THE
INSTITUTE OF
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ACCOUNTANTS
OF SCOTLAND

Intellectual Capital Reporting: Academic Utopia or Corporate Reality in a Brave New World?

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Published by

The Institute of Chartered Accountants of Scotland
CA House, 21 Haymarket Yards
Edinburgh EH12 5BH

First Published 2010
The Institute of Chartered Accountants of Scotland

ISBN 978-1-904574-63-7
EAN 9781904574637

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The Institute of Chartered Accountants of Scotland.
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Printed and bound in Great Britain
by T. J. International Ltd

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List of Abbreviations

AICPA	American Institute of Certified Public Accountants
ASB	Accounting Standards Board
CSR	Corporate social responsibility
DATI	Danish Agency for Trade and Industry
DMSTI	Danish Ministry of Science, Technology and Innovation
DTI	Department of Trade and Industry [now known as Department for Business, Innovation and Skills – BIS]
EBR	Enhanced Business Review
EU	European Union
FAS	Financial Accounting Standard
FASB	Financial Accounting Standards Board
FRC	Financial Reporting Council
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IC	Intellectual capital
ICAEW	Institute of Chartered Accountants in England and Wales
ICAS	The Institute of Chartered Accountants of Scotland
IFRS	International Financial Reporting Standard
KPI	Key Performance Indicator
IPO	Initial Public Offering
OFR	Operating and Financial Review

FOREWORD

Intellectual capital creates company value but generally this value is not recognised in financial statements. The debate on whether “intellectual capital” should be recognised or disclosed in the annual reports of companies continues but how can this debate be moved forward and what steps need to be taken by the accounting profession and standard setters?

This report takes a new perspective on the debate by investigating the views of finance directors, HR and marketing specialists on the relative importance of intellectual capital components to the generation of company value; the level of internal management use versus external disclosure of intellectual capital; the incentives and disincentives for disclosure; and the effectiveness of the annual report and other forms of corporate communication for the disclosure of intellectual capital.

The results confirmed the view that 50% or more of company value is attributed to intellectual capital. The top contributors to value were believed to be customer relationships, competitive edge, company reputation and employee skills and education. In terms of incentives for disclosure for finance directors the capital market related incentives dominated with the most important incentive being “helping to correct an undervalued share price”. As might be expected the most important disincentive was harming competitive disadvantage – but views on this were very much company and intellectual capital component specific. For HR and marketing specialists, there were different perspectives with the most important HR incentive being “helping to create trustworthiness with employees” and for marketing the trade off between providing information to existing or potential customers and protecting competitive advantage.

The annual report was generally identified as an effective communication channel for basic intellectual capital information but its usefulness for complex or previously undisclosed intellectual capital items was questioned and for finance directors the most effective communication channels were one-to-one meetings with investors and analysts and investor presentations.

Generally there was a high level of variation in responses showing that intellectual capital reporting is very much company and industry specific. This represents a challenge to regulators and standards setters as they consider how to address this topical issue. Survey participants supported standardised industry benchmarks for key intellectual capital disclosures – although further research into the constraints across all industries would be necessary.

The researchers' principal recommendation is for the IASB to place the intangibles project on its active agenda. This research project also has relevance to the current IASB project on Management Commentary.

This project was funded by the Scottish Accountancy Trust for Education and Research (SATER). The Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) has also been happy to support this project. The Committee recognises that the views expressed do not necessarily represent those of ICAS itself, but hopes that the report will move the intellectual capital debate forward and build upon the body of recent ICAS research in this area.

David Spence
Convener, Research Committee

April 2010

ACKNOWLEDGEMENTS

The authors would like to thank Professor Christine Helliar, Michelle Crickett and Angie Wilkie at The Institute of Chartered Accountants of Scotland for their help and support. The constructive comments from the anonymous academic and practitioner reviewers of the research proposal and the draft report were invaluable, as were the comments made by those participating in the pilot stage of the questionnaire survey.

The contribution of this research to existing knowledge must be attributed to the Finance Directors, Human Resources Directors, and Marketing Directors who gave so freely of their time and experience when completing the questionnaire survey and during interview.

Finally, the Research Committee and the authors are grateful for the financial support of the Scottish Accountancy Trust for Education and Research; without this support the research would not have been possible.

Executive Summary

Background

Intellectual Capital (IC) refers to the intangible knowledge resources which create company value. The three main categories of IC are human capital, structural capital and relational capital. Human capital includes the knowledge, skills, experiences and abilities of people. Structural capital comprises organisational routines, procedures, systems, cultures and databases, some of which may be legally protected in the form of intellectual property rights. Relational capital is the resources linked to the external relationships of the firm with various stakeholders, for example customers, suppliers or R&D partners. Under International Financial Reporting Standards (IFRS), many of these IC elements are not recognised in the financial statements, although certain non-specific disclosures are required in the Enhanced Business Review by the Companies Act 2006 and others are recommended by the Operating and Financial Review (OFR) Reporting Statement (UK Accounting Standards Board (ASB), 2006). Despite the persuasive force of the OFR Reporting Statement, the description of resources and intangibles in the annual report is still considered to be inadequate (ASB, 2007). This situation appears unsatisfactory, given that the market-to-book value of some companies is extremely high and even the median figure was a multiple of over three in 2007 for FTSE 100 companies.

Aims of study and research approach

The aims of this study, from a preparer perspective, are:

(i) To investigate the perceived relative importance of various components of IC within each of the three main IC categories in the generation of company value;

(ii) To uncover the level of internal management use relative to external disclosure for specific human and relational capital components;

(iii) To investigate the extent to which a range of theoretical incentives and disincentives relating to disclosure apply in the IC information disclosure context; and

(iv) To establish the role and effectiveness of the annual report as a means of IC disclosure in relation to other forms of corporate communication.

To address these issues, questionnaire surveys of three key preparer groups drawn from UK domestic listed companies were conducted. Ninety three finance directors completed the main questionnaire, with shorter variants being completed by 67 human resources specialists (focussing on human capital) and 68 marketing specialists (focussing on relational capital). Across the three groups, the 228 responses represent a 10.1% response rate. Seventeen follow-up interviews were conducted to explore the issues further.

Key findings

Importance of IC in value creation

Questionnaire findings:

- The majority of finance directors believed that 50% or more of corporate value is attributable to IC.

- All listed IC components were viewed by questionnaire respondents as contributing significantly to company value to some degree.
- The top four IC components comprised three relational capital components ('customer relationships', 'competitive edge in terms of quality of product/service', and 'company reputation') and one human capital component ('employee skills and education').
- The top four human capital components were 'employee skills and education', 'employee commitment', 'positive employee attitudes' and 'positive employee behaviour'.
- The top four relational capital components were 'customer relationships', 'company reputation', 'competitive edge in terms of quality of product/service' and 'data/knowledge of customers'.
- There was a high level of variation in responses relating to individual components.

Interview findings emphasised how IC components relate and interact with each other, and how companies transformed far-from-market components and categories into close-to-market components and categories in the value creation process.

Internal management use compared with external disclosure

Questionnaire findings:

- The top five human capital components used internally by company management (by 82% or more), were 'employee training and development', 'workplace safety', 'employee remuneration procedures', 'employee turnover' and 'recruitment and selection procedures'.

- With the exception of 'workplace safety', external disclosure of the vast majority of human capital components was low (under 50%).
- The top four relational capital components used internally by company management were 'data/knowledge of customers', 'marketing strategies', 'customer relationships' and 'competitive edge in terms of cost of product/service'.
- The components most frequently reported as disclosed externally were, however, 'brand names' and 'product portfolio'.

Interviews revealed that companies attempted to capture information on the less tangible human capital components through opinion surveys, appraisal reviews and manager observation. The external disclosure of customer components carried the risk of customer poaching by competitors. Companies struggled with methods of obtaining and coordinating information about their customers.

Incentives and disincentives in relation to IC disclosure

Questionnaire findings:

- All of the listed incentives and disincentives were believed to significantly affect the voluntary disclosure of IC, although the average importance varied considerably.
- Finance directors considered that capital market-related incentives dominated the disclosure of IC information in general, followed in the mid-ranks by marketing-related incentives and finally human capital-related incentives.
- The importance of incentives varied according to the category of IC information being disclosed – 'helping to correct an undervalued share price' was most important in the disclosure of both structural

and relational capital, whereas 'helping to create trustworthiness with employees' was most important in the disclosure of human capital.

- Capital market incentives dominated the disclosure of structural capital. However, the disclosure of human capital and relational capital were also driven by other incentives related to the category of information being disclosed.
- In terms of disincentives, 'avoiding giving away "company secrets" or otherwise harming competitive position' was the most important disincentive for all three groups. 'Preventing the creation of unrealistic expectations' and 'avoiding setting a disclosure precedent' were ranked second and third in importance, respectively.
- Finance directors did not consider that the importance attached to these disincentives varied significantly across the three categories of IC information.

Interview evidence indicated that the human resources specialists viewed 'helping to attract new employees of high calibre' and 'helping to retain employees of high calibre' as the most important incentives in relation to human capital, while finance directors rated 'revealing to outsiders the skill level of our managers' as the highest human capital component. The marketing specialists viewed customer-focused incentives as the leading marketing-related incentives, the most important incentive being 'helping to create trustworthiness with customers'. There was conflict between the disclosure of customer relationship information to create trust with potential customers and the violation of trust with existing customers. Comparative statistics (Key Performance Indicators) were deemed to be of value for benchmarking purposes, only in the presence of industry performance indicators. It was recognised that the standardisation of such indicators is difficult because different measures are important to different companies. Competitive disadvantage was not viewed as a disincentive to IC disclosure in all cases, suggesting that IC disclosure drivers are situation-specific. The marketing specialists emphasised that disclosure is a trade-off between providing information to customers and preventing competitors from receiving the information. Disclosure is not always within a company's control if it wants to avoid potential legal/commercial penalties.

Communication channels for IC disclosure and the role of the annual report

Questionnaire findings:

- Finance directors evaluated 'one-to-one meetings with investors', 'one-to-one meetings with analysts' and 'investor presentations' as the three most effective communication channels for disclosing all three categories of IC information.
- Several other channels were also effective, including the 'annual corporate report' and 'company web pages'; the 'interim report' and 'conference calls' were considered ineffective for all three IC categories.
- Human resources specialists rated the corporate annual report as the most effective channel, significantly higher than the other channels, whereas marketing specialists rated company web pages as marginally more effective than the annual report.
- The annual report was considered effective in communicating basic IC information; however its usefulness for communicating complex IC information or new, previously undisclosed IC information was questioned.

Interviews revealed that both the human resources function and the marketing function contributed significantly to the content of the annual report. For the human resources specialists, the importance of communication to employees took precedence over the external communication about human resources. The marketing specialists cited trade shows, conferences and events for customers/prospects as effective channels for face-to-face communication externally.

Conclusions and implications

These findings confirm the importance of IC to the creation of company value, both generally and at the more detailed level of main categories and individual components. The diversity and the situation-specific nature of IC emerges as a key theme running through the findings, as does variation in disclosure incentives and disincentives, and hence disclosure content and the communication channels used. This is illustrated by:

- the high level of variation in responses relating to the importance of individual IC components for value creation;
- variation in the incentives to disclose IC externally across the main IC categories;
- different views as to whether competitive disadvantage is a disclosure disincentive;
- the differential impact across industry sectors of regulatory constraints and customer disclosure sensitivities;
- variation across functional specialisms in views regarding the relative importance of the incentives to disclose IC; and
- some variation in channel use for the disclosure of each IC category.

Owing to the situation-specific nature of IC, it would seem that regulators cannot hope to address this issue in its entirety. Some support is found for the development of standardised industry benchmarks for key IC component groups; however a degree of IC is unique to individual companies and companies are best placed to describe this uniqueness in their own terms. This study has, nevertheless, shown that certain relational capital and human capital components are considered by a representative cross-section of preparers to be significantly more important than others and these key components should be a focus for future research. There is an opportunity to investigate whether a set of industry-specific standardised metrics can be developed and their disclosure regulated. Regulators and other stakeholders need to be fully aware of the industry constraints which prevent disclosure, specifically in relation to customers and products. Further research into constraints across all industries would appear to be a necessary precursor to industry disclosure standards.

Our principal recommendation is for the International Accounting Standards Board (IASB) to find the resources to place the intangibles project on its active agenda as this will help to generate further research into IC, its measurement and its disclosure. It could be argued that the future of the accounting profession and its role as the key reporting function depends on effectively addressing this issue.

This study makes three contributions to the literature on IC. First, it investigates the views of key personnel regarding the nature of IC, its measurement and its disclosure across the finance, human resources and marketing functions. Second, it investigates whether disclosure incentives and disincentives vary across the three main IC categories. Third, it undertakes a large-scale questionnaire of UK preparers' views regarding IC and its disclosure. While the findings of this study add to the significant body of ICAS-funded research on intangibles and IC in the UK (Fincham and Roslender, 2003; Holland, 2004; Davison and Skerratt, 2006; Mangena *et al.*, 2010; and Roslender *et al.*, 2009), more research is needed.

1 INTRODUCTION

Background to the research

Intellectual Capital (IC) is a term that is now widely used among accounting regulators, professional bodies and academics and increasingly recognised by business professionals. It is a term, borrowed from the management discipline, used to refer to intangible resources which create company value (Ashton, 2005). These knowledge resources, traditionally referred to as 'intangible assets' by accountants, have become increasingly important in the modern knowledge economy.

There are generally recognised to be three main categories of IC: human capital, structural capital and relational capital (Meritum, 2002, p.63). Human capital is the knowledge that employees take with them when they leave the firm and includes the knowledge, skills, experiences and abilities of people. While some of this knowledge is unique to the individual, some may be generic. Structural capital is the knowledge that stays within the firm at the end of the working day. It comprises organisational routines, procedures, systems, cultures and databases, some of which may be legally protected in the form of intellectual property rights. Finally, relational capital is the resources linked to the external relationships of the firm, with for example customers, suppliers or Research and Development (R&D) partners. It comprises that part of human and structural capital involved with the company's relations with stakeholders plus the perceptions that they hold about the company.

At present, many of these IC elements are not recognised as assets in the financial statements, with investment in such resources being expensed in the income statement. The International Accounting Standard (IAS) that relates directly to IC is IAS 38 Intangible Assets

(IASB, 2009a), with IAS 36 Impairment of Assets (IASB, 2009b) and International Financial Reporting Standard (IFRS) 3 Business Combinations (IASB, 2009c) also being relevant. In the UK, IFRS are now mandatory for all domestic listed companies' consolidated accounts. IAS 38 requires an entity to recognise an intangible asset (whether purchased or internally-generated) if 'it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and the cost of the asset can be measured reliably'. Many items, such as internally-generated goodwill, brands, customer lists and most development costs, are specifically not permitted to be recognised. The International Accounting Standards Board's (IASB) intangible assets project observes that current requirements place severe limitations on the types of intangible asset that may be recognised and that mandatory disclosure requirements (which may compensate for the limitations of recognition) are limited. The IASB concluded that IAS 38 requires fundamental review given the increased significance of intangible assets. A few commentators dissent from this view, however, arguing that the earnings from intangibles flow through the income statement and that this is sufficient for valuation purposes (Penman, 2009). At the time of writing, the intangibles project is not on the active list, as the IASB considers that it is unable to resource a project of this scale (IASB, 2009d).

Certain disclosures are required to be made in the corporate annual report outside the financial statements, and some of these relate to IC, although not in a specific way. Companies are required to provide in the directors' report an enhanced business review (EBR) that discloses information that is material to understanding the development, performance and position of the company, and the principal risks and uncertainties facing it (DTI, 2005). Compliance with the Operating and Financial Review (OFR) Reporting Statement (ASB, 2006) will more than meet the legal requirements for the EBR. The reporting statement states that key performance indicators (KPIs), which are defined as quantified measurements that reflect the entity's critical success factors, should be disclosed. It is left to the directors to determine what the entity's KPIs are. The Companies Act 2006 (section 417) extends the EBR requirements for quoted companies to include the main trends and factors likely to affect the future development, performance and position of the company's business; information about the environment, employees and social and community issues; and information on significant contractual or other arrangements which are critical to the business.

Clearly, however, the implementation of these requirements calls for subjective judgement and disclosures relating to IC may be judged not to fall within the parameters of the regulations; alternatively, disclosures may be made at a very high level of generality. Beyond the mandatory requirements relating to IC in the annual report, companies may of course choose to make additional voluntary disclosures and a variety of incentives to do so exist. In a general review of narrative reporting by UK listed companies since the new regulations were introduced, the Accounting Standards Board (ASB) concluded that 'companies need to think carefully about the description of the *resources* available to the entity, in particular those intangible items not reflected in the balance sheet' (2007, p.3, emphasis in original).

If the market is aware of a company's IC and believes that it will bring value, then IC will be reflected in the market share price. Thus, IC will, at least in part[1], be reflected in the difference between market and book values, since, as discussed above, intangibles are not adequately reflected in the traditional accounting framework. Market-to-book ratios can be used to indicate the potential significance of IC. The S&P 500's average market-to-book ratio was 4.5 in September 2003 (Gu and Lev, 2004), indicating for every $4.5 of market value, only $1 appears on the balance sheet. Beattie and Thomson (2005) found the mean market-to-book value for the UK FTSE 100 companies to be 2.52 (based on data for year-end 2002/3 and excluding several companies with negative reserves), indicating that 60% of company value was not shown on the balance sheet. For 2007 year-ends, just before the current financial crisis, the figure had risen to 7.15 for the mean and 3.10 for the median (based on 91 domestic FTSE 100 companies with positive reserves). Wide variation in these ratios is observed, both over time and across industries. Market swings over time occur due to the economic cycle, with more severe crashes being related to financial crises. At any point in time, knowledge-intensive industries such as biotechnology and pharmaceuticals tend to have the highest market-to-book ratios, while property companies have the lowest ratios (Beattie and Thomson, 2005). In modern times, however, even traditional manufacturing companies have significant IC embodied within them.

Given the importance of IC for most companies, efforts have been made to develop specific models for systematically reporting IC externally (e.g. Edvinsson and Malone, 1997; Sveiby, 1997; Lev, 2001; and for a useful review see Ricceri, 2008). Most recently, a focused narrative-based approach to IC reporting has been proposed by Danish industry regulators (DATI, 2000 and 2002; DMSTI, 2003). To date, however, these models have been adopted by very few companies.

The disclosure of IC information in the corporate annual report has been investigated using content analysis (e.g. Guthrie and Petty, 2000; Brennan, 2001; Bozzolan *et al.*, 2003; Guthrie *et al.*, 2007; Li *et al.*, 2008). These studies assess the extent to which different categories of IC information are disclosed and infer from this the relative importance of different components of the IC concept. The documented level of IC disclosure has been evaluated as 'low' in such studies. This is attributed to the lack of an established IC reporting framework and the general lack of a proactive stance by companies in attempting to measure and externally report IC information (Guthrie and Petty, 2000). Some of these studies go on to examine cross-sectional relationships between IC disclosure and company characteristics, as a way of evaluating the incentives (and disincentives) to disclose IC information.

Of course, it may be that, although the annual report continues to be viewed as a central reporting document, IC is disclosed externally using other channels of communication. A crucial characteristic of the annual report is that it is not a timely source of information and it is also becoming extremely long and arguably impenetrable (FRC, 2009). In a single company case study, McInnes *et al*. (2007) investigate the range of communication channels used to communicate with a wide range of stakeholders, not just capital market participants. These channels (e.g. hard copy reports, company website, face-to-face meetings, newsletters) are identified to have a range of attributes, such as timeliness to decision and interactivity, that influence stakeholder uptake and hence their use by preparers. In interviews with UK finance directors, Unerman *et al*. (2007) found that the annual report was not used to make new IC disclosures and the most effective means of communication was considered to be face-to-face meetings with investors and analysts.

Preparers views of IC, its management and its disclosure have also been explored directly using case studies and semi-structured interviews for a small number of companies (e.g. Chaminade and Roberts, 2003; Roslender and Fincham, 2004; Unerman *et al*., 2007). However, there appears to be a dearth of large-sample questionnaire studies of preparers' attitudes and beliefs regarding IC and IC disclosure. The survey method has been recently adopted in the US context (Graham *et al*., 2005) to investigate voluntary disclosure in general, and to establish the relative importance of various theoretical voluntary disclosure issues. To our knowledge, no large-scale questionnaire-based investigation of disclosure decisions that focuses on the particular issue of IC has been undertaken in the UK. It is anticipated that preparers will find it easier to respond to questions about disclosure when given a specific disclosure issue to consider. Furthermore, the impact of certain costs and benefits may vary across disclosure issues.

Aims and research questions

The aim of the proposed study is to obtain the views and opinions of key preparer groups affiliated to UK listed companies in relation to the following research questions (RQs):

1) *IC contribution to corporate value*

   RQ1: What is the view of key preparers regarding the relative importance of the various components of IC that have been identified in the academic literature in the generation of company value?

2) *Internal use and external disclosure*

   RQ2: What are the levels of internal management use and external disclosure for specific human and relational capital components?

3) *Incentives and disincentives in relation to IC disclosure*

   RQ3a: What is the relative importance of the various incentives and disincentives in relation to the IC external disclosure decision?

   RQ3b: How do the costs and benefits of IC disclosure relate to the three IC categories (Human, Structural and Relational Capital)?

4) *Communication channels for IC disclosure and the role of the annual report*

   RQ4a: How effective are the various forms of communication in relation to the disclosure of the three IC categories (Human, Structural and Relational Capital)?

   RQ4b: In what way is the annual report used as a vehicle for IC disclosure?

To address these questions, questionnaire surveys of three key preparer groups were undertaken to investigate the IC disclosure decisions of a cross-section of UK domestic listed companies. Finance directors are considered to be the relevant senior personnel who have specialist knowledge and understanding of the company's capital market relationships as well as a general knowledge and understanding of all aspects of the business. Capital market participants are interested in all three categories of IC. Two shorter, specialist questionnaires were also sent out, asking more finely grained and tailored questions of the functional heads of human resources and marketing. These are the two functional areas that relate directly to one specific category of IC – human capital and relational capital, respectively. Research questions one, three (a) and four (a) were asked of all three groups; research questions three (b) and four (b) were asked of the finance director group only; and research question two was asked of the specialist groups only, in relation to their area of specialism. Seventeen follow-up interviews were conducted to explore the issues further.

Report structure

Chapter two reviews several strands of prior literature relevant to IC disclosure. The specific areas covered are: the nature of the IC concept; theoretical and empirical studies which investigate the incentives and disincentives in relation to voluntary disclosure in general; studies which directly investigate the incentives for IC disclosure using interviews, case studies and questionnaires to preparers; studies which indirectly investigate the measurement and determinants of IC disclosure using content analysis and statistical regression analysis of users' views and the consequences of IC disclosure; and the communication channels used for external reporting generally and for IC reporting.

Chapter three outlines the research methods used in the study, including the sample selection, questionnaire design and administration, questionnaire respondents' profile and the interviewees' profile.

Chapters four to six contain the main results. Chapter four presents the questionnaire and interview findings from the finance directors, chapter five presents results for the human resources directors, while chapter six presents results for the marketing directors.

Chapter seven summarises the findings across the three sample groups. Conclusions are drawn, policy implications are suggested and directions for future research are identified. Finally, the contribution of the study is set out.

Endnote

1 The difference between market and book values can result from other factors such as the undervaluation of tangible and financial assets recognised in the balance sheet, intangible liabilities that are not captured in the balance sheet and market prices that do not accurately capture intrinsic value (García-Ayuso, 2003).

2 Literature Review

Introduction

To achieve its aims, this study draws upon several strands of extant literature in the areas of corporate disclosure and IC. Studies which define the nature of the IC concept are discussed in the next section. In the following section, the key insights from theoretical and empirical studies which investigate the incentives and disincentives in relation to voluntary disclosure in general are summarised. The next three sections focus on the IC literature. The first of these covers studies which directly investigate the incentives for IC disclosure using interviews, case studies and questionnaires to preparers. The second of these summarises studies which indirectly investigate the measurement and determinants of IC disclosure using content analysis and statistical regression analysis. Studies which investigate users' views and the consequences of IC disclosure are briefly reviewed in the third of these sections. The communication channels used for external reporting generally, and for IC reporting in particular, are considered in the subsequent section. A summary and assessment of voluntary disclosure decisions with emphasis on the IC context is provided in the final section.

The nature of the IC concept

The terms 'knowledge resources', 'intangible assets' and 'IC' are often used synonymously (Lev, 2001; Meritum, 2002; Lev and Zambon, 2003; Marr, 2005; Ricceri, 2008). It is thought that these different terms emerged in different disciplines, with intangible assets (or simply intangibles) being associated with the accounting discipline and IC/knowledge resources being associated with the management/human resources discipline (Chaminade and Roberts, 2003, pp.736-7). Increasingly, however, all of these terms are becoming known across each of the relevant disciplines.

Unfortunately, the boundary around the IC construct is not clear (Mouritsen, 2003). However, although there is no agreed precise definition of IC (Marr *et al.*, 2004, p.314), there is broad agreement (see, for example, Lev and Zambon, 2003, p.603) that there are three major categories of IC: human capital, structural capital and relational capital. The latter two elements exist at the organisational rather than the individual level. Structural capital is also sometimes known as 'internal capital' or 'organisational capital'. Relational capital is also sometimes known as 'customer capital' or 'external capital', as it concerns relationships with 'customers' and other groups external to the firm.

An important distinction exists between knowledge resources, which is a static, stock concept and knowledge activities, which are dynamic flows (Meritum, 2002). Rylander *et al.* (2000, p.737) describe flows as 'the transformations between and within stocks of human, structural, physical and financial capital'. Moreover, it is recognised that synergies exist in operating these categories of IC together, creating a fourth IC element, termed connectivity capital (Bjurström and Roberts, 2007). Habersam and Piber (2003) empirically establish connectivity capital as a linking pin.

Most commentators view the IC construct as a hierarchy of nested concepts, with each of the three high-level categories having multiple lower-level components. A total of 128 lower level IC terms, identified from a detailed content analysis of the IC literature, are shown in appendix one (Beattie and Thomson, 2004).

Beattie and Thomson (2007) comment that the IC literature, which covers the broad areas of measurement, management and disclosure, is characterised by an increasing amount of discussion of related concepts such as strategy, value drivers, critical success factors and value creation, suggesting situation-specific IC components.

Corporate voluntary disclosure in general – incentives and disincentives

Theory

The incentives to voluntarily disclose information can be explained in terms of a variety of economic and managerial theories, each of which focuses on a different aspect of corporate behaviour. These theories include agency theory, signalling theory, legitimacy theory and stakeholder theory.

Traditionally, economic theory has provided the main rationales for voluntary disclosure. The existence of information asymmetry between inside managers and outside shareholders creates market uncertainty and increases the information risk premium component of the cost of capital. Voluntary disclosure provides managers with the opportunity to increase their transparency to capital markets, leading to a lower cost of capital, increased share price and increased liquidity (Verrecchia, 2001; Richardson and Welker, 2001; Lundholm and Van Winkle, 2006; Mangena *et al.*, 2010). Moreover, managers are assumed to act in a self-interested way, creating agency costs, whereby managers (the agents) make decisions that transfer wealth away from outside shareholders (the principals). Outside shareholders anticipate this and discount the value of shares accordingly. Voluntary disclosure is one mechanism that managers can use to facilitate monitoring by shareholders, thereby reducing agency costs (Jensen and Meckling, 1976).

There are also economic costs that act as disincentives for disclosure: loss of competitive advantage; litigation exposure; and direct costs of collecting, processing and disseminating (Elliott and Jacobson, 1994). The fear of competitive costs, incurred through the adverse actions of existing and potential competitors, is often considered to arise from giving away proprietary information which assists competitors. However, competitors' reactions to disclosure and non-disclosure are extremely difficult to predict. Disclosure may deter competition and non-disclosure may still give rise to proprietary costs depending on how competitors interpret the non-disclosure (Wagenhofer, 1990). Litigation costs can arise from allegations of either incomplete or misleading disclosure. In the former case, increased informative disclosure reduces expected litigation costs; in the latter case, the issue concerns the accuracy and truthfulness of disclosures, rather than the amount.

Legitimacy theory and stakeholder theory, two closely related managerial theories, have been used to explain voluntary disclosure, in particular corporate social responsibility disclosures (Deegan, 2000). Companies may disclose information to appear legitimate in the eyes of society and avoid the imposition of costs arising from non-legitimacy. The disclosure choices of comparable companies may shape legitimacy. Voluntary disclosure of information could be self perpetuating in terms of maintaining and enhancing corporate value given that 'intangible asset creation occurs through enhanced reputation and disclosure influences the external perception of reputation' (Toms, 2002, p.258). The managerial branch of stakeholder theory argues that voluntary disclosure is a response to the demands of the stakeholders most critical to the company's ongoing survival, in other words, those that have the greatest importance and saliency in relation to the company's activities. The ethical branch of stakeholder theory proposes that different stakeholders have a right to IC information and so disclosure is responsibility-driven.

These theories are, to a great extent, mutually consistent. Rationally, therefore, the observed level and nature of IC disclosure for any company results from preparers trading off the expected benefits arising from disclosure incentives with the expected costs arising from disclosure disincentives, i.e. a cost-benefit trade-off.

Evidence

Evidence about disclosure incentives can be obtained directly, by asking preparers about the reasons for their disclosure decisions, or indirectly, by inferring the reasons from either observed disclosures or the consequences of disclosures. In an important direct study, Graham *et al.* (2005) survey over 400 executives in US firms to investigate the factors that determine disclosure decisions. Executives are found to be concerned about revealing sensitive information to competitors and sustaining corporate/personal reputations. Voluntary disclosure is used to build credibility with the capital market and to avoid potential law suits. Managers were found to make voluntary disclosures to reduce information risk and boost stock price. They suggest that there appears to be a balance between trying to maintain predictability in financial disclosures whilst avoiding the setting of disclosure precedents which are difficult to maintain. Managers believe that the stock market sometimes misinterprets or overreacts to disclosure announcements and thus make every effort to meet disclosure expectations.

Armitage and Marston (2007), focusing on the cost of capital, interviewed the finance director of sixteen UK companies to obtain views on the costs and benefits of corporate disclosure. Findings appear to suggest a lack of consensus across companies. However, cost of capital considerations did not appear to be the main determinant of corporate disclosure. The promotion of investor confidence and a reputation for openness are cited as the main benefits. Information creation, management time and the disclosure of commercially sensitive information were viewed as drawbacks. Face-to-face contact with fund managers and analysts was considered most important to reducing the cost of equity.

A significant body of empirical research also exists which indirectly infers the determinants of disclosure by focusing on individual costs and benefits in specific situations. Useful reviews of this extensive literature appear in Healy and Palepu (2001), Core (2001) and Lundholm and Van Winkle (2006). It should be noted, however, that most research relates to the US capital market. The available evidence generally supports the theoretical association between disclosure and a reduction in the costs of capital (Botosan, 2006), both the cost of equity capital (Botosan, 1997; Mangena *et al.*, 2010) and the cost of debt capital (Sengupta, 1998). Further, Lang and Lundholm (1993, 1997) and Healy *et al.* (1999) find a positive relationship between disclosure and debt and equity issues, implying a benefit to disclosure in the form of lowering the cost of capital. However, although Kristandl and Bontis (2007) find a negative relationship between the level of forward-orientated disclosure and the cost of equity capital, a positive relationship is reported when considering the level of historical disclosure for a sample of firms operating in Austria, Germany, Sweden and Denmark.

Healy and Palepu (2001) suggest that management compensation schemes in the form of stock options provide an incentive to engage in voluntary disclosure to meet insider trading restrictions and reduce contracting costs associated with stock compensation for new employees. In contrast, Core (2001, p.445) suggests managers selectively time both stock trading and disclosures at the expense of other stockholders. The impact of intermediaries, in the form of analysts and institutional investors, has also been investigated. Evidence would appear to suggest that increased disclosure goes hand in hand with increased analyst coverage and a more efficient market valuation (Lang and Lundholm, 1993 and 1996; Healy *et al.*, 1999; Francis *et al.*, 1998 and (in the UK) Walker and Tsalta, 2001). Disclosure appears to be positively associated with institutional ownership (Healy *et al.*, 1999), however too much disclosure is not beneficial if institutional investors are transient (Bushee and Noe, 2000).

The competitive disadvantage (or advantage) to voluntary disclosure is difficult to investigate indirectly. However, Piotroski (1999) finds that firms with less variability in profitability across industry segments are more likely to increase segment disclosure. This evidence is used to infer that competitive edge is a consideration in disclosure decisions. Guo *et al*. (2004) examine proprietary costs for US initial public offerings (IPOs) in the biotech industry, an industry characterised by fierce competition. The amount of product-related information disclosed is found to depend on: stage of product development; availability of patent protection; and venture capital backing. Additionally, as predicted by signalling models, increased disclosure is associated with a reduction in information asymmetry.

The evidence in relation to disclosure and potential litigation is somewhat mixed. Skinner (1994, 1997) provides weak evidence that litigation costs are lower for firms that pre-disclose, whilst Francis *et al*. (1994) concluded that pre-disclosure is not a deterrent to litigation. Lev (1995) finds that litigation targets communicated more extensively than a matched sample of control companies; however, they also issued more optimistic announcements and fewer warnings of an earnings disappointment.

According to Boesso and Kumar (2005), corporate voluntary disclosure continues to be investigated primarily from the perspective of investors and financial markets. They investigate factors other than the needs of financial markets driving the corporate voluntary disclosure of a sample of 72 Italian and US firms. Firm size and industry are found to influence disclosure in both countries. Business complexity, instability and volatility are found to affect the volume but not the quality of disclosure across country contexts. Individual company emphasis on stakeholder management (proxied by quality awards for external communication and the ratio between operating income and number of employees) is a strong indication to the volume of disclosure, supporting the stakeholder theory of corporate disclosure. The need for management of intangibles (measured by the difference in market-to-book values) was significant in relation to the quality of voluntary disclosures by Italian firms.

Direct investigations of the determinants of IC disclosure

Interviews and case studies

The preparer perspective has been explored using case studies. Chaminade and Roberts (2003) compare the findings of two action-based studies that look at the implementation of the IC concept at firm level in Norway and Spain. They argue that the term IC is 'vague and meaningless' for companies that have never worked with IC, the concept of IC generating specific interpretations only when operationalised. They suggest that the provision of many examples and cases will allow companies to 'almost literally see what IC means... from their own local reference point' (p.739) and permit the creation of the 'firm-specific syntax' necessary in order to use the concept (p.747).

Habersam and Piper (2003) undertake two interview-based case studies of the understanding of IC in hospitals, identifying the organisation-specific nature of the three forms of capital in the Meritum (2002) taxonomy and connectivity capital as the 'glue' between these three IC dimensions. It is noted that IC is a technical term not commonly used in organisations. The study identifies four distinct 'spheres of IC transparency': metric (what can be quantified); literal (what can be written down); intuitive (what can be explained) and black box (what cannot be explained, i.e. experiences and personal ability).

Van der Meer-Kooistra and Zijlstra (2001) conducted in-depth discussions with three IC-intensive Dutch companies and four financial analysts. The Dutch companies did not intend to report IC for external purposes because the disadvantages of doing so outweighed any advantages. Disclosing sensitive information to competitors was considered a serious burden, in addition to the information costs. IC reporting was thought to provide companies with the opportunity to increase their transparency to capital markets, resulting in a fairer as opposed to a higher market value. It was also recognised as valuable marketing tool. From a user perspective, the financial analysts view more IC disclosure as a sign of strength compared to competitors, and also a sign of commitment of a company's management to realising their goals.

Abeysekera (2008) conducted 11 case study interviews to investigate the motivations behind human capital disclosure (one category of IC disclosure) in the annual reports of firms in Sri Lanka, a developing nation. All firms were found to disclose information pertaining to employee relations and employee measurement; this disclosure was set against a backdrop of replacing semi-skilled and unskilled workforce with new technology. It is suggested that the motivation behind disclosure in this context relate to gaining support from the capital market and to appear legitimate. Equality and workplace safety disclosures were not prominent, however it is suggested that this is a reflection of the political agenda in Sri Lanka. Abeysekera (2008) concludes that human capital disclosure is used to reduce tension between firms and their capital, social and political constituents in the interest of further capital accumulation.

In the UK, Fincham and Roslender (2003) and Roslender and Fincham (2004) report on semi-structured interviews with six knowledge-based companies to investigate IC issues. They find that the understanding, measurement and reporting of IC in the UK is significantly less well developed compared to Scandinavian countries. They attribute this to the social welfare culture of these countries in contrast to the dominant market culture of the UK.

Unerman *et al*. (2007) conducted 15 in-depth interviews with the finance directors of UK companies. They found that financial statement preparers did not consider the annual report to be used to make new IC disclosures, i.e. any new IC information released to capital markets is through various other forms of communication. The most effective means of communication was considered to be face-to-face meetings with investors and analysts. However, analysts were not always perceived as engaging with or understanding the importance of IC information, especially in companies in less successful stock market sectors. The benefits from informing capital markets and other stakeholders of IC information appear to be weighed against the cost of loss of competitive advantage. Preparers were also concerned that investors and analysts would develop overly optimistic/pessimistic expectations.

Questionnaire studies

Gunther and Beyer (2003) used a questionnaire survey to obtain the views of 54 German listed companies (response rate 16%) in industries where intangible resources were thought to be of significance. Disclosure of information on intangibles was found to be very limited, and where information was disclosed it was primarily qualitative. Respondents were asked to identify the major internal and external factors critical to their company's success. Customers and competition in terms of cost, quality, time and flexibility appeared to be perceived as the most influential external factors. Human capital appeared to be the most relevant internal factor, with internal processes including support processes and innovation in relation to product, service or processes appearing to play a major role. Findings suggest that companies will not disclose information on factors they don't perceive as critical to success. Measurement difficulties and objectivity appear to hamper the disclosure of information pertaining to factors critical to company success to some extent. However, the major hurdle to disclosure is the reluctance to damage competitive position. From the respondent's perspective, the capital market seems unable to process relevant IC information adequately.

Verma and Dewe (2004) investigate the valuation and measurement of human capital by surveying a mix of human resources and accounting professionals in UK private sector companies and local authorities. In total, 288 questionnaire responses were obtained (a response rate of 5.8%). Fifty-two per cent agreed that measuring human resources was very or extremely important to their organisation. From a list of 33 measures, ten were identified as being important by more that 70% of respondents, seven measures were used by more than 50% and five measures appeared in both sets (absenteeism, client satisfaction surveys, competencies, cost of people and turnover rate). The main barriers to the valuation of human resources were identified as being: lack of understanding by others in the organisation; uncertainty as to what should be reported; lack of precision of measures; lack of wide acceptance; and lack of reliability.

O'Regan *et al*. (2005) conducted a postal questionnaire to investigate IC practices in the Irish information and communications technology sector. Based on responses from 88 private firms (effective response rate 23%), an average of 59% of firm value was thought to be attributed to IC, with over half of IC value being attributed to human capital. However, findings suggest that attempts to measure and monitor the IC element of firm value were lacking.

The external disclosure of IC information is governed by the availability of IC information internally. Huang *et al*. (2007) conducted a questionnaire survey of listed Malaysian companies to investigate the availability of internal information in relation to a list of IC items identified from the academic literature, classified as human, customer and structural capital. Based on the responses from 88 companies (17% response rate) and factor analysis to group IC items, an evidence-based taxonomy of IC is proposed. Eight subsets to human, customer and structural capital are suggested based on the internal availability of IC information: employee capabilities; employee development and retention; employee behaviour; development of products/ideas; organisation infrastructure; market perspectives; data on customers; and customer service and relationships.

Indirect investigations of the determinants of IC disclosure

Content analytic studies

Many researchers have used content analysis to examine corporate annual reports in a single country context with the aim of identifying IC disclosures (Guthrie and Petty, 2000; Brennan, 2001; Bontis, 2003; Bozzolan *et al.*, 2003; April *et al.*, 2003; Goh and Lim, 2004; Abeysekera and Guthrie, 2005; Abdolmohammadi, 2005; Li *et al.*, 2008). Typically, the corporate annual reports of a small to medium sized sample of companies are manually searched for a number of pre-specified IC components (sub-categories).

Further studies have adopted both manual and electronic searches across country settings (for example: Bozzolan *et al.*, 2006; Vergauwen and van Alem, 2005; Vandemaele *et al.*, 2005; Guthrie *et al.*, 2007). To date, the observed level of IC disclosure in such studies has been consistently described as 'low'. However, the findings of studies using electronic word searches to investigate IC disclosure is questionable given the inferiority of this method as demonstrated by Beattie and Thomson (2007).

To date, only a few UK studies of listed companies have been published. Unerman *et al.* (2007) and Striukova *et al.* (2008) use content analysis to investigate IC disclosure in a wide range of corporate media for 15 UK companies operating in four different industry sectors. They find that the vast majority of IC information disclosed referred to relational capital (for example, customers and distribution channels). Li *et al.* (2008) content analyse the annual report of a sample of 100 UK listed companies using a checklist of 61 IC components. Based on word count, relational capital accounted for 38% of all IC disclosure, structural capital accounted for 34%, and human capital accounted for the remaining 28%.

The vast majority of prior research has undertaken cross sectional analysis of IC disclosures. Williams (2001) conducted a longitudinal analysis of IC disclosures in the annual reports of 31 randomly selected UK FTSE 100 companies over the period 1996 to 2000. A continuous upward trend in the average amount of IC disclosure was documented. These findings are substantiated by Vandemaele *et al.* (2005) who find, on average, an increase in IC disclosure by Dutch, Swedish and UK firms over the period 1998 to 2002. However, Abdolmohammadi (2005) found an increase in disclosure for only two out of ten IC categories investigated in a sample of 58 US Fortune 500 firms over the period 1993 to 1997. These findings may be the product of a slightly earlier time period, or unique to the US context. Alternatively, to claim the continuous increase in IC reporting over time may be an overstatement.

Other corporate documents are also beginning to be analysed, such as IPO prospectuses (e.g. Bukh *et al.*, 2005; Cordazzo, 2007; and Singh and Van der Zahn, 2008) and presentations to analysts (e.g. García-Meca *et al.*, 2005).

Statistical regression analysis

The use of content analysis to document the extent and nature of IC information disclosed is beginning to be extended. Content analysis is used to obtain IC disclosure indexes which can be employed in statistical regression analysis to indirectly investigate IC disclosure determinants. Bukh *et al.* (2005) investigate what factors explain IC disclosure in the IPO prospectuses for 68 firms listed on the Copenhagen Stock Exchange over the period 1990 to 2001. Managerial ownership prior to the IPO and industry classification was found to influence the amount of IC disclosure, whereas company size and age had no impact.

In a similar study, Singh and Van der Zahn (2007) investigate an association between IC disclosures amongst 334 Singapore IPO prospectuses and the cost of capital. In theory, firms might be expected to disclosure IC information to prevent the underpricing of their equity, which is a major cost of capital. However, a positive association was found between underpricing and the extent of IC disclosure, especially amongst a sub-sample of IC intensive IPOs. Findings appear to suggest that firms may not use IC disclosures effectively to reduce capital costs when issuing equity. Instead, it is suggested that IC disclosure may be strategically used to complement underpricing, to encourage investors to bid up the price they are willing to pay based on the extent of disclosure, resulting in the development of an unhealthy speculative IPO market. However, the IC disclosure index used in this study captures only presence or absence of IC items, rather than volume or indeed quality of disclosure which would be expected to be more influential on a firm's cost of capital.

Oliveira *et al*. (2006) investigate determinants of IC reporting in certain sections of the annual reports for a sample of 56 Portuguese listed firms. Firm size, ownership concentration, type of auditor, industry and listing status were all found to be influential. White *et al*. (2007) investigate the drivers of voluntary IC disclosure in a sample of 96 listed biotechnology companies in Australia. The level of voluntary IC disclosures was found to be significantly related to board independence, leverage and firm size. However, board independence and firm leverage were only found to drive IC disclosures in large firms. They conclude that IC disclosure is being driven by agency theory variables and corporate governance issues. Firer and Williams (2005) claim to provide the first large-scale cross-sectional analysis with their sample of 390 Singapore publicly traded firms. IC disclosure was found to be less likely in firms with concentrated ownership and in firms with a high level of executive director ownership. Findings also indicate that firms linked with government are more likely to disclose.

Unerman *et al*. (2007) find that larger UK companies (FTSE 100 companies) disclose more IC information than smaller companies, and industry sector influences IC disclosure, with the retail industry disclosing the most. This is consistent with the findings of Bozzolan *et al*. (2003) regarding company size and industry membership in the Italian setting. Li *et al*. (2008) find significant associations between IC disclosure and various corporate governance characteristics, specifically, board composition, ownership structure, audit committee size and frequency of audit committee meetings.

Users' views and consequences of IC disclosure

There are a variety of ways in which users' views on, and reactions to, IC disclosure can be investigated. Using a direct questionnaire approach, Beattie and Pratt (2002) ask users about the usefulness, for investment decision-making purposes, of a comprehensive list of 130 information items. These items are grouped into 11 categories, five of which relate directly to IC: process value drivers; employee value drivers; customer value drivers; growth and innovation value drivers; and IC. At the information category level, innovation and customer categories ranked fifth and sixth, while process and employee categories were placed in the lower orders, as was the IC category (pp.80-81). Selected value driver information items were, however, rated very highly by users, notably R&D investment and capital investment.

Another approach taken has been the analysis of the content of analyst reports to see what information they use to justify their stock recommendation of buy, hold or sell (e.g. Arvidsson, 2003; García-Meca and Martinez, 2007). García-Meca and Martinez (2007) use a 60 item IC disclosure index on 260 full-text sell-side analyst reports on Spanish listed companies. They find that analysts usually report information regarding a company's strategy, customers and processes, less frequently providing R&D and innovation information. Relatively greater amounts of IC information are contained in the analyst reports for profitable companies and companies with high growth opportunities.

The relevance of information on intangibles for equity valuation has been examined using capital market based studies. It is argued that, where market value is highly dependent upon intangibles, non-financial performance measures are of key importance (AICPA, 1994; FASB, 2001; Espinosa *et al.*, 2009). The type of information examined includes expenditure (e.g. R&D expenditure as an input indicator of innovation, advertising expenditure which builds up brand equity or customer loyalty, investments in human resources); capitalised values (e.g. software development costs); and non-financial information not included in the financial statements (e.g. number of patents, patent citations, or royalty income from patent licensing; customer satisfaction indices). Illustrative studies include Amir and Lev (1996), Lev and Sougiannis (1996, 1999), Aboody and Lev (1998), Amir, Lev and Sougiannis (2003), Ballester *et al.* (2003), Pfeil (2003), Gu and Lev (2004), Abdolmohammadi (2005), Kohlbeck and Warfield (2007), Lajili and Zéghal (2005), Lev and Radhakrishnan (2005) and Carr and O'Brien (2008). For example, Abdolmohammadi (2005) finds IC disclosure to have a highly significant effect on the market capitalisation of a sample of US S&P 500 firms; Lajili and Zéghal (2005) find that companies that voluntarily disclose labour costs command higher equity market values; and Lev and Radhakrishnan (2005) find that a company-specific measure of organisational capital contributes significantly to the explanation of cross-sectional variation in market values.

Lev and Zarowin (1999) argue that the ability of accounting numbers to explain the variation in share returns has been declining over time, due to the growing importance of intangibles[1]. In a review of this type of study, Canibano *et al.* (2000) conclude that current investment in intangibles is generally associated with higher future earnings and stock returns. They note, however, that the focus of research has been on 'R&D and advertising to the detriment of other intangible assets' (p.113).

Liang and Lin (2008) investigate the importance of different categories of IC in 261 firms operating at different life-cycle stages in the information technology industry in Taiwan. A model which assumes market value is a function of accounting information and information not reflected in the accounting system is adopted to investigate the explanatory power of IC information in the growth, maturing and stagnation life cycle stages. Overall, the order of importance of different categories IC information (listed from most to least importance) was found to be customer, process, innovation and human. Interestingly, however, the importance of each category of IC information differed according to the life-cycle stage a firm was experiencing: customer capital was most important in the maturing stage and least important in the growth stage; process capital was most important in the growth stage and least important in the maturing stage; and innovation and human capital were most important in the growth stage and least important in the stagnation stage.

Communication channels

In a single company case study concerning disclosure in general, McInnes *et al*. (2007) investigate the range of information sources and communication channels (such as hard copy reports, company website, face-to-face meetings and newsletters) used to communicate with a wide range of stakeholders, not just capital market participants. Interviews with company management revealed a disclosure decision-making process which resulted in a complex mosaic of information provision (both mandatory and voluntary). Communication channels were identified to have a range of attributes, such as timeliness to decision and interactivity, that influenced stakeholder uptake and hence their use by preparers.

Cormier *et al*. (2009) investigate the use made of corporate websites as a disclosure platform for corporate performance by the largest listed

Canadian companies. Using a coding grid comprising 111 items, grouped into nine categories, they explore patterns of disclosure and find that human capital category disclosures are linked to the social responsibility category disclosures, while innovation category disclosures and development and growth category disclosures are linked to customer value category disclosures. Gerpott *et al.* (2008) examine IC disclosure quality in annual report and corporate websites for an international sample of 29 listed telecoms network operators. As might be expected, the IC disclosure in both communication channels is significantly positively correlated. European companies had higher IC disclosure levels that US companies.

Unerman *et al.* (2007) find that the annual report contains less than a third of total IC disclosure across all corporate media. The pattern of IC disclosure was found to differ across corporate media, with the largest number of disclosures made on web pages. They conclude that IC disclosure in the annual report is not representative of overall IC disclosure practices. Eighty per cent of IC information was provided in narrative form. In follow-up interviews with finance directors regarding IC disclosure, Unerman *et al.* (2007) found that the annual report was not used to make new IC disclosures and the most effective means of communication was considered to be face-to-face meetings with investors and analysts.

Davison and Skerratt (2006) focus on the annual report and annual review documents as communication channels and explore the use of different formats (words, pictures and graphs) to communicate information about intangibles. Of particular interest is the finding that 94% of all pictures communicated intangible aspects of companies' businesses. There was a strong positive association between the level of uncapitalised intangible assets and the extent to which voluntary words and pictures referred to intangibles. Li *et al.* (2008) investigate three formats for IC disclosure: text, pictures/graphs and numbers. They find that IC disclosures are mainly in text form.

Summary

This chapter has reviewed several strands of the academic literature relating to IC and its external voluntary disclosure by companies. The discussion of the IC concept showed that, although IC is widely recognised to comprise human, structural and relational capital, the individual components of these categories are numerous, diverse and likely to be situation-specific. This depth and breadth of the IC concept renders the construction of an operational definition of IC, and hence the measurement of IC disclosure, problematic (Beattie and Thomson, 2007).

The theoretical voluntary disclosure literature draws upon several disciplines to suggest incentives and disincentives in relation to disclosure. These costs and benefits are associated with issues such as: cost of capital; analyst following; institutional investors; competitive (dis)advantage; litigation; perceived legitimacy and reputation effects; managing stakeholders; and information provision costs. Broad empirical evidence supporting the relevance of these costs and benefits for disclosure decisions exists, however the relative importance of each seems to vary across settings and across individual companies. The majority of prior empirical research on corporate disclosure adopts an indirect approach to make inferences about disclosure incentives, sometimes based on the consequences of disclosure. Establishing relationships indirectly between disclosure and other firm characteristics involves both constructing a measure of disclosure (which is problematic) and using proxies to capture the unobservable disclosure incentives and disincentives, such as those related to information asymmetry and competition.

In the IC-focused literature, direct investigations into the importance of IC, its management and its reporting are limited and dominated by small samples using interview/case study based techniques. Research into the relative importance of different IC main categories and individual components provides contradictory evidence. A lack of development in the management and reporting of IC is also evidenced across studies. Although the findings from interviews/case studies provide direct insight, they are not generalisable to the wider population of companies given the absence of a large cross-sectional representative sample.

The use of content analysis to measure IC disclosure as an end in itself and as an input to statistical regression studies to investigate IC disclosure determinants is increasing in the academic literature. Several studies demonstrate the importance of communication channels other than the annual report in the disclosure of IC information. The subjectivity involved in constructing an operational IC definition hinders researchers' attempts to quantify IC disclosures using content analysis, while the situation-specific nature of the mix of IC components relevant for each company mean that findings to date are potentially a product of the method employed (Beattie and Thomson, 2007). Further, the incentives to disclose IC information may vary according to the nature/type of IC involved in each company.

Overall, studies based solely on interviews or case-based studies, while giving an indication of the uniqueness of the IC embedded in each company and the distinctive set of factors influencing IC disclosure decisions, fail to permit generalisable conclusions to be drawn. By contrast, content analytic and regression studies offer findings in relation to the 'average' company, but mask the underlying variety. Although not without its own limitations, the questionnaire survey method can contribute to our understanding of IC since it permits different facets of the disclosure decision to be comprehensively investigated for a large sample of companies. Not only can a range of theoretical drivers, including economic, managerial and behavioural drivers, be investigated, but their relative importance in relation to the three main IC categories can be explored. Although, the survey method has recently been used in the US to investigate disclosure decisions in general (Graham *et al.*, 2005), very few studies have used the survey approach in the area of IC. In none of the four studies identified in the section above on direct investigations of the determinants of IC disclosure is the disclosure decision the focus of enquiry. Moreover, the use of the survey method in the UK in both the IC context and in relation to a broad range of disclosure incentives and disincentives appears to be unexplored territory.

Endnote

1 A significant debate exists regarding how to assess the trend in value relevance, with some studies concluding that there has been an increase in the US (Francis and Schipper, 1999).

3 Research Methods

Introduction

A postal questionnaire survey was used to investigate the views of senior management in UK listed companies regarding IC and IC disclosure decisions. A survey permits different issues to be comprehensively investigated for a large sample of companies. Seventeen follow-up interviews were conducted to explore the issues further and, in particular, to explore the reasons for the views stated in the questionnaire. The sections in this chapter cover the following aspects of the research methods: sample selection; questionnaire design and administration; questionnaire response profile and sample characteristics; and interviewees' profile.

Sample selection

The main questionnaire was sent to the finance directors of the population (591 companies) of UK domestic companies listed on the London Stock Exchange main market (industrial, commercial and financial companies excluding both investment trusts and real estate companies located in the Channel Islands) and a sample of UK domestic companies listed on the AIM market (the largest 409 qualifying companies by market capitalisation). Finance directors are considered to be senior personnel who have specialist knowledge and understanding of the company's capital market relationships as well as a general knowledge and understanding of all aspects of the business.

Two shorter, specialist questionnaires were also sent out, asking finely grained questions of the functional heads of human resources and marketing. One variant of the questionnaire was sent to human resources directors (or the most senior human resources manager) of the population of UK main market companies on the basis that human capital is one of the major categories of IC (Lev and Zambon, 2003) and a key source of sustained competitive advantage (Verma and Dewe, 2004). A second variant of the questionnaire was sent to the marketing directors (or the most senior marketing manager) of the population of UK domestic companies listed on the London Stock Exchange main market. It has been proposed that IC reporting can be used as a valuable marketing tool (van der Meer-Kooistra and Zijlstra, 2001). Additionally, a recent survey by the Intellectual Assets Centre found that Scottish–based companies are increasingly exploiting their intellectual assets with marketing materials (Outram, 2007).

Questionnaire design and administration

A full listing of the six research questions addressed can be found at the end of chapter one. The content of the questionnaires was derived from an extensive review of the existing IC literature. The initial drafts were piloted using contacts provided by ICAS. The two shorter, specialist questionnaires sent to the functional heads of human resources and marketing relate directly to a specific category of IC – human capital and relational capital respectively. The three groups did not receive the same questionnaire due to their different knowledge bases and experience. It was judged that only the finance director group would have a sufficiently informed understanding of the capital market aspects of IC, whether the incentives and disincentives impacted differently on the three IC categories and the role of the annual report to answer detailed questions on these aspects. On the other hand, this group would have a less detailed understanding of the human resources and marketing functions than the respective functional specialist. Consequently, the human resources and marketing questionnaires did not ask many questions about general capital market aspects but did ask more detailed questions about the particular functional area. In addition, a question concerning the internal use of the components of a specific functional IC category was asked only of these groups.

The questionnaires generally used close-form questions and adopted five-point Likert scales with verbal anchors. The questionnaire responses were not anonymous. Potential respondents were allocated a reference number in order to improve the efficiency of the reminder process and to facilitate further analysis by permitting additional data to be independently collected for responding firms. To elicit a frank response, the confidentiality of answers was stressed, and respondents were assured that any information provided would not be publicly associated with them or their company identity at any stage. The mailing list of finance director names and addresses was constructed using both the Fame database and Hemscott. A pilot test of phone calls to verify the mailing list was performed. However, this test was not very successful in that companies appeared generally unwilling to verify names and addresses over the telephone and often the switchboard is not well informed in relation to the appropriate personnel. The online resource Hoovers was used to verify the name and company address of every finance director in the sample. Marketing and human resources contact names were also collected to the extent the information was available. Any discrepancies in the data obtained from the different sources, for example in relation to change of directors, were resolved by executing internet searches and reference to the company's own website.

The questionnaire was mailed in May 2008. Several techniques were adopted to enhance response rate: clear questionnaire layout; piloting; personally addressed cover letters; individually signed cover letters; reminder letters sent 14 days after the initial mailing and another copy of the questionnaire sent 28 days after the initial mailing to all non-respondents; stamped reply envelopes (rather than pre-paid envelopes); and requests to non-respondents to return the questionnaire.

The response to initial mailings was very poor and slow. In an attempt to increase the final number of completed questionnaires received, an incentive was included in the last round of mailing. Respondents were offered the opportunity to enter a prize draw or have a donation made to charity. These incentives to participate were funded by the researchers themselves; an Ipod nano was awarded to a human resources director and £275 was donated across four charities (Cancer Research, NSPCC, Oxfam and RSPCA). Respondents were asked to indicate their willingness to participate in follow-up interviews.

Questionnaire response profile and sample characteristics

In total, 2,182 questionnaires were issued across the three sample groups. After the two follow-up requests, a total of 228 responses were received (10.5%). The sample groups and response rates are shown in Table 3.1.

Table 3.1 Sample groups and response rates

Sample groups	Number in sample	Completed questionnaires	Completed response rate
Finance directors	1,000	93	9.3%
Human resources	591	67	11.3%
Marketing	591	68	11.5%
Total	**2,182**	**228**	**10.5%**

Of the 93 completed finance director questionnaires, 55 were received from companies listed on the main market and 38 from AIM companies. In terms of reasons for non-completion, it is apparent that many companies have adopted a policy not to participate in surveys. Further, many personnel are operating within severe time constraints and work pressures in the present economic downturn, which prohibited their participation. Irrespective of this, the response rate is consistent with the 10-12% response rate considered to be typical for these 'difficult' target groups (listed company directors) in the current climate (Simsek *et al*., 2009). Other recent UK mail surveys to senior finance executives and human resources professionals have obtained response rates of 8.1% (Marshall and Weetman, 2008) and 5.8% (Verma and Dewe, 2004).

In an attempt to establish the authority of the response provided, the company job title of persons completing the questionnaire was requested. Of respondents who provided personal details, 68% in the finance director group indicated they held the position of group finance director, finance director or chief financial officer (CFO), for whom the questionnaire was intended (Table 3.2). In the human resources group, 87% indicated they held the positions of director or manager of human resources. The remainder appeared to hold other senior relevant corporate positions. In the marketing group 64% indicated they held positions of director, head or manager of marketing/business development.

Table 3.2 Sample groups and corporate positions

Panel A: Finance director group	
Job title	**Percentage of respondents (n=72*)**
Group finance director/finance director	44%
CFO	24%
Group financial controller/financial controller	11%
Group financial accountant/head of financial reporting	7%
Other directors	6%
Other	8%

* 21 respondents failed to provide their company position on the questionnaire

Table 3.2 Sample groups and corporate positions (Cont.)

Panel B: Human resources group	
Job title	**Percentage of respondents (n=61*)**
Group director HR	25%
Head of HR	16%
Group head/manager HR	15%
HR director	15%
HR manager	15%
Other directors	4%
Others	10%

* 6 respondents failed to provide their company position on the questionnaire

Panel C: Marketing group	
Job title	**Percentage of respondents (n=61*)**
Group/company marketing managers	21%
Director of sales/marketing/business development	20%
Other directors	10%
Head of marketing/business development	10%
Commercial director	8%
Group director of sales/marketing/business development	5%
Other	26%

* 7 respondents failed to provide their company position on the questionnaire

To investigate whether the sample of responding companies is representative of the groups mailed, a comparison was made on the basis of: industry profile; company size measured by sales and the number of employees; and market-to-book ratio. Results for industry profile are shown in Table 3.3.

Table 3.3 Industry classification for population and responding groups

Industry sector (Level 3 Datastream)	Finance director sample (n=1000)	Finance director respondents (n=93)	HR and marketing population (n= 591)	Human resources respondents (n=67)[2]	Marketing respondents (n=67)[3]
	%	%	%	%	%
Automobiles & parts	0.4%	0%	0.5%	0%	0%
Banks	0.9%	1.1%	1.4%	3.0%	1.5%
Basic resources	5.4%	2.2%	2.7%	3.0%	0.0%
Chemicals	1.5%	3.2%	1.5%	3.0%	3.0%
Construction & material	3.0%	2.2%	3.4%	5.9%	4.5%
Financial services	7.8%	9.7%	6.1%	4.5%	8.9%
Food & beverage	2.6%	0.0%	3.2%	3.0%	0.0%
Healthcare	6.8%	7.5%	5.9%	4.5%	7.5%
Industrial goods & services	23.3%	28.0%	25.4%	35.8%	29.8%
Insurance	2.8%	2.2%	3.6%	5.8%	1.5%
Media	6.4%	7.5%	5.8%	1.5%	0.0%
Oil & gas	5.8%	5.4%	3.7%	6.0%	5.9%
Personal & household goods	3.6%	1.1%	4.7%	4.5%	0.0%
Real estate	4.9%	6.5%	5.9%	4.5%	11.9%
Retail	6.1%	6.5%	8.3%	4.5%	1.5%
Technology	10.0%	9.3%	9.0%	1.5%	10.5%
Telecommunications	1.3%	0.0%	1.3%	1.5%	1.5%
Travel & leisure	5.4%	4.3%	5.6%	6.0%	10.5%
Utilities	2.0%	2.2%	2.0%	1.5%	1.5%
Total	**100.0%**	**100.0%**	**100%**	**100%**	**100%**

Notes

1. $x^2 = 11.35$, $p = 0.879$
2. $x^2 = 15.55$, $p = 0.624$
3. $x^2 = 24.91$, $p = 0.128$; n=67 because 1 marketing questionnaire was returned anonymously

The industrial goods and services industry is most represented in both the sample who were sent the finance director questionnaire and the finance director group of respondents (23.3% and 28% respectively). Certain small industries, namely automobiles and parts, food and beverage, and telecommunications, are not represented in the finance director group of respondents. Overall, however, the industry profile of finance director respondents is not statistically different from that of the sample mailed. The human resources and marketing questionnaires were sent to the smaller population of 591 main market companies. Again the industrial goods and services industry is most represented: 25.4% in the population, 29.8% in the marketing group of respondents, and 35.8% in the human resources group of respondents. With the exception of automobiles and parts, all of the industry classifications are represented in the human resources group. The marketing group does not include any companies representing automobiles and parts, basic resources, food and beverage, media, and personal and household goods. Irrespective, the industry profiles of the human resources and the marketing groups of respondents are not statistically significantly different from that of the population mailed.

Population and samples descriptive statistics for company size (sales and the number of employees) and the market-to-book ratio are shown in Table 3.4. Companies with missing values have been excluded.

Table 3.4 Size profile for population and responding groups

Panel A: Sales (£m)					
	Finance director sample	**Finance director respondents[1]**	**HR and marketing population**	**Human resources respondents[2]**	**Marketing respondents[3]**
Number	992	93	588	66	67
Mean (average)	1,364	561	2,264	2,931	1,552
Median	97	90	295	454	249
Standard deviation	6,694	1,718	8,581	7,534	6,788
Minimum	0	0	0	0.001	0.5
Maximum	141,637	14,309	141,637	54,600	54,600

Notes
1. $t = 1.1526$, $p = 0.2493$
2. $t = 0.6056$, $p = 0.5450$
3. $t = 0.6561$, $p = 0.5120$

Panel B: Number of employees					
	Finance director sample	**Finance director respondents[1]**	**HR and marketing population**	**Human resources respondents[2]**	**Marketing respondents[3]**
Number	983	91	583	65	67
Mean (average)	7,635	3,108	12,579	4,337	7,561
Median	598	482	2,049		1,380
Standard deviation	30,868	10,023	39,332	7,300	27,891
Minimum	2	3	3	5	12
Maximum	507,480	88,000	507,480	226,400	226,400

Notes
1. $t = 1.3917$, $p = 0.1643$
2. $t = 0.6649$, $p = 0.5063$
3. $t = 1.0153$, $p = 0.3104$

Table 3.4 Size profile for population and responding groups (Cont.)

Panel C: Market-to-book ratio for population and respondents					
	Finance director sample	**Finance director respondents[1]**	**HR and marketing population**	**Human resources respondents[2]**	**Marketing respondents[3]**
Number	943	87	556	62	63
Mean	4.25	3.28	4.64	3.89	3.12
Median	2.34	2.44	2.41	2.60	2.62
Standard deviation	13.30	3.56	16.28	5.35	2.45
Minimum	0.25	0.29	0.25	0.25	0.40
Maximum	239.06	22.16	239.06	40.35	12.89

Notes
1. x2 = 0.615, p = 0.433
2. x2 = 0.287, p = 0.592
3. x2 = 0.866, p = 0.352

On average, the finance group of respondents includes smaller companies in terms of both sales and the number of employees compared to the sample mailed. The average sales for the sample mailed are £1,364m, compared to £561m for the sample of finance director respondents. The average number of employees for the sample mailed is 7,635 compared to 3,108 for the sample of finance director respondents. Despite the sample of finance director respondents containing smaller companies, the sales and employee profiles of the finance director sample are not statistically significantly different from that of the sample mailed. The human resources group appears to include smaller companies in terms of an average number of employees of 4,337 compared to 12,579 for the population. However in terms of sales, the human resources group average of £2,931m is in excess of the average of £2,264 for the population. The marketing group also appears to comprise smaller companies compared to the population in terms of both sales and number of employees (average sales for the marketing group is £1,552m compared to £2,264m for the population; average number of employees for the marketing group is 7,561 compared to 12,579 for the population. Irrespective of which size measure is used, the sales and employee profiles of both the human resources and the marketing groups are not statistically significantly different from those of the population mailed.

Turning to Panel C of Table 3.4, companies with negative net assets have been excluded and one further company has been excluded from the population statistics because its net assets are very close to zero, inflating the market-to-book ratio unduly and distorting the mean. Because several companies have very high market-to-book ratios, the median is a better measure of central tendency than the mean, and so comments focus on this statistic. The median market-to-book ratio of each of the three samples is very close to that of the relevant finance director sample mailed and the populations of marketing and human resources directors. Based on a statistical test that compares the medians, no statistically significant differences are found.

Overall, therefore, it can be concluded that the samples are representative of the relevant sample and populations from which they are drawn.

Interview methods and interviewees' profile

At the end of each questionnaire, we asked if the respondent would be 'willing to be interviewed to enable the issues raised in the questionnaire to be explored in more detail'. Interviewees were selected from those who responded in the affirmative, with a bias towards finance directors, while attempting to ensure variation in company size and industry. An generic interview instrument was prepared which was then tailored for each interview in advance based on the questionnaire responses given to explore the reasons for both 'average' and 'unusual' responses. The interviews were tape-recorded and transcribed.

A total of 17 interviews were conducted (during the period November 2008 to February 2009) across the different groups of respondents: 11 finance directors, two human resources and four marketing. Fourteen interviews were conducted face-to-face, with the remaining three conducted over the telephone. The profiles of the 17 interviewees are shown in Table 3.5.

Table 3.5 Interviewees' profiles

Group	Interviewee's title	Company listing	Industry	Form of interview	Ref
Finance	Group finance director	FTSE 100	Industrial Goods & Services	Face-to-face	FD1
Finance	Group financial reporting	FTSE 100	Healthcare	Face-to-face	FD2
Finance	Finance director	FTSE 250	Utilities	Face-to-face	FD3
Finance	Group financial controller	FTSE 250	Industrial Goods & Services	Face-to-face	FD4
Finance	Finance director	FTSE 250	Industrial Goods & Services	Face-to-face	FD5
Finance	Chief financial officer	AIM	Financial Services	Telephone	FD6
Finance	Group finance director	AIM	Industrial Goods & Services	Telephone	FD7
Finance	Financial controller	AIM	Financial Services	Face-to-face	FD8
Finance	Finance director & company secretary	AIM	Chemicals	Face-to-face	FD9
Finance	Finance director & company secretary	AIM	Financial Services	Face-to-face	FD10
Finance	Finance director	AIM	Healthcare	Face-to-face	FD11
Human Resources	Assistant head of employee engagement	FTSE 100	Banks	Face-to-face	HR1
Human Resources	Group HR director	FTSE Small Cap	Industrial Goods & Services	Face-to-face	HR2
Marketing	Head of marketing & UK retail marketing	FTSE 250	Financial Services	Face-to-face	M1
Marketing	Group development director	FTSE Small Cap	Healthcare	Face-to-face	M2
Marketing	VP marketing	FTSE Small Cap	Technology	Telephone	M3
Marketing	Director, business development	Main Market	Technology	Face-to-face	M4

In the finance director group, five interviews are with respondents from main market companies included in either the FTSE 100 or FTSE 250, and six interviews are with companies listed on the AIM market. The interviews conducted in the human resources and marketing groups are with main market companies. All interviewees appeared to hold senior relevant corporate positions.

Summary

This chapter sets out the populations of interest in this study (listed company finance directors, human resources directors and marketing directors). For each of these, the entire population of main market affiliated respondents was surveyed, augmented by a sample of AIM affiliated finance directors. Three variants of the questionnaire were used, to reflect the different knowledge base of each respondent group. The procedures adopted to compile the mailing lists and administer the postal questionnaire are described. Overall, 228 responses were received across the three groups, representing a 10.5% response rate. The representativeness of the respondent groups in terms of industry, size and market-to-book ratio is assessed. Finally, the profile of the seventeen interviewees is described.

4 Results: Questionnaire Responses and Interviews with Finance Directors

Introduction

The findings from questionnaire responses and follow up interviews with the finance director group are presented in the following sections, which correspond to the research question that they address. The next section in this chapter considers the contribution of IC to corporate value. The relative importance of various incentives and disincentives to the IC disclosure decision is considered in the third section. The fourth section considers the disclosure decision in relation to the nature of IC information being disclosed. Communication channels and the nature of information being disclosed are considered in the fifth section. The sixth section focuses on IC disclosure in the corporate annual reports. A summary of finance director views is provided in the last section of this chapter.

IC contribution to corporate value

The overall contribution of IC to shareholder value for responding companies is evident from the questionnaire responses, with over 57% of respondents perceiving that 50% or more is attributable to IC, as shown in Table 4.1. The contemporaneous FD sample market-to-book median of 2.34 reported in Table 3.4, Panel C is consistent with this expressed belief. A market-to-book value of 2.0 equates to 50% of corporate value being unrecognised IC.

Table 4.1 Perceptions of the amount that IC contributes to shareholder value

IC contribution to shareholder value	Percentage of respondents (n=93)
0% to 25%	19%
26% to 50%	24%
51% to 75%	26%
76% to 100%	31%

The remainder of the evidence presented in this section addresses Research Question 1.

RQ1: What is the view of finance directors regarding the relative importance of the various components of IC that have been identified in the academic literature in the generation of company value?

IC appears to be viewed in the academic literature as a hierarchy of nested concepts, with high-level categories such as human, structural and relational capital having multiple lower-level components. Beattie and Thomson (2004) identified a total of 128 lower level IC components from a detailed content analysis of the IC literature. Although many terms identified might be judged synonymous, IC appears to be a broad concept. According to Mouritsen (2003), the boundary around the IC construct is not clear. The link between the corporate value creation process and the various IC components is also unclear and potentially situation-specific. Consequently, respondents were asked their views in relation to the relative contribution of various IC components to the generation of value for their companies.

Aggregate responses are shown in Table 4.2 in descending rank order where: 1= no contribution; 2 = weak contribution; 3 = moderate contribution; 4 = strong contribution; and 5 = very strong contribution. Percentages may not total 100% as the ‘don’t know’ category in this and other tables is not shown. For the sake of brevity, the average score is shown in the second last column and the consensus or extent of agreement among respondents is categorised as high, medium or low based on the standard deviation of responses.

The average score for all IC components was significantly different from one, i.e. no contribution at all. This appears to suggest that all of the IC components investigated contribute to company value to some degree. 'Customer relationships', with an average score of 4.14, was viewed as providing the most contribution with 81% of respondents indicating it provided a strong or very strong contribution to company value. This was closely followed by 'employee skills and education' with an average score of 4.11 and 84% of respondents indicating a strong or very strong contribution. 'Competitive edge in terms of quality of product/service' and 'company reputation' were considered third and fourth in terms of their contribution to company value respectively, with average scores of 4.08 and 4.05. There appears to be a higher level of consensus with respect to the contribution made by 'employee skills and education' and 'company reputation'.

Table 4.2 The views of finance directors regarding the relative importance of the various components of IC to generating company value (n=93)

To what extent do the following IC components contribute to creating value for your company?	Response category[1] percentage of respondents					Average score	Consensus[2]
	1	2	3	4	5		
Customer relationships	2	1	15	44	37	4.14	Medium
Employee skills and education	1	3	12	51	33	4.11	High
Competitive edge in terms of quality of product/service	1	3	19	40	36	4.08	Medium
Company reputation	0	2	25	38	35	4.05	High
Innovation	3	10	18	39	29	3.82	Medium
Development of products/ideas	3	11	23	35	28	3.74	Medium
Data/knowledge of customers	3	8	29	46	12	3.57	Medium
Intellectual property	4	22	20	29	25	3.49	Low
Employee training and development	2	11	28	52	5	3.47	High
Brand names	8	10	27	41	14	3.44	Medium
Financial resources (assuming no financial distress)	2	9	40	41	8	3.43	High
Competitive edge in terms of adaptability of business practices	2	19	31	37	11	3.36	Medium
Relationship between employees and management	5	11	36	35	11	3.36	Medium
Competitive edge in terms of cost of product/service	2	19	35	29	14	3.34	Medium
Distribution channels	11	16	21	35	16	3.28	Low
Business processes	6	12	46	32	4	3.18	Medium
Low level of employee turnover	5	20	37	30	8	3.14	Medium
Market share	9	22	29	27	13	3.14	Low
Marketing strategies	9	20	26	38	7	3.13	Medium
Organisation infrastructure	5	15	43	34	2	3.12	Medium
Supplier relationships	8	20	42	24	6	3.02	Medium
Organisational development	6	20	48	25	1	2.97	High
Competitive edge in terms of the timing of product/service release	6	33	25	27	6	2.93	Medium
Relationship with the media	17	27	36	14	6	2.63	Medium
Relationship with the community	21	27	33	12	6	2.56	Low
Relationship with the government	23	29	23	19	5	2.54	Low
Relationships with creditors (assuming no financial distress)	16	40	35	8	1	2.40	Medium

Notes

1. Response categories are: 1=no contribution, 2=weak contribution, 3=moderate contribution, 4=strong contribution, 5=very strong contribution.
2. Consensus is based on standard deviation (sd) of responses classified as follows: sd less than or equal to 0.85 = high; sd greater than 0.85 and less than or equal to 1.10 = medium; sd greater than 1.10 = low.

'Relationships with creditors' were viewed as providing the least contribution to company value with an average score of 2.4 and 56% of respondents indicating it provided no contribution or only a weak contribution. Relationships with the government, the community and the media were also viewed to provide low contribution with average scores of 2.54, 2.56 and 2.63 respectively. However, there was a lack of consensus in relation to the contribution of relationships with the community and government, implying that these factors may well be company-specific and important if operating in certain sectors. The contribution of 'intellectual property' and 'distribution channels' also appears to vary markedly across companies. Approximately 26% indicated that 'intellectual property' provided no or only weak contribution whereas 54% indicated it provided a strong or very strong contribution. Similarly, 27% indicated that 'distribution channels' provided no or only weak contribution whereas 51% indicated it provided a strong or very strong contribution. Respondents appeared to be more in agreement in relation to the contribution of 'employee training and development', 'financial resources', and 'organisational development'.

To further investigate the IC concept, finance director interviewees were asked to sum up what IC means to their companies. The contribution of employee skills (human capital) to creating company value was reinforced by the interviews:

> *We're a high technology business and therefore the skill base in our engineers and the knowledge base of our engineers is what sustains the business.* [FD1]

> *The only assets we have in our business are our people... our main route to market is a combination of our people and their ability to convince clients.* [FD5]

> *It* [IC] *means its* [the company's] *relationships built up around its people.* [FD6]

> *Our business is about the people and the decisions our people make... all our revenue is generated by the sort of intellectual capital of the employees.* [FD8]

Innovation and product development also featured strongly in the interviews. The importance of a research and development 'pipeline' was evident in the following response:

> *There's lots of research, it's huge... some of that is pure research. Part of it is developing products through trials, and part of it is supporting products that have already come to market and extending their life cycles... which drives the value of the company.* [FD2]

It is apparent that the IC concept is not always considered in terms of the individual components that create value. A number of companies appeared to focus on how the components come together under a strategy for creating company value. This supports Habersam and Piper (2003) who empirically identify connectivity capital as a linking pin between human, structural and relational capital.

> *We wouldn't dissect it like that.* [FD4]

> *We only sell as much as we sell and export as much as we export because we've created leading edge technology products and services and capability, so it's all important to us.* [FD1]

> *It's around the expertise of management... a lot of what we do as a regulated utility... is to do with customer service standards... How your reputation is gained or lost is a lot to do with ethics and values and integrity within the business.* [FD3]

> *We win and retain work on the basis of the way we do the work, which is about how the company does business, and the people in the company's understanding of what the client requires.* [FD7]

Mouritsen *et al*. (2001) highlight the transformation of human capital into structural capital in the value creation process. This was evident from the interview responses:

> *All our products are based on years of research and developed knowledge and for everything practically we sell, we depend on patenting and protecting that knowledge.* [FD2]

However, it would appear that despite taking protective steps, companies are still very much reliant on the human contribution; with 75% of questionnaire respondents viewing a low level of employee turnover to provide a moderate to very strong contribution to company value:

> *You can have all kind of intellectual property protections you want but basically the knowledge is in the people and therefore our ability to retain those people is really key.* [FD1]

> *There's a lot of intellectual capital within individuals... our business model is very much geared around trying to retain and motivate those individuals... to make it a compelling proposition for them to stay with us.* [FD10]

Incentives and disincentives in relation to IC disclosure

RQ3a: What is the relative importance of the various incentives and disincentives in relation to the IC disclosure decision?

There are various theoretical incentives to voluntarily disclose IC information. For example, IC reporting provides companies with the opportunity to increase their transparency to capital markets, to establish trustworthiness with stakeholders and employ a valuable marketing tool (Van der Meer-Kooistra and Zijlstra, 2001). Respondents were, therefore, asked their views in relation to the relative importance of various incentives in relation to the disclosure of IC information. Aggregate responses are shown in Table 4.3, in descending rank order, where: 1= not important at all; 2 = of little importance; 3 = fairly important; 4 = important; and 5 = very important.

Table 4.3 The views of finance directors regarding the incentives to voluntarily disclose IC information (n=93)

How important are the following incentives in relation to your company's voluntary disclosure of IC information?	Response category[1] percentage of respondents					Average score	Consensus[2]
	1	2	3	4	5		
Helping to correct an undervalued share price	5	8	28	43	16	3.57	Medium
Increasing the predictability of our future prospects	4	18	38	30	10	3.23	Medium
Promoting a reputation for transparent/accurate reporting	9	15	29	41	6	3.19	Medium
Increasing price/earnings ratio	13	16	22	35	11	3.15	Low
Reducing the 'information risk' that investors assign to our stock	9	20	37	28	6	3.03	Medium
Increasing the overall liquidity of our stock	11	27	21	33	7	2.97	Low
Attracting more financial analysts to follow our shares	16	20	28	28	8	2.90	Low
Providing important information to investors that is not included in mandatory financial disclosures	10	23	37	28	1	2.80	Medium
Providing a valuable marketing tool	11	31	27	29	2	2.80	Medium
Revealing to outsiders the skill level of our managers	12	27	38	17	6	2.79	Medium
Reducing cost of capital	17	23	28	26	4	2.77	Low
Helping to create trustworthiness with customers	17	31	23	25	4	2.70	Low
Helping to create trustworthiness with other stakeholders	17	24	34	24	1	2.69	Medium
Helping to create trustworthiness with employees	18	32	28	19	3	2.58	Medium
Avoiding allegations of insufficient disclosure	18	36	30	14	2	2.48	Medium
As a motivation for employees	21	29	34	14	2	2.48	Medium
Demonstrating good employee relations	20	32	36	11	1	2.42	Medium
Helping to create trustworthiness with suppliers	21	36	28	14	1	2.38	Medium

Notes

1. Response categories are: 1=not important at all, 2=of little importance, 3=fairly important, 4=important, 5=very important.
2. Consensus based on standard deviation (sd) of responses classified as follows: sd less than or equal to 0.85 = high; sd greater than 0.85 and less than or equal to 1.10 = medium; sd greater than 1.10 = low.

The average score for all incentives to voluntarily disclose IC information was significantly different from one, i.e. not important at all. This suggests that all of the reasons investigated provide an incentive to some degree. The opportunity to increase transparency to capital markets in terms of 'helping to correct an undervalued share price' ranked significantly higher than all other incentives. 'Increasing the predictability of future prospects', another incentive relating to transparency, ranked second with an average score of 3.23. A further three capital market-related incentives were, on average, at least fairly important (score in excess of 3.00): 'promoting a reputation for transparent/accurate reporting'; 'increasing price/earnings ratio'; and 'reducing the information risk that investors assign to our stock'. These findings support those of Graham *et al.* (2005), where US executives were found to make voluntary disclosure to reduce information risk and boost stock price.

Elliot and Jacobson (1994) suggest that increased transparency to capital markets leads to a lower cost of capital. Findings appear to suggest a lack of consensus across companies with only 58% of respondents indicating that reducing 'cost of capital' (average score 2.77) was fairly to very important. This coincides with previous interview evidence from UK finance directors. Armitage and Marston (2007) also found a lack of consensus across companies with cost of capital considerations not the main determinant of corporate disclosure. They reported that a reputation for openness was one of the main benefits of voluntary disclosure. In the present study, 'promoting a reputation for transparent and accurate reporting' was cited by 76% of respondents as being a fairly to very important incentive to voluntarily disclosing IC information.

Marketing-related incentives generally ranked lower than capital market-related incentives. 'Providing a valuable marketing tool' scored 2.8 and 'helping to create trustworthiness with customers' scored 2.70. This could be considered somewhat surprising given that customer relationships were viewed as contributing the most to company value and this was further explored during the interviews.

Finally, human capital-related incentives ranked even lower. Despite the strong contribution of human capital to company value, none of the three human capital-related incentives was widely viewed as important: 'helping to create trustworthiness with employees'; 'as a motivation for employees'; and 'demonstrating good employee relationships' (average scores of 2.58, 2.48 and 2.42, respectively).

'Helping to create trustworthiness with suppliers' was considered the least important incentive to IC disclosure, with 57% indicating it was either not important or of little importance (mean score 2.38).

The capital market incentives to voluntarily disclose IC information are further emphasised in the interview responses:

> *The attitude of our senior management is to maintain clear communication with our investors so that there are no surprises... they want our share price to correctly value the business... it's a very different culture from some aggressive corporates of the past where communication has been about enhancing share price beyond what it should be.* [FD2]

> *We do pride ourselves on being, within reason, as transparent as possible to the market, and we hope that stands us in good stead, in terms of the value that the market attributes to us.* [FD4]

From the interview evidence it was apparent that communicating IC information to customers and other stakeholders was very important to certain companies in terms of reputation. The nature of their business encouraged disclosure in order to appear legitimate and ethical.

> *We get attacked by various pressure groups outside the organisation saying* [the nature of our business] *is unethical. We have put it* [ethics] *higher up on the corporate agenda. We engage now you know, and we listen and... we change. In the early 90's the test was if it's legal that's alright. The test isn't that anymore, the test is how would it read on the front page of the Daily Mail, and would I be happy explaining this to my mum? The test for all businesses is much different from where the law sits... so you end up having to try and inform all those opinion formers.* [FD1]

> *It still comes back to the whole ethos around, is a company acting responsible?... if a company was not to include details of its corporate social responsibility values, actions, processes, things that it's doing, things that it's doing to address problems from climate change, would that affect the investor base? Well it might do. It still comes back to... investing in that company because it knows what it is doing and it's taking its responsibilities seriously.* [FD3]

Approximately 42% of questionnaire responses indicated that IC disclosure was not important or of little importance in providing a valuable marketing tool. An interviewee employed in the financial services industry offered one potential explanation:

> *We're not allowed to market... we cannot market... we need to be careful on our annual report about marketing... the FSA could clamp down on us and say you are marketing to the general public... talking up* [your] *products too much.* [FD8]

The impact of regulations on marketing and promotion in other industry sectors was also raised:

> *The promotion and marketing of medicines is something that's very regulated… legal obligations in terms of selling and marketing and promotion of our products… makes it different.* [FD2]

Despite the apparent lack of importance placed on suppliers in the questionnaire responses, the incentive to disclose to suppliers did feature in several interviews:

> *For suppliers we need them to work in a way we want them to, they're representing us. We need them to understand how we want to work and why. Actually we need them to understand what* [the company's] *intellectual capital is, why it's different.* [FD7]
>
> *We said to him* [our most critical supplier] *this is what our strategy is, this is where we're trying to take our business. So in that regard, I guess we were giving him a sense of our IC.* [FD4]
>
> *Suppliers… just need to understand what we are doing, what drives us. It is much easier for them to supply us with what we really need, rather than what they think we might want.* [FD11]

However, one particular interviewee actually perceived IC disclosure to suppliers as a disincentive:

> *In some ways you don't want to share too much with the supplier in case they try to sort of find a way around it, or sell directly to the customer rather than through us.* [FD9]

Respondents were asked their views in relation to the relative importance of a range of disincentives to the disclosure of IC information. Aggregate responses are shown in Table 4.4, in descending rank order.

The average score for all disincentives to voluntary disclose IC information was significantly different from one, i.e. not important at all. This suggests that all of the reasons investigated offer a disincentive to some degree. 'Avoiding giving away "company secrets" or otherwise harming competitive position' appears to be the most important with 60% of respondents indicating it was either important or very important. The average score of 3.66 is statistically significantly different from the other disincentives ($z = 2.115$, $p = 0.034$, Wilcoxon Mann-Whitney signed ranks test). However, the consensus in responses is low, being not important or of little importance to 14% of respondents, suggesting that this factor is particularly industry- or company-specific. 'Preventing the creation of unrealistic expectations' was ranked next in terms of importance (average score 3.41) followed by 'avoiding setting a disclosure precedent' (average score 3.16). Both of these disincentives were statistically significantly different from the next highest ranking item. Graham *et al.* (2005) noted, in their US study, the importance of avoiding the setting of disclosure precedents which are difficult to maintain. Further, Unerman *et al.* (2007) also found UK companies to be concerned that investors and analysts would develop overly optimistic/pessimistic expectations in response to IC disclosure. 'Avoiding potential follow-up questions' and 'avoiding attracting unwanted scrutiny by regulators' were, on balance, considered the least important disincentives to voluntarily disclosing IC information with average scores of 2.52 and 2.62, respectively.

Table 4.4 The views of finance directors regarding the disincentives to voluntarily disclose IC information (n=93)

How important are the following disincentives in relation to your company's voluntary disclosure of IC information?	**Response category[1] percentage of respondents**					**Average score**	**Consensus[2]**
	1	**2**	**3**	**4**	**5**		
Avoiding giving away "company secrets" or otherwise harming our competitive position	7	7	26	35	25	3.66	Low
Preventing the creation of unrealistic expectations	9	10	24	45	12	3.41	Low
Avoiding setting a disclosure precedent	8	19	30	34	8	3.16	Medium
Reducing the costs of collecting information	10	24	40	22	3	2.85	Medium
Avoiding possible lawsuits if future results don't match forward-looking disclosures	16	28	23	19	12	2.84	Low
Reduce the costs of obtaining auditor opinion in relation to consistency with financial statements	16	21	38	18	7	2.77	Low
Avoiding attracting unwanted scrutiny by the media	11	37	24	22	6	2.74	Medium
Reducing the costs of disseminating information	12	28	38	19	2	2.71	Medium
Avoiding attracting unwanted scrutiny by regulators	19	31	26	19	5	2.62	Low
Avoiding potential follow-up questions about unimportant items	18	34	29	16	3	2.52	Medium

Notes

1. Response categories are: 1=not important at all, 2=of little importance, 3=fairly important, 4=important, 5=very important.

2. Consensus is based on standard deviation (sd) of responses classified as follows: sd less than or equal to 0.85 = high sd greater than 0.85 and less than or equal to 1.10 = medium; sd greater than 1.10 = low.

The importance of maintaining competitive position dominated interview responses:

> *I'll describe it* [processes, our life cycle, management process] *in the generality to investors but the forms we use and how we go about this is proprietary so we keep it... The sector is prone to industrial espionage by nations, not necessarily by individuals but by nations.* [FD1]

> *We find ourselves in the fortunate position where we are probably sort of number one or number two in most of the markets we operate in... so we set the precedent for the development of the market... so we don't want to give too much of what we are trying to achieve to our competitors.* [FD4]

> *If you disclose exactly it would erode your competitive advantage, because we would read all our competitors stuff and find out what they do, to take the best bits from it.* [FD7]

> *I think it needs to be recognised in financial reporting that there is a fundamental conflict between confidentiality and competitively sensitive information, and providing information to investors... investors want to know what that is* [competitive advantage] *because that helps them to value the business, but competitors want to know... in order that they can knock it down and get around it somehow.* [FD9]

However, competitive disadvantage is not always a disincentive to IC disclosure. In the utilities industry, it appears more a matter of collaboration than harming competitive position, reinforcing the suggestion that IC and its' disclosure are very much situation specific:

> *You pick up a lot of sort of industry intelligence... from quite a large number of operating groups that work across the industry. ...quite a number* [of companies] *on different topics collaborate, work together to try and understand different customer issues, operational problems. I am not sure you'd get that in a more competitive world where people do compete for products.* [FD3]

Comments by several interviewees and questionnaire respondents also indicated that a disincentive to voluntarily disclose IC information was the difficulty in measurement and the degree of subjectivity involved. For example:

> *Impossible to quantify IC in any meaningful manner... risk of confusing reader of accounts even further by providing more complex subjective information, the potential impact of which is unclear.* [FD9]

Disclosure decisions and the category of IC information

RQ3b: How do the incentives and disincentives of IC disclosure relate to the three IC categories (human, structural and relational capital)?

Respondents were asked to indicate the three most important incentives and disincentives in relation to the disclosure of each of human capital, structural capital and relational capital information. The most important incentive for disclosing human capital information was 'helping to create trustworthiness with employees' (cited by 13 respondents); whereas the most important incentive for disclosing both structural and relational capital was 'helping to correct an undervalued share price' (cited by 14 respondents and 11 respondents, respectively). The number of cites received for each incentive, aggregated across the top three slots (most important, second most important and third most important incentive), is summarised in Table 4.5 according to the category of IC information being disclosed. In this table, incentives are ordered as for Table 4.3 (ranked in order of importance for total IC disclosure) and the incentives having the five highest number of cites for each IC category are shaded to facilitate interpretation.

This question reinforces the importance of 'helping to correct an undervalued share price' the top ranking item in Table 4.3. This is the only incentive to feature in the top five for all three IC categories and it receives the highest number of cites for both structural and relational capital. However, this capital market incentive along with four other capital market incentives dominates the incentives for the disclosure of structural capital information. In contrast, the disclosure of human and relational capital, in addition to capital market incentives, is due to incentives related to the nature of the information being disclosed.

Human capital appears to be predominantly disclosed in order to 'motivate' and 'help to create trustworthiness with employees' (29 combined cites across the top three slots and 26 combined cites across the top three slots, respectively). 'Demonstrating good employee relations' (21 combined cites) and 'revealing to outsiders the skill level of managers' (18 combined cites) also appear important. Additional important incentives for the disclosure of relational capital include 'helping to create trustworthiness with customers' (21 combined cites) and 'providing a valuable marketing tool' (16 combined cites). A capital-market related incentive 'attracting more financial analysts to follow our shares' (14 combined cites) is also a top five item.

Table 4.5 The views of finance directors on the three most important incentives for voluntarily disclosing IC information (n=93)

Incentives	**Combined cites across top three slots[1]**		
	Human capital	**Structural capital**	**Relational capital**
Helping to correct an undervalued share price	24	37	25
Increasing the predictability of our future prospects	8	16	12
Promoting a reputation for transparent/accurate reporting	6	21	14
Increasing price/earnings ratio	16	30	18
Reducing the 'information risk' that investors assign to our stock	5	9	12
Increasing the overall liquidity of our stock	4	9	4
Attracting more financial analysts to follow our shares	6	12	14
Providing important information to investors that is not included in mandatory financial disclosures	6	7	5
Providing a valuable marketing tool	7	6	16
Revealing to outsiders the skill level of our managers	18	6	9
Reducing cost of capital	7	15	6
Helping to create trustworthiness with customers	9	6	21
Helping to create trustworthiness with other stakeholders	4	4	15
Helping to create trustworthiness with employees	26	4	3
Avoiding allegations of insufficient disclosure	1	4	5
As a motivation for employees	29	2	2
Demonstrating good employee relations	21	1	1
Helping to create trustworthiness with suppliers	1	4	12

Notes

1. Number of respondents citing the incentive as either the most important, second most important or third most important incentive.
2. The incentives with the five highest number of cites are shaded to facilitate interpretation. Six incentives are shaded for relational capital as there are two incentives which have the 5th highest number of cites (14 cites).

The most important disincentive for disclosing human capital, structural capital and relational capital was 'avoiding giving away "company secrets" or otherwise harming competitive position' (cited by 28, 29 and 26 respondents, respectively). The number of cites received for each disincentive across the top three slots (most important, second most important and third most important) are summarised in Table 4.6 according to the category of IC information being disclosed. The three disincentives having the highest number of cites have been shaded. Other important disincentives appear to be 'preventing the creation of unrealistic expectations' and 'avoiding setting a disclosure precedent'. The importance attached to disincentives does not appear to vary significantly across the different categories of IC information.

Table 4.6 The views of finance directors on three most important disincentives for voluntarily disclosing IC information (n=93)

Disincentives	Combined cites across top three slots[1]		
	Human capital	**Structural capital**	**Relational capital**
Avoiding giving away "company secrets" or otherwise harming our competitive position	38	37	35
Preventing the creation of unrealistic expectations	24	22	30
Avoiding setting a disclosure precedent	25	23	20
Reducing the costs of collecting information	15	15	14
Avoiding possible lawsuits if future results don't match forward-looking disclosures	13	18	15
Reduce the costs of obtaining auditor opinion in relation to consistency with financial statements	4	10	7
Avoiding attracting unwanted scrutiny by the media	14	12	19
Reducing the costs of disseminating information	7	7	3
Avoiding attracting unwanted scrutiny by regulators	11	14	18
Avoiding potential follow-up questions about unimportant items	9	6	9

Notes

1. Number of respondents citing the disincentive as either the most important, second most important or third most important disincentive.
2. The disincentives with the three highest number of cites are shaded to facilitate interpretation.

Overall, the evidence clearly indicates that the incentives for IC disclosure relate differently to the three IC categories. Thus, a substantial part of the observed variation in the importance of various incentives can be attributed to situation-specific variations in the importance of the main IC categories and their constituent components. In contrast, the disincentives for IC disclosure appear to be generic in nature, applying to all company situations in a similar way.

Communication channels and the category of IC information

RQ4a: How effective are the various forms of communication in relation to the disclosure of the three IC categories (human, structural and relational capital)?

Prior research has investigated alternative means of communicating both information in general (McInnes *et al.*, 2007), and IC information (Unerman *et al.*, 2007) to various stakeholders. McInnes *et al.* (2007, pp.116-121) develop a model of stakeholder uptake of information packages and communications channels that highlights the impact of channel attributes, stakeholder characteristics and communication roles. Prior research in relation to the means of communicating the different categories of IC information (human, structural and relational capital) appears somewhat limited. Respondents were, therefore, asked their views in relation to the effectiveness of various forms of communication in relation to the disclosure of human, structural and relational capital information. Aggregate responses are shown in Table 4.7 where: 1= effective; 2 = neutral; 3 = ineffective. The consensus or extent of agreement among respondents is categorised as high, medium or low based on the standard deviation of responses. The final column indicates whether the communication channel is viewed as effective or ineffective, based on whether the average score is statistically significantly different from neutral.

Table 4.7 The views of finance directors regarding IC and forms of communication (n=93)

Panel A: Human capital disclosure						
Rate the following channels for your company's disclosure of human capital information	**Response category[1] percentage of respondents**			**Average score**	**Consensus[2]**	**Statistical significance of response[3]**
	1	**2**	**3**			
1-1 meetings with investors	61	28	11	1.51	Medium	Effective
1-1 meetings with analysts	61	26	13	1.53	Medium	Effective
Investor presentations	57	29	14	1.56	Medium	Effective
Annual corporate report	53	37	10	1.57	Medium	Effective
Analyst presentations	54	28	18	1.64	Low	Effective
Company web pages	51	34	15	1.64	Medium	Effective
Field visits with existing/potential institutional investors	54	27	19	1.66	Low	Effective
Annual review	30	51	19	1.89	Medium	Neutral
Company newsletters	30	41	29	1.99	Medium	Neutral
Press releases	25	47	28	2.03	Medium	Neutral
Corporate social responsibility report	32	32	36	2.05	Low	Neutral
Preliminary report	23	47	30	2.07	Medium	Neutral
Interim report	18	48	34	2.16	Medium	Ineffective
Conference calls	14	45	41	2.26	Medium	Ineffective

Table 4.7 The views of finance directors regarding IC and forms of communication (n=93) (Cont.)

Panel B: Structural capital disclosure						
Rate the following channels for your company's disclosure of structural capital information	**Response category[1] percentage of respondents**			**Average score**	**Consensus[2]**	**Statistical significance of response[3]**
	1	**2**	**3**			
1-1 meetings with investors	62	32	6	1.44	High	Effective
1-1 meetings with analysts	60	34	6	1.46	High	Effective
Investor presentations	61	32	7	1.46	High	Effective
Analyst presentations	56	36	8	1.52	High	Effective
Annual corporate report	52	42	6	1.54	High	Effective
Field visits with existing/potential institutional investors	49	39	12	1.63	Medium	Effective
Company web pages	47	43	10	1.64	Medium	Effective
Annual review	27	58	14	1.87	High	Effective
Press releases	27	49	24	1.98	Medium	Neutral
Preliminary report	24	51	25	2.01	Medium	Neutral
Company newsletters	22	41	37	2.14	Low	Ineffective
Interim report	16	52	32	2.15	Medium	Ineffective
Corporate social responsibility report	15	47	38	2.23	Medium	Ineffective
Conference calls	16	43	41	2.26	Medium	Ineffective

Table 4.7 The views of finance directors regarding IC and forms of communication (n=93) (Cont.)

Panel C: Relational capital disclosure						
Rate the following channels for your company's disclosure of relational capital information	**Response category[1] percentage of respondents**			**Average score**	**Consensus[2]**	**Statistical significance of response[3]**
	1	**2**	**3**			
1-1 meetings with investors	58	32	10	1.53	Medium	Effective
Investor presentations	57	30	13	1.55	Medium	Effective
1-1 meetings with analysts	54	33	13	1.59	Medium	Effective
Analyst presentations	51	35	14	1.63	Medium	Effective
Field visits with existing/potential institutional investors	50	37	13	1.63	Medium	Effective
Annual corporate report	46	41	13	1.67	Medium	Effective
Company web pages	42	46	12	1.70	Medium	Effective
Annual review	26	61	13	1.87	High	Effective
Press releases	25	55	20	1.94	Medium	Neutral
Preliminary report	24	49	27	2.04	Medium	Neutral
Interim report	19	49	32	2.14	Medium	Ineffective
Corporate social responsibility report	20	41	39	2.18	Medium	Ineffective
Conference calls	16	45	39	2.23	Medium	Ineffective
Company newsletters	18	39	43	2.24	Medium	Ineffective

Notes

1. Response categories are: 1=effective, 2=neutral, 3=ineffective.
2. Consensus is based on standard deviation of less than or equal to 0.65 = high; standard deviation of greater than 0.65 and less than or equal to 0.75 = medium; standard deviation of greater than 0.75 = low.
3. Based on statistical test (t-test) to identify if average scores are significantly different from 2-neutral.

Prior research (Unerman *et al.*, 2007) has found that individual meetings with investors and analysts are viewed as the most effective means of communicating IC information. The evidence in Table 4.7 supports this finding and further shows that it holds across each category of IC. The corporate annual report was considered effective in communicating human capital and structural capital by just over half of respondents; it was considered slightly less effective in communicating relational capital (46% of respondents indicated it was effective whilst 13% indicated it was ineffective). Seven forms of communication were viewed as effective for all three IC categories. The top three for all IC categories were '1-1 meetings with investors', '1-1 meetings with analysts', and 'investor presentations'.

'Field visits with existing or potential institutional investors' and 'analyst presentations', although viewed as an effective means of communication across all IC categories, ranked slightly less highly in relation to communicating human capital. Company web pages were viewed as effective by 51% of respondents in relation to human capital; 47% in relation to structural capital and 42% in relation to relational capital. The annual review was considered effective for only structural and relational capital.

Company newsletters and the corporate social responsibility report were viewed as ineffective for communicating structural and relational capital, however they were considered neutral for human capital. Press releases and preliminary reports were viewed as neutral channels for communicating information about all categories of IC. Interim reports and conference calls were viewed as ineffective channels for communicating information about all categories of IC.

The effectiveness of the various channels of communication was further explored in the interviews. According to one finance director:

They [channels of communication] *all have their place.* [FD7]

However, the importance of face-to-face contact with various stakeholders over written communication was a widespread view:

> *Shareholders are buying the future based on past records, the "story", and management credibility. The latter two are best done in presentations/face-to-face – not in a document.* [CFO of an AIM company responding to the questionnaire]
>
> *The best communication is face-to-face communication... certainly our internal employee opinion surveys tell us.* [FD1]
>
> *You need to see the energy and the interplay, because then you get people coming away just feeling that lots of people felt confident... it is as much in our body language as anything else.* [FD11]
>
> *You can use the presentation as a discussion ...allows them* [investors] *to draw conclusions about what you expect to happen and it allows you to bring out the messages you think are important.* [FD7]
>
> *It is very hard to do that* [effective communication] *in writing in a way people can actually understand or see it. You haven't got the props and you can't do the demonstrations.* [FD11]

Face-to-face channels were thought to be especially important in communicating human capital information so recipients could experience and observe senior management first hand:

> *Human capital... I think it is always going to be easier* [to communicate] *face-to-face. It's intangible and different things to different people and a very difficult thing to get across. In the direct conversation you can be more expansive.* [FD10]

Opinion in relation to the effectiveness of the corporate annual report was somewhat mixed. Its use as a communication channel is explored further in the next section.

> *I do you know* [think the annual report is an effective channel for communicating IC information], *I meet the investors, clearly lots of them read it.* [FD1]

> *Those that want to read it* [annual report] *will do, but I think they're few in number actually. People... are swayed more by what gets in the press and the media than anything else.* [FD3]

Several interviewees remarked on the use of company newsletters, despite the fact that questionnaire respondents considered them neutral for communicating human capital information and ineffective for structural and relational capital. The use of websites for communicating human capital information was also commented on.

> *We send out monthly newsletters that go out to our existing clients. Weekly updates as well and they're effective ways of communicating with stakeholders.* [FD8]

> *Company magazines, they're also another really good communication channel... it's in the waiting room downstairs, it's all over the place.* [FD1]

> *You've got the investor site* [website] *that you need a log-in to get into... actually there it talks about human capital.* [FD8]

IC disclosure and the annual report

RQ4b: In what way is the annual report used as a vehicle for IC disclosure?

The corporate annual report remains a key reporting document (for example, see the literature summarised in Beattie, 1999, p.24). Respondents were, therefore, asked the extent of their agreement with statements in relation to IC disclosure in the annual corporate report. Aggregate responses are shown in Table 4.8 in descending order of agreement where: 1 = strongly disagree; 2 = disagree; 3 = neutral; 4 = agree; 5 = strongly agree. The average score is shown in the second last column and the consensus or extent of agreement among respondents is categorised as high, medium or low based on the standard deviation of responses.

Table 4.8 The views of finance directors regarding IC disclosure in the annual corporate report (n=93)

To what extent do you agree with the following statements in relation to IC disclosure in the annual corporate report of your company?	**Response category[1] percentage of respondents**					**Average score**	**Consensus[2]**
	1	**2**	**3**	**4**	**5**		
The annual report is useful for communicating basic IC information for stakeholders less familiar with the business	2	6	17	60	13	3.78	High
Investors would become concerned if important 'new' IC information was released in the annual report instead of on a more timely basis	4	10	18	44	18	3.64	Medium
The annual report is used as an important and credible source of reference, to confirm IC information provided via other sources	3	9	27	48	8	3.51	Medium
IC information in the annual report confirms information previously released to the stock market via other sources	6	17	17	45	13	3.45	Low
IC information is presented or packaged in a different manner in different channels of communication	2	17	33	39	3	3.26	Medium
The annual report is useful for communicating complex IC information in narrative/quantitative form	6	23	27	40	3	3.12	Medium

Notes

1. Response categories are: 1=strongly disagree, 2=disagree, 3=neutral, 4=agree, 5=strongly agree.
2. Consensus is based on standard deviation (sd) of responses classified as follows: sd less than or equal to 0.85 = high; sd greater than 0.85 and less than or equal to 1.10 = medium; sd greater than 1.10 = low.

The annual report appears to be a relevant communication channel with approximately 73% of respondents agreeing or strongly agreeing that it ‘is useful in communicating basic IC information to less familiar stakeholders’ (average score of 3.78). However, respondents were neutral (average score of 3.12 not statistically significantly different from 3-neutral) in relation to its usefulness for ‘communicating complex IC information’. Further, the annual report’s general usefulness is questionable according to several interviewees:

> *For most investors it’s* [annual report] *just too big and unwieldy a document to read.* [FD7]

> *It comes back to the level of detail that’s in these documents now… it’s just a bit of an off-putting document by its sheer size.* [FD4]

> *One of the concerns I’ve got about annual reports is how big they’re getting and how complex they are… my gran down in Brighton, she’s not going to understand a lot of complex disclosures… it’s* [the annual report] *trying to achieve far too much for far too many people, and as a result it’s become a monster in terms of size.* [FD9]

> *A fog of subjective judgement… assumptions and voluminous ‘boiler-plate’ disclosures.* [FD 9]

The annual report does not appear to be the first place where IC information is disclosed. Approximately, 62% of respondents agreed or strongly agreed that ‘investors would become concerned if important ‘new’ IC information was released in the annual report’ (average score 3.64). Further, 58% of respondents agreed or strongly agreed that

'IC information in the annual report confirms information previously released to the stock market via other sources' (average score 3.45). Similarly, 56% of respondents agreed or strongly agreed the annual report's role in confirming IC information provided via other sources (average score 3.51). The main explanation appears to lie in the inability of the annual report to provide timely information. As one interviewee put it:

> *Presentations and relationships with key investors are much more important than that* [annual report]*... because this* [annual report] *is basically old news by the time it's published. So there shouldn't ever be anything in here* [annual report] *that is materially new news.* [FD2]

From questionnaire responses presented in the previous section, it is apparent that various communication channels are used to communicate IC information. Respondents were asked if IC information was presented or packaged in a different manner according to the communication channel being used. There appears to be tentative agreement that this is indeed the case for a number of companies, with 40% in agreement or strong agreement (average score 3.26). However, approximately 19% of respondents disagreed and 33% were neutral inferring that an identical IC disclosure message is used across communication channels by some companies. These findings were corroborated with the mixed views evident during interviews:

> *If you look at all our communications... there's not one story for one lot over here, another lot for another or another, it's all one and we have to work you know, really quite hard to make that the case.* [FD1]

They [companies] *perceive the user base of different channels* [of communication] *is different and that's rightly so.* [FD6]

We will take the same piece of information and bundle it up a different way, in order to appeal to... or provide the information that that particular group of stakeholders needs. [FD7]

Summary: finance directors' views

The evidence presented in this chapter supports the following main findings regarding finance directors' views in relation to IC and its disclosure:

- *RQ1: IC components* – all of the IC components investigated contribute to company value to some degree. 'Customer relationships', 'employee skills and education', 'competitive edge in terms of quality of product/service', and 'company reputation' were ranked the top four components in terms of their contribution. Of these top four components, three belong to the relational capital category of IC and one to the human capital category of IC. There was evidence to suggest that companies take steps to protect their IC, however they continue to rely heavily on human capital which they try to retain.

- *RQ3: Incentives to voluntarily disclose IC* – all of the reasons investigated provide an incentive for the voluntarily disclosure of IC information to some degree. Capital market incentives dominated the disclosure of IC information in general. The opportunity to increase transparency to capital markets in terms of 'helping to correct an undervalued share price' was more important than all other incentives. 'Increasing the predictability of our future prospects' and 'promoting a reputation for transparent/ accurate reporting' were ranked second and third in importance, respectively. Incentives relate differently according to the category of IC information being disclosed. 'Helping to correct an undervalued share price' was most important in the disclosure of both structural and relational capital, whereas 'helping to create trustworthiness with employees' was most important in the disclosure of human capital. Capital market incentives dominate the disclosure of structural capital. However, the disclosure of human and relational capital is also driven by incentives which relate to the category of information being disclosed.

- *RQ3: Disincentives to voluntarily disclose IC* – all of the reasons investigated provide a disincentive to the voluntarily disclosure of IC information to some degree. 'Avoiding giving away "company secrets" or otherwise harming competitive position' was more important than all other disincentives. However, competitive disadvantage is not always a disincentive to IC disclosure, suggesting that IC disclosure drivers are very much situation-specific. 'Preventing the creation of unrealistic expectations' and 'avoiding setting a disclosure precedent' were ranked second and third in importance, respectively. The importance attached to these disincentives does not vary significantly across the different categories of IC information.

- *RQ4a: Communication channels* – 'one-to-one meetings with investors', 'one-to-one meetings with analysts', and 'investor presentations' were the top three most effective communication channels for disclosing all categories of IC information. Other channels of communication which were also effective across the three categories of IC include: 'annual corporate report', 'analyst presentations', 'company web pages' and 'field visits with existing/potential institutional investors'. The 'interim report' and 'conference calls' were considered ineffective for disclosing all three IC categories. 'Company newsletters' and the 'corporate social responsibility report' were also considered ineffective for communicating structural and relational capital.

- *RQ4b: IC disclosure in the corporate annual report* – the annual report is useful in communicating basic IC information. However, its usefulness for communicating complex IC information is not clear. The annual report is not the first place where IC information is disclosed, rather it confirms information previously disclosed via other sources. The ability of the annual report to provide timely information is a concern. Companies use various channels to communicate IC information and a number of them appear to present or package the information in a different manner according to the communication channel being used.

The evidence in this chapter suggests that, although there are some common IC components and common incentives/disincentives to disclosure across companies, it is also very much company or situation-specific. There are differences in the importance of incentives according to which IC category is being disclosed. Further, there are differences in the effectiveness of communication channels according to which category of IC information is being disclosed. The IC concept and the IC disclosure decision means different things to different companies. As one interviewee put it:

> *The IC components clearly constitute the essence of what a company 'is', and every company has a unique mix of IC components.* [FD9]

5 Results: Questionnaire Responses and Interviews with Human Resources Directors

Introduction

Human capital is one of the major categories of IC (Lev and Zambon, 2003) and several empirical IC studies focus exclusively on human capital (Carr and O'Brien, 2008; Abeysekera, 2008; Ax and Morton, 2008; Lajili and Zéghal, 2005 and 2006; Abeysekera and Guthrie, 2004; ICAEW, 2003). *Reporting Statement 1* (ASB, 2006) includes implementation guidance which recognises that employees may be a particularly key resource (and key risk) for many entities (para. 24). Employee health and safety, recruitment and retention, training and development, motivation, and performance and profile are all highlighted as areas to be considered for reporting purposes (para. 26). The individual components of human capital and their disclosure were investigated in greater detail than in chapter four by obtaining views and opinions from the human resources functional specialists across UK companies. The findings from questionnaire responses and follow up interviews are presented in this chapter. The next section considers the extent to which various human capital components contribute to company value. The third section reports the extent to which various human capital components are used internally by management and disclosed externally. The importance of various incentives and disincentives to the voluntary disclosure of human capital information externally is considered in the fourth section. The fifth section considers the effectiveness of alternative channels of corporate communication for disclosing human capital externally. A summary of human resources directors' views is presented in the final section.

Human capital contribution to corporate value

RQ1: What is the view of [human resources directors] *regarding the relative importance of* [eighteen human capital components] *in the generation of company value?*

Aggregate responses are shown in Table 5.1 in descending rank order where: 1= no contribution; 2 = weak contribution; 3 = moderate contribution; 4 = strong contribution; and 5 = very strong contribution. The average score is shown in the second last column and the consensus of responses (extent of agreement among respondents) is categorised as high, medium or low, based on the standard deviation of responses.

The average score for all human capital components was significantly different from one, i.e. no contribution at all. This appears to suggest that all of the human capital components investigated contribute to company value to some degree. 'Employee skills and education', with an average score of 4.46, appears to contribute to company value the most, with 91% of respondents indicating that it made a strong or very strong contribution. Four other components also contribute to company value to a great extent: 'employee commitment'; 'positive employee attitudes'; 'positive employee behaviour'; and 'employee motivation. There is a high level of consensus regarding the importance of these top five components. The next highest ranking component scores are significantly lower than these.

Table 5.1 The views of human resources directors regarding the relative importance of the various components of human capital to generating company value (n=67)

To what extent do the following human capital components contribute to creating value for your company?	Response category[1] percentage of respondents					Average score	Consensus[2]
	1	2	3	4	5		
Employee skills and education	0	0	9	35	56	4.46	High
Employee commitment	0	5	3	43	49	4.37	High
Positive employee attitudes	0	5	6	43	46	4.31	High
Positive employee behaviour	0	5	11	41	43	4.23	High
Employee motivation	0	5	11	43	41	4.22	High
Employee satisfaction	0	6	11	49	34	4.11	High
Good relations with company employees	0	3	18	45	34	4.09	High
Employee experience	0	3	17	51	28	4.05	High
Recruitment and selection procedures	0	3	17	54	26	4.03	High
Employee training and development	0	9	14	46	31	3.98	Medium
Employee adaptability	2	5	14	52	26	3.98	Medium
Workplace safety	3	9	20	23	45	3.97	Low
Employee reputation	3	12	22	31	30	3.73	Low
Employee remuneration procedures	1	5	31	48	15	3.71	High
Employee entrepreneurial skills	3	14	22	32	28	3.69	Low
Low level of employee turnover	0	8	29	55	8	3.63	High
Employee equality	3	17	26	28	26	3.57	Low
Promotion of employee welfare	1	20	34	31	14	3.35	Medium

Notes

1. Response categories are: 1=no contribution, 2=weak contribution, 3=moderate contribution, 4=strong contribution, 5=very strong contribution.
2. Standard deviation of less than or equal to 0.85 =high consensus; standard deviation of greater than 0.85 and less than or equal to 1.10 = medium consensus; standard deviation of greater than 1.10 = low consensus.

There appears to be less consensus regarding the contribution provided in relation to four components: 'workplace safety' (average score 3.97); 'employee reputation' (average score 3.73); 'employee entrepreneurial skills' (average score 3.69); and 'employee equality' (average score 3.57). 'Promotion of employee welfare' appears to contribute the least to company value (average score 3.35), with 21% of respondents indicating it provided no or only weak contribution. This score was significantly less than the next lowest score.

Employee skills and education featured prominently in the interviews, both from the company requirements and the individual employee perspective of the skills they need.

> *Human capital actually starts with the people that we have, the calibre of skills, competencies and experiences that they either bring with them or that they evolve and create by the type of work they do with us.* [HR2]

> *We have a whole pipeline of where we get employees from – everything from pre-graduate, post-graduate, PhD through to experienced hires. We are looking for a breadth of technical skills... we are looking for hybrid skills from the employees.* [HR2]

> *We have an annual employee opinion survey... there will actually be questions asking employees did they think they have the right skills for the job.* [HR1]

The importance of bringing the skills of individuals together, rather than operating in isolation, to create value was strongly alluded to by both questionnaire respondents and interviewees:

> *Sales are made on the basis of the TEAM and its proven ability rather than a mere listing of which senior manager has which skills.* [questionnaire respondent]

> *The sum of the parts is greater than the individual... what we as individuals bring in to the work place; it is how that it is then mixed together like a cake, depends upon the actual output that you get.* [HR2]

However skills and education only appear to be of value if coupled with the 'right' attitude which translates into behaviour which is then a valuable contribution to the company. The following quotations reflect the importance of transformations in relation to IC and value creation:

> *When we hire people we look for their potential... I have just recently come up with a model of what high potential looks like for us... 'three A model'... ability... ambition... and adaptability. Ability to do the job in terms of both commercial and relationship skills and then the two things that actually make a difference for high potential and realising that human capital is ambition, how much do people want to do with it; and adaptability, both in terms of technically... also in terms of business sense... globally mobile and culturally adaptive because the wider cross-section we have of clients, the more our people actually need to associate with that.* [HR2]

> *What you think you feel you do... so if people's value sets are broadly similar... that throws through into behaviours. It drives a collaborative environment so people team and pool their knowledge to create.* [HR2]

From the questionnaire responses, approximately 68% viewed 'workplace safety' as providing a strong or very strong contribution to the creation of company value. However, one interviewee indicated that safety was not only a human capital consideration but also had implications for relational or structural capital in terms of brand name.

> *It* [safety] *is a fundamental commitment from the company for working in an environment. It has an adverse impact on the brand if it is a big enough incident.* [HR2]

This serves to illustrate that an individual IC component can have impact on more than one main category of IC, indicating that synergies exist in operating human, structural and relational capital together, creating connectivity capital as termed by Habersam and Piper (2003).

The low consensus in questionnaire responses to the contribution to company value made by 'employee entrepreneurial skills' is somewhat surprising given employee skills, in general, and education ranked highest. However, from interview responses it appears to very much depend on both the nature of the company and the employee's function:

> [Entrepreneurial skills contribute] *in different ways, depending on the role somebody has.* [HR2]

> *From an engineering perspective it* [entrepreneurial skills] *creates value because it is the creative spur that drives the innovation and effectively it is the innovation that we sell to customers. If you look to the business development aspect, they carry our brand into new avenues, new markets.* [HR2]

It was recognised that not all roles require entrepreneurial skills to the same degree:

> *We are not a call centre where we need people going through things by rote and not using their imagination.* [HR2]

Further, it was recognised that the entrepreneurial skills of individuals must be exercised and harnessed within organisational limits:

> *It* [the company] *is a consultative environment. So we need people to know their own minds, come to the table with what they have got, but operate within a box.* [HR2]

There was a high level of consensus regarding the importance of employee turnover – 84% of questionnaire respondents indicated that a 'low level of employee turnover' provided a moderate or strong contribution to company value, with only 8% rating it as very strong and 8% as weak. One of the interviewees commented on the costs involved in employee turnover. Not only recruitment and selection costs but the induction process and how long it takes for an employee to get up to speed and delivering to the organisation.

> *So the actual replacement costs of an individual is something like, in excess of, a full year's salary.* [HR1]

> *The costs of employee turnaround... really substantial. ...so measuring what the level of turnover is in our organisation and getting insights into perhaps what are our areas with the highest turnover, what are our areas with the lowest turnover... this enables us to then understand what's going on. We've done calculations and even something like a 1% reduction in turnover leads to a multi-million pound impact on the business, so it's really substantial for an organisation of this size.* [HR1]

However, it was recognised that a certain level of turnover was healthy and a valuable contribution in terms of new skills and ideas entering the company. It, therefore, appears somewhat of a balance between costs involved in reappointing and fresh insight:

> *So at a high level absolutely we want to retain our employees and we don't want to have too much turnover, but at the same time zero turnover is not necessarily something that we would aspire to.* [HR1]

Understanding how the various human capital components contribute to company value did appear to be a focus for the human resources specialists participating in this study. As one questionnaire respondent put it:

> *Measuring the correlation between human capital and its contribution to added value is the holy grail! Until this is clear (and in what way) it cannot inform our human capital disclosure policies and practices.* [Questionnaire respondent]

The impact of human capital on corporate performance was further emphasised during the interviews:

> *Human capital is all about obtaining insights and using measurements as a way of gaining deeper insights into what drives effective performance and in turn impacts business results.* [HR1]

Internal use and external disclosure of human capital components

RQ2: What are the levels of internal management use and external disclosure for specific human capital components?

Questionnaire respondents were asked whether information relating to the various components of human capital was used internally by management and whether they were disclosed externally to various stakeholders. The percentage of respondents who responded in the affirmative is shown in Table 5.2, columns two and three, which is ordered in descending order of internal management use. The final column in this table calculates the ratio of external disclosure to internal management use for the sample as a whole.

Table 5.2 The views of human resources directors on internal use and external disclosure of human capital components (n=67)

Are the following human capital components used internally by management and/or disclosed externally in your company?	Used internally by management %	Disclosed externally %	Ratio of external disclosure to internal management use %
Employee training and development	87	25	29
Workplace safety	85	59	69
Employee remuneration procedures	85	32	38
Employee turnover	82	37	45
Recruitment and selection procedures	82	18	22
Employee satisfaction	73	23	32
Employee skills and education	70	22	31
Quality of relations with company employees	64	18	28
Employee attitude	64	15	23
Employee motivation	59	11	19
Employee equality	58	21	36
Employee experience	58	18	31
Employee behaviour	58	8	14
Employee welfare	56	11	20
Employee commitment	56	12	21
Employee entrepreneurial skills	45	5	11
Employee adaptability	43	5	12
Employee reputation	39	15	38

'Employee training and development' is the human capital component which is most widely used internally by company management, with 87% of questionnaire respondents doing so. However, only 29% of these respondents indicated that this information is also disclosed externally. This is somewhat surprising as companies might be expected to promote their training and development to attract high calibre prospective employees. A potential explanation was offered by one of the interviewees. It was suggested that the diversity and mixture of training and development led to "those kind of generic types of statements" [HR1] made externally with specific and relevant information communicated internally:

> *When we are recruiting for particular roles there will clearly be a different kind of learning provision for those types of roles versus a different type of role. That's the kind of information that we probably would include in the induction, when an employee joins the organisation.* [HR1]

'Workplace safety' information is also used internally by a large number of respondents, with 85% indicating this to be the case. Of the companies who use workplace safety information internally, 69% also disclose externally, which is the highest ratio of external to internal disclosure. The high level of internal use probably reflects the legal requirement under the UK Health and Safety Executive to develop policies, undertake risk assessments and provide employees with relevant information. The high level of external disclosure could to some extent reflect the mandatory requirement to report (although not necessarily publicly in the corporate annual report) certain workplace incidents under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (RIDDOR). The importance of information on workplace safety was further highlighted in the interviews:

> *Highly important! We have a number of key performance indicators that are reviewed as part of corporate governance and health and safety is one of those. There is a monthly report to the PLC board as to how our statistics are running. It is an active agenda item.* [HR2]

Employee equality, although a middle ranking component in terms of internal use and external disclosure, is disclosed externally by a significant proportion of those who report internally. In a study of annual report disclosures of equal opportunities for women, Grosser *et al*. (2008) find that most reporting covers women's employment patterns and is more limited in relation to recruitment, development, and career development and training.

Information relating to 'employee remuneration procedures', 'employee turnover', and 'recruitment and selection procedures' were also widely used internally (by more than 80%). The link between these components and the impact on company costs appears to be clearer than for some of the other human capital components.

> *Clearly you have to make sure that you recruit the right person into the job and if you don't you have high turnover and it's expensive.* [HR1]

The clear linkage perhaps explains why employee remuneration procedures and employee turnover are frequently also disclosed externally.

It was, however, apparent from the interviews that companies are attempting to capture information on the less tangible human capital components such as employee satisfaction, motivation and commitment. Methods of doing so included employee opinion surveys, appraisal reviews and manager observation.

> *We have a metric called employee engagement index which measures how committed an employee is to the organisation, whether they're striving, putting in the discretionary effort to stay with the organisation.* [HR1]

> *Everybody has a performance development and review every year. A review of commitments, development, and value. It is a combination of two things. How has someone performed against commitment and what will help the employee realise more worth and value in their job.* [HR2]

However, from questionnaire and interview responses it was apparent that, whilst companies recognise the potential value of using human capital information, they are sometimes frustrated by an inability to adequately capture the information that they felt they needed.

> *I will be doing it* [looking at the skills and education of the workforce] *when I have a HR system to capture it.* [HR2]

> *The structure of our company means that, unlike financial reporting, human capital information is not centralised. This makes it impossible to meaningfully report group-wide human capital information.* [Questionnaire respondent]

Other constraints were also felt:

> *There is a balance you must strike between measuring and doing. If you spend all your time measuring are you focusing enough on the doing? Also, in a cash restrained environment a company sometimes must be careful about too many surveys of employee satisfaction/motivation etc. Because in asking the question you create expectations that things will change and sometimes you*

> *know what you need to do but can't afford it.* [Questionnaire respondent]

The external disclosure of the vast majority of human capital components appears very low. The following section investigates the incentives and disincentives impacting upon voluntary disclosure.

Incentives and disincentives in relation to human capital disclosure

RQ3a: What is the relative importance of the various incentives and disincentives in relation to the [human capital] *external disclosure decision?*

Respondents were asked their views in relation to the relative importance of various incentives in relation to the disclosure of human capital information. Aggregate responses are shown in Table 5.3 in descending rank order where: 1= not important at all; 2 = of little importance; 3 = fairly important; 4 = important; and 5 = very important. The average score for all incentives to voluntarily disclose human capital information was significantly different from one i.e. not important at all, suggesting that all of the reasons investigated provide an incentive to some degree.

Table 5.3 The views of human resources directors on incentives to voluntarily disclose human capital information externally (n=67)

How important are the following incentives in relation to your company's voluntary disclosure of human capital information externally?	Response category[1] percentage of respondents					Average score	Consensus[2]
	1	2	3	4	5		
Helping to attract new employees of high calibre	0	3	12	41	39	4.22	High
Helping to retain employees of high calibre	2	5	10	41	37	4.14	Medium
Demonstrating our company is socially responsible	3	3	16	40	31	3.98	Medium
Promoting a reputation for transparent/ accurate reporting	2	5	23	38	26	3.88	Medium
Providing important information to investors that is not included in mandatory financial disclosures	2	8	20	36	28	3.86	Medium
Helping to create trustworthiness with other stakeholders	5	3	23	40	21	3.75	Medium
Keeping up with comparable companies operating in our industry	5	7	16	44	20	3.73	Medium
Demonstrating good employee relations	3	10	20	37	23	3.71	Medium
Helping to create trustworthiness with employees	5	7	25	34	23	3.68	Medium
As a motivation for employees	7	13	23	30	20	3.46	Low
Revealing to outsiders the skill level of our managers	7	13	23	28	15	3.37	Low
Increasing the predictability of our future prospects	10	8	27	25	10	3.21	Low
Helping to promote good relations with government agencies	10	15	29	26	10	3.13	Low

Notes

1. Response categories are: 1=not important at all, 2=of little importance, 3=fairly important, 4=important, 5=very important.
2. Standard deviation of less than or equal to 0.85 =high consensus; standard deviation of greater than 0.85 and less than or equal to 1.10 = medium consensus; standard deviation of greater than 1.10 = low consensus.

The most important incentives to disclose human capital information externally are perceived as 'attracting and retaining employees of high calibre' (average scores of 4.22 and 4.14, respectively). To obtain employees of high calibre there clearly has to be an exchange of information, achieved, at least partially, through external disclosure. As one interviewee put it:

> *One of our biggest challenges is to get the balance of recruiting people who look like us, and recruiting people who are slightly outside that mould that they could bring their creativity. Clearly you can't mix oil and water and by recruiting people that notionally look like us, it's been a very effective model.* [HR2]

Approximately 71% of respondents viewed 'demonstrating social responsibility' to be an important or very important incentive (average score 3.98). According to one interviewee, social responsibility is important at different levels:

> *At a divisional level or site level, we are a major employer in the communities of which we reside. So there are community programs from the social through to the environmental. We have fireworks and summer garden parties. We work with the local health and safety inspectorate and town councils. We look to see how we can minimise our utilities use and look to the environmental impact. At a corporate level, we actually look to develop training with our directors on corporate social responsibility so that there is a conscious awareness of the impact of doing business in the community at large.* [HR2]

Approximately 61% of respondents indicated that 'creating trustworthiness with other stakeholders' was an important or very important incentive (average score 3.75). However, one of the interviewees noted that communication was one of the reasons that less trust was placed in the executives of the company. The implication was that external disclosure or using 'city speak' internally was not sufficient:

> *We need to re-interpret the business speak into something that people can personally identify with.* [HR2]
>
> *If people can find more personal identity in the message that is being given out, then they can align themselves more to it because it feeds from what is in them, and therefore they are more productive and therefore we get the output.* [HR2]

These findings resonate with the findings of McInnes *et al*. (2007) in relation to the benefits of personalising communications with employees, by using employee road shows.

The least important incentives for disclosing human capital information externally relates to 'promoting good relationships with government agencies' (average score 3.13) and 'increasing the predictability of future prospects' (average score 3.21). However, consensus of opinion was low in relation to these incentives. Consensus in relation to the importance of 'motivating employees' (average score 3.46) and 'revealing to outsiders the skill level of managers' (average score 3.37) through external disclosure was also low. These four average scores were all significantly lower than all other scores. In one interview the motivation of employees was suggested as being achieved through both internal and external communication.

> *They are motivated by that* [the company singing their praises to external people] *because that is a pride and a recognition, and recognition can be worth more than monetary reward. We promote that internally. So if somebody or a team have done a particularly good project, then they get a CEO award and there are all sorts of recognition programs across the company which goes into the newsletters.* [HR2]

The degree of importance attached to revealing to outsiders the skill level of managers may reflect the perceived risk of doing so:

> *We report in our annual report and accounts carefully, because if you have got good people then other people want them. A bit of a catch twenty two.* [HR1]

> *Due to the niche nature of our industry, we are sometimes vulnerable to head hunters, especially in sales.* [Questionnaire respondent]

Questionnaire respondents were asked their views in relation to the relative importance of certain disincentives to disclose human capital information. Aggregate responses are shown in Table 5.4.

Table 5.4 The views of human resources directors on disincentives to voluntarily disclosing human capital information externally (n=67)

How important are the following disincentives in relation to your company's voluntary disclosure of human capital information externally?	Response category[1] percentage of respondents					Average score	Consensus[2]
	1	2	3	4	5		
Avoiding giving away information which may harm our competitive position	7	12	19	17	41	3.77	1.32
Reducing the costs of collecting and disseminating information	7	17	24	29	14	3.28	1.17
Avoiding attracting unwanted scrutiny by other stakeholders	9	32	27	14	10	2.83	1.15
Avoiding attracting unwanted scrutiny by regulators	14	34	17	12	15	2.80	1.32

Notes

1. Response categories are: 1=not important at all, 2=of little importance, 3=fairly important, 4=important, 5=very important.
2. Standard deviation of less than or equal to 0.85 =high consensus; standard deviation of greater than 0.85 and less than or equal to 1.10 = medium consensus; standard deviation of greater than 1.10 = low consensus.

The most important disincentive was 'avoiding giving away information which might harm competitive position' scoring an average of 3.77, significantly higher than the next highest ranking item. Approximately 58% of respondents viewed this as important or very important. As one interviewee put it:

> *We do get quite a feed from people and some of our employees have gone to competitors and some of their people have come to us.* [HR2]

> *We have a strong reputation externally and we place a very high value on our human capital team and our human capital strategy, that's a competitive advantage for us. So we would be cautious to some degree in the level of information, the level of detail we would share with our competitors externally.* [HR1]

However, the competitive advantage side to disclosing human capital was also evident:

> *I look at FTSE 250... best practice if you can find it. Some of the big boys and some of the big consultancies spend multi-millions on what best practice is. So I can look at that, cream off the most valuable twenty per cent for us and will fit it into what we do.* [HR2]

However, the desired information is not always obtained/available via 'free' disclosure from comparable companies. One interviewee mentioned the purchase of human capital information and reliance on academic research:

> *I buy empirical evidence. We get the empirical information from think tanks and I work a lot with academia.* [HR2]

'Reducing the costs of disclosure' (average score 3.28) ranked second, significantly above the next highest ranking item. Avoiding attracting unwanted scrutiny by other stakeholders (average score 2.83) and by regulators (average score 2.80) also acted as disincentives to voluntary disclosure to some degree. Other disincentives mentioned by questionnaire respondents and interviewees included internal data capture, comparability and the relevance of disclosing human capital information:

> *Quality of systems and accuracy of information* [are a disincentive]. [Questionnaire respondent]

> *Ability to measure in such a way as to compare like with like with other companies.* [Questionnaire respondent]

> *Business complexity and diversity make comparisons difficult.* [Questionnaire respondent]

> *Take employee engagement, we cannot compare our employee engagement because the mathematical modelling behind it is different. They* [the company] *always want to benchmark and I sort of said no. Stop looking externally to self validate, it is tougher than that, you have actually got to make your own business decisions yourself. Where people want statistics or information, it can lead you to a real rabbit hole.* [HR2]

However, the latter view appears far from universal when the following interviewee clearly emphasised the importance of benchmarking the company against comparators:

> *We participate in the Sunday Times Best Place to Work Survey and we've scored really well. We've certainly been in the kind of top ten employers.* [HR1]

> *We don't just look at navel gazing at our own results, we want to know how we compare to other organisations. We benchmark all of our employee opinion survey results against the global high performing norms.* [HR1]

Communication channels and human capital information

RQ4a: How effective are the various forms of communication in relation to the disclosure of [human capital]?

Respondents were asked their views in relation to the effectiveness of various forms of written communication in relation to disclosing human capital information. Aggregate responses are shown in Table 5.5, where: 1= effective; 2 = neutral; 3 = ineffective. The number of respondents indicating 'don't know' (DK) or 'not applicable' (N/A) were significant and are thus included in Table 5.5. The consensus of responses (extent of agreement among respondents) is categorised as high, medium or low based on the standard deviation of responses. The final column indicates whether the communication channel is viewed as effective or ineffective, based on whether the average score is statistically significantly different from neutral.

Table 5.5 The views of human resources directors on human capital disclosure and forms of written communication (n=67)

Rate the following channels of corporate communication for your company's disclosure of human capital information externally	Response category[1] percentage of respondents					Average score	Consensus[2]	Statistical significance of response[3]
	1	2	3	DK	N/A			
Annual corporate report	73	11	9	6	1	1.31	High	Effective
Annual review	35	24	5	15	21	1.53	High	Effective
Corporate social responsibility report	38	26	6	8	22	1.54	Medium	Effective
Press releases	44	28	11	6	11	1.59	Medium	Effective
Company web pages	46	34	12	6	2	1.63	Medium	Effective
Company newsletters (external)	30	13	11	11	35	1.65	Low	Effective

Notes

1. Response categories are: 1=effective, 2=neutral, 3=ineffective, DK=don't know, N/A=Not applicable.
2. Standard deviation of less than or equal to 0.65 = high consensus; standard deviation of greater than 0.65 and less than or equal to 0.75 = medium consensus; standard deviation of greater than 0.75 = low consensus.
3. Based on statistical test to identify if average scores are significantly different from 2-neutral.

The 'annual corporate report' was considered the most effective written communication for disclosing human capital externally, with approximately 73% of respondents viewing it as effective. It should be noted, however, that respondents were not asked about as large a range of channels as finance directors. The annual report rated slightly higher than the next highest ranking channel (the annual review).

> *To the shareholders, it* [the annual report] *is their window on the organisation. Current shareholders and prospective shareholders*

and also the directors and of course analysts... would naturally turn to the annual report. [HR2]

The annual report will go out to our shareholders and it's important that the shareholders are aware of the key aspects of what we're doing within the organisation on HR and the human capital strategy. [HR1]

It was evident that the human resources function contributes to the production of the corporate annual report:

I write the remuneration section, the corporate governance section. I write the drafts for the CEO on the people section and then as with the rest of the executive committee, I read it to make sure that the whole thing broadly fits together and we don't cut across each other. [HR2]

Approximately 38% of questionnaire respondents indicated that the corporate social responsibility (CSR) report was an effective channel for communicating human capital information (average score 1.54). This relatively low level is perhaps surprising, given the obvious link between employees and companies responsibilities in respect of them. However, CSR reports are not universally produced – 22% of respondents indicated that it did not apply to them and a further 8% responded don't know. Numerous human resources metrics appear to be externally disclosed in the CSR report:

We externally report our human capital strategy and metrics through our corporate responsibility report. [Questionnaire respondent]

We do have a corporate social responsibility report and within that there are elements of different HR components and that includes information about the human capital team. [HR1]

Approximately 46% of questionnaire respondents indicated that 'company web pages' were effective for external communication (average score 1.63) with only 8% indicating not applicable or don't know. One interviewee noted that communication channels require continuing attention as a consequence of dynamic and changing technologies:

We are refreshing our website because it was a little bit old and we have just worked with Sky Television to take part in a careers program that will be sent out on whatever satellite programs, and it will be streamed into Facebook and Bebo. So we are getting more creative at how we might be able to reach our potential employees. [HR2]

Interviewees further emphasised the importance of the web internally, consistent with the positive views regarding the intranet documented by McInnes *et al*. (2007, p.91):

We have an intranet which is available to the vast majority of employees around the world. [HR1]

Indeed, the importance of communication to human resources appeared to somewhat take precedence over the external communication about human resources. Several respondents mentioned private business TV channels for employees:

We have several strands to our internal communication approach and one of those is TV. Our Chief Executive is interviewed on a frequent basis and has town hall meetings with employees and

> *these are recorded and replayed to lots of different office locations, so that employees around the world can first hand kind of experience that.* [HR1]

'External company newsletters' appear to be the least effective channel for communicating human capital information (average score 1.65). Approximately 30% of questionnaire respondents indicated the question was not applicable as they did not produce company newsletters, and only approximately 30% indicated newsletters were effective. Interviewees appeared to suggest that newsletters were better designed for internal communication:

> *They* [company newsletters] *are written in terms that are much more appropriate for the internal* [audience]. [HR2]

However, it was suggested that newsletters were more effective externally if they were specially targeted:

> *What we do have is a media brochure on some of the jazzy fun stuff that we are doing and the thought-leading stuff that we are doing that comes out quarterly and that is very useful at trade shows and to third parties. It is a way of making us accessible to them.* [HR2]

Summary: human resources directors' views

The evidence presented in this chapter supports the following main conclusions regarding human resources director's views:

- *RQ1: Human capital components* – all of the human capital components investigated contribute to company value to some degree. 'Employee skills and education'; 'employee commitment';

'positive employee attitudes'; 'positive employee behaviour'; and 'employee motivation' were ranked the top five components in terms of their contribution. Bringing employee skills together, rather than skilled individuals operating in isolation, is important. The interaction between individual human capital components such as skills, attitude and behaviour is important in the value creation process. Individual human capital components can impact the other IC categories of structural and relational capital. Human resources directors do appear to focus on how the various human capital components contribute to company value.

- *RQ2: Internal use and external disclosure of human capital* – 'employee training and development'; 'workplace safety'; 'employee remuneration procedures'; 'employee turnover'; 'recruitment and selection procedures'; and 'employee satisfaction' were the top five components used internally by company management. Companies are attempting to capture information on the less tangible human capital components through opinion surveys, appraisal reviews and manager observation. External disclosure of the vast majority of human capital components is low.

- *RQ3a: Incentives to voluntarily disclose human capital* – all of the reasons investigated provide an incentive to the voluntarily disclosure of human capital information to some degree. 'Helping to attract new employees of high calibre' and 'helping to retain employees of high calibre' were the most important incentives.

- *RQ3a: Disincentives to voluntarily disclose human capital* – all of the reasons investigated provide a disincentive to the voluntarily disclosure of human capital information to some degree. 'Avoiding giving away "company secrets" or otherwise harming competitive position' was more important than all other disincentives.

Additional disincentives mentioned included internal data capture, comparability, and relevance.

- *RQ4a: Communication channels* – all of the written communication channels investigated were considered effective for the external disclosure of human capital information. The corporate annual report was the most effective. The human resources function contributes to the annual report production. The CSR report was not produced by a number of companies. The importance of communication to employees takes precedence over the external communication about human resources via private business TV channels or internal newsletters.

6 Results: Questionnaire Responses and Interviews with Marketing Directors

Introduction

Individual marketing and customer relations components and their disclosure were further investigated by obtaining views and opinions from the marketing/commercial functional specialists across UK corporations. Relational capital is one of the major categories of IC (Lev and Zambon, 2003). Relational capital is defined as all resources linked to the external relationships of the firm, with customers, suppliers and R&D partners. According to the American Marketing Association (2007), marketing is defined by as the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large. Relational capital thus appears to be a broad concept which captures a company's marketing function. Obtaining views and opinions from marketing directors can be further justified on the basis of the proposition that IC reporting can be used as a valuable marketing tool (van der Meer-Kooistra and Zijlstra, 2001). A recent survey by the Intellectual Assets Centre also found that Scottish-based companies are increasingly exploiting their intellectual assets with marketing materials (Russell, 2007).

The findings from questionnaire responses and follow up interviews are presented in this chapter. The next section considers the extent to which various marketing and customer relations components are considered to contribute to company value. The third section reports the extent to which various marketing and customer relations components are used internally by management and disclosed externally. The importance of various incentives and disincentives to the voluntary disclosure of marketing and customer relations information externally is considered in the fourth section. The fifth section considers the effectiveness of alternative channels of corporate communication for disclosing marketing and customer relations information externally. A summary of marketing directors' views is presented in the final section.

Marketing and customer relations contribution to corporate value

RQ1: What is the view of [marketing directors]*regarding the relative importance of* [eighteen marketing/customer relations components] *in the generation of company value?*

Questionnaire respondents were asked their views in relation to the relative contribution of eighteen marketing/customer relations components to creating value for their companies.

Aggregate responses are shown in Table 6.1, in descending rank order, where: 1 = no contribution; 2 = weak contribution; 3 = moderate contribution; 4 = strong contribution; and 5 = very strong contribution. Percentages may not total 100% as the 'don't know' category is not shown. The average score is shown in the second last column and the consensus or extent of agreement among respondents is categorised as high, medium or low, based on the standard deviation of responses.

Table 6.1 The views of marketing directors regarding the relative importance of marketing/customer relations components to generating company value (n=68)

To what extent do the following marketing/customer relations components contribute to creating value for your company?	**Response category[1] percentage of respondents**					**Average score**	**Consensus[2]**
	1	**2**	**3**	**4**	**5**		
Customer relationships	1	0	9	30	60	4.46	High
Company reputation	1	3	9	28	58	4.39	Medium
Competitive edge in terms of quality of product/service	2	2	6	53	58	4.25	High
Data/knowledge of customers	1	1	19	27	51	4.24	Medium
Customer loyalty	4	6	18	37	34	3.91	Medium
Company image	4	4	18	43	30	3.90	Medium
Development of products/ideas	4	6	15	54	19	3.79	Medium
Product portfolio	4	7	16	49	21	3.76	Medium
Competitive edge in terms of cost of product/service	4	4	36	33	22	3.64	Medium
Marketing strategies	3	6	34	37	19	3.64	Medium
Brand names	3	13	28	33	22	3.58	Medium
After sales service	11	11	21	32	26	3.52	Low
Distribution channels	6	15	25	31	20	3.44	Low
Competitive edge in terms of adaptability of business practices	1	18	37	27	16	3.39	Medium
Market share	9	7	36	31	13	3.34	Low
Competitive edge in terms of the timing of product/service release	6	13	37	34	9	3.27	Medium
Relationships with the government	21	30	18	15	15	2.73	Low
Relationship with the public	21	27	25	22	4	2.63	Low

Notes

1. Response categories are: 1=no contribution, 2=weak contribution, 3=moderate contribution, 4=strong contribution, 5=very strong contribution.
2. Standard deviation of less than or equal to 0.85 =high consensus; standard deviation of greater than 0.85 and less than or equal to 1.10 = medium consensus; standard deviation of greater than 1.10 = low consensus.

The average score for all marketing/customer relations components was significantly different from one, i.e. no contribution at all. This suggests that all of the components investigated contribute to company value to some degree. 'Customer relationships', with an average score of 4.46, contribute to company value the most – approximately 90% of respondents indicated it made a strong or very strong contribution. 'Company reputation' (average score 4.39), 'competitive edge in terms of quality of product/service' (average score 4.25), and 'data/knowledge of customers' (average score 4.24) also appear to contribute to company value to a great extent. These four components scored significantly higher than the next highest ranking component.

There is a low level of consensus in relation to the contribution provided by three mid-to-low ranking components: 'after sales service' (average score 3.52); 'distribution channels' (average score 3.44); and 'market share' (average score 3.34). 'Relationships with the government' (average score 2.73) and 'relationships with the public' (average score 2.63) contributed the least to company value with 51% and 48% of respondents respectively indicating they provided no or only weak contribution. Both of these components scored significantly lower than the next lowest ranking component. However, there was a low consensus of opinion in relation to these two components also.

Returning to the high ranking items, the contribution of customer relationships featured prominently in the interviews:

> *The customer relationship for us starts from the first introduction on the telephone, having seen an advert from us and then obviously goes right the way through to the after sales care, which is after they've actually transacted some business with us. We will then phone them and say how are you doing?* [MD1]

Trust on the part of customers appears to play a significant part in their relationships with the company which appears to be reflected in corporate reputation. Reputation appeared central to the minds of several interviewees:

> *In terms of reputation, this really comes back down to trust. Longevity is a good core for being trusted.* [MD1]

> *It* [reputation] *is absolutely fundamental. The reason people will buy from us is because they don't have as many people who understand as well as we do, so they have to trust us. When they are trusting us with a multi-million dollar engagement, then that trust needs to be built on something. So our reputation has to come from being recognised by our peers in the industry as knowing what we are doing.* [MD3]

> *Massive! Hard won, easily lost. Service failure is a thing that keeps us all operating in the business awake at nights. Reputation moving forward is increasingly important to us. We would like to think that if people are thinking about good quality value-for-money they'd think of* [company name]. [MD2]

The contribution of 'competitive edge in terms of the quality of the product/service' to company value also featured strongly in the interviews:

> *The quality aspect is fundamental to the ethos of our company. If you want to take an example, if you phone up* [competitor company] *and you want to get support and you actually want to talk to a human which is hard, but assuming you manage it, the first question you will be asked is, what is your support arrangement and are you up to date and if you're not they won't talk to you. We've always taken the opposite ethos that says if the customer phones up, at least we think they are a customer, we actually won't check particularly hard, we'll answer the question, we'll help them*

> *through their problem and the following day we'll work out should they be paying for this, but you fix the customer first.* [MD4]

In the eyes of questionnaire respondents, the contribution of competitive edge in terms of quality appears to contribute more to company value than the contribution of competitive edge in terms of cost (average scores 4.25 and 3.64, respectively).

One interviewee appeared to suggest that competitive edge in terms of quality and cost were somewhat of a trade-off:

> *I don't think anybody deliberately sets out to buy the worst-quality service. I think what most people try to do is to buy the best value for money they can afford.* [MD2]

Approximately 78% of questionnaire respondents viewed 'data/knowledge of customers' as providing a strong or very strong contribution to company value. In the interviews the importance of this information to generating repeat business was emphasised:

> *Knowledge of customers is critical to understand how our customers sell their products to their customers and how they market them. So the more you understand about how customers use our technology as part of their overall marketing message, the better we can actually promote our next technologies to them.* [MD3]

> *If you don't know who your customers are, which of your products they have, what they're doing with them and to a large extent, why they care about them, it's incredibly difficult to go back and sell them anything else.* [MD4]

However it was recognised that possession of 'data/knowledge of customers' was not enough in itself. It was necessary to identify what was important in a specific context and able to be used to create value:

> *The interpretation piece is absolutely crucial because interesting data to one person maybe completely irrelevant to someone else. One man's information is another man's tittle-tattle.* [MD2]

The contribution of 'after-sales service' to company value appears to be very much situation-specific. This supports the evidence of a lack of consensus among questionnaire respondents in relation to this particular component:

> *It's* [after sales service] *an interesting area where we find a huge variation on how our customers work with us. Some customers we will occasionally hear from. We have big maintenance contracts as part of our engagement and how we deliver on that after sales service is fundamental. There are some customers that will use that quite sparingly, because they choose to do their own thing. There are other customers who'll absolutely hammer that service.* [MD3]

> *If they* [customers] *can say we know* [company name] *is really good at delivering after sales support, they're really good, they're responsive, they're well qualified and they help us a lot, then that is a very important tick in the box for the next buying decision, so it adds a lot of value.* [MD3]

Approximately 51% and 48% of questionnaire respondents viewed 'relationships with the government' and 'relationships with the public' as providing no or only weak contribution to company value respectively. However, in the interviews these components appeared to feature indirectly in specific contexts. For example, a particular government department was a major customer for one interviewee. Further, several interviewees alluded to creating a reputation as 'a company the public could trust' with a view to attracting potential customers and retaining existing ones. This serves to illustrate the difficulty involved in separately identifying mutually exclusive IC components. It was apparent that several of the components mentioned were interrelated.

Internal use and external disclosure of marketing/ customer relations components

RQ2: What are the levels of internal management use and external disclosure for specific relational capital components?

Questionnaire respondents were asked whether information relating to the various marketing/customer relations components was used internally by management and whether they were disclosed externally to various stakeholders. The percentage of respondents who responded in the affirmative is shown in Table 6.2, columns two and three, which is ordered in descending order of internal management use. The final column in this table calculates the ratio of external disclosures to internal management use for the sample as a whole.

Table 6.2 The views of marketing directors on internal use and external disclosure of marketing/customer relations components (n=68)

Are the following marketing/customer relations components used internally by management and/or disclosed externally in your company?	**Used internally by management %**	**Disclosed externally %**	**Ratio of external disclosure to internal management use %**
Data/knowledge of customers	85	7	8
Marketing strategies	81	15	19
Customer relationships	79	16	20
Competitive edge in terms of cost of product/service	72	16	22
Market share	71	38	54
Competitive edge in terms of quality of product/service	71	32	45
Customer loyalty	71	12	17
Company reputation	68	43	63
Development of products/ideas	68	18	26
Product portfolio	66	44	67
Company image	66	32	48
After sales service	63	28	44
Distribution channels	62	21	34
Competitive edge in terms of adaptability of business practices	56	12	21
Brand names	53	46	87
Competitive edge in terms of the timing of product/service release	46	18	39
Relationships with the government	38	10	26
Relationships with the public	34	22	65

'Data/knowledge of customers' is the marketing/customer relations component which is most widely used internally by company management, with 85% of questionnaire respondents doing so. From the interviews it became clear that companies struggled with methods of obtaining and coordinating information about their customers:

> *We have many contact points with the customer. All of them touch the customer in different places in different ways, coordinating that information flow is vitally important. Most organisations do a pretty poor job at it. It's hard, it's difficult to do.* [MD4]

> *If you don't know who you are selling to you can't sell to them. So we spend a lot of time, a lot of effort, on maintaining databases of individuals, of organisations.* [MD2]

> *The more valuable information is gathered ad hoc. Historically, we had a system which is very much based around a very restricted formal view of the customer. The new system is fairly simple to do simple things. They* [company employees] *can log something as simple as I had a phone call with Fred and he gave me this snippet and it's recorded against the customer.* [MD4]

> *We have a relatively sophisticated customer-relationship management system which we use, and that will take individual-level data.* [MD2]

Various methods of collecting customer information were mentioned during the interviews:

> *Within the customer services department, we collate how many calls or contacts, a lot of them web based these days, on particular products, on particular regions, on particular time frames.* [MD4]

> *We have introduced an annual customer survey because we can now use the web to do that quickly and easily.* [MD4]

Only 8% of those using the information internally indicated that 'data/knowledge of customers' was also externally disclosed. However, the low level of external disclosure is hardly surprising given that the detail of such information provides the potential for customer poaching from competitors. Information in relation to 'customer relationships' was used internally by 79% of questionnaire respondents (ranking third). However, only 20% of those disclosed externally. From the interviews, it was apparent that while companies might obtain benefit in terms of their reputation from public disclosure of who their customers are, the relationship with that customer may be adversely affected as a consequence:

> *One of the things we're communicating internally is what is sensitive and what is not. Externally what we always try and do is communicate whatever we can about not only our customers and the relationships we have with them, but also our customer's customers.* [MD3]

Approximately 72% and 71% of questionnaire respondents indicated that they internally used information in relation to 'competitive edge in terms of cost of product/service' and 'competitive edge in terms of quality of product/service', respectively (ranking fourth and sixth). Of these respondents, 45% disclosed the information about quality externally, whereas only 22% externally disclosed information about cost. Alternative methods for obtaining information in relation to competitive position were highlighted in the interviews.

> *Customers are incredibly willing to offer information about competitors' products. So most of it comes from informal feedback from a customer. We do subscribe to a number of industry analyst organisations and use them for their external views.* [MD4]

> *We do what I say is mystery shopping... we do phone the competition; look at their response rate. I would take the marketing directors out to lunch and we'll share ideas.* [MD1]

> *We do provide research, 350 telephone based interviews... and we get a matrix out of those. We also subscribe to two pieces of syndicated research.* [MD1]

From Table 6.2 it is evident that information in relation to the majority of marketing/customer relations components is not widely disclosed externally. However, one interviewee also highlighted restrictions placed on the disclosure of information internally, and a culture to safeguard information in the hands of top management:

> *There's a whole series of matrices internally... Of the 60 internal matrices, we're only willing to show internally seven of them. Even internally, we suffer from don't want to put it up there in lights, in case it doesn't look very good, so let's just stick with the basics.* [MD1]

Interestingly, four components that were middle-ranking in terms of internal management use were the highest ranking in terms of external disclosure: 'brand names'; 'product portfolio'; 'company reputation'; and 'market share'. Davison and Skerratt (2006) find that brand names and products are frequently disclosed in the annual report and annual review, using pictures as well as text. One interviewee stressed the importance of images in the external disclosure of marketing/customer relations information:

> *The reason for putting as many pictures in is to try and bring the company to life, and it's what I call emotionalise the brand.* [MD1]

Incentives and disincentives in relation to marketing/customer relations disclosure

RQ3a: What is the relative importance of the various incentives and disincentives in relation to the [relational] *IC external disclosure decision?*

Respondents were asked their views in relation to the relative importance of various incentives in relation to the disclosure of marketing/customer relations information. Aggregate responses are shown in Table 6.3 in descending rank order where: 1= not important at all; 2 = of little importance; 3 = fairly important; 4 = important; and 5 = very important. The average score for all incentives to voluntarily disclose was significantly different from one, i.e. not important at all, suggesting that all of the reasons investigated provide an incentive to some degree.

Table 6.3 The views of marketing directors on incentives to voluntarily disclose marketing/customer relations information externally (n=68)

How important are the following incentives in relation to your company's voluntary disclosure of marketing/ customer relations information externally?	Response category[1] percentage of respondents					Average score	Consensus[2]
	1	2	3	4	5		
Helping to create trustworthiness with customers	6	8	11	36	36	3.90	Low
Helping to create trustworthiness with other stakeholders	3	8	25	36	23	3.72	Medium
Helping to retain customers	6	13	16	35	27	3.65	Low
Helping to attract new customers	10	10	16	37	27	3.63	Low
Providing important information to investors that is not included in mandatory financial disclosures	6	5	30	41	11	3.49	Medium
Promoting a reputation for transparent/ accurate reporting	6	14	28	31	16	3.38	Low
Providing a valuable marketing tool	8	17	27	34	11	3.24	Low
Revealing to outsiders the skill level of our managers	11	20	17	36	13	3.19	Low
Increasing the predictability of our future prospects	8	16	31	16	16	3.18	Low
Keeping up with comparable companies operating in our industry	10	17	22	27	11	3.15	Low
Confirming market position and dissuades competitors	13	21	24	33	6	3.00	Low
Valuable to the launch of new products	14	17	27	32	6	2.98	Low
Beneficial if reciprocated by our competitors	17	21	29	21	2	2.64	Medium

Notes

1. Response categories are: 1=not important at all, 2=of little importance, 3=fairly important, 4=important, 5=very important.
2. Standard deviation of less than or equal to 0.85 =high consensus; standard deviation of greater than 0.85 and less than or equal to 1.10 = medium consensus; standard deviation of greater than 1.10 = low consensus.

Customer-focused incentives represented three of the top four incentives, although the level of consensus was low in all cases. The most important incentive for the disclosure of marketing/customer relations information externally was 'helping to create trustworthiness with customers', with an average score of 3.90. From the interviews it was apparent that this trust was created with new customers through recommendation by existing customers:

> *The most powerful way to sell to a customer is a reference. You'll typically always be asked for references within an industry. The most credible thing you can do with a customer is say we've done the same thing for somebody else in the same industry. So here's the name of the person at the organisation, I'll arrange for you to give the phone call or web conference or whatever and you talk to them direct.* [MD4]

> *When a new customer comes along and says 'OK, I'm considering you and I'm considering company X and I'm considering company Y', we can point to that external information and say 'well you know, obviously a lot of the stuff we do is confidential, but these are examples of where our technology is being used'. That gives people huge confidence.* [MD3]

Although the value of recommendations was clear, interviewees also indicated that they found themselves increasingly in a position where they are unable to disclosure who their existing customers are:

> *We work with* [a particular government department]*, we provide services to the* [government department]*, the* [government department] *as a brand is hugely valuable to us but it's hugely valuable to the* [government department] *and they will therefore in contracts often limit, or try to limit, what we are allowed to say*

> *and how we are allowed to use the* [government department's] *brand in our own materials.* [MD2]

Therefore, there is clearly a conflict between disclosing customer relationship information to create trust with potential customers and in doing so violating trust with existing customers. Retention of customers (average score 3.65) was considered only fractionally more important than attracting new customers (average score 3.63) by questionnaire respondents. As one interviewee put it:

> *We'll only disclose stuff that is consistent with how they* [the customers] *are going to market and that is very, very important.* [MD3]

Only 38% of questionnaire respondents indicated that 'keeping up with comparable companies operating in our industry' was important or very important in the decision to externally disclose marketing/customer relations information. However, this issue featured very prominently during the interviews:

> *There are certain precedents on what information you relate and how you relate it and when you relate it and that is set by your peers in the industry and so every time a competitor makes an announcement or even another company related to you, even if they're operating in different segments, you need to take a look at it and take a view. Do we want to respond or we're not going to play that game because we don't agree that's good information to disclose.* [MD3]

> *We get hold of everybody's newsletter or annual report that we think is good and we take the best parts out of that and try and incorporate it into our own. So we do absolutely look at what other people are doing.* [MD1]

It tends to be very much around the industry analyst communities. With those guys it tends to be very much of a 'you show me yours and I'll show you mine' type of kiddie's conversation, so we have to be able to disclose enough. [MD4]

Only 38% of questionnaire respondents indicated that external disclosure was 'valuable to the launch of new products'. One interviewee, however, considered it crucial:

We can show several generations of products using our technology. That then says because the last couple of generations of our technology worked really well in these products, it is lower risk and much better chance when we say our next generation will do it. [MD3]

Approximately, 38% of questionnaire respondents indicated that 'beneficial if reciprocated by our competitors' was not important at all or of little importance as an incentive to external disclosure; this was the lowest ranking incentive. However, one interviewee highlighted the advantage from competitors' disclosure but was reluctant to reciprocate:

You do get some organisations that will put up an entire list of the entire customer base [on the web]. *I'll never do that. All I do is go to my competitors and I copy those people and I go target them, because I now know they use those products.* [MD4]

Another interviewee noted that drawing comparisons from reciprocated disclosure was not beneficial in the absence of standardised performance indicators:

It would benefit people to have a comparative statistic. So you know, just saying 'Oh our customers gave us 4.2 out of 5' that's *meaningless to a customer if they don't understand that actually everyone else got 4.8. So it's only as good as the industry coming up with some standards. The trouble is of course... you've got different things mean different things to different people. Very different business models for different business units.* [MD1]

No significant differences existed between adjacent ranking incentives.

Questionnaire respondents were asked their views in relation to the relative importance of certain disincentives to disclose marketing/ customer relations information. Aggregate responses are shown in Table 6.4, in descending rank order.

Table 6.4 The views of marketing directors on disincentives to voluntarily disclose marketing/customer relations information externally (n=68)

How important are the following disincentives in relation to your company's voluntary disclosure of marketing/customer relations information externally?	Response category[1] percentage of respondents					Average score	Consensus[2]
	1	2	3	4	5		
Avoiding giving away information which may harm our competitive position	0	2	14	25	52	4.37	High
Avoiding attracting unwanted scrutiny by regulators	3	11	23	30	27	3.70	Low
Avoiding attracting unwanted scrutiny by other stakeholders	5	6	23	37	21	3.68	Medium
Reducing the costs of collecting and disseminating information	17	30	19	16	10	2.67	Low

Notes

1. Response categories are: 1=not important at all, 2=of little importance, 3=fairly important, 4=important, 5=very important.
2. Standard deviation of less than or equal to 0.85 =high consensus; standard deviation of greater than 0.85 and less than or equal to 1.10 = medium consensus; standard deviation of greater than 1.10 = low consensus.

The most important disincentive was 'avoiding giving away information which might harm our competitive position', with an average score of 4.37. This score is significantly higher than the next highest ranking item. Approximately 77% of respondents viewed this as important or very important. Competitive disadvantage dominated the interviews:

> *Whenever you put a piece of information out you're equipping your competitors, you're just making it easier for them to compete with you because they know what to focus on.* [MD3]

The external disclosure of marketing/customer relations information appears to result from a cost-benefit trade off. One interviewee talked about it in terms of 'swings and roundabouts':

> *You want to have as much information in the hands of your customers as possible and you want to have as little information in the hands of your competitors as possible.* [MD4]

> *We have to strike a balance of putting out data that says 'look we're the best at whatever we do'. Every time you do that, that's information that's immediately seized upon by your competition as immediately they can then say 'as long as we can have better numbers than these ones, then we can say we're better than* [company name]'. [MD3]

> *We must also be careful not to reveal too much of our product plans prematurely, as if we are late in development we provide ammunition for our competitors.* [MD3]

However, consistent with theory, information disclosed to competitors was not always considered to harm competitive position:

> *Most of our competitors are kind of philosophically in the same place as we are. We do, on a non-competitive basis, share information with our competitors about what we are doing and why and how. A big issue that affects the industry is something I think is perfectly legitimate to share relatively detailed information with competitors about. We're lobbying as an industry and inevitably in order to do that we have to share information about what we're doing.* [MD2]

Approximately 57% and 58% of questionnaire respondents indicated that 'avoiding attracting unwanted scrutiny by regulators' (average score 3.70) and 'avoiding attracting unwanted scrutiny by other stakeholders' (average score 3.68) were important or very important, respectively. 'Reducing the costs of collecting and disseminating information' was considered the least important disincentive to external disclosure with an average score of 2.67 ranking significantly below the other disincentives. From the interviews, it was evident that the disclosure of marketing/customer relations information was not always entirely within the company's control if they wanted to avoid potential legal/commercial penalties:

> *We must be extremely careful to respect non-disclosure agreements and external relations strategies with our licensees/customers.* [MD3]

> *Constraints placed on us by customers as to how/where/when we are allowed to use information about our relationship with them. Typically this is part of the contract agreement and has changed from unusual to normal over the past few years.* [MD4]

One interviewee mentioned the reluctance to create a disclosure precedent in relation to marketing/customer relations information:

> *My point is that once you start, you can't stop it because it will ask so many questions.* [MD1]

Another interviewee highlighted a non-disclosure precedent in relation to competitors, which support the findings by Gibbins *et al.* (1990) of firms developing internal preferences for managing disclosure:

> *We do not ever knock the opposition. We set the tone that said there are competitors who do a very good job. There are enough regulatory bodies around to say whether somebody is performing properly or not without us wading into it as the kind of all-knowing expert opinion. So there are limitations on what we say, and I think that's an example of it.* [MD2]

Communication channels and marketing/customer relations information

RQ4a: How effective are the various forms of communication in relation to the disclosure of [relational capital]?

Respondents were asked their views in relation to the effectiveness of various forms of written communication in relation to disclosing marketing/customer relations information. The same six channels were listed for evaluation as for the human resources respondents. Aggregate responses are shown in Table 6.5, where: 1= effective; 2 = neutral; 3 = ineffective. The number of respondents indicating 'don't know' (DK) or 'not applicable' (N/A) were significant and are thus included in Table 6.5. The consensus of responses or extent of agreement among respondents is categorised as high, medium or low based on the standard deviation of responses. The final column indicates whether the communication channel is viewed as effective or ineffective, based on whether the average score is statistically significantly different from neutral.

Table 6.5 The views of marketing directors on marketing/customer relations information disclosure and forms of written communication (n=68)

Rate the following channels of corporate communication for your company's disclosure of marketing/customer relations information externally	Response category[1] percentage of respondents					Average score	Consensus[2]	Statistical significance of response[3]
	1	2	3	DK	N/A			
Company web pages	71	17	11	2	0	1.39	Medium	Effective
Annual corporate report	66	25	9	0	0	1.44	Medium	Effective
Press releases	63	22	11	2	3	1.45	Medium	Effective
Annual review	45	22	6	5	22	1.47	High	Effective
Company newsletters (external)	29	22	11	3	35	1.70	Low	Effective
Corporate social responsibility report	22	38	14	6	19	1.89	Medium	Neutral

Notes

1. Response categories are: 1=effective, 2=neutral, 3=ineffective, DK=don't know; N/A=not applicable.
2. Standard deviation of less than or equal to 0.65 = high consensus; standard deviation of greater than 0.65 and less than or equal to 0.75 = medium consensus; standard deviation of greater than 0.75 = low consensus.
3. Based on statistical test to identify if average scores are significantly different from 2-neutral.

'Company web pages' were considered the most effective written communication for disclosing marketing/customer relations information externally, with approximately 71% of respondents viewing it as effective. As one interviewee put it:

> *Whenever people are considering working with us, nine times out of ten they'll have gone to your website and formed a view on what is on your website, and so the web is absolutely fundamental to the business because it sets expectations before they've even talked to you.* [MD3]

The annual report was considered to be effective by 66% of questionnaire respondents with an average score of 1.44. However, it was evident from the interviews that, despite its effectiveness, the annual report's impact was viewed as limited in relation to the external disclosure of marketing/customer relations information:

> *Well it's not the case of it* [the annual report] *isn't effective, but it only reaches certain people.* [MD3]

> *I absolutely view it* [the corporate annual report] *as a marketing document. But I understand the audience who it's talking to is very limited to those who are wanting to invest in your company, rather than take products out with you.* [MD1]

> *The people you actually want to read the annual report are prospective customers, they don't read those, they don't care.* [MD4]

Several interviewees appeared to have a very negative view in relation to the effectiveness of the annual report in the current climate. Their negativity appeared to stem from both the timeliness of the information and the amount of mandatory and standardised disclosure required under current regulations:

> *For me it's* [the annual report] *an anachronism. The days of hard copy annual report are, in my view, over. Nobody cares.* [MD4]

> *Annual reports are an annual snapshot in time and worse than that, they are an annual snapshot that is typically procured and published four or five months after the year ended. So you could be looking at information that's twenty months old – who cares?* [MD4]

> *There should be a printing press set up somewhere that does the standard 97 pages at the back of every report and accounts, because it's always the same, just change the numbers. Who cares frankly? Have the auditors signed you off as being moral, ethical and non-fattening? Yes, lovely, that's it they're legal. So all the rest is kind of pants!* [MD2]

Approximately 63% of questionnaire respondents viewed press releases as an effective channel of communication. The importance of press releases was also highlighted during the interviews:

> *Press releases are bread and butter for us and particularly when you look at how the web feeds have developed now. The press release will get quickly dropped into any number of e-newsletters and e-zines*[1]. [MD3]

> *Press releases are much more aimed at people who are not customers, they are much more aimed at the wider community and just informing people you are active in doing things. Making sure people understand we're still here, we're still alive, we're still doing well, is actually one of the key things we have to deliver to the organisation.* [MD4]

> *We like to put announcements out any time we do a major deal because that shows how more and more people are using our technology – that adds value externally.* [MD3]

External company newsletters were viewed as effective by only 29% of respondents. From the interviews, company newsletters seemed to primarily focus on internal communication with employees. As one interviewee put it:

> *Company newsletters are all about keeping your own staff and existing customer base informed about how wonderfully you're doing.* [MD4]

The corporate social responsibility report was considered an effective channel of communicating marketing/customer relations information by only 22% of questionnaire respondents and on average it was deemed to be neutral. Questionnaire respondents were asked to state any other effective channels of communication for marketing/customer relations information. Trade shows, conferences and events for customers/prospects were widely cited as effective channels for face-to-face communication externally. This view was also evident from the interviews:

> *We will go to our major industry conference and our customers will be part of the audience.* [MD4]

> *We have country based user groups where we will get people* [customers] *together usually at a relatively technical level. I organise a global conference which we call our customer advisory board, which aims to get our top twenty five customers around the world together for a three day conference. The opening of the conference is spent with them telling us what their fundamental business and technology drivers are for next year.* [MD4]

> *If correctly targeted it's* [trade show] *extremely effective. The primary purpose we're there is because all the people we want to speak to are there too.* [MD3]

A further explanation as to the effectiveness of this type of face-to-face communication was suggested by one of the interviewees:

> *We tend to use face-to-face communication, or verbal communication, you can be much more open, because it's not traceable, to be honest.* [MD4]

This appears to suggest that the same information is not disclosed in the same away across all channels of communication. From the interviews, it was apparent that this was indeed the case:

> *I like to think that every channel we use we package it differently. The core of it will be the same information but we package it differently. The level of detail we'll go into on the web pages will be more than we'll put into our annual report.* [MD3]

During the interviews it was evident that the marketing function is one of the significant contributors to corporate external communication. This justifies the inclusion of the views and opinions of marketing functional specialists in the present research:

> *Marketing drives external communication in this company in all aspects. We work as a team between CEO and CFO.* [MD3]
>
> *It's* [the annual report] *the one piece of external collateral over which marketing does not have complete control, we own everything else. We don't own the annual report, the finance department own that, but we control things like the look, the feel, the photography, the imagery, the style. We write all the solutions stuff, we largely create the corporate social responsibility section and we will comment and edit major commentaries upfront.* [MD4]

Summary: marketing directors' views

The evidence presented in this chapter supports the following main conclusions regarding marketing directors' views:

- *RQ1: Marketing/customer relations components* – all of the marketing/customer relations components investigated contribute to company value to some degree. 'Customer relationships' contribute to company value the most. 'Company reputation', 'competitive edge in terms of quality of product/service', and 'data/knowledge of customers' were also ranked in the top four components. 'Data/knowledge of customers' is important in generating new business. It is difficult to separately identify the importance of components as many are interrelated.
- *RQ2: Internal use and external disclosure of relational capital* – 'data/knowledge of customers', 'marketing strategies', 'customer relationships' and 'competitive edge in terms of cost of product/service' were the top four components used internally by company management. Companies struggle with methods of obtaining and coordinating information about their customers. External disclosure carries the risk of customer poaching by competitors. External disclosure of the majority of marketing/customer relations components is low.
- *RQ3a: Incentives to voluntarily disclose relational capital* – all of the reasons investigated provide an incentive to voluntarily disclosure marketing/customer relations information to some degree. Customer-focused incentives represented three of the top four incentives. The most important incentive was 'helping to create trustworthiness with customers'. There is a conflict between disclosing customer relationship information to create trust with potential customers and violating trust with existing

customers. Comparative statistics would be of benefit but only in the presence of industry performance indicators. This is difficult because different measures are important to different companies.

- *RQ3a: Disincentives to voluntarily disclose relational capital* – all of the reasons investigated provide a disincentive to the voluntary disclosure of marketing/customer relations information to some degree. 'Avoiding giving away "company secrets" or otherwise harming competitive position' was significantly more important than all other disincentives. Disclosure is a trade-off between providing information to customers and preventing competitors from receiving the information. Disclosure is not always within a company's control if they want to avoid potential legal/commercial penalties.

- *RQ4a: Communication channels* – all of the written communication channels investigated were considered effective for the external disclosure of marketing/customer relations information with the exception of the CSR report. Company web pages were the most effective. The annual report was criticised for the timeliness of information and the amount of mandatory and standardised disclosure required under current regulations. The primary focus for company newsletters is on internal communication with employees. Trade shows, conferences, and events for customers/prospects were widely cited as effective channels for face-to-face communication externally. The marketing function is one of the significant contributors to corporate external communication.

Endnote

1 E-zine is a generic term commonly applied to small magazines and newsletters distributed by any electronic method, for example, by electronic mail.

7 Conclusions

Introduction

This chapter begins by presenting the main findings of the study for the three respondent groups in relation to each of the main research issues. Subsequent sections cover: conclusions; policy implications; the contribution of the study; and further research.

Main findings of study

This study has undertaken questionnaire surveys of three key preparer groups drawn from UK domestic listed companies. Ninety three finance directors completed the main IC questionnaire (focussing on all three IC categories), with shorter variants being completed by 67 human resources specialists (focussing on human capital) and 68 marketing specialists (focussing on relational capital). Across the three groups, the 228 responses represent a 10.5% response rate. Seventeen follow-up interviews were conducted to explore the issues further.

Importance of IC in value creation (RQ1)

Consistent with the high and variable market-to-book values observed in practice, the majority of finance directors believed that 50% or more of corporate value is attributable to IC. All 28 of the listed IC components were viewed by finance directors to contribute to company value to some degree. The top four comprised three relational capital components ('customer relationships'; 'competitive edge in terms of quality of product/service'; and 'company reputation') and one human capital component ('employee skills and education'). The functional specialists believed that all 18 detailed human capital components and all 18 detailed relational capital components contributed to company value to some degree. 'Employee skills and education'; 'employee commitment'; 'positive employee attitudes'; and 'positive employee behaviour' were ranked the top four human capital components. 'Customer relationships'; 'company reputation'; 'competitive edge in terms of quality of product/service'; and 'data/knowledge of customers' were ranked the top four relational capital components. However, the high level of variation in responses relating to individual components was striking.

Insights into these rankings were provided by the interviews, and emphasised the relatedness and interactions between components. For example, the interaction between individual human capital components such as skills, attitude and behaviour is important in the value creation process. Additionally, human capital components connect with the other IC categories of structural and relational capital and become transformed into the categories of IC which the market focuses on as value drivers.

Internal management use compared with external disclosure (RQ2)

Functional specialists indicated the level of internal management use and external disclosure of the detailed components, allowing the levels to be contrasted. For human capital, 'employee training and development'; 'workplace safety'; 'employee remuneration procedures'; 'employee turnover'; and 'recruitment and selection procedures' were the top four components used internally by company management (by 82% or more). However, with the exception of 'workplace safety', external disclosure of the vast majority of human capital components was low (under 50%). Interviews revealed that companies attempted to capture information on the less tangible human capital components through opinion surveys, appraisal reviews and manager observation. For relational capital, 'data/knowledge of customers'; 'marketing strategies'; 'customer relationships'; and 'competitive edge in terms of cost of product/service' were the top four components used internally by company management. Interestingly, however, these were not the components most frequently disclosed externally (which were 'brand names' and 'product portfolio'). Interviews revealed that external disclosure of customer components carried the risk of customer poaching by competitors. Companies struggled with methods of obtaining and coordinating information about their customers.

Incentives and disincentives in relation to IC disclosure (RQ3)

All of the listed incentives and disincentives were believed to significantly affect the voluntary disclosure of IC, although the average importance varied considerably. Finance directors evaluated 18 incentives and 13 disincentives while the specialist evaluated 13 incentives and four disincentives. The items listed for each group overlapped to some extent. Finance directors considered that capital market-related incentives dominated the disclosure of IC information in general, followed in the mid-ranks by marketing-related incentives and finally human capital-related incentives. The opportunity to increase transparency to capital markets in terms of 'helping to correct an undervalued share price' was significantly more important than all other incentives. It was found that the importance of incentives varied according to the category of IC information being disclosed. 'Helping to correct an undervalued share price' was most important in the disclosure of both structural and relational capital, whereas 'helping to create trustworthiness with employees' was most important in the disclosure of human capital. Capital market incentives dominated the disclosure of structural capital. However, the disclosure of human capital and relational capital were also driven by incentives which relate to the category of information being disclosed.

The human resources specialists reported that 'helping to attract new employees of high calibre' and 'helping to retain employees of high calibre' were the most important incentives in relation to human capital, while finance directors rated 'revealing to outsiders the skill level of our managers' as the highest human capital component. The marketing specialists viewed customer-focused incentives as the leading marketing-related incentives. The most important incentive was 'helping to create trustworthiness with customers'.

The interviews offered insights into the conflict between disclosing customer relationship information to create trust with potential customers and violating trust with existing customers. Comparative statistics (KPIs) were deemed to be of value for benchmarking purposes only in the presence of industry performance indicators. It was recognised that the standardisation of such indicators is difficult because different measures are important to different companies.

In terms of disincentives, 'avoiding giving away "company secrets" or otherwise harming competitive position' was the most important disincentive for all three groups. 'Preventing the creation of unrealistic expectations' and 'avoiding setting a disclosure precedent' were ranked second and third in importance, respectively. Finance directors did not consider that the importance attached to these disincentives varied significantly across the three categories of IC information. It became clear during interviews that competitive disadvantage is not always a disincentive to IC disclosure, suggesting that IC disclosure drivers are very much situation-specific. Additional disincentives mentioned by human resources specialists included internal data capture, comparability, and relevance. The marketing specialists emphasised that disclosure is a trade-off between providing information to customers and preventing competitors from receiving the information. Disclosure is not always within a company's control if they want to avoid potential legal/commercial penalties.

Communication channels for IC disclosure and the role of the annual report (RQ4)

Finance directors evaluated a list of 14 alternative communication channels in relation to each of the three categories of IC, with both specialist groups evaluating a shorter list of six written channels in relation to their functional category of IC. Finance directors evaluated 'one-to-one meetings with investors', 'one-to-one meetings with analysts' and 'investor presentations' as the three most effective communication channels for disclosing all three categories of IC information. Several other channels were also effective, including the 'annual corporate report' and 'company web pages'. The 'interim report' and 'conference calls' were considered ineffective for all three IC categories. Human resources specialists rated the corporate annual report as the most effective channel, significantly higher than the other channels, whereas marketing specialists rated company web pages as marginally more effective than the annual report.

The annual report was considered effective in communicating basic IC information; however its usefulness for communicating complex IC information or new, previously undisclosed IC information was questioned. Companies used various channels to communicate IC information and a number of them appear to present or package the information in a different manner according to the communication channel being used. Interviews revealed that both the human resources function and the marketing function contributed significantly to the content of the annual report. For the human resources specialists, the importance of communication to employees took precedence over the external communication about human resources. The marketing specialists cited trade shows, conferences, and events for customers/prospects as effective channels for face-to-face communication externally.

Conclusions

The importance of IC to the creation of company value is confirmed, as is the importance of each main IC category and the components of each category. Clearly, therefore, accounting for IC (also known as intangibles or knowledge resources) matters. The principal themes running through the findings of this study are diversity and the situation-specific nature of IC and, therefore, its disclosure (in terms of IC information content and communication channels). Several findings illustrate these themes. First, the high level of variation in responses relating to the importance of individual IC components for value creation suggests that IC is situation-specific, driven by each company's individual business model.

Second, the incentives to disclose IC externally are found to vary by IC category (although the disincentives did not).

Third, competitive disadvantage, the main disincentive on average, consistent with the findings of several prior studies, was not a disincentive in the eyes of all respondents. This also suggests that IC disclosure drivers are situation-specific. So too, does the finding that disclosure is constrained by regulation in some industry sectors (e.g. pharmaceutical, defence) and by customer sensitivities in others. Disclosure about customer relationships can sometimes create trust with potential customers only at the expense of undermining the trust of existing customers.

Fourth, the relative importance of the incentives to disclose IC vary by the functional area of respondents, with finance directors emphasising capital-market-related incentives. However, from the perspective of the marketing specialists, relational capital disclosures could assist in gaining repeat and new business from customers; from the perspective of the human resources specialists, human capital disclosure could assist in the retention and recruitment of high calibre employees. Indeed, company value itself is enhanced through the mere disclosure of these value-creating IC components, consistent with Toms (2002) suggestion.

Finally, a range of communication channels were used to communicate IC information, consistent with the findings of Unerman *et al*. (2007); moreover, some variation occurred in channel use for each IC category. Each channel appeared to call for a different packaging of the information.

Policy implications

Since it is shown that IC matters in value creation, it is incumbent upon the accounting profession to work with the various interested parties to develop and implement external reporting standards and guidelines that optimally trade-off the benefits and costs of disclosure in relation to stakeholder groups. The investor group wishes information for valuation purposes, but would not want disclosure to adversely impact shareholder value; other stakeholder groups also have an interest in knowing about aspects of companies' IC.

Establishing what IC information should be disclosed, in what format and through what mix of channels is a complex issue. Inevitably, one is left questioning whether meaningful and effective regulation in this area is desirable. If so, at what level should it operate – specific rules/guidelines that apply universally across industries, rules/guidelines specific to industry sectors (with the level of granularity of industry sector to be defined at a high, mid or low level), or generic rules/guidelines that permit company-specific application?

Owing to the situation-specific nature of IC, it would seem that regulators can't hope to address this issue in its entirety. The participants in this study appear to support the development of standardised industry benchmarks for key IC component groups. A degree of IC is unique to individual companies and the company is best placed to describe this uniqueness in its own terms. However, there does appear to be some common ground. This study has, for example, highlighted those relational capital and human capital components which are considered by a representative cross-section of preparers to be significantly more important than other components. These key components provide a focus for future research – what do they mean in different companies and how do they create value?

There is an opportunity to investigate whether a set of industry-specific standardised metrics can be developed and their disclosure regulated. Regulators and other stakeholders need to be fully aware of the industry constraints which prevent disclosure, specifically in relation to customers and products. Further research into constraints across all industries would appear to be a necessary precursor to industry disclosure standards.

Our principal recommendation is for the IASB to find the resources to place the intangibles project on its active agenda. This will help to generate further research into IC, its measurement and its disclosure. The IASB should not procrastinate in this area, as the future of the accounting profession and its role as the key reporting function depends on it.

Contribution

This study makes three contributions to the literature on IC. First, it investigates, for the first time, the views of key personnel regarding the nature of IC, its measurement and its disclosure across the finance, human resources and marketing functions. Second, it investigates whether disclosure incentives and disincentives vary across the three main IC categories. Third, it undertakes a large-scale questionnaire of UK preparers' views regarding IC and its disclosure. The findings add to the significant body of ICAS-funded research on intangibles and IC in the UK (Fincham and Roslender, 2003; Holland, 2004; Davison and Skerratt, 2006; Mangena *et al.*, 2010; and Roslender *et al.*, 2009).

Further research

No study can hope to address all of the aspects of a particular issue. Three suggestions for further research emerge naturally from the research presented here. First, preparer responses from three functional areas are presented here. It would be interesting to extend the research by surveying corporate decision makers without functional responsibilities, such as the chairman, the CEO and other non-executive board members. This would provide insights into the importance of IC relative to other board issues. In addition, it would be interesting to compare and contrast the views of key corporate advisors, shareholders and other stakeholder groups. Second, future research could usefully undertake more finely grained analysis at the industry level, to identify possible industry patterns in the relative importance of IC components in value creation. Third, it would be very interesting to undertake a longitudinal analysis of market-to-book values, to investigate the impact of the recent financial crisis.

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APPENDIX 1

Intellectual capital terms identified from prior literature

Human capital	Structural capital	Relational capital
Absence	Achieving mechanism culture	Basic marketing capability
Adaptability	Administrative processes	Brands
Attitudes	Brands	Business collaborations
Capability/abilities	Communication systems	Client profile
Commitment	Competitive and market channels	Collaboration
Communicative abilities	Copyrights	Commercial power
Competence	Corporate/organisational culture	Competitive intelligence
Computer literacy	Cultural diversity	Competitors
Creativity	Culture	Connectivity
Development	Customer support	Customer knowledge
Education	Customer-centred	Customer loyalty
Employee expertise	Databases	Customer names
Employee flexibility	Distribution channels	Customer reputation
Employee knowledge	Documentation services	Customer satisfaction
Employee productivity	Financial relations	Customers
Employee satisfaction	Infrastructure	Diffusion
Employee value	Innovation	Distribution channels
Employees	Intellectual property	Environmental activities
Entrepreneurial spirit	Intellectual resources	Favourable contracts
Equality	Knowledge centre	Financial contracts
Expert networks	Knowledge-based infrastructure	Franchising agreements
Expert teams	Laboratories	Image
Friendliness	Management philosophy	Intensity
Further personal/ professional training	Management processes	Knowledge/acquaintance with community
Human assets	Operation process	Knowledge/acquaintance with government
Human resources	Organisational flexibility	Knowledge/acquaintance with suppliers
Human value	Organisational learning	Licensing agreements

Intellectual capital terms identified from prior literature (Cont.)

Human capital	Structural capital	Relational capital
Identification	Organisational routines	Links with suppliers
Innovation	Organisational structure	Market intensity
Innovative capacity	Patents	Negotiating capacity with financial entities
Juristic competence	Procedures	Networking
Know-how (employees)	Process capability	New strategic customers
Learning capacity	Quality improvements	Reputation
Loyalty to organisation	Quality management	Research collaborations
Motivation	Research projects	Stakeholders
Perceptions	Specialised software/IT	Supplier knowledge
Personal/professional experience	Systems (information/network)	
Personal ability	Trademarks	
Personnel		
Recruitment		
Reflect experiences (previous)		
Sensitivity		
Skill (employees)		
Social competence		
Staff (employee) profile		
Staff turnover		
Structural knowledge		
Taking responsibility		
Teamwork capacity		
Tolerance for ambiguity		
Up-to-date competence		
Vocational qualifications		
Work-related competencies		
Work-related knowledge		

Source: Beattie and Thomson (2004)

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Intellectual Capital Reporting: Academic Utopia or Corporate Reality in a Brave New World?

Intellectual capital creates company value but generally this value is not recognised in the financial statements of companies. This report moves forward the debate on how intellectual capital should be recognised and/or disclosed in the annual reports of companies by offering new evidence regarding the views of finance directors, human resources specialists and marketing specialists, all of whom have a particular interest in intellectual capital resources.

The issues investigated include: the relative importance of intellectual capital components to the generation of company value; the level of internal management use compared to external disclosure of intellectual capital; the incentives and disincentives for disclosure; and the effectiveness of the annual report and other forms of corporate communication for the disclosure of intellectual capital.

The generally high level of variation in responses shows that there is considerable diversity in the extent of company value attributable to intellectual capital and in disclosure incentives and disincentives and hence in disclosure content and the communication channels used. The authors conclude that it is this diversity which represents the most significant challenge to standard-setters as they consider how to address intellectual capital reporting.

ISBN 978-1-904574-63-7
EAN 9781904574637

Price: £15.00

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