Workers or Waste?

How Companies Disclose—or Do Not Disclose—Human Capital Investments and What to Do About It

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Introduction and summary

Policymakers, economists, and investors alike are increasingly concerned that myopia at public companies and on Wall Street is choking off profitable long-term investments. BlackRock CEO Larry Fink recently penned a letter to the CEOs of America's largest companies lamenting the fact that "today's culture of quarterly earnings hysteria is totally contrary to the long-term approach we need."[1] In line with Fink's concerns, several studies suggest that public companies are forgoing profitable investments in order to boost short-term returns.[2] But the problem of managers' investment incentives may be even worse than the short-termism research implies.

Studies of short-termism have generally focused on readily measurable types of investments such as physical capital and research and development, or R&D, investment. These show up on a company's financial reports, such as the Form 10-K, which is submitted annually to the Securities and Exchange Commission, or SEC. When a firm spends $10 million on a new piece of equipment, for example, investors see that the firm has $10 million more in assets. Or when a firm spends $10 million on research and development, the R&D spending is clearly designated within the firm's financial statement. Investors can see these investments, and financial markets can price them in to the company's share price, even if they excessively discount them.

But there is a class of investments that financial markets may not just excessively discount but actively penalize: investments in the human capital and skills of a company's workforce. A $10 million investment in worker training shows up in a firm's financial statement—not on its own but lumped into selling, general, and administrative expenses, or SG&A, a measure that includes items such as company lunches and paper clips.[3] Companies' expenditures on worker training and skills show up not as a valuable investment similar to R&D but as an increase in general overhead, a measure that managers have shown a proclivity for cutting and whose reduction is often cheered by investors. This treatment of human capital ignores the findings of numerous studies: Investments in human capital enhance productivity and are more valuable to a firm than general overhead expenses.[4]

Investments in training thus face two hurdles. First, they face the short-termist pressure that affects all investments—public firms are excessively focused on short-term profits rather than long-term value. Second, training's lack of disclosure is itself a disincentive since it appears as general overhead rather than as an investment. This second problem is not a form of short-termism but rather what economists call the multitask problem—when people have an incentive to perform easily measurable tasks, such as increasing reported profits, they will focus on those tasks at the expense of those that are more difficult to measure, such as investing in the skills of their workforce.[5] This is especially concerning given recent evidence suggesting that employer-sponsored training has been in decline: One study found that over the past decade, the share of employees who received training fell 28 percent, with much of this decrease resulting from a declining share of large-firm employees receiving training.[6] While there is no causal evidence that this decline in firm-sponsored training is a result of short-termism, there does appear to be a measurement problem that may create a disincentive for firms to make human capital investments, even when those investments are material to a firm's long-term performance.

This report focuses on ways to fix the human capital investment measurement problem: requiring companies to distinguish investments in training from general overhead by reporting those investments separately. Requiring firms to disclose their investments in human capital, as they do for R&D, has the potential to pay off for investors, firms, and workers. It would allow firms to demonstrate to investors that they are making productivity-enhancing investments in their workers and would supply investors with material information upon which to base investment decisions. Furthermore, to the extent that disclosure would lead firms to increase human capital investment, it should help raise workers' wages and benefit the economy overall.

This remainder of this report evaluates what we know about the state of firm-provided worker training in the United States, examines the economic reasons firms may be providing less worker training, and discusses potential policies to improve the transparency of human capital investments and eliminate firms' disincentives to make them.

Specifically, this report calls for the Securities and Exchange Commission, or SEC, to require firms to disclose their human capital investments and metrics. We argue that this would be a win for all stakeholders, benefitting investors, workers, and firms.

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