QUARTERLY

INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES
www.iafei.org

56th Issue | April 2024

THE PREMIER GLOBAL SOCIETY OF FINANCIAL EXECUTIVES

Message from the Chairman

Three months have passed since I became chairman in January of this year.

For both Mr. Nobuki Taga, Head of Secretariat, and Mr. Anson Kee, Staff Secretariat, it was their first time taking on the secretariat role, which initially led to some hesitation and confusion. However, thanks to the meticulous guidance provided by Mr. Michael Vinluan and his team at FINEX, who had served as the IAFEI secretary until last year, along with their ongoing support, my secretariat team gradually regained its footing. I extend my heartfelt appreciation to Michael and his team for their invaluable assistance.

As articulated during last year's board meeting and reiterated at this year's ExCom, my objective for the current policy is twofold: 1) fostering collaboration and 2) cultivating professionalism.

In accordance with these policies, on February 19th, we convened "The Global CFO Round e-Table: IAFEI Overall Technical Committee (OTC) Initiatives," hosted by Professor Piergiorgio Valente, who assumed the role of OTC chairman this year. He spearheaded the discussion alongside distinguished speakers including Mr. Aleksandar Ivanovski, Director of Tax Policy at CFE Tax Advisers Europe, Ms. Anna Manitara, Tax Lawyer and Policy Officer at the European Commission's DG TAXUD, and Ms. Filipa Correia, Regional Executive Director at Crowe Global. We were pleased to welcome attendees from diverse countries, providing valuable insights into recent developments in international taxation

On February 27th, we successfully conducted a webinar focusing on human resource development. Our esteemed speakers included Mr. Alessandro Bellissima, President of Yanmar Europe R&D S.R.L., and Ms. Norie Shimizu, a seasoned Business Coach from COACH A who served as the interviewer. During the webinar, I introduced the concept of the Human Resource Balance Sheet, originally proposed by Mr. Yaguchi of JACFO. I am delighted to announce that his article discussing the Human Resource Balance Sheet will be featured in this Quarterly publication.

With assistance of Dr. Conchita L. Manabat, IAFEI Advisory Council Chair, I was able to have opportunity to meet representatives of each association starting with Mr. Helmut Schnabel of GEFIU in Frankfurt and then with Mr. Pan of CACFO. I would like to continue to meet with all other leaders of each association virtually to listen to the opinions, needs of the organization and suggestions in order IAFEI to provide more additional value to each member organizations. I also had an opportunity to meet Professor Valente in Milan to discuss OTC objectives and initiatives.

I extend my gratitude to Professor Valente and Dr. Manabat for consistently providing articles each week, and I appreciate Taga-san's dedicated editing efforts over the weekends. Thanks to their collective contributions, I launched the IAFEI Weekly Update on February 17th and have since continued distributing it to our member associations. You will soon find these updates available on our IAFEI website, promptly managed by Anson. I warmly welcome your participation in sharing articles that could potentially benefit our IAFEI members.

While having a World Congress this year would be optimal, unfortunately, no association has yet volunteered to host this annual event. As an alternative proposal, Mr. Pan of CACFO has suggested organizing an IAFEI Day. This informal gathering could serve as a suitable substitute, alleviating the burden on the host association compared to the formal World Congress program. Mr. Yaguchi of JACFO has recommended holding this IAFEI Day in Japan during the middle or late autumn of this year to facilitate collaboration through open discussions and idea exchange. He welcomes your input or suggestions to ensure its success.

Professor Valente has already scheduled his next OTC meeting for the 29th of April, titled "**GLOBAL CFO Round e-Table: VALUE CHAIN ANALYSIS – Critical Issues for CFOs**." I encourage you to register to attend the event. We aim to expand the OTC's capabilities beyond international taxation to encompass areas such as SDGs/Governance, Integrated Reporting, Digitalization, and Sustainability. Your active participation in this significant endeavor is highly encouraged and welcomed.

Let us work together to enhance the value of IAFEI together toward the future.

Tsutomu Mannari
IAFEI Chairman (2024 - 2025)

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A Take on the Future |

by Dr. Conchita L. Manabat, Chairperson IAFEI Advisory Council

"You'll spend most of the rest of your life in the future . . . and you'll never get out of it alive."

-From a futurist

Amidst the festive environment of 2023 Christmas and the onset of the 2024, many international concerning events hugged the headlines – the continuing Ukraine war, the Gaza miseries, the Houthis' encounters, the geo-political threats, the rapid developments in technology, threats & consequences of artificial intelligence, and more. The world seems to be in turmoil.

For most of us, there is always a good promise what the future brings. Experience equips us to overcome the challenges that the future may present. Some believe that the future can be conquered based on what happened in the past. If these premises were correct, how come the world is always besieged with crisis after crisis despite great minds at work. Well heralded new ideas and norms have evolved into threats and real risks.

The world has indeed changed and continues to change. Technology yields robust changes that imply "less relevant experience" has become more practical. You can no longer learn just from experience. Simply extrapolating from what we know and where we are today may no longer be useful. The variables, the timeline, the other significant elements and more, keep on changing and becoming extraneously time sensitive. It seems that the name of the game is to take on and manage risks instead of avoiding them. Reluctance to make bold decisions with more studies and consultations renders actions stale or too late to arrest the likely enormous damages/consequences

The "unknown" is now the realm of all possibilities. Wrapped in a digital skin with an internal clock ticking away 24 x 7 x 52, the global economy resource base knows no boundaries and time zones. Instant response has become the norm. Quickest time is of the essence!

The baggage of experience may be better left behind to provide a clean platform for an entirely new play of things. Clinging to the past serves as constraint. As the buzzwords say, think outside the box! By taking a giant leap into the Great Unknown, we can participate in making the promises of the future happen. We need to participate and make our mark for our future.

Dr. Conchita L. Manabat is the President of the Development Center for Finance. A past Chair of the International Association of Financial Executives Institutes (IAFEI), she now chairs the Advisory Council of the said organization. Dr. Manabat is a member of the Stakeholder Advisory Council (SAC) for the International Audit & Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA).

Artificial Intelligence, Tax in the Metaverse |

by Prof. Piergiorgio Valente, Chair OTC Overall Technical Committee IAFEI

1. FOREWORD

The use of Artificial Intelligence ("AI"), by means of machine learning algorithms to make tax decisions, is the basis of a new relationship between Tax Authorities and Taxpayers.

In terms of taxation:

- AI studies the theoretical foundations and techniques that enable hardware systems and software programs capable of emulating functions and operations considered to be the exclusive domain of the human-taxpayer (reasoning, perception, problem solving, tax planning);
- AI eliminates topographical coordinates in favor of a borderless geography and a ubiquitous relational planisphere, where market rules create a climate of continuous competition capable of producing knock-on effects on economics and law.

On the one hand, for the financial administration, the analysis of networks of connections is especially valuable in identifying complex, sometimes circuitous patterns (mainly transnational in nature) and dubious transactions (seemingly inconsistent or overtly suspicious) involving entities in different countries that might be considered elusive without the use of AI.

On the other hand, for corporations, the study of business connection networks (or business connection networks) focuses on examining the interactions between individuals and corporations in their economic and financial transactions (as well as between individuals and individuals and corporations with corporations/entities) to gain a deeper and more detailed understanding of the intersubjective relational framework. Significantly, such a survey provides a coherent and organic picture of the relationships between people and companies aimed at assessing investment opportunities, risk management, the trustworthiness of financial intermediaries, and the credibility of institutional stakeholders in various contexts (governance, sustainability, etc.).

2. ARTIFICIAL INTELLIGENCE AND TAX FRAUD DETECTION

Tax fraud detection represents one of the most appreciable areas in which AI can be used (and it is intuitive to predict that it will become increasingly so) based on ongoing investments by administrations in various states. With its ability to analyze large amounts of data (quantitative profile) and recognize complex patterns (qualitative profile), AI can detect convoluted conduct that could indicate tax fraud (presumptive models for ex post taxpayer selection and predictive models for ex ante taxpayer behavioral study). In particular, by examining big data, it can determine (once trained on historical data) patterns and trends that could be relevant to tax policy, and recognize irregular patterns/systems (known or new) or structural or enforcement negotiation anomalies (this includes analysis of tax returns, financial statements, financial transactions, bank data, etc.).

In general, AI is able to isolate hidden patterns in data that may not be immediately obvious to humans and may be clues to unusual behavior or equivocal transactions (thus enabling further investigation). In a broader perspective, AI can access external data sources, such as public databases, social media, and third-party data, to enrich the information used in fraud detection.

Specifically, AI:

- can monitor abnormal financial transactions (particularly in the VAT area) in real time and automatically generate detailed reports on potential fraud, enabling swift action by Tax Authorities;
- can analyze taxpayers' financial behavior over time and detect unusual changes or trends that could be indicative of fraud;
- can examine documents and texts, such as contracts, invoices, and corporate communications, for significant fraud detection information, determining the tax risk associated with specific transactions or investments and helping Tax Authorities make informed decisions.

3. ARTIFICIAL INTELLIGENCE AND TRANSACTIONAL PATTERNS

One of the main methods of determining tax fraud through AI is the analysis of financial transactions. This process involves identifying patterns of transactions and monitoring them over time, both of which are decisive in detecting suspicious activity.

In the case of transactional patterns, AI can detect unusual patterns in transactions that may involve fraud, such as exceptional or frequent movements of money between related bank accounts (but which do not appear to be such), especially when they do not match the historical profile of individuals or businesses. In monitoring these transactions, AI can distinguish certain types, such as frequent international payments or the use of financial intermediaries to disguise the origin of funds, which are a red flag. To improve its performance in this area, AI can be trained with historical data on known tax frauds to recognize similar patterns in new transactions.

With regard to period analysis, AI examines nonlinear (or incongruent) time sequences in which transactions occur by measuring sudden increases in financial activity prior to tax audits, which may be indicative of attempts to hide funds or income. By measuring transactions that occur at regular intervals or over longer periods, AI may be able to reveal planned patterns of tax evasion that develop gradually over a period of time. Likewise, AI can relate a taxpayer's activity to external events (such as changes in tax legislation), to ascertain whether changes in a given attitude can be considered a consequence of the events themselves (e.g., taxpayer reaction to legislative change).

Finally, in order to achieve satisfactory results in the recognition of ambiguous transactions, it is necessary to achieve accomplished integration among banking systems to allow AI access to vast data sets from banks, intermediaries, and other financial sources.

4. ARTIFICIAL INTELLIGENCE AND TRANSNATIONAL COOPERATION

International cooperation is essential to effectively address the challenges posed by global business models to taxation in a 'global economy. A world made global by technology needs a multilateral vision in law, with the development of collaborative platforms and coordinated transactional disciplines to detect and prevent fraud, with the hope of achieving a fair and transparent global tax environment.

In the first case, the use of technology platforms, AI, and machine learning accessible to different international tax agencies enables the shared collection, storage, and analysis of huge amounts of tax and financial data with the contribution of analysts from different countries sharing expertise and resources to identify fraud patterns. Such platforms can help standardize data collection and analysis processes, improving the efficiency and consistency of tax investigations, and ensure timely information sharing to respond quickly to tax anomalies (while respecting privacy and data protection).

In the second case, international cooperation induces the exchange of information between the Tax Authorities of different countries, which is useful for tracking money flows and business activities that cross national borders. (Steps forward in this direction have been taken with some multilateral agreements such as the Automatic Exchange of Information (AEOI) under the auspices of the OECD, which allow for regular and structured sharing of financial data between governments, creating a common ground for monitoring and analyzing tax activities. Specifically, the construction of common international standards for tax reporting and transparency helps bridge the gaps and discrepancies exploited by multinational corporations between different tax systems to carve out private spaces for tax exemption. From a cross-state relations perspective, such an approach can provide training and technical support to developing nations, helping to strengthen the global fight against tax fraud.

5. CONCLUSIONS

The collective intelligence (CI) suspended in the network is the product of artificial brains and human minds. The interdependence of one with the other connotes the relationship between structure and process. The two elements, welded together in cyberspace, co-evolve into a digital ecosystem, where the man-made artificial makes the individual intelligence virtual.

Individual intelligence merges with others of the same kind, feeds on them and is enhanced by them. In contact with them, it is not consumed and depleted by its use, nor is it annihilated in its fusion with other intelligences. If one can speak of consumption, it is a consumption that is fruitful and productive of a new rationality, which is enriched and becomes more and more intelligent through the "consumption" of the thoughts of others. From the interaction of different individual intelligences comes a common heritage, a true collective intelligence that elevates cyberspace to a living infosphere, a digital laboratory of human thoughts, desires, memories and traditions sedimented over the centuries. The self-feeding of collective intelligence enhances the latter according to a circularity of cross-references and a reciprocal relationship between past and future.

With the advent of AI, the digital world becomes (further) abstract, immaterial and frayed in its constituent components, dissolved in fluid bonds that form and unravel in the instant of a moment. To lawmakers lies the task of boldly mastering the chaos of this abstract with the interpretive tools of law, to design the contours of this intensified exchange of people, goods, data and financial flows. As a representation of reality, law is also abstract, like the nature of the object it is supposed to regulate. And so, when reality becomes imperceptible in the manifestations of money, ideation, digital exchange, and the maze of AI calculations, 'law finds itself working on itself.

Today we are called upon to forcefully represent the legal lines of the abstract in AI, in sophisticated new technologies, in robotics. This process is essential for the development of the new law (intellectual property, legal liability, privacy and data protection, ethics, and transparency), for ensuring consistency and justice in legal decisions, and for defining the constituent criteria of AI taxation (tax classification of AI-related assets, revenue and cost recognition at the country level, tax credits and benefits, transfer pricing, royalties, and taxation of international transactions).

In the necessary transition to a constituent phase of a new law and a new form of taxation, the double face of economics and law can only be explicated in emancipatory terms to overcome the predation of the globalized economy. Its being double will mean the ability to correspond to the movement of history imprinted by technology in natural science and consciousness. But always labor at the center, with Man, without the false simulacra of legal fictions, nor deforming economic mirrors, or political hypocrisies. Only in this way can we work out a collective intelligence adequate to the noblest faculties of the individual and his vocation for wholeness, capable of containing all the knowledge of humankind delivered to the infinite spaces of the web for the common good of all the peoples of the earth.

Professor Piergiorgio Valente is the Managing Partner of Crowe Valente. He is a known International Tax Advisor who has held various leadership roles in European and global Tax Organizations like President of the CFE Tax Advisers Europe and Chair of the GTAP Global Tax Advisers since 2019 and President of International Tax-Policy Commission at CNDEC. He is active in the Academia and is the Professor of Diritto Internazionale and International Tax Law at the Link Campus University in Rome.

What Drives Goal Achievement |

by Mr. Hiroshi Mochizuki
COACH A Co., Ltd.

In executive coaching, clients establish meaningful goals they genuinely desire to achieve through productive dialogue with their coach. This process emphasizes the significance of comprehending the client's background and personal values. While goal setting may appear straightforward, it is, in reality, a deep and intricate undertaking, as identifying truly impactful goals can be quite challenging.

In a coach training session I attended this January, the focal point was "Transformation". During the session, we dedicated time to contemplate the disparity between "need" and "desire". Needs are transient and surface-level, whereas desire delves deeper and carries a more profound significance (beneath the surface).

During the training, I engaged in introspection regarding the foundation of my goals, questioning how many of them were truly driven by a deep desire. Simultaneously, I had meaningful conversations with my colleagues. Although I sensed that I could not fully attain my "intense desire," I discovered a strong desire to be valuable and acknowledged by others, and to establish connections for that purpose.

Looking Beyond the Goals

Our client, Steve, is currently facing challenges with organizational transformation as the individual responsible for the business in his designated region. In the past, this region's business served as a significant source of global revenue. However, in recent years, customer satisfaction has declined, and performance has stagnated. Steve has been entrusted by management with the responsibility of revitalizing the business. As he implements strategic changes and initiates organizational transformation, he has become increasingly concerned about the lack of motivation among his employees to achieve the set goals.

During interviews with executives, we often come across statements such as:

"We have been generating satisfactory profits thus far."
"We are fulfilling our obligations, but due to our weak strategy, we are being surpassed and outpaced by other companies."

Setting aside the question of whether the strategy is good or bad, as we delve into discussions about the goals that executives and employees are truly passionate about, I shared with Steve the concept of "desire" that I had previously explored during the training. In response, he expressed, "My goal is to surpass the market's expectations. I have been engaging with other executives, hoping that they share the same mindset. However, upon reflection, I realized that my aspirations differ from those of the other executives. My primary focus is on achieving results that will allow all of us to spend more quality time with our family."

Losing Sight of Aspirations Due to Targets

In the past, employees in the region were provided with the autonomy to contemplate their desired pursuits and were granted the time and opportunities to explore them. However, Steve reflects, "Previously, we believed that we couldn't pursue those endeavors due to unfavorable market conditions and limited space. Yet, upon further consideration, it appears that the environment might not be the sole determining factor."

"As performance started to decline, we began assigning specific tasks to our local senior executives. These tasks became their primary goals, which they broke down in order to actualize their vision for the organization. It's possible that they believed that as long as they completed their assigned tasks, it would bring about the desired changes in the organization. Although I had the intention of asking them about their own aspirations, I now realize that I may have inadvertently influenced them by communicating what I wanted them to do and seeking their agreement."

He acknowledged that the current state of the company may not be solely attributed to shifts in the market environment, but rather to his own approach as a top manager, including how he interacted with and perceived his employees.

He shared, "Since I started working in this region, I felt a sense of discomfort, which I interpreted as a crisis and prompted me to drive change. Even in this change initiative, while I may have emphasized the importance of diversity, I realize that I have been seeking individuals who align with my own perspectives to facilitate the transformation. Although we are still in a phase of observing the outcomes of these changes, I have a renewed desire to understand my employees better, including their backgrounds, and to gauge the extent to which they value the aspirations of their colleagues with whom they collaborate."

Steve and I assigned each other homework for the next session, which involved actively listening to the "desires" of three specific subordinates and reflecting upon our own management styles based on the insights gained.

Why Do You Want to Achieve That Goal?

As explained by the American researcher who conducted this training, the concept of "desire" encompasses the following elements:

- Wanting to be understood and acknowledged by others.
- Seeking connection with others, experiencing love and being loved.
- Desiring to have an influence on others.
- Longing for a sense of security.
- Striving to fulfill our purpose.

These desires often go unspoken or unnoticed because they may be perceived as human weaknesses, selfishness, or unrelated to business matters. Consequently, even when we do recognize a deep desire within ourselves, some individuals may hesitate to embrace it. This is why we often disregard our own "desires" and instead set goals based on superficial yearnings.

But what is the underlying reason driving your desire to achieve that goal? Truly understanding others means gaining insight into their aspirations. Through my meaningful dialogue with Steve, I have come to realize that the role of a supervisor extends beyond merely helping individuals develop the necessary skills to complete their tasks. It involves delving deep into their inner desires, providing them with suitable opportunities, and supporting them in realizing their aspirations.

As adults, we often find ourselves setting goals based on societal expectations or what we believe we should do. However, when faced with a lack of desired outcomes, it can be illuminating to reconnect with our core desires, as they hold the potential to guide us towards meaningful progress. At the onset of this year, I have been afforded the opportunity to pause and ponder whether the goals we establish are genuinely capable of igniting a sense of purpose within individuals.

(Reposted from COACH A E-Newsletter, February 19, 2024)

Hiroshi MOCHIZUKI COACH A Co., Ltd. Director
COACH A (Thailand) Co., Ltd. Managing Director
ICF Professional Certified Coach

COACH A E-Newsletter →

Mr. Hiroshi Mochizuki has graduated from Keio University, Department of Political Science. He completed an MBA at Aoyama Gakuin University Graduate School of International Management. He thereafter spent more than 20 years engaged in global business in the provisions division of a general trading company. His responsibilities included planning operations, partnership/investment negotiations, management strategies, business management, etc. He even obtained a business model patent for an initiative that visualizes Japan's food distribution. During his overseas assignment, he collaborated with local and foreign companies to develop new markets and create investment opportunities. After returning to Japan, he built a global network of partners, and expanded the company's range of operations. Through this all, he gained experience with management strategies, organizational management in a global cultural environment, and negotiation in over 20 countries. This engendered an ability to build relationships between the growth process of managers and their surroundings, and a strong interest in behavior modification.

Summary | by Mr. Tsutomu Mannari

Introduction

The key to unlocking corporate value lies in employee engagement. At their core, companies are comprised of individuals whose growth propels organizational progress. As human assets develop, the company's human surplus (value) increases. But what happens if a human asset departs from the company? In the short term, it might seem like a loss. However, in the long run, they are likely to contribute to enhancing the value of another company within the same society. This potential for broader societal value creation offers a unique opportunity to collaborate and generate greater collective value. Yanmar stands out for its focus on human life and societal betterment (the brand statement says "a sustainable future"), allowing it to invest in human assets without fear of potential loss. The essence of sustainability in all sectors is the nurturing of human assets: : through the concept of "Hanasaka", Yanmar nurtures young talent to think about the future of society, with every person being a 'seed' for creating a better tomorrow.

Integrating management, sustainability, and HR strategies is essential. The aim is to refine individual skills while also fostering team building, thereby boosting overall organizational performance. The future success of HR Balance Sheet management depends on unlocking each employee's potential, thus enhancing long-term corporate value.

This webinar will feature a dialogue between Mr. Alessandro Bellissima, President of YANMAR R&D EUROPE S.R.L., and Executive Coach Norie Shimizu from COACH A, including their common experience of coaching as a tool to achieve their goals. They will discuss strategies for organizational strengthening and their vision for societal contributions. Additionally, Mr. Tsutomu Mannari, chairman of IAFEI, will introduce the HR Balance Sheet concept, akin to a financial balance sheet, originally conceived by Mr. Hiroshi Yaguchi, founder and Executive Director of JACFO.

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Tsutomu started the Webinar by introducing the idea of human resource balance sheet which came from Mr. Yaguchi of JACFO and highlighted the value of investing in human resources, comparing it to financial capital. He also mentioned a forthcoming webinar and a subsequent article in a magazine elaborating on the concept of a human resource balance sheet.

Journey of a Local President in Yanmar Europe's R&D Centre

Alessandro Bellissima, President and head of the European R&D operation in Yanmar, a Japanese agricultural machinery company, answered to Norie's question about his career journey as a first local president. He shared that he initially felt excited and honored to be the first local President of the company's R&D Centre in Europe, but also expressed concerns about the challenges ahead. He admitted that his confidence level dropped from 80 to 50 in the initial weeks due to unforeseen challenges. However, he remained optimistic and committed to learning and improving.

Leadership and Collaboration at Yanmar

Alessandro answered to Norie's question about his challenges. He explained his shift in management style from making decision or making plans solely to empowering his team with inclusivity because he became to realize that it is impossible to do everything by himself. Norie agreed with Alessandro's points and acknowledged the changes he has made, including his decision-making process's shift from a top-down approach to a more collaborative one. Alessandro stressed the importance of involving the right people and collaboration in the process. He also shared his experience with coaching and the need for a perceived need for improvement.

Turnover: Maintain Network, Future Collaboration in the Society

Alessandro answered Tsutomu's question about employee turnover that it looks like a loss in the short-term but in the long run, it could be an opportunity to create own network in the society. He suggested to maintain good relationships with departing employees for potential future collaborations. He added his actual example of collaboration with his past colleague.

Importance of Coaching and Feedback

Norie emphasised the importance of coaching and feedback in maximizing the potential of individuals and organizations. Norie shared her experience working with different sectors including business, medical, and communications, and emphasized the importance of creating a culture where employees are comfortable speaking up.

Feedback, Complaint, and Inclusion

The meeting revolved around the topic of feedback, complaints, and employee empowerment within a company. Alessandro emphasized the importance of feedback and the potential for complaints to bring positive change. He also discussed the importance of collaboration and inclusion in innovation, and the role of employees in proposing new ideas.

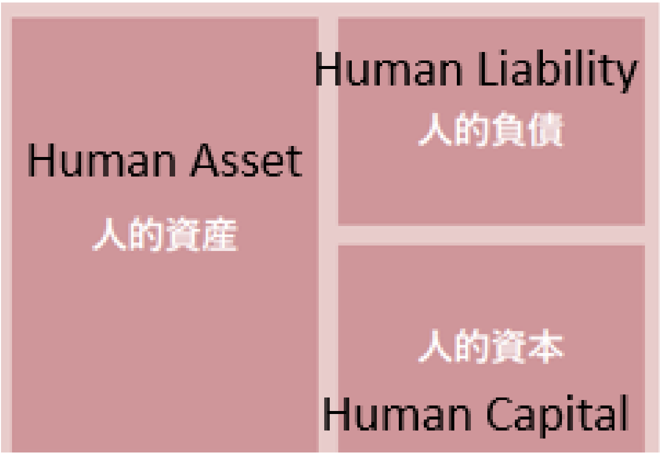
Learning from Mistakes, and Breaking down barriers in the workplace

Tsutomu, Alessandro, and Norie discussed the importance of learning from others' experiences and using information to improve their work environment and necessity of creating a culture where employees feel comfortable making mistakes and sharing ideas as well as the need for confidentiality and tailoring each approach. They also discussed about the importance of inclusivity, dynamism, and breaking down barriers between departments and groups.

Hard to swallow "Human Capital" | by Mr. Hiroshi Yaguchi, JACFO

- Its Impact on Enterprise Value - (Translation: Mr. Tsutomu Mannari)

This HR Balance Sheet concept was first invented by Mr. Hiroshi Yaguchi, JACFO, and introduced at IAFEI Webinar of February 27th by Mr. Mannari, IAFEI Chairman. IAFEI Weekly Update featured the original article written by Mr. Yaguchi in 4 consecutive issues. All articles are re-posted here for the convenience of our readers.



In 1989, he graduated from the Faculty of Economics at the University of Tokyo and joined Sumitomo Banking Corporation (currently Sumitomo Mitsui Banking Corporation). After experiencing business research, human resources, and corporate finance at the bank, he established the Japan CFO Association in 2000. CFO, develop an education business to build a network of management and finance departments and train corporate finance professionals. He has served as the Asian representative and president of the International Federation of Financial Executives (IAFEI). Established the Japan CHRO Association in 2018 and the Japan CLO Association in 2020 to strengthen the corporate functions of companies including human resources and legal affairs.

The word "human capital" is now the keyword of corporate management, but even if you read the explanation about human capital, there are many people who feels unconvincing or hard to swallow.

Until now, "human" or "people" has been regarded as costs and expenses such as labour costs and SG&A and in any case, they have been regarded as a negative image for the company. People are not Human Resources that are consumed or wasted but valuable Human Capital that creates future corporate value, and if people invest, their talents, abilities, and skills are growing, we have to invest in human capital, which is a general explanation of human capital.

But it's hard to understand. Capital is the fund that serves as the source for conducting business activities, and there is a great sense of incongruity in the expression of investing in capital. Isn't the target of investment an asset? If it's human capital, not human resources, shouldn't it be called human assets in the first place?

The term "intangible assets" is also a term that is often used. However, intangible assets are becoming more important these days, so they are now called intangible capital, so apparently the words assets and capital are used emotionally regardless of economics and accounting terms. Same thing happens between the term of Human capital and Human assets. This could be the reason why "investment in human capital" becomes to be difficult to understand.
Then, how will you answer the next question?

<Question>
Talking about the term of "Human capital investment", Who should be the one to make investment to human capital?
1. Investor
2. Management
3. Company
4. Society
5. Vender or Customer
6. Employees
7. All of these
8. None of these

From the generally said context, managers and companies invest in people and increase corporate value, your answer may be "a manager" or "company". If so, I would like you to think about it again.

It is "employees" or people who make human capital investment.

"human capital" and "human assets"

Most people don't understand the meaning of people investing in human capital. By the way, when a person invests in human capital, the investment target is the company. It is human capital investment that people invest in the company. I would like to try a specific explanation below.

Balance sheet and capital

First of all, I want you to think of the balance sheet. It's okay for people who are not good at balance sheets. I don't need any difficult knowledge at all.

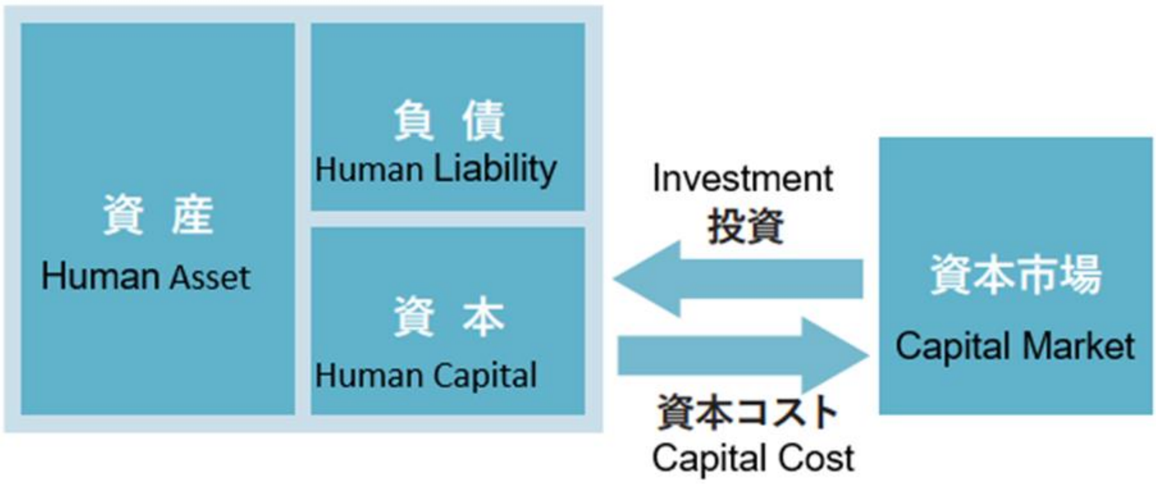
The balance sheet is roughly divided into assets on the left, liabilities on the right, and capital on the bottom right [see Chart 6-1]. Roughly speaking, management is to raise funds from the right side, shape the funds raised into various assets, and generate cash from there. In procurement, there are debts borrowed from banks, and there is capital invested by investors. How to raise funds and what kind of assets will be invested in the funds raised, whether to make a factory, whether to make things and become inventory, or whether to invest in financial products, the contents are various, but roughly speaking, they are all the same. The job of the CFO is to raise funds on the right side, how to throw the funds into the real assets on the left side, maximize the future cash flow generated from the assets, and how to shorten the rotation period of the assets. It is to comprehensively manage corporate activities.

It can be said that the management of the balance sheet is the job of the CFO. In the so-called "Ito report" in Japan, the light was given to capital efficiency, including ROE, and the importance of the balance sheet was once again recognized. In addition to capital efficiency, the concept of capital cost was also highlighted. To be precise, the cost of capital includes the cost of both debt and capital, but here I would like to focus on the cost of shareholder capital.

Capital cost

The initial focus should have been about human capital, but now it comes to balance sheets and capital costs, you might be confused and feel that the story has suddenly deviated, but in order to understand human capital correctly, it is necessary to understand these. Pleases hang out with me.

A long time ago, speaking of the cost of shareholder capital, you would have imagined the dividend paid to shareholders, but the cost of shareholder capital is not about dividends. The cost of shareholder equity is the cost of capital raised by shareholders when the company conducts its business, and it is the minimum expected rate of return (so-called hurdle rate) for shareholders. If the company cannot make a return that exceeds this expected rate of return to shareholders, shareholders will sell their shares and bring back funds. The company can provide investors the base for their investment decision by correctly disclosing information on risks along with future business stories through dialogue with investors, and as a result, the expected rate of return will decrease, and the so-called shareholder capital cost will also be reduced.



The limit of the balance sheet

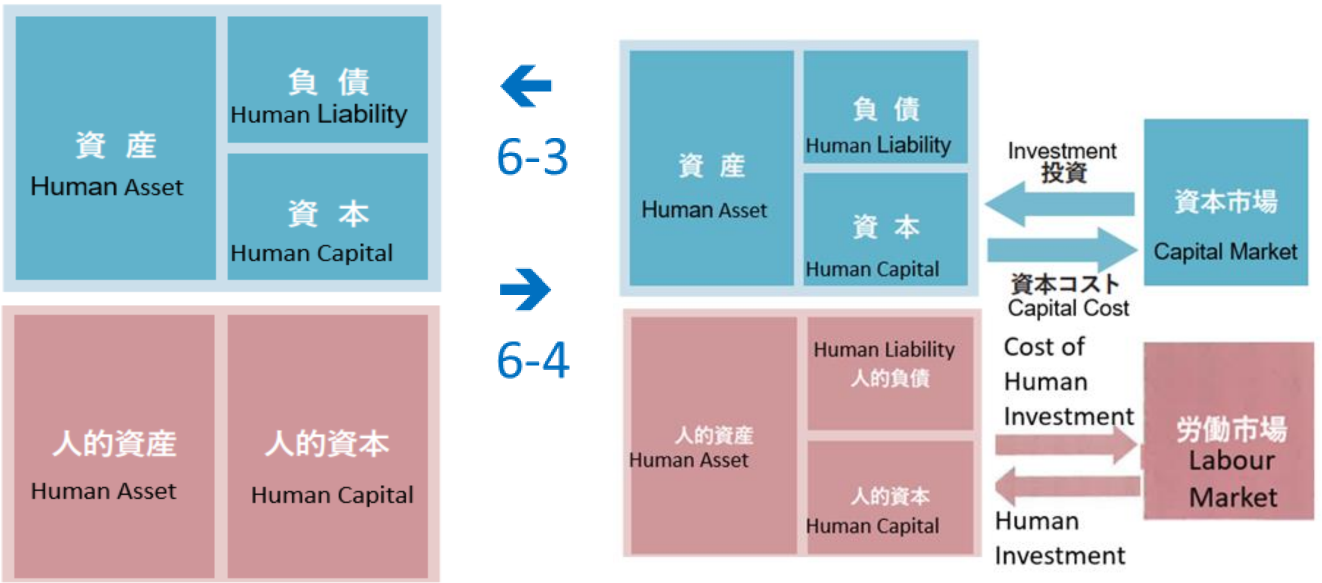
In the first place, the reason why human capital attracted attention is that when overseas investors invest in companies, they are concerned about what kind of people working at the company and what kind of situation they are in as a source that creates future cash flow. In modern times, it has been said to be an information society, but it has also come to be called the era of concepts, and information and value proposition, instead of visible properties. People who work in the company have been important for a long time, but I dare say that it is a person as a group, and it would have been good if the group was motivated to work. Now, people as individuals, not groups, are becoming important, and we are entering an era where ideas and concepts conceived by one excellent person will greatly change the company's business. There are fabless companies in the manufacturing industry that do not have their own factories, and now that the information and service industries are increasing, no matter how much you analyse the assets on the left side of the balance sheet, you can't see the value that the company creates. Intellectual property such as patents attracts attention, investors pay attention to intangible assets, and it is an extremely natural trend to go in the direction of wanting to know about people working at the company. On the other hand, excessive distortion of capitalism has created a trend of ESG investment, and as part of S (Social), investors' interest in human information is increasing from the perspective of human rights issues and diversity as a background.

This is why it attracts attention as non-financial information rather than financial information as interest in so-called invisible things and things that do not appear on the balance sheet.

What is Human Capital

Let's return to "human capital". Capital is a term for the balance sheet, so let's put human capital on the balance sheet. Of course, it's human "capital", so it's on the right-hand side of the balance sheet. Then, what's on the left side? What is invested as capital becomes an asset as a company, so the human "asset" is the correct term. It is precisely that there are human capital and human assets as non-financial information on the bottom of the visible balance sheet [see Chart 6-3].

Human capital must be raised first. This is recruitment (human capital raising). Just as capital collects funds from the capital market, human capital must be recruited from the labour market. Human capital is not only including employees but also management people. It also includes the outside Board of directors. In order to hire them, it requires reasonable expenses such as job advertisements and fees paid to recruitment agencies, but this is the same as the cost of raising capital, including fees to securities companies, but that's not what's important. The important thing is that people in the labour market are happened to invest in the companies that they became to know by chance. Investors in the capital market invest funds in companies they know by chance and look forward to future returns. What about human investment? People invest their abilities, knowledge, experience, sensibility, values, and most importantly, time in the company instead of their cash.



The cost of human capital

Investing oneself to the company means that he or she expects some returns from his or her investment to the company. That is the cost of human capital. If the company can't provide more value than people expect, people will lose motivation or leave the company. This is no different from selling stocks if investors don't get more returns than they expect. Just as the cost of shareholder capital is not about dividends, the cost of human capital is not about salary. The fact that a person invests him or herself in the company means that each person has various expectations in their own time axis and values in terms of what they can get from the company. That is the cost of human capital [see Chart 6-4].

When people search for a job, let's think about what people use as a measure. The compensation including salary is easy to understand, but it shouldn't be all. There are various people with various expectations, such as having fun at work, being rewarding, being able to take a break flexibly, or acquiring skills. It is also said that the many young people who want to work in a company that can provide social value is increasing. What people want from the company is also diversifying.

This is exactly the same as investors who are investing their cash. They are not only investing because of the economic reasons such as the dividend is high, the stock price is likely to rise, and the cash ability is high, but also because of their socially meaningful activities and consideration for the environment and human rights. We can say that the investor expectations became to be diversified. ESG investment might be aiming for economic returns in the long term. However, they are also looking for other meaningful returns other than cash as well. It would be a tread that investors' expectations are diversifying.

Raising human capital is a management responsibility

Even though it is important to have dialogue with investors, there are investors who are not interested and simply aim for the assets that the company has. There is no need to interact with all investors, but it is fine if investors who sympathize your company's management philosophy, management vision, business strategy, and even financial policy based on the disclosure and invest to your company. You may need to choose the person with whom you want to have dialogue.

Human capital is the same. There are also various people in the labour market. Some people aim for a return in the short term, while others have a long-term life plan and overlap the growth of the company with their own growth. The company only needs those who sympathize with its management philosophy, management vision, business strategy and personnel policy to join.

Raising human capital is the job of the management as well as raising capital. In order for them to choose what kind of investors and human resources, it is essential to have a deep understanding of the management philosophy, vision, and strategy.

The recruitment of people (in Japan) used to be focusing on a Group as a resource, but needs to be more focused on the ability and personality of each individual. It's not a job of HR department to make a recruitment plan only from its past experience and recruitment results. You may realize the importance of recruitment. This job should be carried out by the management. This is the reason why it is so called as human capital management. It is not an ambiguous definition of human capital because people are important. If you position it correctly like a balance sheet, you can see that human capital is the result of people investing in the company. Similar to the capital market, you can see the essence of the job of raising human capital by confronting the labour market.

People-centred engagement

The word "engagement" became to be more popular as a human resources terminology than before. It is often used to evaluate the company's HR policy and measures, such as increasing engagement or the engagement index has dropped. But investors are the ones who engage. In the case of the capital market, “engagement” means a constructive dialogue between the companies and their investors or potential investors. Similarly, it is people who engage in the labour market, and people are the protagonists. Employee engagement should be dialogues between the company and the employees about management philosophy, management vision, specific work, and colleagues who work together as judgement material for investors (employees). If the working people don't have this understanding, an engagement index can merely be at the same level as the satisfaction survey.

Liquidity of the labour market

When the essence of human capital comes to be visible, the necessity of increasing the liquidity and efficiency of the labour market and upgrading it become to be more visible.
Along with the corporate governance reform, the stewardship code has also been established. The principle of action has been introduced that institutional investors put the interests of investors and beneficiaries first, with a view to both investors/beneficiaries and investee companies. In addition, although it greatly betrayed expectations, capital market reforms have also been carried out in Japan and many companies are forced to bring up its PBR above 1.

The same thing will be needed in the labour market. The era of indirect finance under bank control so far actually overlaps with the era when companies played the leading role and people were positioned as resources and costs. Although the equity of human capital does not have "holding" as expected, it has been sealed by the rigidity of the labour market, which has been maintained by Japanese-style human resources practices such as lifetime employment and family like management.

In the corporate governance reform, the introduction of outside board of directors became a major highlight, but company management will not be revitalized by bringing an external perspective only in the board of directors. If the executive team, including young employees, does not have opportunities to gain various experiences and grow through many difficulties, the company's performance will not increase.

In the view of corporate finance, investors have no choice but to wait for the management to allocate investment in which business and how much and how much to return after investing in the company's stocks. Although It was a long time ago, it became a hot topic when Sony raised capital by each business unit called tracking stock. I haven't heard this kind of story since then, but originally, it is rational for investors to invest in a business unit. In recent years, under the name of conglomerate discount, there is a strong tendency to dislike to diversify investment funds in multiple businesses.

Even if you invest to the company with not enough governance or not enough HQ/Corporate function, there is no guarantee that the funds will be successfully invested in the business as described by the company. This is the same for human capital investment. It is necessary to have a clear idea as a "human capitalist" about what kind of job he or she wants to do in which department, and to gain experience after making efforts to enhance their knowledge and skills so that the investment can achieve the desired results. Recently, more and more companies are getting their hands on the work that employees want, such as the posting system, but it is natural considering that this is a human investment.

Just as two type of investors like professional investors (specific investors) and general investors, there are also professional investors and general investors in human capital investors. Post graduate new employees may not necessarily be general investors, but after gaining some experience, it is necessary to have responsibility and awareness as a professional investor. We have seen a lot of people who are suddenly forced to make decision without a choice by the company around the age of 50 after continuing to accept the opportunities provided only by the company, we should not increase the number of these sad people. On the other hand, if the company only regards employees as human resources or providing job to the employees or purchasing employees' labour at a low price, under the current trend of population decreases and labour shortage becoming more serious, highly conscious people will be out and taken by a foreign capital company. If not only financial capital but also human capital is taken to foreign capital, there is no future in Japanese society.

What is "human assets"?

Let's think about human assets when we can clearly see what human capital is.

If there is human capital, it does not mean that it will function as a human asset immediately. Just because you raise capital from shareholders, the asset is only recorded as a cash, and what kind of asset will this cash be capitalized to, and how to increase the corporate value of that asset, as an asset It is depending upon the ability of the management and the executive team. In order for human capital to function as a human asset, it is depending upon whether people who are human capital will be able to work appropriately according to the management strategy or not after sharing the corporate philosophy and corporate culture. In order to do that, it is also important to create an environment where people can be actively realizing their abilities and individuality. As already mentioned, it goes without saying that it is necessary for people to be aware that they are human capitalists and make efforts to grow as independent individuals.

Jobs such as talent management, talent development, compensation system and education and training as the role of the human resources department can function only under these circumstances, In short, the big difference of the human asset from the physical assets is that human assets do not always depreciate after acquisition like physical assets, but rather are incremental assets. Human assets are not at the acquisition cost, but the value fluctuates at the market value evaluation. The unrealized gain is the required human capital disclosure and the future return.

"Human debt"

I have been talking about human capital and human assets so far. If you compare with the balance sheet in blue colour, one thing is missing. That is human debt [see Chart 6-5].

6-5

The typical debt is bank borrowing. The bank lends the funds necessary for business growth. The cost is interest. Fees may be added, but the procurement cost is much lower than the cost of shareholder capital. However, the money has to be returned.

What about human debt? Like human investment, instead of spending your life as an investor and capitalist, it would be a way of working to provide time and ability and get a stable money. There may be cases where people with professional licenses and people with high ability who have retired from the company should help several companies with their work. You can't get a return like human capital, but you can get a stable money and feel free to quit. From the perspective of working people, it is a "human creditor". Similar to repaying the loan to the bank, company can terminate the contract any time.

Even if people want to work as a human investor, the human debt which was generated as a result of the current social system and company-dominated political measures must be resolved not only as an individual responsibility but also as a social problem. Efforts such as employment of people with disabilities, foreign workers, and women, prohibition of discrimination to those socially vulnerable and disclosure requirements are progressing. But if there are people who are not willing to work as a human debts but forced to work as a human debts, it would be our responsibility to change this society to where anyone can be a Human investor or human capitalist with own effort.

I have already pointed out that "Japanese-style human resources practices such as lifetime employment and family like management" are the cause of the rigidity of the labour market in Japan, but this also had an important meaning if you go back to the past. From the Edo period to the Meiji period, workers such as craftsmen and farmers worked according to demand in short-term employment, including day labour, and the human debt type was the mainstream.

We cannot forget that the "modernization" due to the influence of the Industrial Revolution progressed, in addition to the need for a large amount of labour to work long-term and stably, together with the appearance of the new management people with people-oriented philosophy such as Konosuke Matsushita changed this norm and made the human capital type of employment general with a philosophy of developing employees like family members.

Because of stable employment and income, employees were able to increase their knowledge with peace of mind, hone their skills, and improve their humanity through their work. Since the collapse of the bubble, which led to the so-called lost decades, by partially been influenced by overseas investors in recent years, the ratio of non-regular employment has greatly expanded due to the emphasis on efficiency and liquidity in human resources to increase the company's profits.

These would have been a historical background and reason why the human debt is expanding again. The expansion of human debt causes not only a social and political issue, but also raising the cost of recruitment and training for the company. The turnover or the replacement of human resources has already caused wrinkles in the inheritance of corporate culture and know-how. If you take human resources from the perspective of whether it is human capital fixed in long-term employment or human debt with liquidity, you can see that it is important to adjust the balance between immobilization and liquidity according to the state of the company and the state of the labour market. You will see how the procurement of human resources is a management job, including the combination of human capital and human debt, which is a debt-equity ratio.

From the maximization of capital to the sustainable growth of human resources

The idea that human capital investment is done by people into the company overlaps with the current economic and social structure that is shifting from the era of the company to the era of individuals. Before entering the high growth period of the Showa era, in the era of coal mining, management treated people as a simple disposable resource and positioned that people should just work as a group as a labour force. It is a human rights issue, so we have entered the era of labour movements and union activities. Even after this era to now, people have been still "resources" and costs". Human capital management is required based on the reflection in the above historical background.

From the era of the company to the era of individuals

From the company point of view, now is an era of human capital management. However, the situation of society has changed a lot. To be clear, we are moving from the era of the company to the era of individuals. The leading role is not the company.

The era of having a computer in my father's company is long over, and it's not uncommon for children to have smartphones to perform better than their parents' computers. As long as you have a battery and WiFi, you can do almost everything with your smartphone. It's understandable that there are many young people who don't have any interest in the company. In addition, generated AI like ChatGPT has been born here, with your smartphone, you can dramatically increase your personal ability without an app. While the company is still debating whether to use ChatGPT at work or not, regardless of an employee, a customer, or an investor, the individual is surpassing that of the company in terms of information and intelligence. Of course, there is a limit to what generating AI can do, and of course it is not as good as human intelligence in certain areas, but no matter what the word singularity is, it is far beyond human intelligence in terms of specific abilities.

Company will become to be merely a platform.

In the past, there used be situations that the head office held all the information as its privilege and only the management knew them, but in this digitalized society, if companies that continue to do such things will eventually become extinct. Regardless of whether it is centralized management or decentralized management, all information is in an era where everyone uses it as needed. The era of not knowing the financial numbers of the company unless you ask accounting, or not knowing about people unless you ask HR, will end with digitalization. If all employees tamp the terminal, they can get all the necessary information. The question is how to make use of that information.

That's what it means that we are moving to an era of concept, empathy, and sensibility. It's not the era when the company managed and controlled people as needed. The company will become to be just a platform to fully demonstrate the employee’s individuality and abilities.

Since the governance reform in recent years, it has been exposed to the pressure of globally connected capital markets, and the company's challenges have been highlighted from all angles, and various initiatives and their disclosures have been enforced.

On the other hand, what about the people who work? People has been placed in an environment where they are not required to think spontaneously for a long time, such as collective recruitment of new graduates, new employee training provided to everyone, training by hierarchy, uniform salary system withholding tax system, and a notice of change in location under which you have to move without family. People in our generation have been told as “If you graduate from university and join a company, you only need to do about that company. You don't need to be interested in society or politics. Rather, if you are interested in such things, it should adversely affect your promotion”.

Company (*kai-sha 会社)* is a word that reverses the word society (*sha-kai 社会*) in Japanese. it is exactly the opposite in meaning. Parents say things like "You'll have a hard time if you go out to the society after graduate" while your child is a student, but in fact, parents do not live in the society but only in the company. As long as you enter the special environment of the company, you don't have to go out into society. That's why people get depressed when they are suddenly told to go out into society after the age of 50 years old. (It is very common in Japan, around the age of 50, that employees are suggested to think about the 2nd life by the Company.)

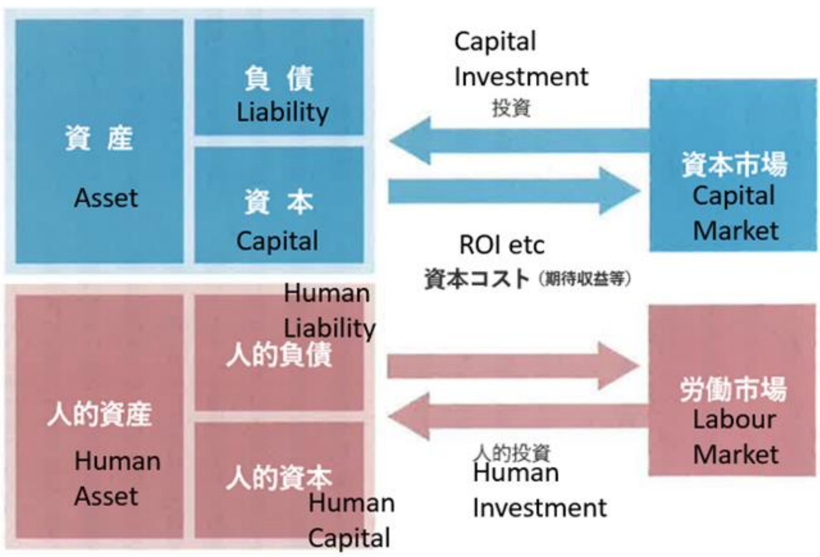
However, this era is gradually changing. Due to the sudden COVID19 disaster three years ago, remote work started everywhere, and attention came to focus more in home and local communities, essential part of our lives. Opportunities to see the company objectively have also increased. I think the trend of the SDGs has been accelerated by the excessive distortion of capitalism also through this COVID19 disaster. Even if it is the era when the individual plays the leading role, the individual who does not wake up spontaneously will never be the protagonist. Only those who position themselves as capitalists or creditors and grow with their own responsibilities and efforts can be the protagonists.

The role of CFO and CHRO

Well, by positioning human capital, human assets and human liabilities just same as CFO (Chief Financial Officer) is responsible for the balance sheet, you may realize that CHRO (Chief Human Resources Officer) should be responsible for the management of the Human resource balance sheet which you can see the red part of Chart 6-6. Just same as CFO formulating financial strategies and financial policies and manage the entire balance sheet such as capital allocation and capital cost reduction in order to optimize the business portfolio, in order to optimize the human resource portfolio, CHRO's job is to manage the "human balance sheet" that formulates human resources strategies and human resources policies and reduces the cost of human capital.

Therefore, human capital management is an integrated corporate management that regards people as debt, capital, and assets just same in the case of finance.

Chart 6-6



Conclusion : A fusion of balance sheets and human balance sheets

The concept of human capital being considered, it becomes clear that individuals, not companies, are the protagonists of society. If the individual is not the protagonist, maybe some political or company problems may exist, but the individual's consciousness and effort could be a route cause.

However, there are many people who don't like to compare people to accounting. At the beginning, I said that there was a sense of discomfort with the word human capital, but it is certain that there is not only because it is not understandable the meaning in terms of accounting, but also because of rejective reactions to imitating people as capital in the first place. This may come from the idea that people are not the target of investment and do not exist to make money.

They may think such as, company management has been imposed many challenges due to the demands of investors in the globalizing capital market, in addition to this, why people will have to be teased for the return of investment. In fact, there are many people in charge of human resources who have a strong pride that corporate management is not for investors, and that human resources measures are not changed according to the demands of investors. human capital, I am sure that you'll be beaten if you say human debt, since even human capital is not acceptable for them.

However, this word, which was born from the interest of investors called human capital, instead of just having such dissenting prejudice, by going through accounting concepts, can be the key word toward the era in which individual who seriously thinks about his life and grows into an independent existence are playing the leading role.

Human capital management for human restoration

By the way, capital and human capital can be well integrated. As you know, mechanisms such as employee stock holding associations and stock options also have the effect of aligning the expectations of shareholders with the direction of the company. However, what I would like to introduce here is Gunze at the time of its founding.

Mr. Tsuruyoshi Hatano, the founder of Gunze in the Meiji period, created a regional revitalization model by looking at the reality of local sericulture farmers suffering from the poverty. He hired children of sericulture farmers as workers and make their parents to be shareholders for the company with a small stock price. Moreover, the founder went to collect instalment payment every month. He strived to improve the quality of sericulture, promised to purchase cocoons from farmers as high price as possible, and provided education to the workers. He was told by the people around him that it was more like a school than a factory, and surprisingly, he created an education department on top of the sales department. As a Japanese-style management system, this is not a “family management” which has a bad reputation recently, but "local society management".

Not only integrating human capital and capital through the family, but also human capital and human assets were fused through education, and ultimately financial assets were also integrated with human assets and human capital through purchase. At first glance, it may look like the recent financial methods such as microfinance and crowdfunding, but the big difference is not just an efficient and effective scheme, but his idea of human capital management that started from human love.

His outstanding conceptual power and execution ability that has already incorporated a social perspective into the management model in the Meiji period and achieved the revival of the local community while using the stock company system could be a great hint for modern corporate management that seems to follow the American-style capitalism and management style. Isn't the essence of human capital management only with this idea of human restoration?

The above is a personal view and only one interpretation. " I hope this could be an opportunity or inviting water for various ideas and opinions about "human capital" to come out.

A Special Endorsement by Dr. Conchita L. Manabat

I fully agree with Hiroshi-san on the significant and continuing value of human contribution usually treated as an expense or cost. The vision, strategies, operations' oversight and continuing enhancements provided by some members of the manpower team more importantly, the management and leadership as well as the governing board have far-reaching value to the enterprise. The measurable costs in terms of compensation, benefits and other related costs are not one time charge but have valuable continuing impact in the enterprise's existence. Indeed, such value is intangible and tough to measure. Thus, enterprise value is different from book value of the entity.

I congratulate Hiroshi-san for his well-thought-out article.

IAFEI Secretariat

Nobuki Taga
Head of Secretariat
Email: nobukitaga.iafei@gmail.com

Anson Kee
Staff Secretariat
Email: ansonkjl.iafei@gmail.com