

# Intellectual Capital Information Disclosure of Top Indian Corporations

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**Abstract**—Intellectual capital (IC) can prove to be a source of competitive advantage for businesses which may stimulate growth and lead to wealth generation in the long-term. Currently, Intellectual Capital information disclosure is not compulsory and is done on “voluntary” basis. This study measures the intellectual capital information disclosed by top 20 Indian firms by market capitalization by analyzing their annual report of F.Y. 2013-14 using content analysis method. IC information disclosure was very poor according to the study. It was found that there were 43% intellectual capital terms out of 37 which were reported by these firms. Moreover many terms were only once disclosed. 22 terms were not disclosed at all. Among companies, Infosys and ITS reported maximum number of terms whereas Coal India and HDFC didn't report anything. Lack of uniformity and standardization was found while disclosing therefore it is recommended that the companies should voluntarily disclose such information and professional accounting bodies at international level should mane uniform and standard process for disclosure of IC information..

**Keywords**—Accounting; Annual Reports; Intellectual Capital.

**Abbreviations**—Chartered Institute of Management Accountants (CIMA); Intellectual Capital (IC); Merger and Acquisition (M&A); Public Sector Undertaking (PSU).

## I. INTRODUCTION

THE world is fast changing from industrial to knowledge economy and Indian economy has attracted the attention of the whole globe with its fast growing knowledge sector. Business dynamics of the 21st century are increasingly determined and driven by Intellectual Capital (IC) elements. The future drivers of any modern economy will no longer be capital, land or equipment, but the “people” and their “knowledge” reservoir. A knowledge-intensive company leverages their know-how, innovation and reputation to achieve success in the marketplace [Vergauwen & Frits J.C. van Alem, 17]. Market participants, practitioners and regulators alike argue that there is an important need for greater investigation and understanding of IC (or knowledge assets) disclosure as the usefulness of financial information in explaining firm profitability continues to deteriorate. Traditional disclosure mechanisms are not able to cope adequately with the disclosure requirements of new economy firms. He observed an increasing dissatisfaction with traditional financial disclosure and its ability to convey to investors the wealth-creation potential of firms [Bukh, 8].

### 1.1. Why to Measure Intellectual Capital?

Companies may want to measure IC for a variety of reasons. One study [Bernard, 4] identified the following five main reasons. First, measuring IC can help an organization to

formulate business strategy. By identifying and developing its IC, an organization may gain a competitive advantage. Second, measuring IC may lead to the development of key performance indicators that will help evaluate the execution of strategy. IC, even if measured properly, has little value unless it can be linked to the firm's strategy. Third, IC may be measured to assist in evaluating mergers and acquisitions (M&A), particularly to determine the prices paid by the acquiring firms. Fourth, using non-financial measures of IC can be linked to an organization's incentive and compensation plan. However, the first four reasons are all internal to the organization. A fifth reason is external: to communicate to external stakeholders' what intellectual property the firm owns. Shorter list of the reasons companies may want to measure IC: to improve internal management, to improve external disclosure, and to satisfy statutory and transactional factors [Andriessen, 3].

### 1.2. Disclosure and Measurement of IC

It is said that “what is measured in companies is also what is managed.” Income statement and balance sheet tools are “able to present an X-ray (or snapshot) of a firm's performance and financial position.” Balance sheets provide indications of how the company appears within a specific period, but are not ‘reliable’ tools to perceive a company's future performance. There is growing criticism that the ‘traditional’ balance sheet does not take account of those

“intangible factors that largely determine a company’s value and its growth prospects.” Industrial-age companies needed balance sheets to show their value to investors. In the knowledge-economy, the balance sheet as tool is no longer sufficient to provide the assurance that a safe investment is being made. With the rise of the “knowledge-economy” over the past 20 years, however, IC is becoming more important and should be disclosed. Unfortunately, IC does not appear officially in the traditional financial report. Accountants are not yet ready to make significant changes to a 500-year-old system. It is therefore not strange that it is generally seen as an enormous step forward that efforts to capture IC more appropriately are being made from the accounting domain. The movement away from the ‘black-and-white’ balance sheet information is known as the ‘colorizing’ of balance sheets, which in today’s world of colourful multimedia appears to be a very apt description. However, alternative methods of measuring and evaluating IC have been slow to develop. This is because investors, through ignorance or short-sightedness, have continued to value balance sheet information. Thus, it is obvious that the measuring and reporting of IC should be seen as a tool separate but complimentary to the balance sheet. Business has always relied on its “intangible resources, along with tangible and capital resources, to create value and achieve the organization’s goals.” Business performance and success, therefore, depends on how well an organization ‘manages’ its resources. The objective of a typical for-profit business firm is to use its assets for producing goods and/or render services, which it can sell for generating cash. To attain the goal of a business firm “both tangible and intangible assets” are used in this process. It is the ‘readiness’ of the intangible assets that determines the ‘efficiency’ of this cycle. The cash so generated is ‘used’ in general in one of three different ways. It is either capitalized into more tangible assets or spent for the development of more intangible assets or paid out as dividends. This is also the reason why tangible assets appear on the balance sheet, whereas intangible assets do not. [Madan Bhasin, 16].

### 1.3. Components of Intellectual Capital

The concept of IC measurement, management, and reporting is relatively new. Accountants, business managers and policy makers have still to grapple with its concepts and detailed application. Sveiby [18] first proposed a classification for IC into three broad areas of intangibles, viz., Human capital, Structural capital and Customer capital—a classification that was later modified and extended by replacing customer capital by relational capital. Some examples of IC are shown in Table-1. One of the most comprehensive definitions of IC is offered by the Chartered Institute of Management Accountants (CIMA): —The possession of knowledge and experience, professional knowledge and skill, good relationships, and technological capacities, which when applied will give organizations competitive advantage.

Table1: Components of Intellectual Capital

Human Capital	Structural Capital	Customer Capital
Knowledge	Business Process	Customer Relations
Competence	Manuals/policies	Customer Loyalty
Skills	Information Systems	Repeat Business
Individual & Collective Experience	Research Findings	Relational Capital
Training	Trademarks	Relations with Vendors
Communities of Practice	Brands	Investor Trust & Feedback

## II. OBJECTIVES

1. To analyze the intellectual capital information disclosed by top 20 firms in India.
2. To analyze uniformity and standardization of IC disclosure by firms.
3. To analyze company wise disclosure of IC terms.

## III. LITERATURE REVIEW

Some of the leading IC reporting studies, widely reported in the literature, were conducted in Australia, UK & Ireland, Sweden, Canada, Malaysia, Sri Lanka, New Zealand, Bangladesh and India. In the past, most studies employed content analysis as the research methodology. Despite the fact that the importance of IC has increased in recent times, there are inadequate reporting of IC in the financial statements of corporations.

Most of the IC reporting studies were cross-sectional and country-specific. Examples include studies in Australia [Guthrie et al., 12], Ireland [Brennan, 7], Italy [Bozzolan et al., 6], and Canada [Bontis, 5]. Relatively very few longitudinal studies have been reported (e.g. Abeysekera & Guthrie, 2). Moreover, some studies focused on the specific aspects of IC reporting, such as human capital reporting (e.g. Subbarao & Zeghal, 1), while others conducted international comparative studies (e.g. Vergauwen and van Alem, 2005; Cerbioni & Parbonetti, 10). Some IC reporting studies have looked beyond annual reports to examine other communication channels, such as, analyst presentations.

Studies have also been conducted to explore IC related issues from the firm’s perspective. Chaminade & Roberts [9] investigate the implementation of IC reporting systems in Norway and Spain. Habersam & Piper [13] employed case studies to explore the relevance and awareness of IC in hospitals. Studies that looked at possible determinants of voluntary IC reporting include García-Meca et al., [11] and Cerbioni & Parbonetti [10]. Guthrie et al., [12] analysis of IC reporting practices suggests that reporting has been expressed in discursive rather than numerical terms and that little attempt has been made to translate the rhetoric into measures that enable performance of various forms of IC to be evaluated.

In India, a study on IC disclosure of IT firms was carried out by Madan Bhasin [16] in which he conducted a study of 16 IT corporations in which “content analysis” was performed on their 2007 to 2009 annual reports. The results of this study confirmed that IC reporting in these corporations is almost negligible, and IC reporting had not received any preference from the mentors of these corporations.

#### IV. CONTENT ANALYSIS OF INTELLECTUAL CAPITAL

The sample used in this study is 20 listed firms in India, selected according to market capitalization as on 2013. The study uses the annual reports of F.Y. 2013-14 of these firms as a source of information as this is the only document which provides the opportunity to communicate with investors regarding financial performance and show leadership and vision.

The method used in this research is “content analysis”. The content analysis of annual reports involves codification of qualitative and quantitative information into pre-defined categories in order to derive patterns in the presentation and reporting of information [Vergauwen & Frits J.C. van Alem, 17]. The coding process involved reading the annual report of each corporation and coding the information according to pre-defined categories of IC. By looking at the reporting of terminology within their annual reports, one can examine the extent to which Indian corporations publicly document the presence (or importance) of IC. In identifying corporations disclosing IC, a list of related terminology was compiled. The panel of researchers from the World Congress on Intellectual Capital finalized the list of IC items into a collection of 39 terms that encompassed much of the IC literature. The final list of IC terms is reported in Table-2. Each of these terms was searched in the annual report to find presence and absence of these firms.

Table 2: Intellectual Capital--38 Search Terms

Business Knowledge	Employee efficiency	Intellectual resources
Corporation reputation	Employee skill	Expert networks
Competitive intelligence	Employee value	Knowledge management
Corporate learning	Knowledge assets	Human assets
Corporate university	Expert teams	Human capital
Cultural diversity	Knowledge sharing	Human value
Customer capital	Knowledge stock	Organizational culture
Customer knowledge	Management quality	Organizational learning
Economic Value added	Information systems	Intellectual assets
Employee expertise	Relational capital	Structural capital
Employee know-how	Intellectual capital	Superior knowledge
Employee knowledge	Intellectual material	
Employee productivity	Intellectual property	
Source: Bontis [5]		

#### V. ANALYSIS AND FINDINGS

Figure 1 indicates that only 43% of the intellectual capital terms were reported by top 20 firms in India. Among these reported terms, 4 terms were reported only once. The most popular term reported was “Intellectual property” which includes patents, trademarks, brand valuation etc. This finding is quite similar to the literature reviewed and studies made in the past. The item was reported by 60% of the firms, most of them being from service sector where intellectual property plays a vital role and it has a legal status when it comes to reporting. After Intellectual property, “Human Capital” was reported by 50% firms. The surprising item was “Intellectual capital” which was reported by only 3 firms namely Axis Bank, Bharti Airtel and Infosys.

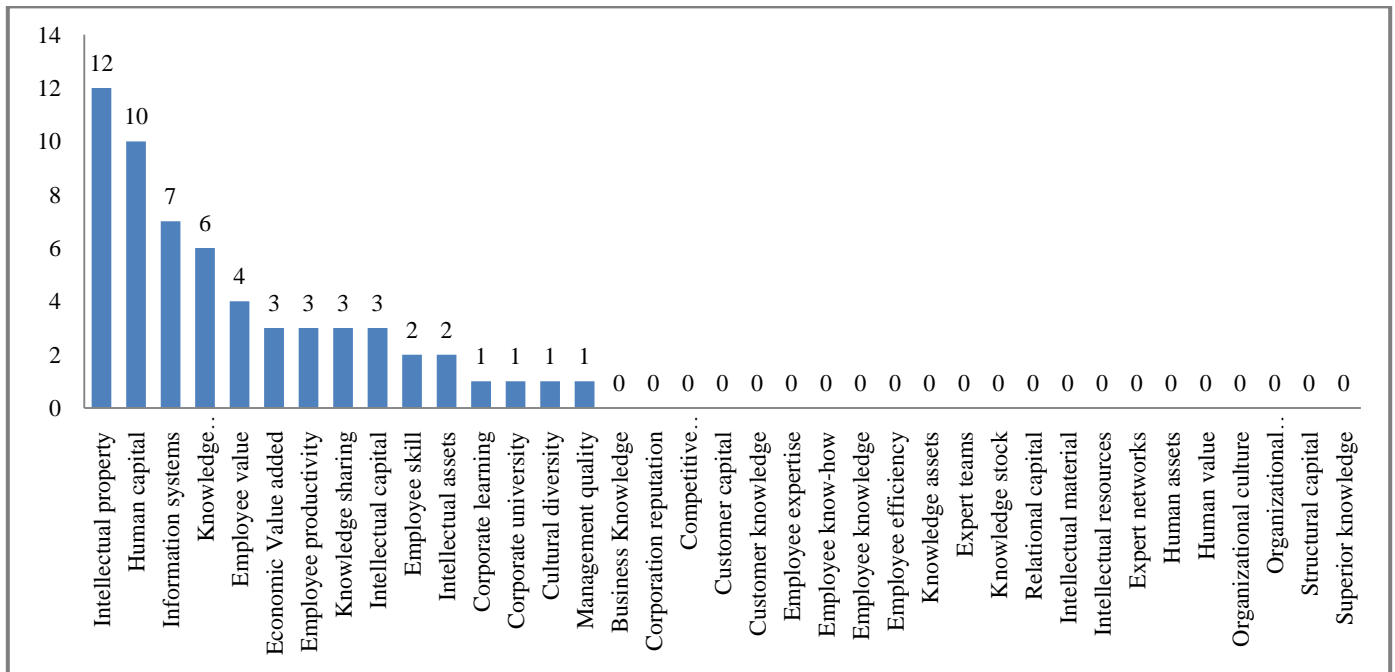


Figure 1: Content-wise Analysis of Intellectual Capital Terms Reported

One more surprising finding was that the 3 components of Intellectual Capital namely Customer Capital, Relational Capital and Structural Capital did not find place in any of the annual reports. 22 Intellectual Items did not appear even once and that shows the lack of seriousness in reporting the intangible information among these corporations. The study

reveals that the annual reports largely disclose that information which is visible but ignores that information which makes the difference between book value and market value of the company.

Further, figure 2 shows the company wise disclosures of IC terms.

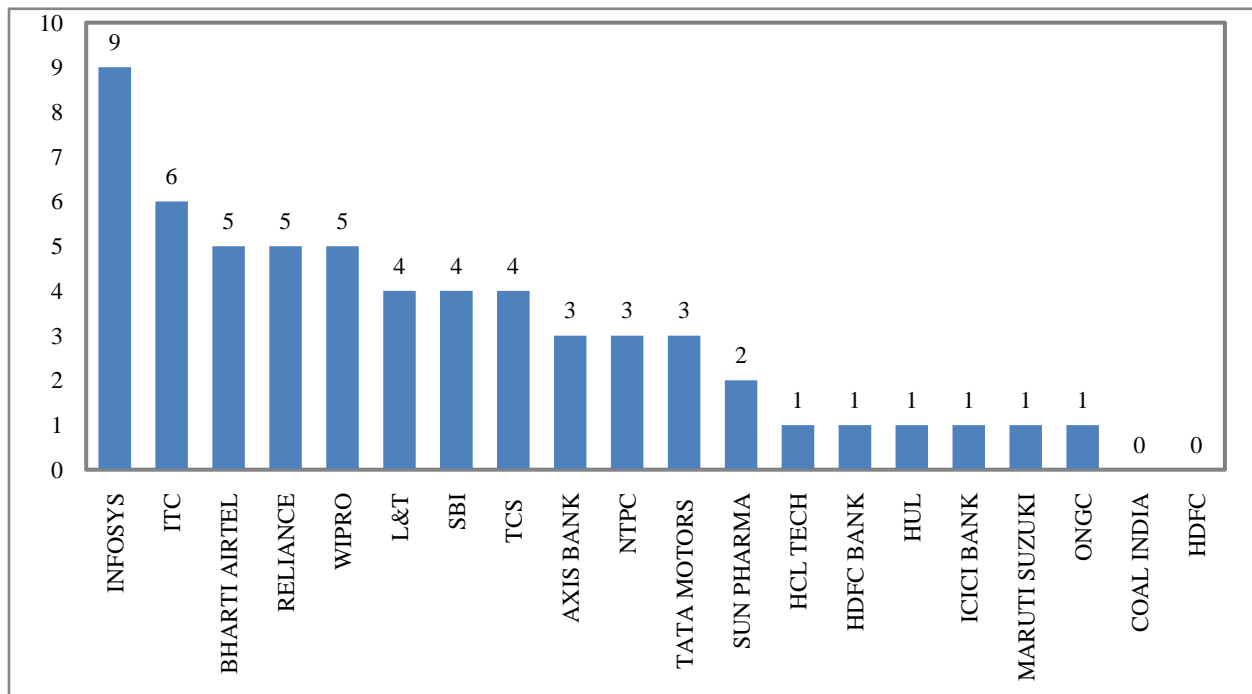


Figure 2: Company wise Disclosures of IC Terms

It clearly highlights that Infosys Technologies Limited, a corporation acclaimed widely by the international community and the media too, had reported the maximum number (09) of IC-related items from the total list of 37 items. It is worth mentioning here that Infosys was the first Indian corporation

to win the Most Admired Knowledge Enterprise in Asia award in the year 2002. However, it is surprising to note that this corporation did not make any mention of term 'Intellectual Capital' in its annual report. Perhaps, Infosys is the only IT-corporation in India, which has been regularly

reporting its —Intangible Assets Score Sheet, as a measure of intangible assets (or IC). These findings are very much consistent with other studies carried out on the same topic in past. Second highest in the list followed by tie for third position by Bharti Airtel, Reliance and Wipro.

Coal India, which is second largest PSU by market capitalization, did not report any of the 37 IC terms in its annual reports. Same is the case with HDFC reporting none of the IC terms.

The involvement of IC terms in annual reports is so low that it does not convey suitable information to the stakeholders. If this is the case with top 20 firms, then we can imagine the situation with other firms. There is lack of uniformity and standardization while reporting.

## VI. CONCLUSIONS AND SUGGESTIONS

Intellectual capital can be a tool for competitive advantage and can stimulate growth. Intellectual capital is the gap between market value and book value of the firm so it is important to disclose the intellectual capital information in annual reports of the firms. Studies have shown that there is a long way to move ahead as far as reporting IC in annual reports is concerned.

Top 20 companies were analyzed for involvement of IC terms disclosure in annual reports. Out of the total 37 IC terms, the study revealed that IC reporting is very low (43%) i.e. only 15 out of 37 IC terms were disclosed in the annual report. 22 IC terms were not at all disclosed by any of the firms. Infosys and ITC were top 2 firms reporting highest number of IC terms whereas coal India and HDFC didn't report any term.

It is recommended that the firm should not only disclose the IC terms in their annual reports but there should also be uniformity and consistency while doing so. Apart from voluntary reporting, professional accounting bodies at global level should also develop some internationally accepted, standardized approach for reporting IC.

There can also be a special report which should disclose the Intellectual Capital information which should be available to external shareholders of the firm.

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