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Market performance impacts of human capital disclosures

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Abstract

This paper examines the market valuation and performance impacts of human capital-related information disclosures. Following a labor economics approach and using the annual reports of a sample of United States public companies, we construct human capital productivity and efficiency indicators and test for their informational content and value relevance following a portfolio performance approach. Results indicate that on average, firms with higher labor cost disclosures outperform their low labor cost counterparts. Estimated labor productivity and efficiency indicators also appear to be value-relevant since firms with higher value marginal products of labor, and higher marginal productivity relative to average labor costs, outperform their counterparts with lower values of both measures. We conclude that labor cost voluntary disclosures might be potentially useful in assessing human capital asset management and performance which could be relevant to market participants particularly for firms in knowledge-based industries.

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1. Introduction

Human capital information in North America is predominantly voluntarily disclosed, scarce, non-standardized and thus difficult to synthesize from annual reports. Further, and despite the evidence on the relevance of goodwill accounting disclosures in capturing a major part of a firm's intellectual capital or intangible assets (e.g., Chauvin and Hirschey, 1994; Hirschey and Richardson, 2002), accounting goodwill numbers remain aggregated figures encompassing several dimensions and facets of intellectual capital assets and particularly the externally generated ones following for example mergers and acquisitions corporate strategies. Thus, a more refined framework for identifying, measuring and assessing the performance of different intangible assets, and particularly internally-generated ones such as human capital and organizational capital is needed to single out its contribution to the value of the firm and to rationalize investment decisions in intangible resources both at the firm (managerial) and at the market (e.g., investor) levels. The general objective of this study is to further our understanding of the informational content and value of voluntarily disclosing labor and related costs by publicly traded firms, by examining investors' perceived value of such disclosures. With the establishment of knowledge-based economies around the world, human capital asset management is increasingly becoming an important and critical aspect of business operational management and efficiency. In particular, human capital is increasingly viewed as a value driver asset in leading industries, such as the fast-growing high-technology sector and the financial services sector (Hayes and Schaefer, 1999; Murphy, 1985; Lev, 2001). As a result, the accountancy profession has been under pressure from financial information users, such as investors and analysts, to provide transparent, concise, and comparable financial and other information disclosures regarding human capital-related accounting issues, such as executive and employee stock-based compensation and pension and post-retirement benefits data (e.g., Amir, 1996; Aboody et al., 2004). Moreover, the financial reporting and accounting regulations of intangible assets, and particularly the more difficult types to measure such as human capital, have been the subject of ongoing debate and increasing research interest at the academic, professional and public policy levels (e.g., Chauvin and Hirschey, 1994; Skinner, 1996; Rosett, 2001). This debate is further fuelled by the increasing discrepancy between accounting book values and the market values of most large public companies (i.e., the price-to-book ratio) where only about one third of the economic value of a firm as perceived by investors is recognized in its balance sheet.