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WICI Japan

Human Capital Subcommittee report

- English excerpted version -

World Intellectual Capital/Assets Initiatives

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This English excerpted version was compiled by translating “Executive summary” and “Chapter-3 Looking Ahead -Key Points” of the Japanese full report into English.

Executive Summary

An ongoing discussion about human capital management and human capital information disclosure is taking place among domestic and foreign stakeholders. In this paper, we share issues that we would like to see developed among these stakeholders, based on insights gained from discussions among members of diverse backgrounds during the one-year WICI Japan Human Capital Subcommittee meeting, held from January to December 2022.

In Chapter 1, we clarify the definition of human capital and address the link between corporate human capital and value creation. The Subcommittee defines human capital as "the value (as a resource) provided by employees and managers through their skills, ability to perform tasks, and knowledge." We then focus on the connection between human capital and value creation, rather than viewing human capital statically. We dynamically view the value creation process using human capital and emphasize the importance of active management in driving value creation from human capital. We also note that Japanese companies need to reconstruct the relationship between organizations and individuals.

Chapter 2 deals with human capital-related disclosure and dialogue. We share insights about domestic and international guidance trends and human capital disclosure case studies and present the Subcommittee's view on how companies should approach human capital-related disclosure to focus on corporate value creation. We particularly emphasize the importance of creating a virtuous cycle of value creation involving internal and external stakeholders by fostering dialogue with key human capital stakeholders through the disclosure process.

Based on the discussions in Chapters 1 and 2, Chapter 3 presents four perspectives for future discussion by domestic and foreign stakeholders: "perspectives on human capital and value creation," "the role of management and the monitoring function of the board of directors," "human capital-related information disclosure," and "the society surrounding the corporation." We present the Subcommittee's views from each of these perspectives and present a promising approach for the future.

Chapter 4 presents examples from two perspectives. The first perspective involves value creation utilizing human capital, showcasing a case study of value creation through the use of human capital. The second perspective focuses on human capital disclosure, introducing examples of good disclosures from the WICI Japan Integrated Reporting Awards and sharing insights on how they compare with overseas disclosures.

Chapter 3: Looking Ahead - Key Points

The debate on human capital is ongoing. Based on our analysis and discussions thus far, we summarize points that provide insights for future discussions, dialogues, and corporate actions from four perspectives: "human capital and value creation," "the role of management and the monitoring function of the board of directors," "human capital-related information disclosure," and "society surrounding the corporation."

1. Perspectives on Human Capital and Value Creation

(Findings)

The utilization of human capital, rather than the capital itself, leads to corporate value creation. The performance of the organization/team, as well as the ability of each individual, is also an important perspective. Therefore, the selection of KPIs related to human capital should be made from the perspective of human capital utilization leading to value creation. In many cases, human capital is a core factor that, combined with other intangible assets, creates a company's unique competitive advantage. The time frame and process of converting human capital into value are unique to each company and can vary depending on the motivation of employees.

(Preferred Approach)

In both management and disclosure, companies should focus on the dynamic perspective of how human capital leads to value creation, rather than the static value of human capital itself. Companies will select KPIs related to human capital based on their relationship with value creation, distinguishing between obligatory indicators for disclosure (required metrics) and those that are core elements of value creation (KPIs).

2. Role of Management and Monitoring Function of the Board of Directors

(Findings)

When considering the dynamism of value creation utilizing human capital, the role of management in steering the entire value creation mechanism from a long-term perspective is crucial, and this is what human capital management entails. This is an essential element of management policy, and the role of the board of directors is extremely important in its formulation and steering.

(Preferred Approach)

Management should understand how the company's human capital connects to value creation, and create mechanisms to facilitate more effective use of human capital to enhance value creation and motivate employees. KPIs related to human capital will be selected accordingly. The Board of Directors should also establish systems to facilitate more effective use of human capital to enhance value creation and motivate employees.

The Board of Directors should check whether human capital management is functioning effectively and propose specific necessary measures to management, requiring them to implement these measures.

3. Disclosure of Human Capital-Related Information

(Findings)

Human capital KPIs are not only essential for human capital management for value creation but also useful for deepening understanding among target stakeholders. By fostering dialogue with target stakeholders through information disclosure, companies can create a virtuous cycle of value creation involving these stakeholders. Even indicators and items related to DE&I, which are easy to focus on, may or may not lead to value creation, depending on the uniqueness of each company's value creation mechanism.

(Preferred Approach)

Companies should explain how they create value by managing human capital, including the selected human capital-related KPIs, in their information disclosure so that target stakeholders will be convinced.

If the indicators and items related to DE&I are KPIs, their relationship to value creation should be clearly explained. Otherwise, it is sufficient to present them in a manner within the scope required by the rules, and avoid misunderstandings on the part of the viewer by making a sharp distinction between required metrics and value creation indicators.

The reporting process itself creates a dialogue among management, employees, target stakeholders, etc. leading to a virtuous cycle toward further value creation by enhancing the sense of conviction, expanding the circle of empathy, and gaining further commitment. To this end, the organization will communicate the uniqueness of the company to target stakeholders through the effective use of multiple media, such as financial reports and integrated reports.

4. Society Surrounding the Company

(Findings)

Employees, who are the human capital of a company and a key audience for corporate information disclosure, are also the recipients of the diverse benefits that the company creates for society. From the perspective of realizing their own personal path, they choose where and how they work of their own volition. The trend of increasing awareness of autonomous career development and decreasing psychological hurdles to changing jobs has become more pronounced over the years and has been further accelerated by the pandemic, and is expected to continue in the future. The analysis of

information about human capital by external third parties is also beginning to influence evaluations by investors, consumer purchasing behavior, and company evaluations from the perspective of workers.

(Preferred Approach)

As the factors that determine where each individual works are diversifying, companies should be aware that they are providing value to workers in terms of total rewards, including compensation, opportunities for skill improvement, and job satisfaction. Participants should recognize that society's interest in non-financial information, including human capital, influences the evaluation of a company's economic value, and all stakeholders should be able to accurately grasp the magnitude and time frame of this impact.

