Institution: Lancaster University		
Unit of Assessment: 17, Business and Management Studies		
Title of case study: Enhancing financial reporting policy in the UK and US: valuing human capital in financial reporting		
Period when the underpinning research was undertaken: 2004-2019		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	**Role(s) (e.g. job title):**	**Period(s) employed by submitting HEI:**
Anthony Hesketh Steve Fleetwood	Senior Lecturer Senior Lecturer	1999-present 2006-2010
Period when the claimed impact occurred: 2013-2020		
Is this case study continued from a case study submitted in 2014? N		

1. Summary of the impact

Since 2004, Lancaster University Management School (LUMS) researchers have examined the relationship between the economic value added by human resources (human capital, or HC) and the propensity of companies to publicly report relevant data. The research has: challenged and redefined the principles and practices of the world's leading accounting firms; led to the development of a new HC reporting framework positively impacting UK company disclosures; and it has supported HC research for a major global initiative, *Embankment Project for Inclusive Capitalism* (EPIC), which subsequently adopted LUMS techniques of measuring HC. In a culmination of the recognition of LUMS' work, in August 2020 the U.S. Securities and Exchange Commission (SEC) made a significant policy change that requires >7,000 globally significant U.S. companies to disclose the number of people they employ and any HC measures or objectives they focus on in managing the business.

2. Underpinning research

The way we value our relationships with organisations and the products they create is changing, and this has a concomitant effect on the underlying financial value of organisations. People and their management are becoming increasingly material to this revaluation. Over a decade-and-a-half, research carried out into performance-led HR at LUMS has sought to raise awareness of human capital (HC) management, and to enable global corporations and their stakeholders - investors, employees, suppliers and wider society - to better understand how they manage, measure and report on the value creation of their people. In their early development of an alternative approach to HC measurement, Hesketh and Fleetwood were able to combine academic research with unusually deep levels of participative collaboration with leading global companies over a long period. These companies had combined strategic responsibility for around 7 million UK employees, approximately one quarter of all UK employees.

An alternative path to understanding human capital: Return on Invested Talent (ROIT)
In 2004, Hesketh and Fleetwood interviewed 50 corporate executives in FTSE 100 companies (such as Barclays Bank, Lloyds Bank, Marks & Spencer and Tesco), revealing the difficulties confronted – patchy and inchoate practices, inaccurate data – when using conventional methods to understand, develop, measure and report the value of HC in organisations [R1]. Between 2006 and 2010, the researchers set out an alternative path to understanding the value released by HC, one that took account of its materiality to a firm's financial performance [R2]. Viewed retrospectively, this approach represented a marked, and sometimes unwelcomed, but necessary departure from a long-standing focus in academic, managerial, consulting and financial circles on property, plant, and equipment, and recognised the role of HC in driving value creation [R3]. When these research insights and conceptual framework were unpacked in a subsequent piece of work with Deloitte, the resulting research led to a five-step process to calculate gross and net returns on HC, conceptualised as *Return On Invested Talent* (ROIT) [R4]. This gave a firm's executives, shareholders and other interested parties an objective, analytically informed measure of the financial implications of employee-related interventions – the opening salvo on the long

journey towards a change in U.S. financial reporting regulations that recognised HC factors as 'material' to investors' or wider stakeholders' concerns.

New standards for human capital disclosures: Valuing Your Talent
In 2013, following increased awareness among practitioners of his work, Hesketh obtained funding from the UK Commission for Employment and Skills (UKCES) for the Valuing Your Talent (VyT) research project. In collaboration with the three professional bodies representing accountancy (CIMA), management (CMI) and human resources (CIPD), Hesketh developed, tested, and published a significant piece of empirical research [R5] with participation by 70 major companies (e.g. Asda, Diageo, Nestle, Oracle) and the investment and regulation communities (Financial Reporting Council, International Accounting Standards Board). Supporting case studies (Microsoft, Xerox, Unilever, Arcelor Mittal) illustrated the processes and practices of HC management in leading multinationals. Analysis mapped and established the financial value of HC through a new analytical framework to inform disclosures by companies. This meant narrowing down indicative metrics from an unwieldy 400-plus to just 4: employee turnover, well-being, training and cost.

Performance advantage and human capital disclosure: EPIC
In November 2016, accounting firm Ernst & Young (EY) and the Coalition for Inclusive Capitalism in the US, invited LUMS to develop a new human capital disclosure instrument based on [R5] for inclusion in the *Embankment Project for Inclusive Capitalism* (EPIC) [R6]. EPIC was set up with the intention of making corporate reporting more useful by developing a framework and metrics to better articulate the long-term value created by businesses. Participants included 31 CEOs from asset owners (pension managers such as CalPERS), asset managers (investment banks such as J.P. Morgan) and companies (leading global firms such as Johnson & Johnson).

Building on techniques from ROIT and VyT research, Hesketh examined the HC reporting practices of the globe's top 700 firms by revenue. Findings demonstrated that: HC disclosers perform better, and are disproportionately represented in the highest performing firms; that financial performance increases in step with HC reporting intensity; and that higher levels of HC disclosure on average secure higher levels of operating margin and retain higher levels of earnings to reinvest in the future returns of their businesses. Hesketh's financial equation was endorsed by EPIC participants and enabled the initiative to establish the return on invested talent (or ROIT) for those firms with deeper and wider levels of HC reporting (GBP3.17 for every GBP1 invested) were nearly three times those with the lowest levels of HC disclosure (GBP1.17) [R6].

3. References to the research

[R1] **Hesketh, A. & Fleetwood, S.** (2006). Beyond Measuring the HRM-Organizational Performance Link: Applying Critical Realist Meta-theory. *Organization*,13(5), 677-699 https://doi.org/10.1177/1350508406067009 (231 citations Google scholar)

[R2] **Fleetwood, S. & Hesketh, A.** (2010). *Explaining the Performance of Human Resource Management.* Cambridge University Press. https://doi.org/10.1017/CBO9780511781100 The book draws from articles already published including: Fleetwood, S. & Hesketh, A. (2006). HRM-Performance Research: Under-theorised and Lacking Explanatory Power. *International Journal of Human Resources Management*, 17(12),1979-1995; Fleetwood, S. & Hesketh, A.J. (2006). Theorising Under-Theorisation: Research on the Human Resources' – Performance Link. *Journal of Critical Realism* 5 (2), 228-250; Fleetwood, S. & Hesketh, A. (2008). Theorising Under-theorisation in Research on the HRM – Performance Link. *Personnel Review* 37(2),126-144.

[R3] **Hesketh, A**. & Ross, S. (2020). *A Company's Workforce Is Its Most Strategic Asset. Investors Deserve Clarity About It*. *Barron's,* 19 October, 2020.

[R4] **Hesketh, A.** & McMinn, H and Lewis, H. (2014). *What Price Talent? Introducing a new metric to understand the return on investment from talent*. Deloitte.

[R5] **Hesketh, A.** (2014). *Managing the Value of Your Talent*. CIMA, CMI, CIPD, RSA, UKCES.
[R6] Coalition for Inclusive Capitalism (CIC) & Ernst & Young (EY) (2018). *Embankment Project for Inclusive Capitalism*. EY/CIC. Further details can be accessed in Forester de Rothschild, L. (2019). *The Embankment Project for Inclusive Capitalism ("EPIC"): A Better Way to Value the American Worker*. Washington: D.C.

Grants:
Valuing your Talent: A New Framework for Human Capital Management, Funded by the Department of Education and UK Treasury Commission on Education and Skills (UK CES) and the Chartered Institutes of Accounting (CIMA), Management (CMI) and Human Resources (CIPD), September 2013 to August 2014, GBP61,844.

4. Details of the impact

LUMS research has had an impact on professional bodies and services in the UK and the US, providing an impetus for debate about the value of HC disclosure, redefining best practice, influencing professional standards and codes of practice, and underpinning authoritative guidance. Hesketh and Fleetwood's work has had an impact on public policy in the US, as an important lobbying tool to mandate for deeper HC disclosures and influencing policy decisions at the highest level, leading to a draft Bill before U.S. Congress to amend the 1934 Securities and Exchange Act to include all of the indicators represented in LUMS research.

In the words of the Chartered Institute of Personnel and Development, LUMS work on VyT, "*helped create a new human capital management framework to enable organisations to improve how they generate, report and analyse HR data to support strategic investment in people"* [S1].

In February 2014, LUMS research was discussed at an All Parliamentary Group Roundtable in the House of Commons contributing to the future of management and leadership in the UK [S2]. Additional government-funded research after the Roundtable [S3(a)] demonstrated human capital reporting increased by 18% in the UK in the immediate period after the publication of the VyT research report, with a second and more recent report highlighting how 3 of the 4 specific human capital elements prescribed by the original LUMS research – wellbeing, employee turnover and training – had increased by 113%, 22% and 31% respectively, between 2013 and 2017 [S3(b)].

Between 2016 to 2018, participation in EPIC accelerated the reach of LUMS research on a global scale. The participants publicly endorsing LUMS research represented the collective power and diversity of 31 firms across the entire investment chain, with USD30 trillion of assets under management and almost 2 million employees around the world. Hesketh's original ROIT equation and VyT's human capital disclosure items were incorporated into EPIC's final recommendations and a Statement of Support was published in the Wall Street Journal and signed by CEOs of all participating firms [S4]. The research was formally acknowledged as central by the Chair of the Human Capital Deployment Group of EPIC, who noted that the findings of her group were, *"the most credible and tangible of the nine workstreams and the basis of this success is the work [Lancaster] did… [Hesketh] was central to this work continuing to move forward"* [S5].

Impact on policy and law
The Chair of the EPIC Human Capital Deployment group, also a senior executive at Johnson & Johnson, added that LUMS research, "*played a central role in shaping the thinking of EPIC and continuing the post-EPIC impact of the research with the SEC and Congress"* [S5].

The collective power of the EPIC participants triggered the U.S. Securities and Exchange Commission (SEC) into debating the inclusion, for the first time, of HC disclosures via its Investor Advisory Committee (IAC). LUMS research [R1], [R5], [R6] was pivotal to the deliberations [S6], and IAC members voted to take HC disclosure through to the SEC's roundtable stage for consideration for inclusion.

Subsequent testimonies before the US House of Representatives made specific mention of Lancaster's research. These came from a senior executive at AFL-CIO, the largest federation of unions in the US [S7(a)]; and the Managing Investment Director, Board Governance & Sustainability, of California Public Employees' Retirement System (CalPERS), who is also a member of the SEC's Investor Advisory Committee, who testified that, *"Our investment beliefs are grounded in an extensive review of evidence during CalPERS' Sustainable Investment Research Initiative. This evidence has since been strengthened by the work of Dr Anthony Hesketh who presented to the CalPERS board yesterday in order to highlight the growing case for human capital disclosure by firms"* [S7(b)]. Hesketh's research was also cited in a May 2020 joint letter from a Senator and a Congresswoman to the chairman of the SEC calling on them to improve their human capital management reporting requirements by updating Regulation S-K 101(c)(1)(xiii) [S7(c)]. The SEC's policy adoption and implementation process is recognised as being extremely rigorous and evidence-based, embedding research directly into policy development, even more so than the UK's Financial Conduct Authority (FCA).

On 26 August 2020, the SEC voted to change Regulation S-K 101(c)(1)(xiii) which requires firms to disclose, *"a description of the registrant's human capital resources to the extent such disclosures would be material to an understanding of the registrant's business"* [S8].

In October 2020, the world's largest asset manager, Blackrock, observed how human capital management reporting has increased by 188% across the 214 companies in its portfolio [S9(a)], accompanied by releases by other 'Big Four' auditors Deloitte [S9(b)] and PwC [S9(c)] bringing the significance of the SEC's ruling to the attention of their clients.

Impact on professional services

Hesketh's work has changed the attitudes of executives and regulators to enhancing the practices of HC measurement and disclosures. 'Big Four' accounting firms, Deloitte, followed by EY, have adopted the *Return On Invested Talent* (or ROIT) equation in their advice to their clients in meeting the formal requirements for measuring the value of human capital [S10(a),(b)] with coverage by CFO Magazine, with a readership of 44,000 senior financial decision-makers every month, acknowledging the impact of LUMS research on the SEC's original recognition of human capital [S10(c)]. Hesketh's Valuing your Talent research, as well as the work of EPIC, are cited several times in the Sustainability Accounting Standards Board's December 2020 revised Preliminary Framework on Human Capital and the SASB Standards**.** LUMS research has also played an important role in a new Draft Bill, under consideration by U.S. Congress [S11(a)]. The wording of the bill, which is supported by the AFL-CIO and is currently under consideration by the US House of Representatives. Although delayed due to COVID-19, it includes specific items of human capital disclosure outlined in LUMS original Valuing your Talent and EPIC. In the words of the SEC's guidance note prepared for the initial Congressional Hearing: *"because …[human capital] disclosures are not required and are thus only voluntary in the US, only 15% of S&P 500 firms do so (Hesketh, 2020). However, according to research from the Embankment Project for Inclusive Capitalism (EPIC), a project bringing together businesses with more than $1.5 trillion in market capitalization and asset managers managing more than $30 trillion, those U.S. companies that voluntarily disclose this information outperform those that do not and receive better returns on their investment in human capital (Hesketh, 2020)*" [S11(b)].

5. Sources to corroborate the impact

[S1] Pensions and Investments Research Consultants (PIRC) Research report: Human Capital Reporting: Investing for sustainable growth, 2015, p.8.

[S2] All Parliamentary Group Roundtable on Management, Commission on the Future of Management and Leadership Commission on the Future of Management and Leadership Transcript of Roundtable event: 'How do you value your talent?', 2014, pp.62-65.

[S3] Chartered Institute for Personnel Development reports: a) Reporting Human Capital: Illustrating your company's true value, 2016, p.16 and b) Hidden figures: how workforce data is missing from corporate reports, 2018, pp.6-7.

[S4] Wall Street Journal article: 'Business leaders unite to advance long-term value measures', November 17, 2018, p.A5.
[S5] Personal Letter of Endorsement from Senior Vice President, Finance, Johnson and Johnson, also Chair of the Human Capital Deployment Group, EPIC, 2019.
[S6] Evidence related to the United States Securities and Exchange Commission (SEC) Investor Advisory Committee 28th March 2019: a) Submission to the Committee by A. Hesketh, 2019; b) Video of the Committee Meeting: 2:16:00 for the start of the discussion on human capital and 2:23:45 for specific mention of LUMS's research by the IAC Chair.
[S7] Evidence from US Congress: a)Testimony of Director of Capital Markets Policy, AFL-CIO Senior Fellow, before Financial Services Committee Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, U.S. House of Representatives, May 15, 2019, p.3; b) Testimony of Interim Managing Investment Director, Board Governance & Sustainability, California Public Employees' Retirement System before Financial Services Committee Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, U.S. House of Representatives, July 14, 2020, p.3; c) Letter to the SEC from a US Senator and a Member of Congress about the Modernization of Regulation S-K Items 101, 103, and 105, May 19, 2020.
[S8] United States SEC Final rule on the Modernization of Regulation S-K Items 101, 103, and 105, 2020 p.8.
[S9] Evidence regarding the financial and audit sectors' recognition of the SEC ruling's impact: a) BlackRock Investment Stewardship Global Quarterly Stewardship Report, Q3 2020, p. 8; b) Deloitte Heads Up, Volume 27, Issue 24: 'Human Capital Measures Up' 2020; c) Pricewaterhouse Coopers (PwC) In the loop: 'New human capital disclosure rules: Getting your company ready' December 22, 2020.
[S10] Evidence of impact on professional services: a) Deloitte 'What Price Talent? Introducing a new metric to understand the return on investment talent', 2014; b) Ernst & Young 'How to approach the SEC's new human capital disclosures', 2020; c) CFO Magazine: 'Human Capital's Big Reveal', 2019.
[S11] Evidence regarding a new Draft Bill amending the Securities Exchange Act,1934: a) Draft Bill To amend the Securities Exchange Act of 1934 to require issuers to disclose information about human capital management in annual reports, 116th Congress, 2019 and b) Memorandum to the United States House of Representatives Committee on Financial Services, 'Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers' 2019, p.2.