Refining the York Index Investment Criteria
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Refining the York Index Investment Criteria

Summary
There is evidence to suggest that large institutional investors (for example pension funds and mutual funds) are combining socially responsible investment criteria along with their primary criteria of maximization of returns. Additionally investment analysts are increasingly recognizing that intangible assets such as human capital (HC), social capital and intellectual capital contribute to the value creation process of a firm and improve company performance and thus enhance shareholder returns. Measuring these resources can therefore be a powerful tool for active investment management. The link between socially responsible investments and these intangible assets has been comprehensively studied and advocated by a number of academic commentators (Nahapiet and Ghoshal, 1998; Kingsmill, 2003; Wheeler, Colbert and Freeman, 2003) but the challenges in measuring the intangible assets have hindered the process of socially responsible investments in the quantitative world of financial investments. However, based on the premise that some indicators of the quality of human resource management (HRM) are measurable and may be correlated with financial performance, Thomson and Wheeler (2004) devised a set of Human Capital (HC) based investment criteria (the York Index) and Milevski et al (2005) tested these criteria against the financial performance of the S&P/TSX60 (Toronto Stock Exchange) and found some positive correlations. These authors also highlighted the areas on which the HC investment criteria could be refined further to produce measurement reproducibility and statistical granularity in order to strengthen the HC investment criteria. The purpose of the study reported in the current paper is to explore approaches for refinement of HRM measures and other employment practices by conducting in-depth interviews with HR professionals and academics in the UK and Canada. The guiding principles for the refining the York Index were the links to value creation and measurement. The study identifies four measurable areas that directly relate to the HC of a firm- Workplace Culture; Reputation of the Employer; Training and Development; and Negative Measures. This is potentially a value added investment analysis tool to assess companies on the basis of their capabilities to create and maintain HC, which is recognized to be an important intangible resource for corporations in the information age.

Keywords: Socially Responsible Investing, Human Capital Performance Criteria, Human Resource Accounting

JEL classification: M14, M40, M59

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1. Introduction

Among all the resources a firm draws on, human capital (HC hereafter) may be the key resource to mobilise other resources efficiently (Thomson and Wheeler, 2004). In strategic management literature, HC of a firm is considered to be a source of competitive advantage (Barney, 1991). Unlike many other resources of a firm, it is difficult to duplicate or substitute (O’Reilly and Pfeffer, 2001), as people cannot be separated from their knowledge, skills and values (Becker, 1975). As much as 80% of a company’s market value may be tied to the human capital embodied in the workforce (Scott-Jackson and Tajer, 2005).

From a socially responsible investment (SRI) perspective, HC measures can act as a more concrete differentiator among otherwise non-distinguishable policies based corporate social responsibility performance. From a stakeholder perspective, it is often argued that good relationships with employees are crucial for wealth maximisation in business, for example, through enhanced customer loyalty (Wheeler et al, 2003). Also, a company with good employment practices and employee relations is more likely to have good relations with other stakeholders (Kingsmill, 2003).

From an accounting perspective, HC accounting is gaining momentum as many of the characteristics that create value for a company and its investors are not captured in current accounting and financial reporting standards (Silvers, Patterson and Mason, 2001) HC accounting is being promoted as an approach to measuring the contribution of employees and other intangibles in the performance of organisations (CIPD, 2005, CFO, 2003). The Kingsmill Report (2001) has stressed the importance of accounting for HC of firms in the Operating and Financial Reviews of companies. As CIPD (2005) note in their guide to HC internal reporting, organisations with an ability to communicate the value and contribution of its people to key stakeholders in the business have been recognised to be more competitive and deliver higher levels of service and performance. In simple words, HC accounting enables an organization to understand and report on one of its key intangible assets and may reflect a firm’s superior capabilities in risk management and in navigation of complexity in the business environment (Wheeler, 2004).

In summary, based on the above reasoning from strategy, corporate responsibility and human resource management literatures, we wish to advance the proposition that HC contributes directly to the performance of a firm and can act as a differentiator in investment analysis. We wish to demonstrate how HC metrics may be developed and successfully inform investment analysis on a replicable and pragmatic basis as part of routine company assessments.
Thompson and Wheeler (2004) identified a set of HC criteria as a tool for institutional investors to identify high performing companies and eliminate those with poor or riskier employment practices from their portfolios. This positive SRI screen aimed at promoting ‘a race to the top’ in terms of employment practices has been named— the York University Corporate Social Responsibility [Employment Practices] (York Index hereafter) (Milevski et al, 2005).

The main (and gradually fading) opposition to SRI screens is the restriction imposed by such screens on the investment universe resulting in lack of diversification (Aslaksen and Synnestvedt, 2003; Geczy et al, 2003), which has been a basic tenet of investment prescribed in Markowitz’s portfolio theory. According to this traditional view, screening results in an inevitable economic penalty because there is a decline in diversification necessary to eliminate unsystematic risk in the portfolio.

Using the York Index, Milevski et al (2005) researched Toronto Stock Exchange index (the TSX60) companies and suggested that the economic penalty of eliminating a relatively small group of undesirable stocks in a passive index is insignificant when the remaining investments are re-aligned properly using risk-modeling software. In addition to showing a minimal cost of applying this SRI screen on the TSX based portfolio, the results of the modeling exercise showed that companies with better scores on the York Index criteria have better performance over a one year period, lending some support to the view that HC contributes to financial performance (Milevski et al, 2005).

Notwithstanding the positive results observed with respect to the York Index, a number of the HC criteria were found to be sub-optimal in two dimensions: i) measurement reproducibility and ii) statistical ‘granularity’ or spread in the scoring system. To some extent this can be attributed to the general difficulties of devising objective and universal indicators or measurements for intangible assets like the HC, social capital and intellectual capital of firms. Nevertheless, a number of the criteria in the York Index did satisfy reproducibility and granularity requirements and in these cases some correlations with economic performance did emerge.

The intention of this paper is to recommend refinements to the HC criteria employed by Milevsky et al, 2005 and by increasing the ‘reproducibility’ and ‘granularity’ enable further research into links between HC (performance and reporting) with financial performance of firms. The process of refining the York Index criteria is reported here. The objective is to make the criteria more focused on value creation, more generally applicable, more reliable and usable.
than the previous edition (Thomson and Wheeler, 2004). Using in-depth interviews with HR professionals and academics, the aim is to overcome the challenges of standardization without being too theoretical or impractical about HC.

In subsequent sections of this paper we provide a brief background to the York Index (Section 2). We then outline the literature pertaining to HC and firm performance and other efforts in designing a standard for HC (Section 3). Section 4 describes the methodology used in this research. Section 5 summarises the results of the interviews and data analysis. The penultimate section discusses some of the challenges and limitations of the research and the final section provides a summary and conclusions from the research.

2. Background

2.1 The York Index investment criteria

Thompson and Wheeler (2004) hypothesized that among all potential corporate social responsibility (CSR) and corporate social performance measures, issues of good labour and employment practices are likely to be especially salient to firm performance and risk minimization. Employing the resource based view of strategic management (Barney, 1991) and evidence of the growing importance of intangible assets to firm performance, the study resulted in the generation of 14 final candidate investment criteria based on HC. The following indicators collectively formed what we now call the York Index:

1. Board Composition, Skills and Diversity
2. Health and Safety Record
3. Health and Safety Culture
4. Reputation as an Employer
5. Community Investment
6. Employee Attitude Survey
7. Employee Retention
8. Work/ Life Balance
9. Performance Based Compensation
10. Pension Plan
11. Training
12. Employment Practice and Other Policies
13. Convictions and Fines
14. Freedom of Association (i.e. Unionization)
2.2 Scoring and Ranking of TSX60

The criteria were tested for their validity and relation to shareholder returns through financial modeling of the TSX60 using Algorithmics risk management software. A ranking of the TSX60 was carried out on the basis of the 14 indicators using desk based research. The ranking utilized information available in the public domain (websites of the companies, annual reports, external reports and surveys) and assigning scores for the indicators adding up to a total of 100. Each company was assigned a score out of 100 based on the information available on their practices related to each criterion.

2.3 Financial Modeling- the Relationship between the Criteria and Firm Performance

Using an optimization algorithm, Milevski et al (2005) assumed that if the market is rewarding (punishing) firms with good (poor) employment practices (as measured by position in the index), regression analysis should uncover any potential relationship between scores and returns. Using 1-year returns as the dependent variable, the York Index coefficient was positive and statistically significant. In other words, firms with better employment practices (as defined by the HC index) demonstrated better stock performance (Milevski et al, 2005).

Their approach separated out the relative power of each criterion, independent of the masking effects of aggregation. Most of the coefficients had the expected signs, but the results were interpreted with caution given the lack of statistical significance of some of the coefficients and the presence of multi-collinearity among some of the variables.

From the above analysis, Milevski et al (2005) concluded that the financial modeling showed that:

- there appears to be a statistically significant relationship between the HCGILP based ranking and 1-year returns
- the “work-life balance” indicator appears to be particularly powerful in explaining equity returns
- a number of other indicators show a statistically valid relationship with investment performance
- question over whether some variables should be included at all.

2.4 Focus of the paper
Notwithstanding these observations, there are several areas in the criteria and the scoring system and quality of data obtained which the authors recognised could be improved. Based on this, following are the objectives of this research exercise:

- to improve discrimination ('statistical granularity') in the scores for each main criterion by identifying and refining main indicators of HC leading to value creation;
- to select a streamlined list of criteria that would provide a number of statistical benefits; and
- to identify and include any other new indicators of HC.

3. Human Capital and Firm Performance

The section explores the literature on links between corporate practices related to developing and retaining HC and corporate financial performance. In human resource management (HRM) it is often asserted that better HC practices contribute to financial health of a company (Truss, 2001) and subsequently to increased shareholder wealth (Watson Wyatt, 2002). Stiles and Kulvisaechana (2003) undertook a comprehensive literature review on HC and performance and concluded that there is a large and growing body of evidence that demonstrates a positive link between the development of HC and organisational performance.

3.1 Human Capital Theory

A number of theories including general systems theory, role behaviour theory, institutional theory, resource dependency theory, human capital theory, transaction cost economics, agency theory and resource based theory of firms have been used to explain HR strategies and performance links (Truss, 2001).

According to human capital theory, people possess knowledge, skills and abilities that are of economic value to the firm (Truss, 2001). Flowing from HC theory is the resource based point of view which states that, ‘human capital pool and employee behaviour…can constitute a sustained competitive advantage’ (Wright et al, 1994: 318-19 as cited in Truss, 2001).

The resource-based view acknowledges that internal resources are crucial to sustaining the effective competitive advantage of a firm (Wright et al, 2001). In this view, initiated by the work of Penrose (1959), competitive advantage is ‘dependent on the valuable, rare, and hard-to-imitate resources that reside within an organisation’ (Stiles and Kulvisaechana, 2003: 4). Human resources, a good example of such internal resources, is difficult to imitate because of causal
ambiguity (causal relationships hard to establish) and path dependency i.e. no clear cut relationship between factors and process (Becker and Gerhart 1996, Barney, 1991).

The increasing importance of the resource-based view has promoted HC management and has brought a convergence in the fields of strategy and human resource management (Stiles and Kulvisaechana, 2003). In strategic management, HC is also considered to be a competitive advantage in today’s dynamic business environment due to increased emphasis on knowledge based and value based networks (Wheeler et al, 2003). The knowledge based view of the firm (Grant, 1996) emphasises the requirement of organisations to develop and increase the knowledge and learning capabilities of employees to achieve competitive advantage. Therefore, ‘given the importance of knowledge in the organisation…it becomes crucial that the employees who are the source of knowledge are managed well’ (Stiles and Kulvisaechana, 2003: 9).

Additionally, it is asserted that building HC requires other complementarities like social capital and organisational capital which essentially refer to ‘the valuable relationships among people’ and ‘the processes and routines within the firm’ respectively (Wright et al, 2001: 716). Organisational capital in relation to employees refers to ‘Incentives, controls and performance measurement systems’ and ‘organisational culture, values and leadership’ (Dess and Picken, 1999: 11).

### 3.2 Human Capital and Shareholder Value

With the rise in perceived importance of HRM in the 1980s, the debate about the link between management of people and performance received a great deal of attention from academic researchers and a number of scholars linked the effect of certain human resource practices to specific organisational outcomes. Training programmes were positively associated with financial performance; job security, presence of a union, compensation level, culture and demographics have an impact on turnover, transformational labour relations (including partnership and involvement) have all been linked to increased productivity (Stiles and Kulvisaechana, 2003: 12). However, according to Barney (1995) human resource practices realise their full competitive advantage in combination as they have limited ability to generate competitive advantage in isolation. Concurring with the literature, here, we have tried to identify a set of indicators of these practices and their effects on value creation.

There are two primary approaches towards human resource practices, the ‘Contingency’ or ‘fit’ approach and ‘universal’ or ‘best practices’ approach (Stiles and Kulvisaechana, 2003: 13 & 14). The contingency approach prescribes that human resource practices should be vertically
aligned with the organisational strategy of the firm. Huselid (1995) found that those organisations which link human resource management practices to strategy report higher performance outcomes. In the universal or best practices approach, scholars have identified sets of human resource practices which emphasise the need for strong consistency between the practices to achieve better performance (Stiles and Kulvisaechana, 2003). This approach has strong empirical support and has established some best practices in HRM (Stiles and Kulvisaechana, 2003). These best practices might indicate the capacity of a firm to perform better and provide better returns to its shareholders. We align with the best practices approach in the York Index.

Human Capital Management (HCM) has also been linked to value creation on a broader level. According to the Kingsmill (2003) report to the UK government, performance is related to the way organisations manage their people. From an accounting perspective, Kingsmill’s recommendations argued that although good HCM is an important element in organisations’ performance and productivity, it is routinely under-reported (Kingsmill, 2003). The report suggested that ‘greater transparency of HCM practices was desirable to aid the efficient and well-considered allocation of resources by investors and shareholders and that it would benefit all key stakeholders’ (Kingsmill, 2003: 7). Links have also been made between disclosure of HC policies and practices and effective working of capital markets as this issue is considered to be sufficiently material in increasing the value of financial reports as people are increasingly looking for reports that demonstrate to other stakeholders (such as customers, suppliers, employees and regulators) that the organisation is focusing on all the drivers of value (Kingsmill, 2003).

To sum up the discussion - the practitioner literature shows the importance of HC strategies to the market value of the firm and consequently to increased shareholder value (Watson Wyatt, 2002). The contemporary management literature ‘the emphasis on human capital in organisations reflects the view that market value depends less on tangible resources, but rather on intangible ones, particularly human resources’ (Stiles and Kulvisaechana, 2003: 3).

4. Methodology

Senior HR practitioners and academics were interviewed face to face and over the phone with an interview guide (Patton, 2002) in Canada and the UK. The interviewees were selected on the basis of their experience and knowledge of HC. In-depth interviews preclude standardised questions and are based on themes. These are usually designed for small samples with an assumption that interviewees have knowledge of or particular experience in the subject matter (Marshall and Rossman, 1989). The interviewees were sent a project brief before the interviews
as a background and summary of previous research in the project. It outlined the objectives, parameters and plan of action for the research. Interviewees were also sent the previous two papers and the documents from the desk based ranking and scoring of the TSX60. These documents provided an in-depth understanding of the project and the next stages to the interviewees. The subject of the interviews required the interviewees to reflect on their knowledge and come up with their opinions in the discussion. Availability of the project brief and the documents gave interviewees time to consider the issues well in advance. The interviews open-ended- like ‘conversations with a purpose’ (Legard et al, 2003).

Interviewees were asked to give a commentary of their ideas on each of the 14 criteria designed by Thomson and Wheeler (2004). It included the likely accuracy of the criteria as an HC indicator and its links to value creation. They were asked to rank the criteria on the basis of value creation on scales of their choice. Advice was solicited on the measurability and comparability; any additions/deletions and changes in sub-indicators of the criteria; and; a potential scoring system for the criteria. This helped in restructuring and streamlining the York Index along the lines of value creation, differentiation and adding new indicators of HC for added statistical benefits for future financial modeling of the criteria.

The interviews were recorded and transcribed. The data are extremely rich in detail with respect to discussing the criteria, its links with value creation, how to measure HC and other issues in HRM. Reducing the data for analysis might result in losing some of the rich descriptions and meanings. On the other hand, it is problematic to present the raw data concisely. Hence, the data was sorted and organised with the help of computer aided qualitative data analysis software (CAQDAS) called QUALRUS. QUALRUS permits the researcher the flexibility of choosing an appropriate analysis technique that is highly desirable in qualitative research. It is a type of code and retrieve program in which passages of textual data can labelled or ‘tagged’ and can be retrieved at any stage using the codes applied (Spencer et al, 2003). Apart from systematising and organising the data, QUALRUS also offers options to create links between the codes which helps in forming associations and meanings in the data.

The coding scheme is pre-conceived and identified on the basis of the research objectives. Table 1 shows the coding and cross coding of the interview responses according to their corresponding criteria and characteristic of York Index. The other codes in data analysis which occurred in the interview data serendipitously were ‘structure’ of the criteria as a whole and ‘new indicators’.
Use of the software tools was not a substitute for analytical rigour (Weitzman, 2000) as the software used only facilitated organisation of data, thus, speeding the analytical process. It was helpful in improving the reliability and transparency of the analytical process: ‘In comparison to with manual methods, the main benefits are seen to be the speed that CAQDAS methods offer the analyst for handling large amounts of (textual) data; the improvements in rigour or consistency of approach; the facilitation of team research; the ability of computer software to assist with conceptualisation of data and theory building; and the relative ease of navigation and linking of data’ (Spencer et al, 2003: 207). By tagging large paragraphs with codes, the problem of ‘removing segments from their context’ (Coffey and Atkinson, 1996) has been minimised.

5. Refining the York Index Investment Criteria

5.1 HC indicators and value creation

Predicting future financial performance is the Holy Grail for investment analysts. Thus, the first concern in refining process of the York Index criteria is to explore the link with value creation specifically financial value. All interviewees were questioned on their view of the potential links between the individual indicators and financial performance. The responses were mixed. There was no consensus on which indicators might contribute more to value creation and the interviewees had differing opinions on what contributes to value creation. However, the strategy of making the interviewees rank each indicator was useful in the analysis. Table 2 summarizes the responses on the perceived strongest and weakest linked HC indicators to value creation in the view of the interviewees:

<table>
<thead>
<tr>
<th>Codes List</th>
<th>Value creation</th>
<th>Measurement</th>
<th>Differentiation</th>
<th>Accessibility</th>
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<tr>
<td>Board Composition</td>
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<td>H&amp;S Record</td>
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<td>Work/Life Balance</td>
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<td>Employment Practice and Other Policies</td>
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<td>Convictions and Fines</td>
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<tr>
<td>Freedom of Association (i.e. Unionization)</td>
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Table 2: List of codes and cross coding type
Work-life balance, performance-based compensation, training and reputation are considered to be likely contributors to economic performance. Work-life balance is considered to be an approach towards maintaining a trusting and caring relationship and working environment that results in increased motivation and loyalty:

“There is probably a size bias to that one but if we are looking mainly at big companies then it shouldn’t matter. But the rest of them are pretty good. So I would put it at 1. Difference between policies and practice…I don’t know how you measure that perhaps employee surveys. So again there is difficulty in measuring other than the options available but firms tend to be more active on work-life balance if they have the policies.”

(Interviewee P, Nov. 2006)

“This [work-life balance] again to me is part of what I would call as the environment a company creates for knowledge workers that says that they really do respect them and trust them. The trust comes with the flexible working hours, comes into the flexible location part, if they trust them to accomplish their objectives in whatever way it works for them, in whatever location or whatever time of the day it works for them. So I think work-life balance is a very strong indicator of the relationship a company has with its employees.”

(Interviewee W, Nov. 2006)

“Training, I would that one as a 1. It is an investment and it pays off.”

(Interviewee P, Nov. 2006)

The main reason according to the interviewees for reputation as a strong indicator of value is that it is a good composite indicator of an organisation’s commitment and culture to developing and retaining HC. The following quote encapsulates the responses on reputation:

“The reason I chose reputation as no. 1 is that it seems to be a surrogate for other measures, so essentially if a company is a company which is deemed by other ranking agencies as good at the way they manage their employees or their attractiveness as an employer or in terms of indices which make it their business to determine which companies are doing the best job in sustainability, then they probably would have a good reputation and although I think its not perhaps a direct indicator, its an indirect indicator and that others have gone through the rigour of trying to find out which companies are doing the best job, so reputation would probably be a good thing to look at…and also I think it would be an indicator of value creation because many of those indices are related to value themselves…”

(Interviewee W, Nov. 2004)
Conversely, policies, freedom of association, convictions and fines, employee retention and health and safety indicators are considered to be lower on the value creation scale, mainly because they could potentially be contradictory to performance and might not be reflected directly in value creation process.

“Freedom of association, I think it’s critical but I don’t think it will be an easy one to relate to value creation... percentage of workforce that’s unionised, I think ____ (company name) had no percentage of the workforce which was unionised and we bend over backwards trying to keep it that way by ensuring that we didn’t need a union. That the way we treated our people, the way we paid our people etc was so good that they wouldn’t even think of being in a union. So the absence of a union might almost be better than the presence of a union in this metric. Although it’s very difficult, I can think of so many reasons why it is vital and so many reasons why it is irrelevant that I ended up saying this is not going to be a useful one. So I think it is going to be misleading at best. Even though it’s important”

(Interviewee W, Nov. 2004)

“Well in terms of value creation the issue isn't freedom of association the issue is participation and that is about consulting employees and informing employees which isn't really on your list”

(Interviewee H, March 2005)

Board composition, employee attitude survey and pension plan are perceived to be moderately linked to value creation by the interviewees. They suggested that these indicators are relevant to creating and maintaining HC but it is the implementation of these provisions which counts and hence can be misleading inform of measuring as policies. For example, employee attitude surveys could be non-effective and even a waste of resources if the results are not disclosed, shared and worked upon (Interviewee R, 2004)

In the interviews, the notion of good HC practices leading to value creation itself was questioned on the basis of reverse causality i.e. financial performance causes good employment practices and not vice versa. Of course this is not necessarily relevant to the issue of correlation.

“Maybe the more successful firms tend do these things well. People buy from firms with good PR and good PR results in good scores for these measures (intervening variable - PR causes sales and high scores). Would be interesting to do correlations on each item individually, especially over time, to try and detect reverse causality.”

(Academic II, March 2005)

5.2 Future value and growth of organisational HC

An often-repeated observation by the interviewees is that a potentially high correlation existed between the indicators i.e. one criterion fed the other in creating HC in a firm. Based on this and
other observations on main factors in creation of HC from the interviews, the following relationship model of developing and valuing HC factors has emerged:

**Figure 1: Developing and Valuing Human Capital**

![Diagram of Developing and Valuing Human Capital]

This model proposes that several indicators in the York Index criteria are not stand-alone indicators. They are interlinked with one factor affecting another. This is also indicated in the financial modeling exercise where a problem of multicollinearity was identified (Milevski et al, 2005). As depicted in figure 1, *policies* may affect *workplace culture*, for example, work-life balance policies like flexi-working, working from home etc. reflect on maturity level and trust between workers and managers and hence reflect in the workplace culture. Similarly, a creative *workplace culture* marked with trust and respect may contribute to *loyalty, motivation and innovation*.

Similarly we may postulate that *reputation as an employer* is an outcome of multiple factors - workplace and organisational *culture*, the *compensation* policies of a firm, how a firm develops its HC through *training* and personal *development* and the resulting *loyalty, motivation and innovation*. *Reputation* is seemingly a two way relationship with *loyalty, motivation and innovation* and attracting and retaining new talent.

It may also be posited that the kind of HR *policies* a firm has determines its relationship with its employees and determines the *training* and personnel *development* options available to them. HR *policies on compensation* also determine whether a company values its employees enough to reward them appropriately for their effort for example- merit based pay.

*Corporate culture* (as defined by Schein, 1992) is suggested as a significant indicator of the quality of the competitive value of HC of a firm. It is a composite measure of policies and
implementation that indicates the kind of relationship with and between employees and workplace environment. An effective culture leads to increased loyalty, motivation and innovation, hence an enhanced ability to leverage HC and drive value.

5.3 Differentiation

The main concern in differentiation expressed by the interviewees is that most companies, especially the ones listed in top indices of stock markets like TSX60 and FTSE100, would already have ‘best practice’ policies. However, policies alone do not ensure that such practices are operating effectively and this is where the differentiation between companies can be made on the basis of HC.

“I think for large companies you would find hard to differentiate between the companies because this is with every company…large company would have these just because of the size. So I am not sure that this is going to be a big differentiator. When you get below the veneer, whether they have a diversity policy or not and see what it says, I think then you can get into differentiation. But I think the presence of a policy is going to be a weak differentiator.”

(Interviewee W, 2004)

Workplace culture and not just health and safety culture have been regarded important for differentiators by the interviewees.

“Some of them are widespread that I think it makes it difficult to differentiate. Most companies if not all have something like an attitude survey, they have performance based compensation, they have a pension plan, they have training, the government has legislated occupational H & S. So there is a large component in this (criterion) which is regulated and a large component that is so commonplace in the industry that you will not find much differentiation on the basis of these criteria.”

(Interviewee R, 2004)

Differentiation could also be achieved at the level of reporting. The better a company is at HC reporting, the easier it would be for the analyst to link it to its transparency and management of the company.

5.4 Applicability

Some indicators are considered to be sector specific. They could not be applied universally to all types of companies (Interviewee R, 2004; Academic III, 2005). Table 3 summarises the responses from the interviews on which criteria of the York Index are universally applicable and one that may be sector specific:
Table 3: Applicability

<table>
<thead>
<tr>
<th>NON-UNIVERSAL</th>
<th>UNIVERSAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Retention</td>
<td>Board Composition</td>
</tr>
<tr>
<td>Health and Safety Record</td>
<td>Reputation</td>
</tr>
<tr>
<td>Health and Safety Culture</td>
<td>Community Investing</td>
</tr>
<tr>
<td>Employee Attitude Surveys</td>
<td>Work-Life Balance</td>
</tr>
<tr>
<td>Pension Plan</td>
<td>Performance based Compensation</td>
</tr>
<tr>
<td>Training</td>
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<td>Policies</td>
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<tr>
<td>Convictions and Fines</td>
<td></td>
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<tr>
<td>Freedom of Association.</td>
<td></td>
</tr>
</tbody>
</table>

5.5 Structure and streamlining

Many interviewees suggested that the criteria have some structural issues e.g. homogeneity (Interviewee R, 2004, Interviewee H, 2005). Some indicators are topic areas like ‘Work-Life Balance’, ‘Health and Safety’ whereas others are mechanisms, e.g., ‘Employee Attitude Survey’ (Interviewee H, 2005).

“When I look down that list some of them are sort of topic areas and some of them are ways of getting at it. For me health and safety is a topic area.”

(Interviewee H, 2005)

Similarly, some indicators are compliance issues rather than HC, e.g. ‘Conviction and fines’ and ‘Freedom of Association’. ‘Community investing’ is said to be a market pressure or investment availability option and not HC.

“Looking at the individual criteria, many of them didn’t seem related to human capital or human resources e.g. knowledge, innovation, team working, speed of change…”

(Academic II, March 2005)

5.6 New indicators

New indicator refers to the indicators considered important by interviewees but not currently represented in the York Index criteria.

Employer sponsored volunteering

“You could include a new indicator- employer sponsored employee volunteering. I would rate that one as relatively high as well. I know there are troubles in measuring it but it definitely helps people think that they work for a great place or whatever, well respected in the community.”

(Interviewee P, 2004)

Diversity of the workforce
“Diversity of the workforce is missing here and I think it is a significant measurement of how diverse your workforce is compared to the community you are doing business in. and this is something which is recorded and is data you can get your hands on.”

(Interviewee R, 2004)

Employee suggestion programs:

“Some companies have wonderfully supportive, sharing kind of suggestion programs, so if an employee comes up with a good idea which is not necessarily part of their job...When you have those kinds of programs then the company cares about smart ideas coming from their people and that's what HC is all about.”

(Interviewee W, 2004)

Stress:

“...which reminds me there is nothing about stress on here or is that on the health...increasingly in the UK there is interest in stress as a very particular issue in the work place and whether the organisation measures level of stress whether it has proper ways of dealing with people who are suffering from stress before it becomes manifested as a health issue so I put it under health...”

(Academic I, March 2005)

Equal opportunity:

“I don’t see equal opportunities on that list... you know in England you can fall foul of race discrimination, sex discrimination...”

(Academic I, March 2005)

5.7 Deletions

Some indicators in the York Index criteria were felt not to be suitable for the purpose of measuring HC of a firm. These are freedom of association, employee retention and health and safety. For example, freedom of association is considered to be a non-differentiator for investment analysis. As mentioned by Thomson and Wheeler (2004), ‘The presence of a union would seem likely to represent social capital between workers, but could signal the absence of social capital between workers and management. Logical reasoning would suggest that a firm with workers who trust that the organization operates with enlightened consideration given to their interests would not feel compelled to organize and collectively bargain. The emphasis here is on right to organize, thus indicating a company’s respect for this basic human right versus taking an antagonistic approach.’

A company might not challenge the right to organise but it might have informal procedures to hinder it. Also, as suggested in the above quote, this indicator could be a negative indicator in some circumstances. Hence, due to lack of clarity, doubtfulness to value creation and lack of verification, it is suggested that this indicator is found not suitable for the York Index criteria. Similarly, health and safety is considered a compliance issue, not an HC differentiator and it is said to be affected by compliance pressures with success varying with size of the firm (Academic II, March 2005).
5.8 Measuring HC

Based on the results of previous study on financial modeling (indicators with higher correlation with financial performance of TSX60), a literature search (on HR practices and financial performance) and further expert interviews (on refining the York Index on reliability for indicating HC), the 14 indicators in York Index criteria have been condensed into three main positive measures (Appendix- I) - workplace culture, reputation as an employer and training and development.

Apart from these proposed positive measures, it is considered essential to add a negative measure in the York Index that ascertains that a company is not involved in any worst forms of labour and employment practices which can lead to financial harm. Therefore, the fourth proposed measure is Negative indicators.

5.8.1 Scoring system

Based on the results of prior research (Milevsky et al, 2006) and the interviews, we are proposing a measurement and scoring system based on a combination of nominal and ordinal measures. Although it is difficult to quantify HC indicators, it is essential to put a scoring system to the index to enable ranking of companies based on their HC.

6. Limitations and Future Research

There are arguments in the literature against ‘best practices’ or ‘universalisation’ of HR practices and firm performance. Truss (2001) argues that ‘informal organisation’ plays an important role in translating policies into practice. The challenge in this perspective, however, is in measuring it. Informal organisation might be reflected in employee attitude surveys and that is included as one of the indicators in the York Index.

The resource based view has also been challenged on the argument that external environment factors such as competition and cost cutting also play a key role in how the HR strategy of a firm evolves. We recognise these perspectives on HR practices. We also recognise that a number of composite factors contribute to the profitability of any business in a certain period of time. However, our argument is that superior HC helps a firm to better anticipate changing internal and external environmental factors, navigate the uncertainties and adapt to the changing external environment to remain profitable and sustainable.
Another limitation of the research premise is that the statistically significant relationship found by Milevski et al (2005) does not establish an \textit{a priori} causal relationship between individual and composite York Index criteria and financial performance. In complex business world it is hard to establish causal relationships between factors and financial performance. It could be argued vice versa too. It might be the case that successful firms have better HC policies and practices. This reverse causation i.e. successful firms have successful or better HC strategy is also supported in the literature (Truss, 2001). Hence a HC based investment tool might not act as a differentiator but might just be a lagging indicator of successful firms.

Another viewpoint in HR on which serious work is going on is ‘performance management’ i.e. having bundles of practices for high performing organisations (Academic I, 2005). One interesting piece of research could be to devise a framework for measuring HC against the strategy of the firm. This calls for extensive research on types of business strategies and respectively suitable bundles of HC practices.

The strength of the research approach used here lies in its theoretical as well as practical grounding i.e. drawing on the normative HC measures existing in the business environment and then putting these measures through the lens of experienced HR professionals on how successful companies create and maintain HC, is particularly useful for practitioners and investment analysts who desire to look beyond the traditional financial analysis to seek long term financial returns.

Future research could utilize the York Index in further strengthening of links between HC and financial performance by ranking companies in a different geographical location.

References


