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Why reporting on human capital matters

The events of 2020, including the impact of Covid-19 on social imbalances and the murder of George Floyd have very firmly put the "S" back into ESG. However, apart from media headlines bringing social considerations into the spotlight, little has been said about what this might look like for company reporting.

ESG reporting today

ESG-related disclosures by issuers are largely made on a voluntary basis. In the absence of a mandatory ESG disclosure framework, companies exercise their own discretion in determining which ESG risks and opportunities are material to their business and which to disclose to investors. The result has been a lack of consistency, quality and comparability of ESG data, which is of limited value to investors.

Companies are making progress on environmental and governance reporting. Indeed, they have been providing governance reporting in one form or another since the first corporate came into being. The Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) has helped make progress on a major aspect of environmental reporting with a focus on climate change-related risks.

What is the state of Human Capital reporting?

In the last year, Capital Group invested over 4,000 hours of analysts' time in building our bottom-up ESG frameworks. These frameworks give us an excellent understanding of which issues matter most to the companies in which we're invested. This in turn builds our understanding of the impact that companies have on their local communities, the broader economy and the market as a whole. This level of detailed analysis reveals just how much an issue of unique importance, human capital is.

Today, there is little or uneven reporting on even the simplest human capital indicators.

More and more of the value of companies, and hence the savings of people, is represented by intangible assets such as software, brands and data, all of which is driven and sustained by human innovation. Yet while an investor can find out exactly how much is invested in research and development or the cost of new equipment, finding out how much has been invested in workforce training is much more difficult.

What is missing from current requirements?

Last year, the Securities Exchange Commission (SEC) acknowledged the importance of human capital but stopped short of providing specific reporting requirements. They called for companies to disclose the number of employees and a description of its human capital resources if material to the business as a whole. Training, recruitment, safety, engagement and mention of objectives are all voluntary. This coupled with US Generally Accepted Accounting Practices (GAAP) requirements means that even calculating what the average employee earns is difficult.

The EU's Non-Financial Reporting Directive (NFRD) currently has one human capital reporting requirement, on diversity. But the fact that individual member states have added in additional requirements such as board diversity, distribution of employees in terms of age, gender and pay indicates more is needed.

What we'd like to see

Companies are reporting more on a voluntary basis but much more can be done to encourage more disclosure of the following:

1. Total workforce cost

2. Employee turnover

3. Comprehensive workforce demographic data (EEO-1 equivalent in the US)

4. Total cost and hours of employee training provided

5. Gender pay gap reporting

6. Monitoring of internal engagement and workplace culture

What is also crucial is that this information and these disclosures apply globally. Indeed, global consistency is a key factor in allowing investors to make valuable comparisons across regions and can help companies draw financing from a wider range of investors.

We believe these six metrics would put "S" on equal footing as other types of environmental and governance metrics. It is widely acknowledged that we face a climate emergency, let's not wait for the next human emergency before we start reporting on human capital.