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Motivations behind human capital disclosure in annual reports

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Abstract

Although much has been discussed about voluntary disclosure of human capital in annual reports there has been limited examination of the motivations behind such disclosure. This study uses the perspective of the political economy of accounting to understand motivations. Using the method of content analysis, this paper examines human capital disclosure practices in annual reports of a sample of firms in Sri Lanka, a developing nation. Eleven case study interviews from the sample explore the motivations behind the disclosure practices of firms. Findings reveal that firms use disclosure to reduce tension between firms and their constituents, in the interest of further capital accumulation.

Keywords: Capital accumulation; Content analysis; Human capital; Political economy of accounting; Sri Lanka

1. Introduction

Traditional accounting can be described as an institutional process regulated by the accounting profession, constructed for the purpose of reporting on and communicating the impact of economic activity. It is largely designed as a reporting mechanism for profit-oriented firms (Boczko, 2000). This regulated process secures economic capital accumulation (hereafter called capital accumulation) through institutional rules, laws and agreements, and norms. The capital accumulation regime is supported by the formulation and implementation of laws, government policies, political practice, rules of negotiation and bargaining, the culture of consumption, and social expectations (Amin, 1994, p. 8). Tinker (1985, p. 84) explains that accounting measures and appraises capital accumulation as an exchange between the firm and parties involved in the exchange process. Accounting has become part of that exchange process by helping firms to make decisions relating to economic exchanges favouring capital accumulation.

The combination of factors possessed by individuals and the collective workforce of a firm is referred to as *human capital*, to differentiate it from economic capital. Human capital encompasses knowledge, skills, and technical ability; personal traits such as intelligence, energy, attitude, reliability, and commitment; ability to learn, including aptitude, imagination, and creativity; desire to share information, participate in a team, and focus on the goals of the firm (Fitz-enz, 2000). Several authorities consider that human capital is important because its extraction creates capital accumulation of firms (Edvinsson & Sullivan, 1996; Graham & Pizzo, 1998, p. 25; O'Donnell et al., 2006).

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This study examines the human capital disclosure practices of the top 30 listed firms in Sri Lanka over two consecutive years. The aim of the study is to gain insight into the motivations behind human capital disclosure in annual reports. Three major factors motivated the present research examining the human capital disclosure of firms and their motivations in a developing country, and selecting Sri Lanka as an empirical site. *Motivation* in this paper means the arousal, direction and persistent behaviour of a firm in annual report disclosure (Samson & Daft, 2005, p. 623). First, devising human capital measures for disclosure has so far resulted in little progress in recognising them in financial statements (Fitz-enz, 2000, pp. 116–117; Roslender, 1997). Although human capital disclosure is theoretically interesting, there is little empirical evidence to suggest the usefulness of the associated financial models (Flamholtz, 1976; Grojer & Johanson, 1996, p. 24). Second, there is a dearth of research into the motivations behind voluntarily disclosed human capital information of firms in developing nations. The need for a study of firms in developing countries has become increasingly evident because of increasing competition with firms in developed countries due to rapid globalisation, lower transaction costs and more freely available capital. Daley (2001, p. 5) notes that the competitive advantage of firms lies increasingly in intangibles (such as human capital) which are immutable. These immutable intangibles are used to differentiate the products and services of firms. Third, the recent emphasis of the Sri Lankan government on encouraging a knowledge economy (as highlighted in the amendments to the *Intellectual Property Act* and the liberalisation of the foreign ownership of firms) has heightened the importance of utilising human capital for economic growth (BOI, 2000; McSheehy, 2001, p. 57). An amendment to the *Intellectual Property Act* prohibits the application or fixing of a registered trademark in such a way that it is likely to mislead the public. The amendments also deal with areas of copyright and related rights, and geographical indications, which were not sufficiently protected its precursor.

The second section presents a brief review of the capital accumulation of firms in the context of human capital. Section 3 describes the theoretical perspective of the political economy of accounting and introduces the three constituents influencing or influenced by firms: political, economic, and social. Section 4 describes the research methods employed. This study coded and analysed human capital disclosures in the sample of annual reports of two consecutive years (2001 and 2002) by frequency of disclosure using content analysis, and subsequently carried out case study interviews to examine the motivations behind such disclosure. The empirical evidence from the content analysis and case study based interviews are presented in section five, while the last section provides the summary and conclusion.

2. Literature review

Capital is more than a mere collection of transferable resources. Capital is an institutional system through which technology and organisational structures are progressively developed, organisational processes are differentiated and legitimated for capital accumulation (Clegg & Dunkerley, 1980, p. 5).

The chaotic search for profits, new products and markets, new technologies, new spaces and locations, and new processes of firms has changed the nature of capital accumulation in the economic environment. Since capital is to a large extent mobile, it is imprudent to analyse capital as if it were immobile and attached to particular activities and firms (Holloway, 1994). The transience of economic capital makes it imperative for a firm to convince economic capital providers to remain with the firm.

Capitalist accumulation strategies have three consequences. First, they can free increasing quantities of human capital and re-allocate them in accordance with the demands of the market (Tinker, 1999, p. 656). Second, they can add to social costs but the firms involved need not be held accountable, because of firm's relations with the government. Such costs are often underestimated by developing countries (such as Sri Lanka) due to their hunger to achieve the material luxuries enjoyed by developed nations (Isaak, 1991, p. 138). Third, the pursuit of individualistic self-interest for capital accumulation aimed at increasing individuals' share of economic wealth may encourage firms to rationalise their approaches towards human capital treatment in interactions with the government and with other social actors (Isaak, 1991, p. 138; Picciotto, 1992, pp. 80–81). This approach of capital accumulation can give rise to unfair competition through imperfect markets, thereby encouraging firms to maximise their capital accumulation through practices such as economies of scale and subordination of human capital practices to technology (Isaak, 1991, p. 166; Murray, 1981, p. 147).

Firms must convince capital providers that they are capable of using their assets (such as human capital) at the highest levels of efficiency for capital accumulation. This is done through news releases, which include accounting reports such as company annual reports. The disclosure of human capital is distinctive in two ways. First, human capital disclosure is presently unregulated, allowing firms to choose what, when and where to disclose. Second, human capital