

not just the numbers

Financial analyses may be clinically accurate, but can ignore the human qualities of organisations. Two academics build a case for change



THE ADAGE “what gets measured gets done” is all too familiar to those challenging established business methods and models. Part of the appeal of numerical data, of course, is its clean, untainted appearance. After all, the figures can't lie, can they? Well, yes. They can. More and more commentators in the post-Enron business world are arguing that a focus on numbers can give the appearance of transparency while masking deep flaws.

It's not that numbers are wrong, but they are no longer enough. The time has come, say two Australian academics, to temper financial analysis with qualitative data on the human capital, which they define as human resource management systems that are likely to affect share price.

Highly skilled as they are, many financial analysts are viewing companies without a crucial lens, says Carol Royal, of the School of Industrial Relations and Organisational Behaviour in the faculty of commerce and economics at the University of NSW. She and Loretta O'Donnell, of the Australian Graduate School of Management, have been establishing a case for including

human capital analysis in financial markets. The two are passionate about the topic and have already sparked interest from the Australian Securities and Investments Commission, which invited them to present a paper on the topic at a Sydney forum in August.

It's a compelling argument at a time when people issues are taking a front seat in debates about business value and productivity, and triple-bottom-line reporting moves beyond theory. While they advocate a blending of techniques to build greater transparency in investment recommendations, the academics also point out that primary financial data can actually obscure rather than clarify.

“Financial analysts are adept at using a series of instruments to assess the performance of a company,” says O'Donnell. “Most of these tools are numerically based and look at historical data to predict future performance.”

But research by the academics shows quantitative data does not always provide the richness of analysis and may focus on lag, not lead, indicators of sustainability. “They are lacking a lens to view an organisation which is just as important to the final picture but seen as far too



The power of two: Royal (right) and O'Donnell say human capital is a crucial indicator of performance

complex – the area of human capital,” says Royal. “Just how a company recruits, retains and manages its employees is an under-utilised measure.”

Financial data often only measures properties common to all organisations or an industry. It can ignore or understate differences, and neglect complexity and variety in organisations. Using qualitative tools, they say, incorporates the human capital data that distinguishes organisations from each other, regardless of their core activity. Without the qualitative, says O'Donnell, analysts produce a report that misses a good slice of what a company is about.

Putting a microscope on the analyst's job by conducting in-depth research, Royal and O'Donnell have taken a look at what is standard practice, and extended analysis beyond the financial parameters. There's a growing body of research, they say, that finds a need for more tools in the analysis of corporate performance.

“There are lead indicators around retention and recruitment and it's quite conclusive,” O'Donnell says. “If we knew what was going on in Enron in these areas, it would have been more obvious what was happening.”

This is not a case for discarding the numbers approach. Royal and O'Donnell repeatedly emphasise they are arguing for analysts to use both the financial and the qualitative together.

“Both financial and human capital approaches are complementary,” says O'Donnell. “It's about how we get the best of both worlds.”

The move to include this kind of information has begun, albeit at a low level. “Some analysts are doing this, but making it systematic reduces the variability of the results,” Royal points out. “The industry worldwide is looking at the tools. They'd love to do more and want to learn.”

There is a misconception that human capital is synonymous with management quality, which is seen as based on the character of the CEO and board. “But that's a different thing,” Royal argues. Management quality is, in fact, a “top of mind” element for analysts, but is loosely defined and subjectively measured. It can be assessed far more rigorously through human capital analysis.

To trigger change in the area, Royal and O'Donnell suggest the use of a template for analysis of human capital variables, looking at its drivers, and the need for sophisticated skills in qualitative analysis to understand them. Not surprisingly, all the current training and systems for analysts are about financial data, O'Donnell says.

“If they do include human resources information, it's based on gut feel, anecdotes and so on. Human capital may be top of mind but they don't know how to get a handle on it.”

They suggest three alternatives:

- ❖ Analysts acquire new qualifications in human capital analysis.
- ❖ Analysts work side by side with qualified human capital analysts.
- ❖ Brokerage houses import the skills from research firms.

It may be impractical to retrain analysts, who are usually already highly qualified. Royal says the idea of working with a suitably qualified human capital researcher, who could pass on the skills or be used as a shared resource among a group of broking firms, is a viable option. Whatever. “The market will lead these changes,” she adds.

The frustrating element is that many of the tools and expertise needed for human capital analysis already exist – mainly in academia – but are largely untapped by analysts. It's time to build a bridge between the two arenas. The result, says Royal, must be more transparent investment recommendations and less room for error. It's an approach that fits the times. ❖

THE DATA

Qualitative data for human capital analysis:

- ❖ Library sources and academic journals
- ❖ Structured and semi-structured interviews
- ❖ Content analysis of interview data
- ❖ Publicly available documentary sources
- ❖ Media analysis
- ❖ Archival and historical analysis
- ❖ Oral history