

**“We Manage What We Measure”:
Testimony to the U.S. House Committee on Financial Services**

May 15, 2019
by Nili Gilbert

Good morning, everyone. My name is Nili Gilbert, and I am a Co-Founder and Portfolio Manager of Matarin Capital Management, an institutional asset management firm based in New York City. I also speak to you today as the Chair of the Investment Committees of both the David Rockefeller Fund and the Synergos Institute, as a World Economic Forum Young Global Leader, and as a permanent member of the Council on Foreign Relations and the Economic Club of New York.

Before I continue, I would like to qualify my remarks. I am speaking today only for myself and not for Matarin Capital Management or its staff, and my remarks constitute neither recommendations nor solicitations for any investment.

I am testifying in support of H.R. ____, “to amend the Securities Exchange Act of 1934 to require issuers to disclose information about human capital management in annual reports.”

The Power of Information

Asset owners from Wall Street to Main Street, representing tens of trillions of dollars around the world, and many asset managers like me, who serve them, are increasingly seeking to better understand certain material non-financial information about the companies of which, as shareholders, we are owners.

This call to require issuers to disclose information about human capital management in annual reports is rising because better insight into the material non-financial information of individual companies will help us to better understand and respond to the broad macroeconomic environment in which we all are operating. We can think of the country’s macro-economy as being an amalgam of the individual institutions and actors within it. So, with clearer information about individual companies’ human capital management practices, we could gain a clearer picture of the environment for American labor and productivity overall, at a pivotal moment for both of these economic drivers.

This call is also rising because we know that better information can lead to better investment results. An investor in possession of perfect information would be the best investor in the world, and an investor in

possession of no information should expect results no better than a coin toss. Better investment results could buoy our country's individual savers and pension funds, supporting our country's retirement system at a critical time; better investment could support our nation's education system through its school's endowments, support our civil society through its foundations and endowed nonprofits, and beyond.

H.R. ____ would implement a rulemaking petition to the SEC which was put forward by a group of investors called the Human Capital Management Coalition, representing \$2.8 trillion in assets, including public pensions and state Treasuries from California, to Illinois, New York, Ohio, Oregon, and Pennsylvania, as well as labor unions representing millions of American workers and their pension funds, and several others.¹ The petition calls on the SEC to require human capital disclosures from public companies. In particular, H.R. ____ would require companies to report information on their workforces' skills, culture, stability, productivity, and safety, among other factors, which may be important to investors in assessing the long-term value of the companies that we invest in.

Many of those seeking deeper data disclosure are owners of these companies, as shareholders, extending beyond the specific asset owners, asset managers and labor unions represented by this petition. For example, the Sustainable Accounting Standards Board (SASB) has called for similar data in its detailed "Materiality Map" of non-financial data.²

The specific data items requested in this bill have been culled from the Embankment Project for Inclusive Capitalism (EPIC), an 18-month, multi-stakeholder, multi-sector project in which 32 companies representing \$30 trillion in assets came together to identify a list of human capital management practices that both the corporate leaders and the market participants who participated in the study found to be value creating.³ The EPIC project researched over 400 different human capital metrics to develop a recommended list of just forty in its formal report. From that initial list of forty items identified, the bill H.R. ____ that we are discussing today focuses on just nine.

These nine items have been put forward with the expectation that they would not be too onerous or expensive for companies to collect – many companies are already tracking them, as well as with the

¹ HCMC. "Rulemaking Petition To Require Issuers To Disclose Information About Their Human Capital Management Policies, Practices, and Performance." *SEC*, Human Capital Management Coalition, 6 July 2017, www.sec.gov/rules/petitions/2017/petn4-711.pdf.

² "SASB Materiality Map." *SASB Materiality Map*, SASB, 2018, materiality.sasb.org/.

³ "Business Leaders Unite To Create Long-Term Value Measures." *Epic-Value*, Coalition for Inclusive Capitalism, 2018, <https://www.epic-value.com/static/epic-state-of-support-9728b8997666e8c5979b3202e8713297.pdf>.

belief that this information would be broadly relevant across a wide group of companies, and with the support of studies which have shown these data items to be material.⁴

Reports from the Field

I come to you today as a traditional, financial-first, data-driven investor, to give you a sense of how lack of data availability is playing out on the ground. Our clients are increasingly interested in identifying and analyzing non-financial risks and opportunities in their portfolios, and although we are actively seeking ways to respond to their requests, we are often running into limitations when it comes to finding good data. And of course, investors like me are also always motivated to turn over any new stones that may help us to make even more insightful decisions about the companies we are investing in. That's our job.

We understand that human capital is an increasingly important part of companies' success – especially here in the US, where innovation is such an important driver of our economic growth and of the success of the country's largest companies. By way of example, the four largest sector weightings in the S&P 500 Index today are Technology, Health Care, Financials and Communications, all of which rely a great deal on talent and innovation for their success.

For many investors, when we are doing our analysis, we are seeking to compare companies side-by-side (where comparisons are appropriate), using data that has been collected and measured according to the same standards, to avoid any apples-to-oranges comparisons or “garbage in, garbage out” situations that could lead to poor or nonsensical results within our investment analysis. Regulatory standards have proven very effective in offering frameworks such as the Generally Accepted Accounting Principles that investors around the world rely on for receiving sound financial data that we can trust on an ongoing basis.

It may sometimes be easy to forget that until the 1930s, even the disclosure of *financial* data about publicly-traded companies was not standardized. Companies could calculate and report their results in any way that they wanted. The faulty and misleading information that resulted from this contributed to the stock market crash of 1929, and the Great Depression. As a result, market participants and regulators came to realize they needed better information. The Generally Accepted Accounting Principles that we rely on today thus began to be established with legislation such as the Securities Act

⁴Bernstein, Aaron, and Larry Beeferman. “Corporate Disclosure of Human Capital Metrics.” *Labour and Worklife Program*, Harvard Law, Oct. 2017, lwp.law.harvard.edu/files/lwp/files/pension_paper_corporate_disclosure_of_human_capital_metrics_102317.pdf.

of 1933 and the Securities Exchange Act of 1934, which the bill that we have before us today seeks to expand.⁵

Today, when it comes to human capital and other non-financial metrics, the data and disclosures that would be required to evaluate US companies on a broad scale are in a similar state to financial data before the Great Depression. The data are “fragmented,” meaning that they are available only for a limited number of companies.⁶ Additionally, whatever data is available may not even be “clean,” resulting, for example, from a lack of common standards about how the data should be collected and reported.

Due to the fact that companies are not making standardized disclosures on these issues, many investors are forced to use data prepared by third-party data providers in order to evaluate non-financial information, which is by definition more subjective and less standardized. This third-party data is also in many cases too expensive for the average individual investor to consider accessing, which has the potential to put them at a disadvantage relative to large financial firms.

What’s more, you’ll find professional firms whose preference, rather than to buy data from third party providers, is whenever we can to gain access to clean, “raw,” objective data about companies in our investment universe, and then to use those building blocks to create our own analysis and draw our own conclusions. Investors may all start with the same raw data, but then find different ways to use it, and draw different types of conclusions. This type of uniqueness in analysis is what drives the markets as we know them. It drives a good deal of the so-called “price discovery process” across asset classes, which helps our markets to be more efficient. However, unfortunately, it is very hard to find the necessary data required to apply this type of analysis in the important field of human capital, due to limited availability. And it seems highly unlikely that this situation will change without the support of regulation.

It is also foreseeable that standardizing disclosures could actually help American companies by lowering their burden of reporting material non-financial information over time. Currently, over 150 ratings systems exist, covering over 10,000 sustainability performance metrics that are trying to fill in the gap that is left by the lack of a generally accepted standard.⁷ Corporate leaders have begun expressing

⁵ “The Comprehensive Guide to Understanding GAAP.” What Is GAAP, Accounting.com, 26 Apr. 2019, www.accounting.com/resources/gAAP/.

⁶ Comment of the Sustainability Accounting Standards Board on “Concept Release: Business and Financial Disclosure Required by Regulation S-K,” dated July 1, 2016, <https://www.sec.gov/comments/s7-06-16/s70616-25.pdf> (hereinafter, “S-K Concept Release”).

⁷ Hower, Mike. “Could Sustainability ‘Survey Fatigue’ Launch A \$1 Billion Industry?” GreenBiz, GreenBiz Group Inc., 2 Apr. 2015, www.greenbiz.com/article/gisr-program-cuts-core-esg-research-and-ratings.

“survey fatigue” from having to complete scores of reports that are all requesting disparate data. Standardization, in the future, could help to lower this burden.

It is also interesting to consider that expanded data disclosure may improve companies’ business results by lowering their cost of capital, as greater transparency lowers perceived risk and allows investors to feel more confident in our analysis.⁸ Lower borrowing costs for American corporations would have the potential to act as an economic stimulus.

Living in a Material World

What makes us think that data about human capital management is “material,” even though it is non-financial?

During 2017 Harvard Law School’s Forum on Corporate Governance and Financial Regulation published a review of 92 studies that measured the impact of human capital management policies on corporate performance and concluded that there is sufficient evidence of human capital materiality to financial performance to warrant inclusion in standard investment analysis.⁹ This is just one of several academic and financial industry studies which draw similar conclusions. Of course, market actors will want to work with the data to draw our own applications and conclusions, if provided with the raw informational inputs.

Traditional financial data helps us to be informed about companies’ physical tangible assets, such as property, plant and equipment, but over the course of the past several decades, an increasing portion of American companies’ assets are now *intangible* – for example, talent and the patents that it generates. So, these findings on the materiality of human capital management data should strike us as intuitively correct.

During 2017, Matarin Capital published a thought piece about the US economy becoming more ‘asset-light’, which was entitled “Less is More”.¹⁰ In this piece, we highlighted the five largest companies by

⁸ Naumer, Hans-Jörg. Added Value or a Mere Marketing Tool? What Does ESG Mean for Investments? Allianz Global Advisors, Dec. 2017, hk.allianzgi.com/-/media/allianzgi/ap/hongkong/pdf/en/investment-themes/201712-esg-hk-en-final.pdf.

⁹ Bernstein, Aaron, and Larry Beeferman. “The Materiality of Human Capital to Corporate Financial Performance.” *Labour and Worklife Program*, Harvard Law, April 2015, https://lwp.law.harvard.edu/files/lwp/files/pension_paper_materiality_of_human_capital_042015.pdf.

¹⁰ “Less Is More.” *Matarin Capital Quarterly Newsletters*, Matarin Capital, 2017, matarin.com/wp-content/uploads/2013/02/Q2-2017-Less-is-More.pdf.

market cap in the US at that time (which remain the five largest companies today) and compared these to the five largest companies in the US thirty years ago. What we discovered is that back in 1987, one unit of physical assets, as measured by net property, plant and equipment, supported only 2 times its value in the stock markets. (For example, applying this ratio, a company with \$10 billion in physical assets would have approximately \$20 billion in stock market capitalization.) Today, among our 5 largest companies in the US, that same amount of property, plant and equipment supports 28 times its value! (Applying today’s ratio, a company with that same \$10 billion in physical assets would today have a \$280 billion market cap, instead of \$20 billion.) This tells us that there is something new that is driving value in the US markets, to a great degree.

	2017				
	Market Cap	Net PPE	Mkt Cap/PPE	Book Value	Price/Book
Apple	750	27	28	132	5.7
Alphabet	643	34	19	139	4.6
Microsoft	532	18	29	69	7.7
Amazon	463	29	16	19	23.9
Facebook	438	9	51	59	7.4
	Average		28		9.9
US Market			4		3.1
	1987				
	Market Cap	Net PPE	Mkt Cap/PPE	Book Value	Price/Book
IBM	98	22	5	35	2.8
Exxon	66	50	1	33	2.0
GE	50	10	5	16	3.1
AT&T	30	20	1	14	2.2
Du Pont	29	16	2	13	2.2
	Average		2		2.4
US Market			2		2.1

Data as of June 30, 2017. Source: Matarin Capital, Compustat, FactSet

Similarly, the group Ocean Tomo published a report highlighting the fact that tangible assets had fallen to just 13% of the market value of the S&P 500 in 2015, compared with 87% of the S&P 500’s value in 1975.¹¹

The Weightless Economy

In his book *The Map and the Territory*, former Federal Reserve Chair Alan Greenspan reflects on his time as a young economist in the 1950s, when the change in the *physical weight of goods* produced in the

¹¹ “Annual Study of Intangible Asset Market Value from Ocean Tomo, LLC.” *Annual Study of Intangible Asset Market Value from Ocean Tomo, LLC*, Ocean Tomo, 15 Mar. 2015, www.oceantomo.com/2015/03/04/2015-intangible-asset-market-value-study/.

U.S. was a popular measure for tracking our economic growth.¹² He recalls visiting Pittsburgh back in those days and hearing the coke oven ash crunching under his feet – the sound was kind of a symbol of American economic greatness, at the time. Greenspan then observes that the U.S. economy has *not grown at all since the late 1970s* by this measure of the physical weight of production. He says that we have substituted “ideas for physical volume,” and “intellectual for physical labor.” Today, a sign of American economic progress is that the goods that we are producing are getting smaller and lighter, not bigger or heavier. And some of our most important assets are weightless.

As the physical weight of goods produced in the US economy has fallen, the value and importance of our human capital has risen. The next frontier for investment and economic analysis will be to understand these dynamics, and a crucial next step in this will be for companies to disclose better data about their human capital management.

The Future of Work

We are living in a moment in history in which the role of labor in the production process is in flux. With the rise of robotics, automation, and artificial intelligence, there is an open question about how and to what extent companies will use human workers going forward. There is consensus that the effects will be broad and lie just around the corner.^{13,14} One common way of thinking is that we may be able to improve outcomes by re-training workers to be able to work collaboratively with machines, to improve results on both sides. But another way of thinking suggests that many workers will be displaced entirely. A recent Brookings Institution report suggests that 36 million Americans today have jobs in which 70 percent or more of their tasks could soon be performed by machines using existing technology.¹⁵ In addition to understanding the sheer number of jobs that are at risk, we need to consider the nature of those jobs. While autonomous vehicles and sensor-based grocery stores clearly threaten drivers and

¹² Greenspan, Alan. *The Map and the Territory: Risk, Human Nature, and the Future of Forecasting*. Penguin Group USA, 2013.

¹³ “Artificial Intelligence, Automation, and The Economy.” *White House Archives*, Executive Office Of the President, Dec. 2016, obamawhitehouse.archives.gov/sites/whitehouse.gov/files/documents/Artificial-Intelligence-Automation-Economy.PDF.

¹⁴ Lee, Kai-Fu. “How Artificial Intelligence Job Displacement Will Affect The Worldwide Economy.” *Forbes Innovation*, Forbes, 9 Oct. 2018, www.forbes.com/sites/quora/2018/10/09/how-artificial-intelligence-job-displacement-will-affect-the-worldwide-economy/#1e5c29b91f52.

¹⁵ Associated Press. “Over 30 Million U.S. Workers Will Lose Their Jobs Because of AI.” *Economics and Politics*, MarketWatch, 24 Jan. 2019, www.marketwatch.com/story/ai-is-set-to-replace-36-million-us-workers-2019-01-24.

cashiers, less obvious is the threat to accountants, financial advisors, lawyers, doctors and other professional jobs.¹⁶

This is an issue of great national importance. By gathering clearer data today about issues such as worker skill gaps and training, workforce stability and turnover, and workforce productivity trends, we would have the information resources required to prepare for the changes of tomorrow. We could gain better understanding of how individual companies are strategically preparing for these rising competitive forces. Additionally, by looking across all American companies in total, we could gain a better understanding of our whole economy's preparedness for this shift. It seems likely that this will become an issue of rising importance in the coming years, both in my work, and in all of yours.

"We Manage What We Measure"

I know that within these historic walls, there have been many important debates about how American institutions should behave. What should they be doing; how should they act; for and with whom? But that is not why I have come here to testify before you today. I, and other market participants like me, are only seeking information when it comes to data disclosure, not prescription.

To a certain extent, I believe that the markets have the potential to adapt themselves to the emerging realities of the present and the future, but as the old adage goes, "We Manage What We Measure." Please give us the tools that will be required to measure even more of what matters, for generating successful investment returns for our people and our institutions, and for creating a market that is purpose-built for the bright future that we all dream of for America's economy and its citizens.

Thank You. I look forward to your questions.

¹⁶ Yang, Andrew. "We're Undergoing the Greatest Economic Transformation in Our History." *Yang2020*, 19 Apr. 2019, <https://www.cnn.com/2019/04/14/opinions/greatest-economic-transformation-andrew-yang/index.html>