

A CAPITAL INVESTMENT

Research has linked a company's investment in employee training with its future stock performance. But until universal standards are created for reporting such information, investors will continue to be left in the dark.

Does a company's investment in its people pay off? You bet. And if you knew what firms were investing in education and training, you could significantly improve the performance of your investment portfolio.

Research has shown that companies investing above-average amounts on training per employee tend to outperform the market. But don't bother rushing to speak to your broker. Information on corporate spending in areas such as training and learning for employees – factors that drive future wealth creation – is not in the public domain.

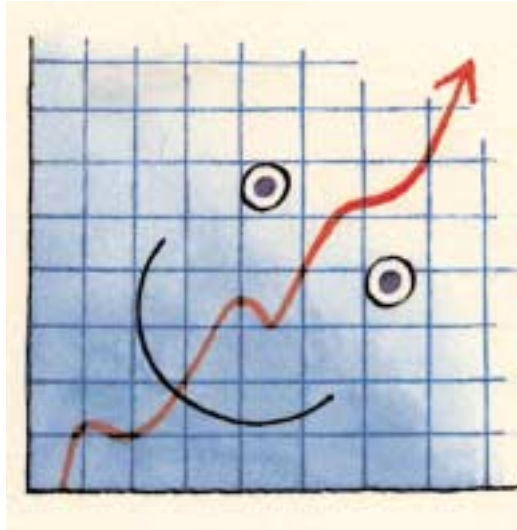
So although CEOs routinely declare that “our people are our most important asset,” investors have no way of knowing the extent to which a firm is or isn't investing in its “human capital.”

Until companies are required to make disclosures of investments in human capital management, they are unlikely to do so. In the US not a single *Fortune* 500 firm reports the amount it spends on employee training. Based on the accounting standards used in most countries, investments in human capital are treated as costs and there are no guidelines for how such investments should be measured.

In collaboration with an international initiative by the American Society for Training and Development, we have been working to create standard training definitions and metrics. Through this effort, we have collected comparable data on the education and training investments made by thousands of firms in dozens of countries.

Together with publicly available financial information, we analysed data from 550 publicly traded US companies. The findings are quite remarkable. Take a multi-industry portfolio of 225 US firms, selected because they invest an above-average amount annually per employee on training – \$1,128. Collectively, these companies returned an annual average of 45 per cent more than the S&P 500 index in 1997, 1998 and 1999.

A firm's current training investment is the single most important statistical predictor of



its total stockholder return (stock price change plus dividends) for the following year – more telling than other key investments which have to be reported such as R&D.

Certainly our measures of human capital investments are imperfect. They capture only “quantity,” the raw number of dollars spent per employee, when we'd really like to know the “quality” of that spending – a measure of its likely effect on the company's bottom line. Quality, however, is notoriously tricky to capture – this is true even for publicly reported investments such as R&D. As for quantity, even our simple measure is virtually impossi-

“The lack of reporting on firms' people investments reduces the efficiency of the stockmarket”

ble for investors to obtain. But despite its relatively crude nature, its predictive power is quite impressive.

But is it really surprising? Precisely because information on human capital investments is not publicly known, such spending (if and only if it is effective) is capable of surprising and moving the market when its effects become visible. Publicly reported variables such as R&D and equipment expenditures are important in determining firms' future financial performance. But they, unlike training expenditures, are

of relatively little use in predicting future stock performance.

Stockmarkets quickly incorporate all known important information into a stock's current price. Consequently, regularly reported variables cease to be a predictor of future prices. For any information to impact future stock prices, two things must be true: it must not be publicly available, and it must be relevant to a company's financial performance. Both are true of human capital investments.

The absence of reporting on firms' human capital investments reduces the efficiency of the stockmarket. If investors had this information, they could make better informed investments. In addition, because education and training are currently treated as costs, firms make these investments in spite of stockmarket pressures, rather than because of them. This leads to a tendency to under-invest in human capital.

That's not only bad for firms, it's bad for the people who work in them. Research has clearly shown that workplace training is an important determinant of workers' future earnings capacity. As this outcome is not optimal for investors, employers or workers, it's not optimal for society at large. But the situation is correctable.

It's time for public agencies that regulate financial disclosure to modify reporting

and accounting requirements to promote value creation in the knowledge economy. At the same time, investors should begin asking questions of the firms in which they invest. “If people really are your most important asset, then how much are you investing in them?” Or “why don't you measure and manage investments in human capital in the same way that you do other strategic investments?”

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