed; only 2% of companies disclosed information on this dimension. Most interviewees try to get this information themselves by exchanging views with others or by asking their contacts.

Closely related to employee satisfaction is employee loyalty. Interviewee L, for instance, looks at employee loyalty and what makes them stay on in a company. However, only 12% of companies disclosed this information - and in descriptive form only. In the annual reports most companies only blandly acknowledged their appreciation of their employees’ loyalty.

According to Nielsen et al. (2006), employee training and employees’ education are features considered by analysts when the future growth potential of an organisation is estimated. In our research, some of the fund managers and financial analysts do seek information related to employee training. Interviewee D sees employees’ training detail as relevant to his task but he said such information is not in the companies’ annual reports. In our survey of annual reports, 42% of the companies disclosed information on employee training and some companies included non-financial numerical and financial figures, but there was very little detail provided. Only 5% provided details on levels of employees’ education.

Recruitment policy is deemed important by interviewee D, but information related to this is lacking in Malaysian companies though he would like to get it. This
was confirmed by the survey; only 12% of companies disclosed this information (discursively) in their annual reports.

Table 4 summarises our comparative analysis of human capital information desired by users against what is actually disclosed by companies in their annual reports.

**Table 4 Comparison of frequency of disclosure of ‘content analysis items’ against how often this information was desired by users**

<table>
<thead>
<tr>
<th>HC ‘disclosure items’ that were expressly desired by financial analysts</th>
<th>No. of companies disclosing this HC information in their annual reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Movement of and dependence on key people</td>
<td>0%</td>
</tr>
<tr>
<td>Employee turnover</td>
<td>1%</td>
</tr>
<tr>
<td>Employees’ compensation</td>
<td>9%</td>
</tr>
<tr>
<td>Employees’ satisfaction</td>
<td>2%</td>
</tr>
<tr>
<td>Employees’ loyalty</td>
<td>12%</td>
</tr>
<tr>
<td>Employee’s training &amp; education</td>
<td>42%</td>
</tr>
<tr>
<td>Employees’ recruitment policy</td>
<td>12%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>HC ‘items’ widely disclosed in annual reports but not referred to at all by users</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directors’ years of experience</td>
</tr>
<tr>
<td>Directors’ qualifications</td>
</tr>
<tr>
<td>Directors’ skills</td>
</tr>
<tr>
<td>Directors’ training programme</td>
</tr>
<tr>
<td>Directors’ education</td>
</tr>
<tr>
<td>Directors’ knowledge</td>
</tr>
<tr>
<td>Directors’ expertise</td>
</tr>
<tr>
<td>Directors’ competence</td>
</tr>
</tbody>
</table>

Turning our attention to information specifically about senior personnel, we find that all of the annual reports provide data on the directors especially concerning their qualifications and years of experience and the skill, training programmes, education, knowledge and competence of directors are addressed in most of the annual reports. This information, according to interviewee D is generally not significant. He argued that the real decision maker is usually not highlighted, but that
disclosed information is centered on the nominees or non-executive directors who may have little, if any, impact on the way the company is run.

"in Malaysia you show all these nominees and whatever, you have this Puan (Mrs) or Encik (Mr) whatever, 45 years old, chartered accountant for 20 years, public services, blah, blah, blah - basically a person i.e. his name and picture there, but he has no impact on the management, attending perhaps the board meetings six or eight times, but doing nothing there. The real decision maker, he will be on page 14. You can see his face among 15 people standing, he looks younger too. Normally when you meet the company, you will meet that guy, that young guy, or if he likes you, you will meet the CEO. All these other faces you see in the annual report, these are what I crudely will say - these are rancid. But the analysts and investment community are saying that they have nil value."

In addition, interviewee E stated that “Management is very important; make sure they have enough people with expertise in the business.” The expertise of the key employees and managers is seldom discussed in the annual reports.

As noted earlier, information on quality of management is similarly important to users in other countries. The MORI (2006) global survey of financial analysts’ opinions singled out the quality of management as the most crucial factor in an analyst’s rating - above market position, strategy, past performance and corporate governance. Likewise, Vance (2001) surveyed fund managers and analysts and stated that:

Management quality and strategy came up repeatedly. This tended not to be regarded explicitly as an asset, but of central importance to the whole
Dissatisfaction with disclosure about the quality of management is not unique to Malaysian users. Beattie (1999) came to the same conclusion in the UK. In order to gain the trust of analysts, companies need to publicise the experience and expertise of their senior managers and, generally, more disclosure of information on management in the annual reports is desired.

6. Discussion

Our research confirms that there is indeed a strong demand for human capital information and that a disparity exists between what is desired by fund managers and financial analysts and what is voluntarily disclosed by companies in their annual reports. Users suggest that this information ‘comes into play’ when subjective premiums or discounts are taken into account in arriving at their final decisions. In addition to an unsatisfied general demand for human capital information by fund managers and financial analysts, specific matters that are particularly useful aids to their investment decisions and recommendations are typically not dealt with in the annual reports, necessitating private search for such information.

The key issue that emerges is that analysts are centrally interested in information about the qualities of fully-employed managers. The activities and decisions of these personnel can give firms competitive advantage and create value. This is, as things presently stand, ‘hidden’ value and analysts need to incur extra cost to seek private information on the individuals who are ‘value creators’ in the companies. Our content analysis of annual reports shows that when Malaysian
companies do disclose information about human capital, it is mostly related to the board of directors who are not necessarily the value creators.

What might explain the differences between what is desired and what is disclosed i.e. human capital information gap? Prior research indicates that this information gap is also apparent in developed countries.\textsuperscript{18} However, our contention is that the gap is especially large in developing countries, and we now consider why this may be.

We surmise, firstly, that the asymmetry found in our study is partly a reaction to the 1997/8 East-Asian crisis. This, together with highly publicised company-specific crises elsewhere in the world, led to emphasis on transparency and corporate governance with associated voluntary disclosure implications. For instance, since 2000, listed companies in Malaysia were required “to make a statement in their annual report disclosing the extent of compliance with the best practices.”\textsuperscript{19} These ‘best practices’ include a number of detailed matters concerning boards of directors. The worldwide focus on corporate governance, emphasized even more strongly in developing countries in the Far East by the Asian crisis, has had a significant impact on one aspect of human capital information – details about directors. However, a recommendation in the corporate governance code to have a majority board members consisting of non-executive directors, may have contributed to most of such information relating to this group.

Our second, geographically broader, explanation relates to the power relationship between shareholders and other stakeholders and the locus of legitimacy in developing countries. In general, discretionary (voluntary) disclosure in company annual reports can be seen as a response to one or more pressures and is used as a vehicle to publicise a company’s image and legitimize its activities, as suggested by
legitimacy theory. Companies secure organizational legitimacy with stakeholders by conformity to expectations of behaviour, and this in itself requires discretionary disclosures of symbols, values and affiliations. In societies such as in Malaysia, where external stakeholders other than shareholders wield relatively high constraint or veto power, there are strong incentives for companies to signal their awareness of, and responsiveness to, this power by co-opting and ‘displaying’ representatives of these non-equity stakeholders. In European and Anglo-Saxon countries, legitimacy demands nowadays come from groups such as consumers, whereas in many developing countries strong influence comes from government and certain elite groups; class hegemony “which adopts the view that … the role of the board will emphasise recruiting the ‘right’ individuals in terms of social status and influence” (Pye and Camm, 2003, p56) is also relevant here. When companies depend on resources from other parties for growth and survival as suggested by resource dependence theory, they will seek contacts and networks. This is often through recruitment of powerful figures in society to sit as non-executive directors on the boards not so much for their business acumen but often for ‘political’ reasons. Such individuals may be described as figureheads by which, in this paper, we mean “A nominal leader who has little or no authority or influence” (OED, 1993, p.946) and “A person who allows his name to be used to give standing to enterprises in which he has no responsible interest or duties; a nominal, but not real, head” (Webster, 2009). Historically, in the 19th century, such individuals were apparently common on the boards of European companies (see Slinn and Spira, 2010) but Copeman (1955, p.53) concluded that by the 1950s non-executive directors were “no longer very influential in attracting capital or business.” For our purposes, figureheads are those directors
who were not included in the term ‘management’ to which our finance industry interviewees so frequently referred.

We suggest that intrinsic cultural influences provide a third reason for the high level of director-related disclosure, notwithstanding the fact that such persons are not individually significant. Since Malaysian society accepts power distance and respects hierarchical and formal structures, it is not surprising to find this focus on figureheads. Othman (1999), and Haniffa and Cooke (2002) document a scepticism about the ability of directors in Malaysia, especially non-executive directors who are often perceived as a rubber stamp “selected for reasons other than monitoring” of executive directors (Haniffa and Hudaib, 2006, p.1037). Furthermore, Wan-Hussin (2009, p. 328), in a Malaysian study, concludes “that the value of amateur, part-time independent directors is doubtful.” Likewise, Uddin and Choudhury (2008) provide evidence that, in Bangladesh, “the majority of (these) external directors … have hardly any involvement in the true affairs of the companies they are elected to serve. … some of these nominated directors only play the role of attending stipulated board meetings. … Decisions are taken and implemented by the executives without any reference to the board” (pp.1034-35).

We are not arguing, in this paper, that director-related disclosures are harmful. But our evidence from Malaysia does suggest that much of this information is perceived to be of little, if any, value to many readers of annual reports – especially the influential analysts and fund managers that serve the interests of capital. And whoever’s interests are being served “the knowledge container designated human capital … [should be] assumed to develop creativity.” (Mouritsen and Roslender, 2009, p.802).
Our fourth and final explanation arises out of a combination of Hofstede-Gray ‘secretness’ culture, and a tendency towards more concentrated company ownership in developing countries with relatively immature capital markets. Voluntary disclosure of human resource capabilities is costly to produce and may risk commercial advantage, such as the poaching of key personnel who are value creators. Thus, in circumstances where existing and potential shareholders are perceived to come from a limited pool, especially if reinforced by a relatively secretive culture in which one discloses only what one has to, less informative human capital disclosures should be expected.21 In this Malaysian case study, there appears to be a pattern of disclosing human capital information which is commonly known, readily available, convenient and to a degree quantifiable. These are not the characteristics of human capital information which are necessary or useful in evaluating companies’ potential. Some of the data suit the stewardship and governance role of corporate reporting but it is not helpful in assessing value. Its predominance may be attributed to an overlay of “a full-disclosure regime (responding after the 1997-8 crisis to) … an embedded-relational governance model” (Loftus and Purcell, 2008, pp. 337-345). But it is less helpful for the user who wants to consult the financial reports in order to make a decision about company strengths, competitive advantage and prospects. There is an apparent reluctance or inability to report the more difficult uncertain and intangible data surrounding the human capital of the enterprise.

Our research echoes the concern, in this developing country, about a “box-ticking mentality … where companies merely comply in form … without giving heed to the spirit of the requirement”22 We find support for the work of Ensslin and de Carvalho (2007) who were also interested in human capital disclosure in developing countries. They contrasted their findings from the annual reports of 25 listed
Brazilian companies and from Abeysekera’s (2007) Sri Lankan study (both proxies for developing countries) against Guthrie and Petty’s (2000) study of IC disclosure by Australian companies in a developed country context. An adapted extract of their results is shown in Table 5.

**Table 5: Human capital disclosure: reporting frequency in developed versus developing countries**

<table>
<thead>
<tr>
<th>Most reported elements</th>
<th>Least reported elements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed country</td>
<td>Entrepreneurial spirit</td>
</tr>
<tr>
<td></td>
<td>Vocational qualifications</td>
</tr>
<tr>
<td>Developing countries</td>
<td>Education</td>
</tr>
<tr>
<td></td>
<td>(and employee relations)</td>
</tr>
<tr>
<td></td>
<td>Entrepreneurial spirit; know-how</td>
</tr>
</tbody>
</table>

Source: Ensslin and de Carvalho (2007)

Table 5 shows a contrast between Australia (proxy for developed countries) where companies adopt the relatively active approach of reporting more of the less readily quantified, and arguably more valuable human capital information, as against Brazil and Sri Lanka which display a more compliant, formal, quantifiable, mechanistic ‘box-ticking’ posture. This can be illustrated in more detail by the fact that only 30% of the Australian companies disclosed information about the education levels of their workforce while in Brazil the proportion giving this information was 72% (Ensslin and de Carvalho, 2007).

We identify a tension between, in one dimension, value-adding versus non value-adding information and in the other dimension the degree of measurability; this is depicted in Figure 1. The reporting of measurable data (often tangible matters such as qualifications and length of service etc of directors, most of whom are non-execs), may not be value adding (top right quadrant) but serves the purpose of stewardship and governance functions of disclosure. Conversely, there is reluctance and difficulty in providing data on aspects such as details of companies’ human capital strategies.
(which are necessarily narrative) which are of greater value in decision making but raise challenges of collection, communication and verification (bottom left quadrant).

**Figure 1: A trade-off between what is measurable and what is value-adding**

<table>
<thead>
<tr>
<th>MEASURABLE</th>
<th>NON - VALUE ADDING</th>
</tr>
</thead>
<tbody>
<tr>
<td>VALUE - ADDING</td>
<td>Stewardship</td>
</tr>
<tr>
<td></td>
<td>Governance</td>
</tr>
<tr>
<td>IMMEASURABLE</td>
<td>Decision making</td>
</tr>
</tbody>
</table>

Directors, both executive and non-executive, are certainly in a position to potentially add value to a business. Through their experience, the generation of ideas, environmental awareness and external contacts, they may contribute significantly to corporate profitability. However, much of the data disclosed about directors offers no meaningful signal of this capability in creating value. Furthermore, profit generation and value creation also requires an efficient workforce, a cohesive senior management team capable of managing resources strategically, employee competence and high level of morale. These feature much less visibly in the Malaysian external reports causing analysts to obtain only limited information or need to resort to other, perhaps less satisfactory, means to collect these insights.

**7. Conclusion**

It can be concluded that there is a need for greater human capital disclosure through public channels, such as the annual report, to aid financial analysts, fund
managers and private shareholders to make decisions without privileged access via private meetings. Despite its limitations, the annual report remains the basic source of information for a range of stakeholders (Holland, 1998, pp.255-256). There has been real progress in corporate governance and stewardship-related disclosures. However, in developing countries in particular, greater emphasis in annual reports on information about corporate value-creators and decision makers, and less emphasis on figurehead directors, would be welcomed by the investment community.

We speculate, in this exploratory paper, whether in other parts of the world (such as Egypt, Thailand, South Africa, Fiji, Sri Lanka, India, Russia and some other Eastern European States) which experience similar legitimacy and class hegemony pressures, parallel issues regarding the demand for, and supply of, human capital disclosure may be evident. If so, there may be excessive disclosure of information about directors *per se* rather than about the active decision makers and value creators.

In summary, the central theme of this paper is that, in developing countries, the human capital information that is disclosed appears to be especially inappropriate to the needs of the investment community to aid in valuing companies and in investment decision making. There is inadequate human capital information generally and what there is, is largely mechanistic disclosure of readily quantifiable details to meet corporate governance expectations; it places disproportionate emphasis on relatively irrelevant director-related metrics and insufficient emphasis on the human capital drivers of corporate performance. One factor is that ‘Government linked companies’ (GLCs) are a prominent feature in many developing countries and their dependence on official support may cause them to pay attention to non-executive directors and other political figureheads; such companies may set a pattern which is mimicked more widely. Secondly, in developing countries that incorporate
hierarchical structures, there may be a legitimacy-related deferential tendency for companies to focus their human capital disclosure on iconic figureheads even if they are not necessarily companies’ value creators. Thirdly, greater concentration of share ownership may reinforce cultural tendencies to approach disclosure on a ‘need to know’ rather than ‘value adding’ basis.

This study is not without its limitations. Firstly, we address the demand of only one group of users of annual reports, the investment community. Future studies might usefully consider the demand for human capital information by other groups of stakeholders in developing country companies. Secondly, our study searched only annual reports for the supply of information; future research may want to incorporate other media of communication. Thirdly, our study chose Malaysia as a representative case study and the results may not necessarily reflect the situation in other developing countries; a comparative human capital information study would address whether or not similar information gaps exist more widely. Notwithstanding these limitations, our study does provide exploratory insight into the importance of human capital information concerning value creators, as opposed to figureheads, in this era of knowledge management.
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1 “… it is left in the hands of producers of business reporting … to choose selectively ‘relevant’ information, and the users of this information may to some extent become victims” Nielsen and Toft Madsen (2009, p. 851)
3 However, despite calls from the considerable value relevance-centric literature, standard setting authorities are unlikely “to adopt more flexible reporting given their stated goal of meeting the information needs of a diverse group of users, not just investors.” (Jones and Dean, 2009, p.ii)”
4 “Human capital leaves the firm at the end of the working day and cannot be owned by the company”.
(Holland, 2006, p.289)
5 Sell-side analysts use their greater access to companies to obtain relevant information that is not disclosed in annual reports. Eccles et al. (2001)
6 This is illustrated by the following comments from an analyst interviewee “I work in Asia, I work with Malaysian, Singaporean, Hong Kong and Thai companies. … Certain companies are very interesting. Lets say I go and see Maxis - at the moment investing in Indonesia. Basically market is saying that saturation has been reached in Telekom sector Malaysia … you go to Indonesia invest 500 million, … resource is going there, what is enticing but Indonesia? … I try to find out whether there is a convincing story. … the market is looking at Indonesia, that’s the question mark, the market hasn’t made up the mind yet”. Likewise, another financial specialist based in Kuala Lumpur told us: “my previous use (in Kuala Lumpur) as the International Funds manager, apportioning funds of about 1 billion RM and 20 currency exposures…and asset allocation”.
7 We acknowledge that there is considerable debate about the appropriateness of generalisations about national culture and Hofstede’s cultural dimensions (see, for instance, McSweeney, B. (2002) and Baskerville, R.F. (2003).
8 Despite the wider use of supplementary stand alone reports, the annual report remains “a significant element in the overall disclosure process, given that it is the most widely disseminated source of (company) information.” Gray et al. (1995), p.45
9 A stratified random sampling technique was applied to ensure that the proportion of various industry sectors incorporated in the sample reflects the population
10 Disclosure of human capital mainly in qualitative form was also the case in Spain (Garcia-Meca et al., 2005).
11 For instance, Ranhill Utilities Berhad showed, in tabular form, the ‘average training days per employee’ and ‘average training for each employee’ (Ranhill Utilities, Annual Report, 2004: 46) and PJI Holdings disclosed that its spending on training and development amounted to RM221,705 (PJI Holdings, Annual Report, 2004: 20). United Energy stated that ‘UEM Academy successfully conducted 186 courses covering 418 training days and 2000 participants’ (United Engineering Berhad, Annual Report, 2004: 36).
12 Petronas Gas, in its 2005 Annual Report, p.46, did have “Employment Costs” of RM153.3 million, but this represented total labour cost rather than the cost of recruiting staff.
13 Grand United Holdings Berhad disclosed its revenue per employee for the years ended December 2003 (RM165,000) and 2004 (RM153,000) in its Financial Highlights (Annual Report, 2004: 9). Malaysian Airlines System Berhad disclosed the relationship between human capital and productivity in its Chairman’s Statement (Annual Report, 2005: 20), showing a 19.5% increase in profitability to RM504,789 per employee compared with RM422,378 in the previous year.
14 Similarly, Holland 2006 reports that UK “Fund managers wish to know who are the critical staff in the company, R&D or brand managers, and how were they retained, and exploited to create shareholder value” p. 292
15 A dissenting view on this came from one expatriate interviewee: “Loyalty that is an Asian question, always demand loyalty before competence. No, I don’t really care about loyalty”.
16 It was found that only 15 companies discussed employees’ expertise in the annual report.
17 …. information on qualitative factors was crucial to rethinking this information (collected from cyclic reporting) and valuation”. Holland, 2006, p.288.
18 As evidenced by private meetings between management and institutional investors.
19 Malaysian Code of Corporate Governance, 2000, Explanatory Notes, para.4.15.
21 Statistics reported in ITIM International (2009) state that Malaysia, for instance, has a high ‘Uncertainty avoidance index’ which indicates a low tolerance for uncertainty and ambiguity.
Uncertainty avoiding cultures try to minimize the possibility of unstructured situations by adhering to laws and rules.

22 Para 2.7 (Introductory Notes) of Malaysian Code on Corporate Governance, 2000.

23 Holland (2002) found, in the UK context, that recruitment, training and education of the general workforce are not of central interest to fund managers.