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HUMAN CAPITAL REPORTING AND CORPORATE EARNINGS: EVIDENCE FROM NIGERIA

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ABSTRACT

This study investigated the influence of human capital reporting on earnings of quoted manufacturing companies in Nigeria. The study used secondary data from 2007 to 2014 collected from selected Annual Report and Accounts of 50 listed manufacturing companies, and Fact Books published by the Nigeria Stock Exchange. Pooled least squares were used in the analysis. The results indicate that total earnings present a positive relationship with all the components of human capital but a significant one with salaries and wages and labour turnover. This then suggests that capitalization of corporate investment on its human resource has the aptitude of increasing the total earnings of quoted manufacturing companies in Nigeria.

JEL: M40, M41

KEYWORDS: Total Earnings, Human Capital Cost, Capitalization, Corporate Success, Nigeria

INTRODUCTION

The drive for accounting for a firm's labour force is born out of the quest to find new ways and explicit methods of recording and reporting corporate financial commitments to its personnel in the annual report. In the conventional way of accounting for corporate investments on its human resource, all expenses relating to human capital are charged against the income statement of the companies and are used to reduce the profit for the accounting period and subsequently the shareholders' fund. It is the belief that this customary accounting method is a farce, as it does not give due recognition to the organization's labour force as an invaluable asset.

Non-current assets like buildings, plants, machinery and other physical assets are considered as capital investments whose benefits to the company go into the distant future and as such capitalized in the company's statement of financial position as part of the asset base of the company. Thus the argument in favour of human capital reporting therefore is that employees in an organization are responsible for the implementation, execution and management of these physical assets. Therefore, the profitability, solvency effectiveness and efficiency, and the ultimate achievement of corporate goal and the going concern of a firm depend largely on the intellect, expertise, experience, proficiency, attitude, technical skills, education and value of such employees (Singh, 2009). The question that needs to be asked is why are investments in these physical assets of the company regarded as non-current assets which are then capitalized in the statement of financial position while corporate expenditure on the firm's labour force are treated as meager expenses?

An employer has the responsibility of ensuring retention over a long period of time. Often, in an attempt to improve the creativity and performance of employees, various career advancement programs are instituted by the management which include in-house training, on-the-job training, seminars, and continuous education of employees, among others, all of which are expected to bring about long term benefits to the establishment, just like any other non-current assets. Human capital reporting is the process of computing and reporting investments and contributions of employees and managements in a firm to interested parties. It does not only involve measurement of all costs or investments connected with the recruitment, placement, training and development of employees, but also the quantification of the economic values of staff members in an organization (American Accounting Association's committee on Human Resource Accounting, 1973). It is not a completely new phenomenon after all, as economists regard human capital as an important factor in the production process, without which all other factors of production will remain in their natural and unprocessed state.

The current traditional presentation of work force in the financial statement does not show the true and fair place or role of human resources vis-à-vis revenue generation, ultimate profitability and value significance to the organization. Also, the recent adoption of the international financial reporting standards (IFRS) in the disclosure of financial statements by Nigerian companies which practically encourages the consideration of an alternative means of measures and reporting, lends credence and support to the possibility that future reports may include non-conventional dimensions and recognition. Hence this gives room to redress issues bordering on the disclosure of human capital expenditure in the financial statements of Nigerian firms, especially those quoted on the stock exchange.

The Nigerian manufacturing sector is one of the mainstays of the nation's economy. It is involved in the invention, production and delivery of goods and services to various stakeholders in the economy and any tension therefore in this sector will cause serious distortion in the nation's economy. Manufacturing firms in Nigeria are also notable, among other things, for high recruitment of labour force, and in a bid to ensure an efficient and effective performance, they get the best hands to handle daily transactions and activities. They spend huge amounts on recruitment exercises. Most often this may be outsourced to other human resources consulting firms. Also, after the recruitment and selection exercise have been done, they also commit fortunes towards training and retraining of staff members. All of these are geared towards improving the technicality and efficiency of each employee so that he/she can contribute maximally towards achieving the corporate goal of the firms. Examples include Nigerian Breweries which spent over ₦700 Million on staff recruitments, training and development in year 2008 (Annual Report, 2008), and Unilever plc, which invested over ₦250Million in 2009 on the training of its employees, besides other in-house programmes and arrangements designed for the purpose of staff development (Annual Report, 2009). Also, Nestle Nigeria plc expended over ₦790 Million on staff recruitments, training and development and over ₦200 Million on Staff medical expenses (Annual Report 2012).

Despite these high costs incurred by these Nigerian manufacturing companies on human capital development in recent times, they are not recognized as elements in determining the value of a firm. Conventional accounting systems still treat investment/cost associated with the selection, recruitment and training of personnel in an organization as an expense charged against the income statement, which is also used to reduce profit, whereas the cost of acquisition of any other physical asset is capitalized in the statement of financial position, and only a depreciable amount is charged against the statement of comprehensive income every financial year. The amount of intangible/intermediate assets is also capitalized in the statement of financial position and is amortized for a respective number of years.

This problem of how firms should choose the benchmark treatment for human capital costs in the financial report has called for a great deal of attention and debate in corporate financial literature. The interest is due to the fact that human capital accounting information aims to aid decision making by giving due recognition and value to managers and employees, while a remarkable human resource practice also enhances the significance of an organization. In merger and acquisition, for instance, an important reason for purchasing a company may be its human expertise and a formidable human resource team and stunning success (Akinsulire, 2010). Human capital accounting can also be a signaling contrivance to shareholders and other key stakeholders in demonstrating corporate success and future company's prospect.

At the outset of such debates, among others issues, is the question of the relevance of firms' strategic human capital reporting decision to its own valuation and shareholders' fund. Thus effectual use of assets, value creation, capitalization of human resource investments and corporate success are all strongly linked in explaining how companies, shareholders and other investors form and modify their investment acquisition decisions through firms and capital markets and thereby influence the proportion of their income and returns on investments, whether in the form of direct earnings, dividends or capital gains.

To understand this subject matter better requires a critical look at the concept of human capital reporting and its weight on the largest possible earnings which quoted companies can make. In view of relatively scanty evidences available on the effects of human capital accounting information on earnings in listed companies in Nigeria, this study attempts to examine the effects of human capital reporting on earnings of quoted manufacturing companies in Nigeria in the context of prevailing economic reforms and conditions in Nigeria.

The rest of this paper is set out as follows: in section 2, there is a brief review of literature; section 3 describes the methodology adopted; section 4 presents the empirical results; and the final section contains the conclusions and policy implications.

LITERATURE REVIEW

Most of the empirical evidence on human capital reporting emanate from: (a) studies on the appropriate treatment and valuation method to be employed in recognizing human capital as assets e.g. Flamholtz (1971), Strauss (1976), Lau & Lau (1978), Dawson (1992 &1994), Flamholtz, Maria & Hua (2003), Theeke & Mitchel (2008), Pedro & Ana (2013); (b) studies on human capital measures and firms' decision e.g. Hendrick (1976); (c) its effect on value significance in an enterprise e.g. Md. H. Khan (2010), Adelowotan, Christo & Wingard (2013); and (d) the influence of reporting and measuring human capital on investment decisions e.g. Avazzadahtah & Raiashekar (2011).

These studies have successfully identified human capital accounting information as important determinants of economic success both at macro and enterprise levels, and as such several valuation models have been suggested in order to decipher the economic benefits of human capital. The upshot associated with profitability, quality of corporate reports, investment ratios has been found to be especially imperative.

This concept of reporting human capital investments in the annual reports of companies and its wave on corporate characteristics is based on two theories of corporate finance namely, Agency theory and Propriety theory. Agency theory provides the necessary basis for the consideration of relationship existing among stakeholders in large corporations, the divergence of interest that may arise from such relationships and possible corrective measures needed to combat such discrepancy. Agency relationship is evident in large corporations because of the divorce between ownership and control. Agency theory therefore implies that a high level of information disclosure in companies' financial reports brings about a greater benefit of reducing the cost of agency (Fernando & Clea; 2012) while, conversely, the proponents of Propriety theory are of the opinion that high level of corporate information reporting brings about an innately higher cost to be incurred by the company which may include the cost of preparation and dissemination of information (Elliot & Jacobson; 1994), cost associated with loss of competitive advantage due to the competitors' reaction drawn from the information disclosure (Wangenhofer; 1990), and cost relating to assessing earnings per share estimates (Verecchia; 1990).

Obviously, divulging information pertaining to intangible assets, especially human capital has been found to have a premeditated bearing for firms because the intrinsic strategic importance which human capital offers depicts a competitive edge for business enterprise in any economy, even though such benefits are not recorded in the annual reports and account (Fernando & Clea, 2012). Therefore, the substantial significance which intangible asset like human capital offers to an organization is due to the defrayal that accompanies such information as increased productivity, increased market share, increased profit margin and innovations which are escape routes for intense competitiveness (Lev, 2004). Hence, human capital accounting information is beneficial to corporate organizations in the area of reducing information unevenness and minimizing agency cost as Agency theory has postulated. However, it may also spur reactions among other stakeholders of the company which may lead to loss of competitive advantages, which indicates a leaning or tendency toward propriety theory (Fernando & Clea, 2012).

Empirical studies on human capital accounting in Nigeria have been clustered around effects of human capital reporting and valuation on quality of financial reports (Abubakar, 2011; Akintoye, 2012; Ijeoma, Bilesanmi & Anonu, 2013; Oyewo B.M., 2014), its relevance to productivity (Bassey & Tapang, 2012), its effect on firms' performance and profitability (Ifurueze, Odesa & Ifurueze, 2014; Enofe, Mgbame & Ofuye, 2013) and its associated effects on stock investment decision (Okpala & Chidi; 2010). Ifurueze, Binglar, & Etyale (2013) examined the impact of human resource capital on the goodwill of Nigerian banking industry. The study revealed that human resource capital and goodwill are positively and significantly correlated, and the inclusion of human resource capital in the statement of financial position can help investors to make more rational investment decision.

METHODOLOGY

The study uses annual data of 50 manufacturing companies quoted on the Nigerian Stock Exchange for the period from 2007 to 2014. Companies with missing data and companies that are newly quoted were excluded from the study. Secondary data utilized for the study consist of selected variables from the financial statements of the sampled firms.

The estimation model uses pooled data. Pooled data econometric techniques were employed for the data covering years 2007 to 2014.

The estimation equation is as follow:

$$TE = f(HCC, TA, TL, SP, \varepsilon) \quad (1)$$

$$TE_{it} = \beta_0 + \beta_1 \textstyle\sum_{it=1}^{n} HCC_{it} + \beta_2 TA_{it} + \beta_3 TL_{it} + \beta_4 SP_{it} + \varepsilon_{it} \quad (2)$$

However, the model is re-specified to examine the effect of selected variants of HCC often reported in financial statements on TE.

$$TE_{it} = \beta_0 + \beta_1\, SW_{it} + \beta_2\, RBC_{it} + \beta_3\, OEC_{it} + \beta_4\, LTR_{it} + \beta_5\, TA_{it} + \beta_6\, TL_{it} + \beta_7\, SP_{it} + \varepsilon_{it} \quad (3)$$

Where
TE = Total Earnings,
HCC = Human Capital Cost (In Aggregate),
SW= Salaries and Wages,
RBC= Retirement benefit cost,
OEC= other employees' cost,
LTR= Labour turnover rate,
TA= Total Assets,
TL= Total Liabilities and SP= Share prices,
A priori Expectations $\beta1$ to β_7 = +/-

RESULTS AND DISCUSSION

Table 1 shows the descriptive statistics of the study variables, which provides information about the sample statistics of data series such as mean, medium, minimum and maximum value and distribution of the sample measured by skewness, Jarque-Bera, and Kurtosis. All variables are expressed in logarithm. A high level of consistency was displayed by the series in table 1, as their mean and median fall within the minimum and maximum values of the series. Also, the standard deviations are generally low, showing that the deviations of the actual data from their mean values are small.

Table1: Descriptive Statistics

	LLTR	LOEC	LRBC	LSP	LSW	LTA	LTE	LTL
Mean	-2.909	18.432	18.018	21.393	20.113	22.937	20.329	22.339
Median	-2.818	18.486	17.945	21.291	20.037	23.037	20.675	22.367
Maximum	0.9293	22.460	22.653	27.870	25.015	27.005	25.330	26.638
Minimum	-6.299	12.786	12.983	13.138	15.616	18.913	13.918	18.158
Std. Dev.	1.333	1.797	1.9551	2.760	1.760	1.835	2.234	1.828
Skewness	-0.1594	-0.2168	0.0047	-0.2653	-0.1809	-0.0788	-0.3763	-0.1144
Kurtosis	2.956	2.796	2.3392	3.340	2.777	2.095	2.764	2.368
Jarque-Bera	0.6433	1.426	2.711	2.465	1.121	5.237	3.863	2.814
Probability	0.7250	0.4903	0.2578	0.2916	0.5708	0.0730	0.1450	0.2449
Sum	-433.48	2746.4	2684.6	3187.6	2996.9	3417.6	3029.1	3328.5
Sum Sq. Dev.	262.94	478.12	565.71	1127.5	458.34	498.11	738.32	494.43
Observations	149	149	149	149	149	149	149	149

Note: LTR= Labour turnover rate, OEC= other employees' cost, , RBC= Retirement benefit cost, SP= Share prices, SW= Salaries and Wages, TA= Total Assets, TE = Total Earnings and TL= Total Liabilities .

Table 2 shows that there is a positive correlation between TE and all other variables and they are significant at 1% except the relationship between TE and LTR which is significant at 5%. However, caution should be exercised in interpreting results from correlation, because simple bivarite correlation in a conventional matrix does not consider each variable's correlation with all other independent variables. The conventional correlation matrix in table 2 only portrays the extent of the linear relationship between pairs of relationship used in this study, and caution must be exercised in interpreting results from correlation analysis, because correlation between variables does not mean causation. Thus, negative or positive correlation coefficients reported in Table 2 only depicts the extent of the linear relationship between pairs of variables used in this paper.

Table 3 presents the result of the Pooled OLS regression conducted to examine the influence of major determinants of human capital investments on total earnings of listed manufacturing companies. Each econometric methodology is used to estimate the pooled OLS for the different sectors individually and then collectively. The adjusted R2 ranges from 0.572 to 0.918. This simply suggests that the independent variables explain between 57% to 92% of the variation in the dependent variable. The results show that LSW has a significant positive effect on all the firms. However, when the firms are broken into sectors, LSW has significant positive effect on Industrial goods, conglomerates and others, but a significant negative effect on healthcare. LRBC has no significant effect on the various subsectors except for healthcare only at 10%. In the same way, LOEC has no significant effect on the various subsectors except in the consumer goods sector, where it has significant positive effect on LTE at 5%. LLTR has positive effect on the aggregate and the subsectors except in consumer goods and conglomerates subsections. In the sectors where the components of human capital reporting are positive, it could be that such costs positively affect workers' productivity and thus, total earnings. The findings then imply that as human capital reporting increases in listed manufacturing firms, earnings will also increase.

Table 2: Correlation Matrix

Correlation Probability	LLTR	LOEC	LRBC	LSP	LSW	LTA	LTE	LTL
LLTR	1							

LOEC	-0.0444	1						
	0.591	-----						
LRBC	0.0993	0.7016	1					
	0.228	0.000	-----					
LSP	0.0711	0.5076	0.5865	1				
	0.389	0.000	0.000	-----				
LSW	0.0757	0.7097	0.8780	0.6150	1			
	0.359	0.000	0.000	0.000	-----			
LTA	0.0784	0.7780	0.8583	0.6695	0.8802	1		
	0.342	0.000	0.000	0.000	0.000	-----		
LTE	0.1838	0.566088	0.6832	0.5306	0.7230	0.6969	1	
	0.025	0.000	0.000	0.000	0.000	0.000	-----	
LTL	0.0782	0.7639	0.8522	0.6415	0.8684	0.9702	0.6881	1
	0.343	0.000	0.000	0.000	0.000	0.000	0.000	-----

This table shows the relationship among the variables used in the study. For most of the variables, the results showed a strong relationship.

Table 3: Relationship between Human Capital Cost (HCC) and Total Earnings

Variables	1	2	3	4	5	6
C	2.206	-2.755	-3.378	54.178***	12.205**	0.9023
	(0.5470)	(-1.4432)	(-0.8709)	(4.306)	(2.371)	(0.5449)
LSW	0.9552*	0.1684	1.144***	-1.169**	1.250**	0.3929**
	(1.861)	(0.9977)	(3.424)	(-2.331)	(2.108)	(2.321)
LRBC	0.6920	-0.0237	-0.2056	-0.8081*	0.4621	0.0777
	(1.256)	(-0.1874)	(-0.9392)	(-1.990)	(1.102)	(0.5616)
LOEC	0.4751	0.2673**	-0.0659	-0.1622	-0.0064	0.0227
	(1.2296)	(2.228)	(-0.5309)	(-0.7303)	(-0.0161)	(0.2067)
LLTR	0.2873	-0.0636	-0.0160	0.4635**	0.1421	0.1919**
	(1.221)	(-0.789)	(-0.1564)	(2.255)	(0.4076)	(2.073)
LTA	0.1383	1.245***	1.270**	-0.4452	-3.635**	-0.1785
	(0.1148)	(3.318)	(2.749)	(-1.351)	(-3.121)	(-0.7942)
LTL	-1.386	-0.7143*	-1.336***	-0.4760	2.463***	0.5224***
	(-1.386)	(-1.770)	(-3.452)	(-1.347)	(2.814)	(2.923)
LSP	0.2660	0.1081**	0.2765**	1.283***	0.2377	0.1258**
	(1.342)	(2.218)	(2.579)	(3.969)	(1.223)	(2.202)
R^{-2}	0.5822	0.8277	0.9496	0.7964	0.5921	0.5720
Adjusted R^{-2}	0.4679	0.7990	0.9176	0.6946	0.4624	0.5530
Schwarz criterion	4.487	2.698	2.349	3.198	4.839	3.897
F-statistic	6.172	28.823	29.617	7.824	4.563	30.163
Prob(F-statistics)	0.0001	0	0.0000	0.0006	0.0028	0
Akaike criterion	4.1459	2.392	1.951	2.802	4.465	3.747
Durbin Watson	0.3919	1.425	1.385	1.881	0.5893	0.4065
No. of Observation	39	50	19	22	30	166

*The figure in parenthesis indicate t-statistics ***, **, * implies significant at 1%, 5% and 10% respectively. Note that: 1=industrial goods , 2=consumer goods, 3= conglomerates, 4=healthcare, 5 = others and 6=all industries.*

CONCLUSION

This paper examined the effect of human capital reporting on earnings of quoted manufacturing companies in Nigeria. The study made use of annual data for manufacturing firms in Nigeria over the period 2007 – 2014. The data was sourced from the Annual Reports and Accounts of the firms. Findings revealed that the measure of human capital cost exerts a positive and significant impact on corporate earnings, which therefore implies that the capitalization of human resource investment in the annual reports has the propensity to increase corporate earnings.

The policy implications of the findings are as follows: manufacturing companies in Nigeria need to recognize and treat human capital as an intangible asset in their financial statement with a certain amount amortized over a certain number of years. Hence the conventional way of treating human resource costs should be dropped. Secondly, the NSE should enforce capitalization of human resource costs in the annual reports of companies since such capitalization has impetus to increase earnings and performance of companies. A limitation of this study is that it has not considered all the listed firms on the Nigerian Stock Exchange. Subsequent studies should either look at all the sectors or do a comparative study of two or more sectors.

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