ISSUES ASSOCIATED WITH IDENTIFICATION OF INTELLECTUAL CAPITAL: AN EXPLORATION

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ABSTRACT

This era of business world is dependent upon the working of intellectual capital as intangibles to a large extent. Academicians as well people from the corporate fraternity are striving in finding or developing a measure to assess and manage the intellectual capital but prior to this, identification of the same is fairly required. Identification of intellectual capital has always been a big challenge in front of people connected to it because of its intangible nature and ambiguity lying with it. In this treatise an attempt has been made by the authors to explore the issues related to the identification of intellectual capital. Some of intangibles are “recognized” and have an attributed value in the financial statements but some of the intangible assets fails to meet the criteria for recognition under current national and international reporting standards, the identification, assessment, management, control, retention, and nurturing of these assets is necessary for an organization to maintain its capacity to operate.

KEYWORDS: Intellectual Capital, Intangible assets, Recognition and Identification, AS 26, IFRS 38, IFRS 3.

INTRODUCTION

In order to attain and maintain market share in the market, every business firm have to strive and to keep pace with the changing the nature of business world. And today’s main value driver of a firm is associated with intangibles or intellectual capital. Several methods have been developed on the measurement and management of intellectual capital, but there are few common problems with these models that are all of much customised nature and are not successful in assessing true value of intellectual capital or intangibles. And before measurement and management of intellectual capital the first step is to identification of intellectual capital, several conceptualisation have been made in studies (Bontis, 1998; Galbraith, 1969; Brooking, 1996; A Dictionary of Business and Management, 2006; Sveiby, 1997; Guilding and Pike, 1990; Leliaert et. al., 2003; Stewart, 1997; Choudhary, 2010; Bontis et. al., 2000; Edvinsson and Malone, 1997; Edvinsson and Sullivan, 1996; Roos et. al., 1997; Saint-Onge, 1996)
concomitant to intellectual capital no one is successful in identifying the components of intellectual capital. Identification of intellectual capital has always been a big challenge in front of people connected to it because of its intangible nature and ambiguity lying with it.

1 (a) Market capitalisation method which includes models eg. Market to book value, Tobin’s Q, Invisible balance sheet, Knowledge capital earning, EVA\textsuperscript{tm}, Calculated intangible value, IAMV\textsuperscript{tm}, FIMIAM, VAIC, (b) Direct Intellectual Capital method which include models eg. Citation weighted patents, Intellectual Asset valuation, The Value Explorer\textsuperscript{tm}, Inclusive Valuation Methodology, EVVICAETM, FIMIAM, (c) Score Card Method which includes models eg. IC index, IC Ratings, Merritum Guidelines, Balance Score Card, MAGIC, IC- dVAL, Value Chain Score Card, Skandia Navigator\textsuperscript{TM}, Knowledge Audit Cycle, BusinessIQ\textsuperscript{TM}, Danish Guidelines, National IC, (d) Return on Asset Method which include models eg. VAICTM, EVATM, Calculated Intangible Value, Knowledge Capital Earnings.

Intellectual capital hardly influence performance directly, instead, they work indirectly through relationships of cause and effect (Kaplan and Norton, 2004). It is essential to recognise that intangibles are not per se sufficient for organization’s successful performance. As yet there is no universal definition for intellectual capital as the nature of intellectual capital is still unknown and hard to capture in explicit terms (Seetharaman et al., 2002). (Bontis, 1998) and (Ross Dawson, 2000, p.43), identified the three most common components in the intellectual capital concept: human capital, structural capital and relational capital.

There are umpteen reasons why an organisation should identify, measure and manage intangible assets. First is a related legal formality, means to comply with legislation, such as the recent changes to the Companies Act that seeks organisation to furnish an OFR (Operating and Financial Review) Regulation, second, corporate governance pressure, third is for corporate social responsibility and most important reason is, it adds value to business.

**REVIEW OF ALREADY IDENTIFIED COMPONENTS OF INTELLECTUAL CAPITAL**

In previous studies, since last decade, intellectual capital has been broken down into three main types of capital, e.g. Human Capital, Relational Capital, and Structural (Organisational) Capital. (Edvinson and Malone, 1997: 44), defined intellectual capital in the following way:

“Intellectual Capital is the possession of the knowledge, applied experience, organisational technology, customer relationships and professional skills that provide Skandia with a competitive edge in the market”

An intangible asset other than goodwill is defined as "[a]n identifiable non-monetary asset without physical substance" (IFRS 3.A). (Stewart, 1997), broadened the definition to IC as “intellectual material – knowledge, information, intellectual property, experience – that can be put to use to create wealth” by developing competitive advantage in an organization.
(A Dictionary of Business and Management, 2006), infers that “intellectual capital” is a complex concept that includes human knowledge, information systems, brand names, and reputation. One popular definition is given by the equation:

\[ \text{Intellectual capital} = \text{human capital} + \text{structural capital} + \text{relationship capital}. \]

Here human capital includes knowledge, competences, and the experience and expertise of staff, structural capital includes information systems and databases, and relationship (or customer) capital includes customer relationships, brands, and trademarks.

In other words (Choudhary, 2010), Intellectual capital can be defined as the ‘economic value’ of three categories of intangible assets of a company—— that includes human capital, organisational capital and social capital collectively. Intellectual capital is “firm’s overall or holistic capacity and capability which emerges from its creative and flexible orchestration and co-ordination of its human capital, innovativeness, competencies and capabilities, streamlined processes and expertise, replacing customer capital with relational capital by Nick Bontis (Bontis, 1996). Classification of Intellectual Capital, (IFAC, 1998, Source: ICS, Research Reports)

Human Capital = Know-how, Education, Vocational qualification, Work-related knowledge, Occupational assessments, Work-related competencies, Entrepreneurial élan, innovativeness, proactive and reactive abilities, and changeability.

Organisational Capital (Structural Capital) = Intellectual Property, Patents, Copyrights, Design rights, Trade secrets, Trademarks, Service marks.

Relational (Customer) Capital = Brands, Customers, Customer loyalty, Company names, Backlog orders, Distribution channels, Business collaborations, Licensing agreements, Favourable contracts, Franchising agreements

(Sveiby, 1997), divided intellectual capital in three parts. First employees` competences, second internal structure and third external structure. The first is ability of acting in a variety of situations to create tangible and intangible assets using their experience and education. Internal structure consists of patents, concepts, models and IT systems. The external structure includes relations with clients and suppliers. It includes brands, reputations and images. According to Edvinsson and Malone (1997), IC takes three basic forms: human capital, structural capital, and customer capital.

1. Human capital includes knowledge, skills, and abilities of employees. It is an organization’s combined human capability for solving business problems.

2. Structural capital is everything in an organization that supports employees (human capital) in their work. It is the supportive infrastructure that enables human capital to function. Because of its diverse components, (Edvinsson and Malone, 1997) classify structural capital further into organizational, process, innovation and intangible capital.

   – Organizational capital includes the organization philosophy and systems for leveraging the organization’s capability.
– Process capital includes the techniques, procedures, and programs that implement and enhance the delivery of goods and services.

– Innovation capital includes intellectual properties and intangible capital. Intellectual properties are protected by commercial rights, such as patents, copyrights and trademarks.

– Intangible capital is all of the other talents and theory by which an organization is run.

3. Customer capital is the strength and loyalty of customer relations. The relationship with customers is distinct from other relationships either within or outside an organization. (Roos, et. al., 2005) divide intellectual capital into three categories based on their economic behaviour. These are (1) Relational which include all the relationships that the organisation has, such as customers, consumers, intermediaries, representatives, suppliers, partners, owners, lenders, and the like., (2) Organisational means all those things that remain in the organisation when the employees have left the building but that you cannot find in the balance sheet. This includes resources such as brands, intellectual property, processes, systems, organisational structures, information (on paper or in data bases), and the like., (3) Human which includes all the attributes that relate to individuals as resources for the company and under the requirement that these attributes cannot be replaced by machines or written down on a piece of paper. This includes resources such as competence, attitude, skill, tacit knowledge, personal networks, and the like. Define by (Bontis et. al., 2000), and its key dimensions and with their sub factor of each of these dimensions and their measurement indicators. In their model, the three dimensions (Human, Structural and Relational) of Intellectual Capital are further subdivided into sub factors. The dimensions of Human Capital includes: - employees’ capability, employees’ satisfaction, and employee sustainability. Structural Capital comprises the sub factors culture, organizational process, information system and intellectual property, while Relational Capital is divided into three sub factors customer, partner and community. (Brooking, 1996), classified intellectual capital in: market assets, assets centered on humans, intellectual property and infrastructure assets. Market assets consists in the potential that an organization has due to intangibles related to the market that gives a competitive advantage like clients’ loyalty, brands, distribution channel, contracts and advertisement. Assets centered on humans are composed by experience, creativity, solving problems ability, and leadership, entrepreneurship, and management skills such as psychometric data and to perform under great stress. Infrastructure assets are technology, methodologies, corporate culture, hedging, data cases, communication systems, etc. Intellectual property is know-how, trade secrets, trademarks, patents and design rights. (Guthrie et. al., 2003), classified the intellectual capital in human capital, structural capital and relation capital. Human capital is further classified into people competence, competence improvement, staff structure and stability, structural capital is classified into process technology and IT penetration, business philosophy, organisation structure and intellectual property and relation capital is classified into customer base, customer loyalty, market proximity, suppliers and interrelation with other actors.
### LOGICAL CATEGORISATION OF INTANGIBLE ASSETS

<table>
<thead>
<tr>
<th>Human capital</th>
<th>Organisational Capital</th>
<th>Relational Capital</th>
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<tbody>
<tr>
<td>Employee Satisfaction</td>
<td>Conducive atmosphere</td>
<td>Relationship with customer/client</td>
</tr>
<tr>
<td>Consistence performance of employees</td>
<td>Grievance Redressal Mechanism</td>
<td>Relationship with suppliers</td>
</tr>
<tr>
<td>Proper coordination</td>
<td>Research and Development</td>
<td>Relationship with alliances/partners</td>
</tr>
<tr>
<td>Employees capability of understanding target market</td>
<td>Intellectual Property Rights</td>
<td>Relationship with Govt.</td>
</tr>
<tr>
<td>Employee sustainability</td>
<td>No. of Licensed Software</td>
<td>Relationship with Public/society</td>
</tr>
<tr>
<td>Internal relations</td>
<td>No. of Licensed E-Resource</td>
<td>Relationship with Environment</td>
</tr>
<tr>
<td>Employee’s skill, knowledge, experiences and expertise</td>
<td>Information system</td>
<td>Brand, Images and Network</td>
</tr>
<tr>
<td>Entrepreneurial élan</td>
<td>Internal good practises</td>
<td>Feedback from customers</td>
</tr>
<tr>
<td>Innovativeness</td>
<td>Process and procedure</td>
<td>Relationship with intermediaries</td>
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<tr>
<td>Proactive and reactive abilities</td>
<td>Loyalty and goodwill among stakeholders</td>
<td>Backlog orders</td>
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<tr>
<td>Changeability.</td>
<td>Quality of service or product</td>
<td>Distribution channels</td>
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<td>Organisational structure</td>
<td>Business collaborations</td>
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<td>Business philosophy</td>
<td>Licensing agreements</td>
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<td>Favourable contracts</td>
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<td>Franchising agreements</td>
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(Source: Self developed by the authors themselves)
Identifiability of Intangible Assets under International Financial Reporting Standards 38 (for intangibles) and International Financial Reporting Standards 3 (Business Combinations)

The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

(a) The definition of an intangible asset; and

(b) The recognition criteria.

This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it.

An asset is identifiable if it either:

(a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

(b) Arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

An intangible asset shall be recognised if, and only if:

(a) It is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) The cost of the asset can be measured reliably.

DISCUSSION AND CONCLUSION

As per Financial Reporting Standards all intangibles not comes under the area of identifiability and recognition, which leads to organisations in lots of dilemma concomitant to ascertainment of the true value of intangibles. And for ascertainment of true value of intangibles or intellectual capital of organisations due diligence is must, in which our Financial Reporting Standards are lacking. Several studies and researches have also been done in this regard; up to some extent they are quite successful in identifying intangibles or intellectual capital of an organisation but not fully and bearing lots of ambiguity in this regard. Previous studies segregate intellectual Capital into human capital, relational capital, and structural (organisational) capital. In first component, all concentration is given to human but the journey is not over; it probably never will be. The exploration of intellectual capital and, more generally, management science is dynamic process which will always turn up new areas to explore. It is difficult to provide a unified definition of Intellectual Capital, and even more difficult it is to propose a commonly accepted typology for it, because this phenomenon still is at an emerging stage of development (Martín-de-Castro et. al, 2010). As can be concluded from it, the term has not yet solidified, and its identification with the concept of ‘capital’- in accountability terms- presents controversy (Dean and Kretschner, 2007).
Besides so many controversies and complexities pertaining to the components of intellectual capital, it is badly needed for making a measure to measure the intellectual capital, so that proper management of intellectual capital in the organisational could be possible in order to sustain in the market for long. By reviewing several studies and going through the Accounting Standards pertaining to it, it felt that due diligence must be given to identify the components or variables of intellectual capital, so that no single variable be left. In the previous extraction is found that, they are lacking in inclusion of variables which plays significant role in enhancing value of business organisation.

REFERENCES


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