The Importance of Intellectual Capital Disclosure

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Introduction

The concept of intellectual capital seems to emerge from the discussion of goodwill and the difference between book value and purchase value (Lynn,1998) . The traditional accounting system seems both the tangible and intangible values of the organization in today information age (Westnes , 2005) . According to GAAP , intellectual capital is the value of firms intangible assets that aren't reflected on the balance sheet . Intellectual capital is defined in different ways :

- Intellectual capital is a set of non- financial ,non physical resources that procures a copmpetitive advantage for the enterprise (Jussupova , Mariethoz and Probst , 2007) .
- Difference between company market value and its book value , or the resource created from internal learning and development of valuable relationship(De Pablos, 2003) .
- Any monetary investments made by a company in expectation of future profits that are not immediately embodied in intangible from constitute an intangible asset and in most cases , an intellectual capital (Coakes and Bradburn , 2005) .
- Mouritsen and Larson (2001) suggest that intellectual capital is the aggregate sum of intangible assets which comprise both human and structural capital .
- Roos et al (2005) define intellectual capital as all non – monetary and non – physical resources that are fully or partly controlled by the organization and that contribute to the organizations value creation (Peng et al . 2007).
- The OECD describes intellectual capital as the economic value of two categories of intangible assets of a company.
- Knowledge that can be converted into profit (Harison , Sullivan , 2000) .
- Wood (2003) states that IC is information in people minds .
- Intellectual Capital is intellectual materials – knowledge, information , intellectual property , experience that can be put to use to create wealth (Stewart , T.A,1998) .
- Brooking (1996) defined intellectual capital as the combination of intangible assets which enable the company to function .

Sveibyfirst proposed a classification for intellectual capital into three broad areas of intangibles viz , human capital , structural capital and customer capital a classification that was later modified and externded by replacing customer capital by relational capital (Bhasin , 2008) .

Also , the World Congress on Intellectual Capital classified intellectual capital into three categories , they are : 1) Human capital , 2) Structural capital , 3) Relational capital .

According to Davis (2001) Structural Capital encompasses the hardware , software , database , systems , work processes , businessmodels , organizational structure , patents , trademarks , trade secrets and all other codified knowledge .

Relational capital is defined as all resources linked to the external relationships of the firm , with customers , suppliers , or partners in research and development . it comprises that part of human and structural capital involved with the companys relations with stockholders (investors , creditors , customers , suppliers) , plus the preceptions that they hold about the company (Starvoic and Marr) . It also includes the image of the image of the organization in the market , its social identity and brand equity (Mageza , 2004) .

Schultz (1993) define the term human capital as a key element in improving a firm assets and employee in order to increase productivity as well as to sustain competitive advantage . Human capital is the combined capabilities , knowledge , skills , experience , innovativeness and problem – solving abilities of each individuals knowledge (Davis and Harrison , 2001) . Human capital involves processes that relate to training , education and other inverventions in order to increase the levels of knowledge , skills , abilities , values and social assets of an employee which will lead to the employees satisfaction and performance and eventually on a firm performance (Rizvi , 2010).

Intellectual Capital Disclosure

Intellectual Capital Disclosure is defined by Abeyesekera and Guthrie (2002) as a report intended to meet the information needs common to users who are unable to command the preparation of reports about Intellectual Capital tailored so as to satisfy ,specifically all of their information needs (Gan et al.2008) . Intellectual Capital Disclosure represents an approach that can be used to measure intangible assets and describe the results of a companys knowledge – based activities (Ismail , 2008) .

The type of intellectual capital disclosure is valuable information for investors , as it can help them redusing the uncertainly of the companys future prospect and facilitate in valuing the firm(Bukh , 2003). There are many reasons for the companies to disclose intellectual capital information in their annual reports . they are a to help organizations formulate their strategies , (b) to assess strategy executions , (c) to assist in diversification and expansion decisions , (d) to use as basis for compensations and to communicate measures to external stakeholders . (Marr et al , 2003) . According to Pricewaterhouse Coopers (1999) disclosure of intellectual capital will raise some benefits for the organization . Among of the benefits are (a) It will enhances transparency in term of more disclose on intangible information rather than tangible information , (b) It will helps inspire a sense of faith among the workforce other major stakeholders and (c) It will supports long term vision of the organization (Taliyang , 2008) .

intellectual capital disclosure also come at a cost , such as the cost of gathering , processing and interpreting the necessary data . Vergauwenand Vanalem (2005) identify three other opposing factors for intellectual capital disclosure, such as :

1) The transparency drawback in competitive markets .
2) Regulatory barriers ; and
3) Auditor conservatism . (Vergauwen et , al , 2007)

Intellectual Capital Disclosure Theories

The disclosure of intellectual capital will be analyzed using three theories .They are Stakeholder theory , Legitimacy theory and Signaling theory .

Under Stakeholder theory , an organization management is expected to take an activities expected by their stackeholders and to report on those activities to the stakeholders (Guthrie et al , 2004). This theory also suggests that all stakeholders have a right to be provided with information about how organizational activities impacts on them , even if they choose not to use the information , and even if they cannot directly play a constructive role in the survival of the organization (Deegan , 2000) .

Stakeholder theory suggests that every legitimate person or group practiciputing in the activities firm to so to obtain benefits for all stakeholders and companies (Donaldson and preston , 1995) . it is argued that firms have stakeholders rather than just shareholders to account for . this means that the groups that have a stake in the firm may include shareholders , employees , customers , suppliers , leaders , the government and so ciety . thus , this theory emphasizes that : organizations should disclose intellectual capital information for the benefits of all stakeholders. Another theory that supports the intellectual capital disclosure is legitimacy theory .this theory closely linked to the stakeholder theory . legitimacy theory hypothesizes that organizations will ensure that they operate within the limits and standards of the societies they are in (Guthrie et al . 2004) . by adopting a legitimacy theory , a company would voluntarily report on activities if management perceived that the particular activities were expected by the communities in which it operates (deegan . 2000) . hence , this theory encourages the organization to voluntarily disclose intellectual capital information for the benefits of society .

Signaling theory is based on two general assumptions (myers and majult , 1984) . firstly , managers are better informed than shareholders or the public concerning of firms positions . secondly , given that managers have information advantage , they may choose to disclose information in an attempt to signal to the public regarding firms position . for the purpose of thise study . the signaling theory suggests that more profitable firms will disclose more information to inform their stakeholders about theire good performance . in other words , firms with good performance are more likely would disclose more information regularding the ic as compared to firms with bud performance .

Intellectual Capital Reporting and the Capital Markets

IC reporting began as an accounting/management practitioner-created concept. In the early 1990s organisations such as Skandia, Rambøll and GrandVision realised that existing financial accounting frameworks were unable to adequately address the measurement and recognition of the new value drivers in the economy. These organisations developed their own frameworks and methods for measuring and managing intellectual capital. It has only been more recently that scholarly contributions appeared to analyse and use the potential offered by IC reporting (Bontis, et al., 1999; Bounfour, 2003; Brooking, 1996; Edvinsson& Malone, 1997; Guthrie, Petty & Johanson, 2001; Sveiby, 1997).

Behind intellectual capital reporting there is an idea that the traditional financial information concerning the past performance of the company and non of the enterprise future potential .Reporting of intellectual capital will create a transparency that allow the manager of the enterprise to manage its intangible resource better . By creating transparency it helps management to allocate resources ,to monitor development and to create strategy , in summary : it faciliate decision making for companies (European Commission , 2006) . The European commission (2006) emphasizes two main reasons for intellectual capital reporting : 1) reporting of ic provides additional information which can be used to improve the management of the company as a whole . 2) reporting of ic complements the financial statement of the company and therefor provides a broader , more truthful image of the company(Basta . and Bertilsson , 2009) .

Internal strategic decision-making and external disclosure should focus on IC information such as staff competencies, managerial capabilities, customers and suppliers relationships, strategic collaborations, R&D, and organisational systems etc. Guthrie et al. (2001) identified two evolving intellectual capital (IC) missions; (1) ‘developing systems for creating, capturing and disseminating IC within organisations’ for internal strategic decision-making and (2) ‘establishing new measures and ways of reporting externally the value attributable to IC’. The latter mission addresses information needs of the managers for internal management of the company and information needs of investors for valuing the firm as an investment opportunity.

(SubhashAbhayawansa) Annual report is the most common disclosure medium used by researchers (e.g. Abeysekera, 2007; Guthrie et al., 2006; Vergauwen et al., 2007) in investigating intangibles or intellectual capital disclosure trend. Guthrie and Petty (2000) points out that annual report is viewed as a communication device used by companies to convey their information to various stakeholders. Previous literature, however, provides example where researchers (e.g. Bukh et al., 2005; Cordazzo, 2007; Singh and Van der Zahn, 2007) have looked at initial public offering (IPO) prospectus employed by management to describe the shares the companies are offering for potential investors. It is worthy to note that prospectus and annual report are tailored to the specific needs of different users.

Unlike annual report that focus on historical performance, a prospectus provides information that focus on the company's future perspectives. Cordazzo (2007) asserts that prospectus offers additional information on the companies' long term strategy, company risk and future profitability, and it is generally more forward oriented than annual report. These differences are likely to be reflected in the disclosure practices of the two documents. However, literature on intangibles or intellectual capital disclosure study comparing between prospectus and annual report is scarce. In a slightly similar study, Nielsen et al. (2006) observed similarities between prospectuses with intellectual capital statements. They further argued that a common framework for analysing business reporting could be developed based on the findings.(Azwan Abdul Rashid, Wan Mohammad Taufik Wan Abdullah, MahlindayuTarmidi and ZaifudinZainol) . According to lev and Zambon(2003) , economic development in recent years has been characterised by continuous innovation , thespread of digital and communication technologied , the relevance of network forms of organization , and the prevalence of soft , intangible and human factors . firms operating in competitive , global markets recognize that the traditional reliance on tangible assets as value drivers , has been supplemented – or even superseded – by softer , intangible asset forms . Hence , for most organizations , intellectual capital is now recognized as an integral part of the firms value – creating proces (Bukh , 2003 . Holland , 2003) .

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