

## **OFR: a human capital perspective**

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### **Introduction**

Before setting out the agenda for the human capital component of the OFR, we need to travel back in time to a point at which the balance sheet, profit & loss and cash flow statements were available but organisation reporting was still in its infancy.

The annual report, as we now know it, has had a long evolutionary journey. Its current format has common features but the underlying structure causes concern from an interpretive perspective. Organisations have been left to their own devices, as long as the three fundamental accounting statements are displayed.

One could view the fact that the OFR is actually a retrospective take on what an 'annual report' ought to be, ie the inclusion of forward-looking indicators (however they are defined). In this sense, the OFR is really a tool to 'fill a hole' that has been left unfilled for too long.

Given the recent focus and what we now know about organisational measures beyond financial ones – the question to ask is - what would a good organisational annual report look like?

### **Hindsight**

Thus, given our 20/20 hindsight, let us visit a parallel universe and see how an annual report may have developed.

Here, the 'annual report' looks a little different. Instead of a long and winding publication ('mishmash' of information) with the three financial statements at the core, we have an altogether different document.

The annual report is actually a document of documents which contain sub-reports on an important facet of organisational performance. From this particular view, we find the annual report complete with sections including:

- Financial report
- Human capital report
- Client/customer capital report
- Corporate sociability/environmental report (where required)
- Strategy execution report
- Corporate governance report
- Infrastructure report

Thus, it is easy to look at an individual slice of organisational performance as much as the whole.

### **One major difference**

However, there is one major difference. Rather than a set of ratios (with no obvious framework), there are a set of baseline numbers which provide the propensity to compare and contrast (and are not vanilla nor anodyne in nature as per the common argument), together with associated narrative and further analysis where appropriate.

So with that preface, I would like to return to our universe and the present time; and to the point of human capital reporting as an illustration.

Finance provides us with great template to use as a guide, given its history and combined intellectual power that has been spent on its development to its present day format.

It is worthwhile remembering that the structure of financial accounts – i.e. ‘accounts’ that contain baseline numbers are the starting point. The next stage advances to the analysis provided by various equations using structures, such as the ‘DuPont’ formulae (ROA etc.) and other associated ratio-type metrics.

A further level has since emerged which provides valuation-type metrics, such as economic profit and cost of capital, which are often referred to as advanced financial analysis.

Thus, can we apply this ‘model framework’ to the human capital perspective?

The answer is yes.

### **Solution to the puzzle**

One of the solutions that the OFR could not provide was an underlying composite structure that encapsulated forward-looking statements with associated measures. This was particularly true to those relating to people management. Arguably the people components are just a ‘bag of metrics’ with no inherent format.

However, using finance as a guide, there is a potential solution that has been provided. The HC accounts consist of:

- The Human Capital Operating Statement
- PeopleFlow™ Statement
- HC Productivity Statement

These statements are underpinned by SHCROPs, just as standard operating principles underpin financial accounting statements. These are designed to minimise distorting interpretative effects that can render reporting meaningless.

Each of these statements provides baseline 'numbers' which not only provides a 'dynamic' view of organisations from a people perspective, but which provides the structure for more forward-looking ratios.

### *Human Capital Operating Statement*

This basically combines financial numbers with people numbers (including certain base ratios).

Calculations such as revenue attributable to human capital, based on the operating model, rather than the more unreliable revenue per FTE are used. An outline of the associated support costs, attributed to people, is presented.

## Human Capital Operating Statement

	ye 31 <sup>st</sup> Dec 2005		ye 31 <sup>st</sup> Dec 2004	
<b>OPERATING INCOME</b>		%		
Revenue (£000s)	1,057,016		1,015,020	
FTEs	16,352		16,047	
Revenue per FTE	64,641		63,253	
<b>OPERATING COSTS</b>				
Total operating costs (£000s)	904,371		815,094	
People costs (£000s)	532,181		464,317	
Human Capital Intensity (HCI)		58.85		56.96
<b>OPERATING INCOME ATTRIBUTABLE TO HC (HCIR per FTE)</b>	<b>38,041</b>		<b>36,029</b>	
	£	%	£	%
<b>ANCILLARY PEOPLE COSTS (APC)</b>				
Training & Development costs (£000s)	8,176		7,342	
Recruitment costs (£000s)	2,314		2,954	
Health & Safety costs (£000s)	740		691	
HR functional and related costs (£000s)	6,254		6,879	
Outplacement costs (£000s)	256		53	
<b>Total</b>	<b>17,740</b>		<b>17,919</b>	
<b>HC LEVERAGE (HCIR/APC per FTE)</b>	<b>35.06</b>		<b>32.26</b>	

### PeopleFlow™ Statement

This statement actively reports the dynamics of the business, much the same way in which the cashflow statement reports the underlying dynamics of the business in movement of cash. This format reveals the underlying activity and cost to the business, which can ordinarily stay hidden in end of year figures. The presentation of the numbers themselves provides potentially ‘forward-looking’ information without the necessity of further ratios.

### PeopleFlow® Statement

<b>STAFFING</b>	ye 31 <sup>st</sup> Dec 2005	ye 31 <sup>st</sup> Dec 2004
	%	
No of full-time staff at start of year	14,011	13,865
Number of part-time staff at start of year (FTE eqv)	1,932	1,491
Number of other at start of year (FTE eqv)	104	175
<b>Full time equivalents (FTEs) at start of year</b>	<b>16,047</b>	<b>15,531</b>
	%	£ %
<b>STAFFING MOVEMENT</b>		
Number of FTEs recruited in period (+)	1,427	1,874
Number of acquisitioned FTEs during period (+)	-	-
	1,427	1,874
Number of voluntary leavers (FTE) in period (-)	996	1,065
Number of FTEs made redundant or outplaced in period (-)	35	217
Number of FTE retirements in period (-)	91	76
Number of FTEs outsourced in period (-)	-	
<b>Full time equivalents (FTEs) at end of year</b>	<b>16,352</b>	<b>16,047</b>
<b>STAFFING MISCELLANEOUS</b>		
Mean tenure (years)	5.2	5.3
Mean age of workforce	34	34
Retirement population	5,391	5,304

## HC Productivity Statement

This statement provides a picture of overall productivity taking account of the various people resourcing models that organisations employ. It also provides a means of comparison across organisation and sector. Again, reporting numbers in a structured format provides interesting and revealing detail.

### HC Productivity Statement

<b>CONTRACTED RESOURCE</b>	ye 31 <sup>st</sup> Dec 2005	ye 31 <sup>st</sup> Dec 2004
Total number of FTE days contracted in year	3,530,340	3,401,289
Total number of FTE vacation days taken in year	336,987	333,144
<b>TOTAL NUMBER OF CONTRACTED FTE DAYS AVAILABLE</b>	<b>3,193,353</b>	<b>3,068,145</b>
<b>WORK RESOURCE ADJUSTMENT</b>		
FTE days gained through recorded overtime work (+)	61,932	65,371
FTE days lost to illness (-)	18,431	19,016
FTE days lost to work-related illness/injury (-)	2,773	2,816
FTE days lost to industrial action (-)	249	167
FTE days recorded as lost under miscellaneous (-)	763	1,075
<b>ACTUAL NUMBER OF CONTRACTED FTE DAYS WORKED</b>	<b>3,233,069</b>	<b>3,110,442</b>
<b>PRODUCTIVITY</b>		
HCI*Revenue per FTE day (optimal)	£192.96	£185.42
HCI*Revenue per FTE day (actual)	£190.59	£182.90
HCI*Revenue per FTE day differential	£2.37	£2.52
<b>EMPLOYER-EMPLOYEE RELATED INDICES</b>		
Employee engagement index	69.2	68.5
Employer brand index	71.3	71.0
<b>HUMAN CAPITAL MANAGEMENT INDEX</b>		
VB-HR Rating	BB-BB-R	BB-B-R
HC Performance	Sustaining +	Sustaining +

## Ratio analysis and advanced ratio analysis

The data provided by these statements provides a rich environment for further analysis as well as providing sub-text for other related and useful information that can be interpreted as forward-looking. A degree of autonomy should always be granted to organisations in reporting terms. Those that unduly withhold information are invariably punished by markets or subject to investigation where appropriate.

## **Summary**

Returning to the central thesis of the OFR being a forward-looking document, the question remains: What is forward-looking? From a non-financial perspective this question actually may have provided an unnecessary strait-jacket. The question perhaps to ask is, 'Does the OFR components need to provide added insight and/or detail which provide recipients with what is required to make forward-looking observations/deductions?'

Surely the answer should be yes. With this in mind, perhaps the answer does not necessarily rely on advanced ratios with no underlying structure. Perhaps, a greater and deeper understanding of operational and strategic aspects that are provided in a format, similar to those of finance, can provide what investors and stakeholders require to make forward-looking judgements.