UK REPORTING OF INTELLECTUAL CAPITAL

A report by
Professor Jeffrey Unerman, Royal Holloway, University of London, UK
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Dr Ludmila Striukova, Roehampton University, UK
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Professor Jeffrey Unerman
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## List of abbreviations

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<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>DIC</td>
<td>Direct intellectual capital methods (for measuring intellectual capital)</td>
</tr>
<tr>
<td>DMSTI</td>
<td>Danish Ministry of Science, Technology and Innovation</td>
</tr>
<tr>
<td>IC</td>
<td>Intellectual capital</td>
</tr>
<tr>
<td>ICAEW</td>
<td>Institute of Chartered Accountants in England and Wales</td>
</tr>
<tr>
<td>ICD</td>
<td>Intellectual capital disclosure</td>
</tr>
<tr>
<td>ICR</td>
<td>Intellectual capital reporting</td>
</tr>
<tr>
<td>MCM</td>
<td>Market capitalisation methods (for measuring intellectual capital)</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on assets methods (for measuring intellectual capital)</td>
</tr>
<tr>
<td>SC</td>
<td>Scorecard methods (for measuring intellectual capital)</td>
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Recent years have witnessed a substantial increase in the significance of intangible knowledge-based factors in driving business success. Many sectors in the UK, EU and global economy rely on such intellectual value drivers to a much greater extent than they rely upon more traditional tangible resources. Even in sectors which still substantially rely upon more traditional tangible value drivers, competitive advantage often depends upon how intellectual factors are coupled with tangible resources to differentiate the operations of one business (or economy) from its competitors.

With this growth in significance of intangible, knowledge-based, intellectual factors (often referred to as intellectual capital) in driving business success, it is important that accounting and reporting practices develop to effectively account for these major aspects of business performance. In the area of corporate reporting, accountancy practices historically evolved to enable managers to report to external stakeholders (primarily providers of capital) on managers’ stewardship of tangible resources. Now financial accounting and reporting practice needs to continue to adapt to provide stakeholders (especially shareholders and investment advisors) with effective information regarding the key intellectual capital (IC) value drivers of any business. Without the provision of such information, corporate reports would be an ineffective medium for stakeholders to rely upon when making decisions, such as investors' decisions regarding whether to buy, hold or sell shares.

This research report explains and analyses the results of an empirical investigation into the intellectual capital reporting (ICR) practices of UK companies in four distinct sectors, using content analysis and interviews. It differs from prior ICR studies in two distinct ways. Firstly, it examines a wide range of corporate media for their IC content, in contrast to prior studies which have tended to focus on the annual report and/or intellectual capital statement. Secondly, it explores the motivations of those preparing corporate reports in voluntarily reporting IC information.

Therefore, the study addresses two main research objectives. Firstly, it seeks to ascertain the type, amount and patterns of intellectual capital disclosures (ICD) reported via different media among a selection of large UK companies from four distinct sectors (information technology/software; pharmaceuticals/biotechnology; retail; and real estate/utilities). Secondly, it aims to understand, through in-depth interviews, the motivations of those preparing the different reporting media for their voluntary provision of external ICR information – including their perceptions regarding how they can effectively report IC to capital markets.

Consistent with prior research into ICR, the study used a tripartite definition of IC, which separates IC value drivers into the following three broad categories:

- **internal (structural) capital** refers to the structures and processes employees develop and deploy in order to be productive, effective and innovative;

- **external (relational) capital** refers to an organisation’s relationships with external stakeholders be they suppliers, customers, the community or others; and
• **competence (human) capital** refers to the skills, attitudes, abilities, competencies and qualities of an organisation's employees.

Among the key findings of this study are:

• A wide range of media were used to report ICDs, with the annual report accounting for less than a third of total ICDs across all reporting media. Furthermore, the pattern of ICDs in the annual report did not reflect the pattern of ICDs in other reports, so examination of ICDs in annual reports was not a good proxy for overall ICD practices in the sample studied. This has significant implications for future ICR research studies, which should no longer focus exclusively on ICD in one type of statement, such as the annual report.

• The senior financial executives interviewed generally believed that ICDs in the annual report had little, if any, information content of value beyond confirming information that had been released to capital markets through other media during the preceding year. Indeed, there was a view that if an annual report contained new, unexpected key information, this may lead to concerns among analysts that the company had been withholding important information which should have been released to the market in a more timely manner. Therefore, while recognising the important confirmatory role that audited annual reports play in enhancing the credibility of information that has already been released during the accounting period, preparers did not consider the annual report to have new IC information content of value – other than by omission/exception.

• Each of the different media used in ICR were considered by managers to have different levels of effectiveness in communicating information about their IC value drivers. The most effective media was generally considered to be face-to-face meetings with analysts and investors (where information already in the public domain could be discussed and explained in an interactive manner), with the least effective being the annual report and accounts.

• Counter-intuitively, companies in the retail sector, which does not rely on IC value drivers to the same extent as the two ‘high’ IC reliance sectors studied (pharmaceuticals/ biotechnology and ICT/software), had a higher frequency of ICD than each of the other sectors. Furthermore, the ‘low’ expected IC sector (property/utilities) had approximately the same frequency of ICD per company as one of the ‘high’ IC sectors (ICT/software).

• Consistent with ICD analyses in other countries, disclosures in the external relational capital category of IC predominated. In the sample they accounted for 61% of overall ICDs across all reports studied.

• Disclosures in the external relational capital category of IC were much higher than disclosures in the other two IC categories for each of the sectors examined, other than the pharmaceutical/biotechnology sector where there was a more even balance between each of the three categories.

• The largest companies in the sample (seven FTSE 100 companies) on average had a much higher frequency of ICDs across all media types than the smaller companies in the sample. Again, this is consistent with other IC studies, which have tended to find a size effect.

• The senior financial executives interviewed had varying faith in the abilities of analysts from their sector to engage with, and understand the importance of, their IC value drivers. This level of faith seemed to depend partially upon how successful the sector was in stock market terms (with analysts in more ‘wealthy’ sectors having more...
resources to devote to understanding each company’s value drivers). The executives therefore considered that analysts did not always systematically understand their business in terms of IC value drivers.

- The senior financial executives were strongly opposed to the regulation of ICR, other than possibly at a very broad level.

- There were some perceived drawbacks and trade-offs in the provision of ICR information, but these were not considered to be major obstacles to the provision of some key IC information through corporate reports.

**Policy implications and recommendations**

Drawing out policy implications from this study has led to the following recommendations:

1. In addressing issues of whether corporate reporting can be effectively used to communicate information about IC to a variety of stakeholders, it was notable that most of the interviewees focused on the role of ICR in disseminating information about key IC value drivers to analysts and investors. If this focus is representative of the focus of account preparers in other companies, then any broadening of the use of corporate reports to communicate IC to a broader range of stakeholders will require a substantial shift in the focus and relative priorities of preparers of accounting reports.

2. Results from both the analysis of ICDs and the interviews indicate that while still playing a vital confirmatory role to enhance the credibility of information that has been released during the accounting period, traditional forms of reporting via the annual report are becoming ever less relevant and significant in communicating new and complex information about IC value drivers. Rather, use of analyst briefings was generally considered to be the most useful medium because this interactive medium was considered to be the most effective in communicating and explaining current information (already in the public domain) about conceptually more difficult value drivers. Websites were considered to be more effective than the annual report (partially because they could be updated regularly), and therefore a more important medium for ICR. These findings could apply to many other areas of corporate reporting, and might reflect a shift in accepted media for corporate reporting more generally – a shift which the accounting profession and accounting regulators will need to take into account in shaping future practices and regulations.

3. In respect of the voluntary versus mandatory status of ICR, the interviews found overwhelming reasoned opposition to ICR regulation at anything other than a very broad general level. The principal reason for this seemed to be that as every company’s key IC value drivers were specific to that company, detailed mandatory reporting would be far too restrictive to result in effective communication of these IC value drivers.

4. The senior financial executives interviewed considered a good understanding of IC to be important in understanding their business and the value of their business. Possibly because of this concern with effective communication of IC value drivers, the interviewees also expressed considerable opposition to any attempt to try to capture complex IC value drivers in quantified form, and recognised that such complex and company-specific issues are most effectively reported in narrative terms rather than attempting to reduce them to a common currency of a single monetary measure.
1. Introduction

1.1 The importance of intellectual capital reporting

Recent years have witnessed a substantial increase in the significance of intangible knowledge-based factors in driving business success. Many sectors in the UK, EU and global economy rely on such intellectual value drivers to a much greater extent than they rely upon more traditional tangible resources. Even in sectors that still substantially rely upon the more traditional tangible value drivers, competitive advantage often depends upon how intellectual factors are coupled with tangible resources to differentiate the operations of one business (or economy) from its competitors.

These intangible, knowledge-based, intellectual factors are often referred to as intellectual capital (IC). With IC’s growth in significance in driving business success, it is important that accounting and reporting practices develop to effectively account for these major aspects of business performance. In the area of corporate reporting, accountancy practices which historically evolved to enable managers to report to external stakeholders (primarily providers of capital) on managers’ stewardship of tangible resources need to continue to adapt to provide stakeholders with effective information regarding the key IC value drivers of any business. Without the provision of such information, corporate reports would be an ineffective medium for stakeholders to rely upon when making decisions, such as investors’ decisions regarding whether to buy, hold or sell shares.

If corporate reports fail to maintain their effectiveness in communicating key aspects and drivers of business performance in the evolving knowledge economy, the relevance and importance of corporate reporting and accounting may be brought into question. Without an understanding of extant practices in the area of intellectual capital reporting (ICR), which is currently largely unregulated, it is difficult to ascertain how effectively corporate reporting practices are developing to maintain their relevance.

While several studies have investigated corporate reporting of IC in a number of countries, relatively little research of this nature has been conducted into ICR practices in the UK. The aims of this research study are to add to our understanding of UK ICR practices, with this aim being addressed through analysis of the intellectual capital disclosures (ICD) in a range of corporate reporting media of a sample of companies quoted on the London Stock Exchange, and through interviewing senior financial executives from these companies to ascertain the key factors which appear to drive such practices.

To set the context for this study in greater depth, the following section explores several factors that have brought IC into prominence. It starts by examining key aspects of the economic environment which demonstrate the contemporary significance of IC, and then explains what is meant by the term intellectual capital as used in this research study. An understanding of what is encompassed by the term intellectual capital tends to vary, this is an important step in framing the remainder of the study. The subsequent section then explains the rise in importance of ICR, including discussion of how ICR is relevant to the ICAEW Information for Better Markets campaign. The chapter concludes by explaining in greater depth the aims and objectives of this study, linking these aims to the discussion in the rest of this chapter.
1.2 The intellectual capital context

1.2.1 Changing national economies

Over the past century, national economies have witnessed major transformations in the factors of economic production. The industrial economy (making tangible goods) in many Western nations has largely been superseded by the service economy (delivering knowledge solutions). In contemporary times, many organisations and national economies derive their competitive advantage from intangible, knowledge intensive resources – even where their main products derive from tangible forms of production (Boedker, Guthrie and Binney, 2007). Within this context, managing relationships, business structures and processes, information systems and technology, and human capital are critical to organisational wealth and sustainability (Holland, 2004, 2006; Roslender & Fincham, 2003).

Table 1.1 shows the major transformations in the structure of the Western economy. In service-based industries, which characterise the knowledge-based economy, intangible resources, be they relational, structural or human, constitute the main part of the value creation process. In 2003, service-based industries comprised over 68% of world GDP, up from 61% in 1990 (World Bank, 2005, table 4.2). Meanwhile, goods-producing industries contributed 28% to world GDP, down from 34% in 1990; and agriculture contributed 4%, down from 5% in 1990 (ibid).

Table 1.1: Economic transformations

<table>
<thead>
<tr>
<th>Economic Activity</th>
<th>Factors of Economic Production</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural Economy Pre-1800</td>
<td>Harvesting</td>
</tr>
<tr>
<td>Industrial Economy 18th to 20th century</td>
<td>Manufacturing</td>
</tr>
<tr>
<td>Knowledge Economy 20th century and onwards</td>
<td>Mediation of Knowledge and Services</td>
</tr>
<tr>
<td></td>
<td>• Land</td>
</tr>
<tr>
<td></td>
<td>• Land owners and workers</td>
</tr>
<tr>
<td></td>
<td>• Labour</td>
</tr>
<tr>
<td></td>
<td>• Machinery</td>
</tr>
<tr>
<td></td>
<td>• Raw material</td>
</tr>
<tr>
<td></td>
<td>• Relational capital</td>
</tr>
<tr>
<td></td>
<td>• Structural capital</td>
</tr>
<tr>
<td></td>
<td>• Human capital</td>
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</table>


In conjunction with the growth in importance of the knowledge economy, since the late 1980s there has been growing recognition among both business practitioners and academic communities that IC is an increasingly significant value driver for many organisations (European Commission, 2006; Guthrie & Petty, 2000b; Holland, 2004; Society for Knowledge Economics, 2005; Task Force on Human Capital Management, 2003).

1.2.2 Changing emphasis in the UK economy

Consistent with the growing importance of knowledge-based industries to the global economy, there has been a marked shift towards a knowledge-based economy in the UK. Figure 1.1, which is based on figures published in the UK Annual Business Information survey (ONS, 2006), illustrates the trends in value added by the manufacturing sector and the distribution and services sector over the 10 year period 1995 to 2004, as a proportion of value added by all businesses in the UK each year.1

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1. The percentages in Figure 1.1 do not add up to 100% in any year because the value added by some relatively small sectors, such as agriculture, fisheries, construction and power have not been shown in the analysis. Each of these sectors comprise substantially less than 5% of the total value added, other than construction which has ranged between 6% and 8% of value added annually during the period analysed in the graph.
Figure 1.1 clearly shows that not only do the distribution and services sectors account for a growing proportion of total gross value added by business activities in the UK, but together they have contributed over 50% of total value added for more than a decade now. As IC resources are also an important value driver in some manufacturing industries, these figures demonstrate how significant intangible knowledge-based IC resources are to UK businesses and the UK economy, and consequently how important it is for corporate reporting to effectively communicate information about the existence and management of IC.

As will be seen in Chapter 2, various models have been proposed to help classify, measure and report IC. Therefore, an understanding of the way in which IC is defined in any study is an important factor in understanding the results and recommendations of the study, as each model defines the boundaries of IC in a slightly different manner. The next subsection explains the model of IC that has been used to define IC in this study, which is a widespread tripartite model of IC that has also been used to conduct ICR studies in other countries and regions.

1.2.3 IC tripartite model used in this study

To facilitate general comparative analysis of the results of this study with other studies, this study has chosen to follow a tripartite model of IC that has been used extensively in other ICR studies. This tripartite model conceptualises IC in terms of the three broad categories of: internal (structural), external (relational) and competence (human) resources (see: Guthrie & Petty, 2000a, also see Appendix A to this research report), which together conceptualise and summarise the ‘new’ factors of economic production in the ‘knowledge economy’. In general terms, these three categories are defined as follows:

- **internal (structural) capital** refers to the structures and processes employees develop and deploy in order to be productive, effective and innovative;

- **external (relational) capital** refers to an organisation’s relationships with external stakeholders be they suppliers, customers, the community or others; and

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2 Conversely, individual distribution and service industries will rely on a certain amount of tangible resources – to a varying extent depending upon the nature of the particular business.
• **competence (human) capital** refers to the skills, attitudes, abilities, competencies and qualities of an organisation’s employees.

This tripartite model acknowledges the interconnectedness of organisational management and the context within which organisations operate, taking into consideration the intangible costs and benefits that flow to the broader community, economy and environment, as a result of organisational performance (Society for Knowledge Economics, 2005).

Each of the broad categories in the model comprise a number of more detailed elements. Within this study, the elements (and the decision rules defining these elements, as detailed in Appendix B of this research report) developed by Guthrie and Petty (see, for example, Guthrie & Petty, 2000a; Guthrie *et al.*, 2004) to conduct ICR content analyses in a number of empirical studies in other countries have been adopted (after minor adaptation to the UK context – as explained in Chapter 3). Specifically, IC in this study is understood as comprising factors related to the elements shown in Table 1.2:

**Table 1.2: Intellectual capital categories and elements**

<table>
<thead>
<tr>
<th>Category</th>
<th>Elements</th>
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<tbody>
<tr>
<td><strong>1 Internal (structural capital)</strong></td>
<td><strong>1.1 Intellectual property</strong></td>
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<td></td>
<td><strong>1.2 Management philosophy</strong></td>
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<td><strong>1.3 Corporate culture</strong></td>
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<td></td>
<td><strong>1.4 Management processes</strong></td>
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<td><strong>1.5 Information systems</strong></td>
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<td><strong>1.6 Networking (communication systems)</strong></td>
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<td></td>
<td><strong>1.7 Financial relations</strong></td>
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<tr>
<td><strong>2 External (relational capital)</strong></td>
<td><strong>2.1 Brands</strong></td>
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<td></td>
<td><strong>2.2 Customers (including new product development)</strong></td>
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<td></td>
<td><strong>2.3 Customer satisfaction and loyalty</strong></td>
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<td></td>
<td><strong>2.4 Company reputation</strong></td>
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<td></td>
<td><strong>2.5 Distribution channels</strong></td>
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<td></td>
<td><strong>2.6 Business collaboration</strong></td>
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<td></td>
<td><strong>2.7 Favourable contracts/licensing agreement</strong></td>
</tr>
<tr>
<td></td>
<td><strong>2.8 General research and development issues</strong></td>
</tr>
<tr>
<td><strong>3 Employee competencies (human capital)</strong></td>
<td><strong>3.1 Employee</strong></td>
</tr>
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<td></td>
<td><strong>3.2 Education and vocational qualifications</strong></td>
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<td></td>
<td><strong>3.3 Training</strong></td>
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<tr>
<td></td>
<td><strong>3.4 Work-related knowledge</strong></td>
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<td></td>
<td><strong>3.5 Innovativeness of employees/teams of employees</strong></td>
</tr>
</tbody>
</table>
1.3 Recognition of importance of consistent IC reporting

With the emergence of the knowledge-based economy outlined in the previous section, greater attention has been drawn to the inability of the traditional financial reporting framework to meet the needs of users (Barsky et al., 2003; Beattie et al., 2004; Byrnes & Henry, 2001; Collins, 2003; Holland, 2004). Furthermore, the widening gap between market and book values also suggests that the traditional financial reporting framework presents an incomplete account of a firm’s value (Guthrie et al., 2006; ICAEW, 2003; Roslender & Fincham, 2003).

Given the increasing importance of IC to individual organisations and to national economies, it is therefore clear that without effective reporting of IC, the representation of organisations’ activities conveyed by annual reports risks becoming increasingly irrelevant (see, for example, Beattie et al., 2004; Holland, 2004; Roslender & Fincham, 2003; Task Force on Human Capital Management, 2003). Research has demonstrated that managers of many publicly quoted companies are acutely aware of the need for corporate reporting to continue to adapt so that it effectively communicates information about increasingly important knowledge-based value drivers to capital markets (see, for example, Holland, 2004 for evidence of this in the UK context).

Despite the development of several models for measuring and reporting IC (see, for example, Brennan & Connell, 2000; Celemi, 1998; DATI, 1998; Edvinsson, 1997; Edvinsson & Malone, 1997; Kaplan & Norton, 1992, 1996; Petty & Guthrie, 2000; Society for Knowledge Economics, 2005; Sveiby, 1988; Sveiby, 1997), there is little reporting regulation in this area – notwithstanding its recognised growing importance to understanding organisational performance and value (Guthrie & Petty, 2000b).

As the reporting of IC has been largely voluntary, it has the potential to be inconsistent between organisations. Lack of consistency in rendering an account of IC may hamper comparability between organisations. It also allows the possibility of ‘creative’ biased ICR, with organisations focusing on the positive aspects of their management of IC.

The Institute of Chartered Accountants in England and Wales (ICAEW), through its Information for Better Markets campaign, has recognised the importance to the effective operations of investment markets of companies effectively reporting on IC, and the next sub-section will explain how this research study addresses some of the issues raised by the ICAEW in this regard.

1.3.1 Relevance of this study to ICAEW Information for Better Markets campaign

Several of the factors investigated within this research project, and many of its findings, address some of the policy issues raised in the ICAEW Information for Better Markets campaign. In the foreword to a special report related to this campaign, published by the ICAEW’s Faculty of Finance and Management (ICAEW, 2004, p. 3), it was stated that:

Interestingly, many of those who argue that our traditional reporting model is not up to the job focus on the growing role of intangibles, such as intellectual capital, and question the ability of traditional reporting to cope with it. If you have been a member of the Faculty for a few years, you will know that the problem of measuring and managing intellectual capital has been one of our regular topics. Clearly, this issue remains of central importance.

Many of the policy issues from the Information for Better Markets campaign which are directly relevant to the current research study are contained in the report New Reporting Models for Business (NRMB) (ICAEW, 2003). In particular, the NRMB report identified a ‘growing concern in recent years that corporate reporting is inadequate’ (p. 6), with some of this concern being derived from the large observed gap between the book and market values of many businesses. The report further identified a need for research
studies to provide evidence to inform debates about changing the future shape of corporate reporting practices in a number of areas, where such practices need to be changed to address any perceived inadequacies of corporate reporting in the contemporary business world.

Among the policy-oriented questions asked were:

- Can corporate reporting be used to communicate to a variety of stakeholders rather than solely addressing the information needs of investors?
- Can traditional forms of corporate reporting provide all the information investors need upon which to base their investment decisions, or are a variety of channels of communication needed for this purpose?
- Can voluntary reporting initiatives be relied upon to provide effective levels of information on new aspects of business performance, or does such information provision need to be mandated through regulation?
- Can and should corporate reporting be adapted to place a financial value on intangible value drivers, which are of growing importance in many businesses?

The NRMB report argues that ‘Any reformer needs to present a persuasive analysis of how the current reporting model operates’ (p. 10). This research study provides some evidence in respect of the above issues. As such, it should help to inform the debate regarding the adequacy of current reporting practices concerning ‘information on new aspects of business performance’, specifically IC. It should also help to provide evidence for the need (if any) for changes to these practices, and on preparers’ viewpoints regarding the desirable shape of any changes needed to practice in the key area of reporting on the intellectual value drivers of businesses in the UK, an area the NRMB report recognises as one of significance. Furthermore, the NRMB report recognises that it is important to identify potential problems in developing new reporting models, and this is a further issue addressed within the current research study, which analyses the experiences of senior executives of reporting through a variety of channels on aspects of their IC value drivers.

A key aspect emerging more generally from reports in the ICAEW Information for Better Markets campaign is a call for more evidence-based research to help answer the questions raised in the reports, for example, analytical questions regarding identified potential new reporting models. Furthermore, there is a recognition within this ICAEW campaign that useful information for markets is not restricted to information provided in financial form, but that other non-quantified discursive information can also be important.

1.4 Aims of this research

A prerequisite to the development of new reporting models, and more specifically to the development of consistent ICR practices, is an analysis and understanding of existing practices, and the key factors which appear to drive such practices. The aims of this research project are to contribute to the provision of such an analysis and understanding of ICR practices among UK publicly quoted companies.

These aims have been addressed through a two-stage empirical investigation. Firstly, a wide range of corporate reports of a sample of UK quoted companies in four distinct sectors have been analysed to ascertain the IC issues upon which the companies studied report, and to compare these ICR practices according to a range of criteria. Secondly, one or more senior financial executives, from each of the companies whose ICR was examined in the first stage, were interviewed to ascertain and then analyse their views on a range of factors driving voluntary ICR practices.
As will be shown in the literature review in Chapter 2, ICR research to date has focused nearly exclusively on analysing ICDs in annual reports and stand-alone IC statements. With the notable exception of studies by Holland (2004; 2006, as discussed and distinguished from this study in chapter two), ICR research has also been relatively silent in terms of understanding the motivations of those preparing reports (referred to in this report as *preparers*). This study therefore differs from most prior ICR studies in two distinct ways. Firstly, it examines a wide range of corporate media for their ICR content. Secondly, it explores the motivations of preparers in voluntarily reporting IC information, including their perceptions regarding how they can effectively report IC to capital markets.

In addressing its aims, the detailed objectives of the empirical analysis in this study are to:

- provide an in-depth assessment of the nature and extent of ICR practices among a sample of UK quoted companies;
- analyse ICR practices of the sample of UK companies in a manner, and using specific research methods, which will facilitate international comparisons with studies of reporting practices in other countries;
- identify key motivating factors underlying voluntary external reporting of IC by the preparers of corporate reports; and
- make recommendations regarding possible future directions for ICR, both in the UK and in an international context.

To address these aims and objectives, this research report is structured as follows: Chapter 2 briefly explores the IC literature and then analyses key empirical ICR studies to identify their features and help locate this study, and its contribution, within the extant literature. Chapter 3 then explains the research methods used in this study, including the content analysis methods used to conduct the ICR analysis and the approach to conducting and analysing interviews to understand preparers’ key motivations. Chapter 4 reports the results of the ICD analysis undertaken for this study, and explores the implications of its key findings. Chapter 5 then summarises and analyses the interview data and the implications of these findings. In Chapter 6 the general findings of the study, along with its policy implications, are presented.
2. Literature review

2.1 Introduction

This chapter examines the ICR literature for insights regarding how and why firms voluntarily report IC in their annual report and other media. The review elucidates important theoretical and empirical contributions relating to the identification and voluntary reporting of IC. Understanding the research that has been conducted in this (or any) area is an important step in identifying any gaps in the literature and establishing possible paths for future progress.

Within this chapter, section 2.2 provides an introduction to IC literature identifying several trends and reviewing research activities undertaken in the field of ICR in various nations. Section 2.3 summarises several recent major ICR research studies. Section 2.4 summarises the contributions made by the literature review and identifies how they relate to the purpose of this research study.

2.2 Rapid growth in the field of IC and ICR

The following subsection provides a brief review of several contemporary IC and extended performance frameworks. Sveiby (2002) identifies 21 of these frameworks and several more have been added to make a comprehensive list of 38 which covers 15 years (Sveiby, 2004).

Sveiby (2002) also identifies four IC measurement methods within these various frameworks:

1. Direct intellectual capital methods (DIC): Estimate the monetary value of intangible assets by identifying its various components. Once these components are identified, they can be directly evaluated, either individually or as an aggregated coefficient.

2. Market capitalisation methods (MCM): Calculate the difference between a company’s market capitalization and its stockholders’ equity as the value of its intellectual capital or intangible assets.

3. Return on assets methods (ROA): average pre-tax earnings of a company for a period of time are divided by the average tangible assets of the company. The result is a company ROA that is then compared with its industry average. The difference is multiplied by the company’s average tangible assets to calculate an average annual earning from the Intangibles. Dividing the above-average earnings by the company’s average cost of capital or an interest rate, one can derive an estimate of the value of its intangible assets or intellectual capital.

4. Scorecard methods (SC): the various components of intangible assets or intellectual capital are identified and indicators and indices are generated and reported in scorecards or as graphs.

These methods can be collapsed into two different approaches: the ‘stock’ approach (DIC, MCM and ROA methods) and the ‘flow’ approach (SC methods) (see Guthrie & Ricceri, 2002). Under the ‘stock’ approach, IC is thought to be static and able to be
assigned a monetary value. Under the ‘flow’ approach IC is viewed as being concerned with observing knowledge resources and understanding value creation, rather than assigning a specific monetary value.

Of the available ICR frameworks, a popular one is that of the Danish Ministry of Science, Technology and Innovation (DMSTI), which has released guidelines for the production of IC statements (Mouritsen et al., 2003). Comparable efforts have also been made throughout the European Union with the MERITUM research project which, among other aims, has sought to produce guidelines for managing and reporting intangibles (MERITUM, 2002). More recently, new legislation in Austria required all state universities to produce IC statements (Schaffhauser-Linzatti, 2004) and, in Australia, draft guidelines have been established for the management and reporting of IC by way of extended performance accounts (Boedker et al., 2005).

Researchers in the field of ICR have been primarily interested in the substance of the disclosures that emanate from annual reports and stand-alone IC reports (Guthrie et al., 2004). This is because the annual report (and, to a lesser extent, the stand-alone IC report used in some countries, but not common in the UK) has become a focal point in external IC disclosure. This is evidenced by the proliferation of frameworks that use the annual and/or IC report as an appropriate vehicle for the public disclosure of IC (MERITUM, 2002; Mouritsen et al., 2003). Among the ICR researchers, content analysis has been a popular method of determining the extent of ICR found in company reports (Guthrie et al., 2004).

Several studies, which focus on what is being reported, have attempted to capture and organise diverse empirical data. Studies using annual reporting data have attempted to capture the reporting of IC in Australia (Guthrie & Petty, 2000a; Guthrie et al., 2005), Canada (Bontis, 2003), Hong Kong (Guthrie et al., 2005), Ireland (Brennan, 2001), Italy (Bozzolan et al., 2003), Italy and UK (Bozzolan et al., 2006), South Africa (April et al., 2003), Sri Lanka (Abeysekera & Guthrie, 2005), Sweden (Olsson, 2001) and Austria, Denmark, India, Israel, Korea, Spain and Sweden (Ordóñez de Pablos, 2002) to name a few.

These studies have generally concluded that IC disclosure in practice is deficient. In one of the earlier studies, Guthrie and Petty (2000a) examined reporting practices amongst 20 leading Australian companies and found ‘a lot of empty rhetoric surrounding the notion of measuring, valuing and reporting intellectual capital’ (Guthrie & Petty, 2000a: p.246). In related fashion, Bontis (2003) found insignificant reporting of IC from an analysis of 10,000 annual reports in Canada. Other private sector studies have found varying levels of IC disclosure (April et al., 2003; Bassi et al., 1999; Brennan, 2001; Ordóñez de Pablos, 2003). However, as these studies have only focused upon capturing and analysing ICDs in the annual report or in stand-alone IC reports, they have not been able to ascertain the existence or extent of ICD in other media used by corporations as part of their corporate reporting strategies (such as websites, meetings with analysts, interim reports, and so on).

### 2.3 IC-related research monographs

This subsection will briefly review six existing research monographs (covering four distinct studies) that deal with aspects of ICR. Three of these monographs (covering two distinct empirical studies) have taken an ‘outside’ approach (Beattie et al., 2002; Beattie et al., 2004; Guthrie et al., 2007), in which the empirical data was exclusively, or predominantly, collected from publicly available sources (available outside of the organisations whose reporting practices were being studied) with little or no data collected from inside the organisations. The other three monographs (also covering two distinct empirical studies) have taken a predominantly ‘inside’ organisation approach (Holland, 2004, 2006; Roslender & Fincham, 2003), examining aspects of IC and ICR using sources (such as interviews) from within the organisations.
2.3.1 Summary of monographs taking an ‘outside’ organisation approach

In the most recent IC research monograph which has taken an ‘outside’ organisation approach to collecting its empirical data, Guthrie et al. (2007) reported on ICR patterns in Hong Kong and Australia. In common with other ICR studies, their study focused on ICDs within annual reports, and summarised contemporary international practices of extended performance reporting including IC. The contribution of the study was that it provided evidence of Hong Kong and Australian IC reporting and explored several important policy implications.

In a monograph on UK corporate reporting practices, Beattie et al. (2004) developed the insights they provided about narrative reporting in their interim monograph (Beattie et al., 2002). This in-depth study of the narrative disclosures within the non-mandatory sections of annual reports from 1999 of a sample of 27 UK quoted companies across three sectors found, inter alia, that the amount of narrative disclosures varied both with company size (a strongly positive correlation [Beattie et al., 2004, pp. 38-39]) and between the three different sectors. Beattie et al. (2004) argued that as ‘there may be good economic reasons for cross-sector variation in practice… the DTI [the UK government ministry which regulates accounting] is right not to seek to impose a uniform set of disclosures, even at sector level’ (p. xiv). They also found that 78% of the narrative disclosures they analysed were non-quantitative in nature and that 63% of the narrative disclosures they analysed were non-financial in nature. They further observed that there was no systematic approach by any company in their sample towards ICR. Rather, disclosures regarding IC issues ‘appeared to be scattered [throughout the annual reports] and somewhat ad hoc’ (p. 108).

Beattie et al. (2004) also noted that the move towards a greater reliance on intangible value drivers by many companies had potentially ‘profound… consequences for corporate reporting… [which] have been the subject of extensive debate and investigation within the worldwide profession for some years’ (p. 2). This was because of widespread perceptions that by focusing ‘on physical and financial assets’, existing financial accounting practices were ‘increasingly inadequate to satisfy the demands of the market’ (p. 2). To address these perceived deficiencies in existing financial reporting practices, there was seen to be a need ‘to incorporate greater discussion of the critical drivers of business success (especially intangible assets), more non-financial performance indicators relating to these critical business drivers, and more forward looking information’ (p. 2). Beattie et al. indicated that other studies had also shown that:

In the absence of mandatory requirements… empirical studies of the content of voluntary disclosures show that company practice is very variable, with few companies offering an adequate coverage of key issues, such as forward-looking information and information on intangibles (p. 29).

Within their recommendations, Beattie et al. (2004) argued that a broadly-based structure for narrative disclosures was desirable, as it would help to identify those companies which did not disclose any information on individual broad issues, while leaving companies flexibility regarding the precise types and formats of information suitable for their particular circumstances. One of the issues which Beattie et al. argued should be included within this broad structure of narrative reporting was IC (p. xviii and p. 114). Despite the importance of narrative reporting, especially in possible future reforms to reporting requirements, Beattie et al. concluded that other than their study, ‘there has been little detailed systematic research into what companies actually report in their narratives, how these narratives are structured, and what factors might influence the nature of these disclosures’ (p.101, emphasis in original).

This study addresses some of these issues raised in the Beattie et al. (2002; 2004) study. In particular it responds to Beattie et al’s acknowledgement that while ICR is growing in
importance, there has been little research into actual reporting practices (in ICR and other narrative areas) or into the motives driving this voluntary reporting. A number of factors noted in Beattie et al's analysis (such as the predominance of non-quantified disclosures, and variations in practices between sectors) are also addressed in the analysis of ICR within this study.

2.3.2 Summary of monographs taking an ‘inside’ organisation approach

Roslender and Fincham (2003) looked at IC and its management in six case study organisations, providing an ‘inside’ perspective. They selected companies which were likely to have a heavy reliance on IC as their case study organisations and, in addition to interviewing a total of 22 managers from these six companies, they also interviewed a number of experts from outside the companies who were considered to have an interest in IC value drivers. The interviews were conducted between May 2001 and March 2002. Managerial and ‘outside’ experts’ attitudes towards ICR formed only a part of the study, which did not examine corporate reports for evidence of such ICR. The main findings of the study were that although managers perceived value in IC, there were few systematic technologies and technical practices used inside the organisations for managing and evaluating this IC. Thus, for example, managers stated that human capital was important, but did not have measurement systems to manage this value driver. While managers were generally acutely aware of the aspects of IC that were essential value drivers in their own organisations, they neither used the terminology of IC nor did they have much familiarity with developments in IC accounting or reporting – hence the minimal use of systematic technologies for IC accounting or reporting. Roslender and Fincham (2003) the accounting profession needed to be more aware of the importance of, and developments in, this area and the key role that narrative reporting is likely to play in effective ICR.

The other research monograph study looking at ICR from an ‘inside’ perspective was Holland (2004; 2006), who conducted a series of interviews about ICR with directors of 25 large UK companies across 15 sectors in 2000. The bulk of the questions in the interviews related to the role of IC in driving corporate value, with other questions asking about ICD practices and managerial perceptions regarding investor use of IC disclosures. To help provide background and context for each interview, archival material was analysed for each company before the interview, encompassing: the annual report, presentations made to analysts, other public announcements, and interviews which Holland had conducted with most of the companies in this study for previous studies (in the mid-1990s) on the issue of private disclosures between companies and users of accounting information, and in the late 1980s with some of the companies about bank-related corporate information flows. IC disclosures found in the corporate reports that were examined were not separately analysed in the monographs emanating from this study.

In the first monograph based on this research study, Holland (2004) focused on the development of an ‘ideal’ IC corporate disclosure model. This model was theorised from an in-depth analysis of managerial perceptions in three key areas. Firstly, managers of both knowledge economy and more traditional economy firms were acutely aware of how knowledge-based factors had impacted upon, and were significant value drivers for, their firms. This had changed the ‘supply-side’ of corporate information provision by introducing new factors about their businesses that managers could communicate to capital markets through corporate disclosures. Secondly, managers were also acutely aware of a variety of factors driving the demand from analysts and fund managers for information about their IC value drivers. The third area examined how the first two factors (changes in the supply side and the demand side in the market for corporate IC information) had interacted to change the corporations’ ‘agenda for private and public disclosure’ (p. vi).
Whilst giving some examples of the types of ICD which formed part of this ‘disclosure agenda’, the main focus of the Holland (2004) monograph was on how the interactions between corporate managers and analysts/fund managers worked to negotiate and provide effective IC information to capital markets. This corporate communication was achieved primarily through the provision of a consistent ‘value-creation story’ (p. x) comprising a narrative using both private and public disclosure of information, although the private disclosure in meetings with analysts seemed to predominate. This private disclosure sought to avoid provision of price-sensitive information not available in the public domain, but used private disclosures to elaborate and clarify existing public information. The monograph recommended that new accounting standards on ICR should be developed, based on the provision of information in what Holland (2004) argued were the three key (and dynamically interacting) areas in which IC worked to add value in all organisations studied, being: ‘hierarchical value-creation processes’ (pp. 20-28) in which value is created through the particular hierarchical systems and processes adopted by each business; ‘horizontal value-creation processes’ (pp. 28-32) in which value is created through IC-related aspects of the production chain for the particular business; and finally the ‘network value-creation process’ (p. 32-35) in which IC is added through the interactions of an organisation with other organisations. Although Holland noted that the precise details of where IC added value within these three key areas varied from organisation to organisation, he argued that all organisations in his study had IC value drivers in each of these three key areas.

Holland (2006) extended the analysis of the empirical data in Holland (2004) by adding more detail and depth to the theoretical model of corporate disclosure and information dynamics developed in the earlier monograph, and by exploring the nature and dynamics of the disclosure decisions faced by managers and the processes through which these disclosure decisions were understood and taken by managers. This model was more firmly linked to the competitive market for information, wherein managers were aware of the need to provide information about their operations (including their IC value drivers) in a manner which would be most effective in reducing their cost of capital by convincing capital markets of the future value of a range of value drivers perceived as important by analysts and fund managers, while not giving away information to competitors which may erode their competitive advantage.

Although this current study also takes a predominately ‘inside’ approach to investigating ICR, it differs in some important respect from both the Roslender and Fincham (2003) and the Holland (2004; 2006) studies.

Firstly, unlike the Roslender and Fincham (2003) study which focused on companies which relied heavily on IC value drivers, this study examines ICR practices in companies from four sectors chosen to represent a range of significance (or reliance upon) IC (see Chapter 3 for further discussion on this point). This has enabled the analysis of empirical data to be partially informed by the IC context of differing sectors. Secondly, unlike the Roslender and Fincham (2003) study, this current study focuses exclusively on ICR practices, and the interviews conducted to ascertain managerial attitudes towards ICR were informed by a prior analysis of the ICDs of each company whose manager(s) were interviewed.

However, both of these key factors which distinguish this current study from Roslender and Fincham (2003) were present in the Holland (2004; 2006) study, which analysed the ICDs of companies before interviewing managers from these companies, and which examined managerial attitudes towards ICR among companies from a range of 15 different sectors (although there was only one company studied within a number of these sectors in Holland’s study).
Although this current study shares these important empirical methods with Holland (2004; 2006) at a broad level, the studies do differ in important respects. The main one of these is that unlike the Holland (2004; 2006) study which focused on theorising the processes driving IC information provision in the context of the market for information, this study aims to provide a picture of actual ICR practices and make policy recommendations based on these practices and the factors motivating them. Furthermore, while Holland (2004; 2006) analysed ICDs to help inform the interviews and therefore did not report or analyse separately these ICDs, a separate analysis of these ICDs is an important element in this current study, to provide a picture of ICR among a diverse sample.

Finally, both the Roslender and Fincham (2003) and the Holland (2004; 2006) studies were based on interviews with managers producing ICD several years ago – 2000 in Holland (2004; 2006) and 2001/02 in Roslender and Fincham (2003). This study, which conducted interviews between December 2004 and September 2005, therefore provides more recent evidence in this rapidly developing field.

2.4 Summary of literature review, and location of research objectives

The literature reviewed in this chapter has indicated that while IC is generally regarded as an important value driver in many economies (including the UK) and while there is recognition of the need for development of corporate reporting so that it more effectively communicates corporate IC value drivers:

1. Most ICR studies which have analysed corporate reports have focused on analysis of ICDs in the annual report and the intellectual capital report.

2. Although ICDs have been systematically studied and reported upon in many other countries, there has been very little empirical research reporting ICD practices among UK companies, despite recognition among UK managers that IC represents an important value driver.

3. Most ICR research studies have examined ICR using an ‘outside’ organisation approach. The two UK-based studies which have examined managerial perceptions regarding aspects of ICR have either focused on theorising a model of information disclosure processes or have examined companies only from sectors which rely heavily on IC value drivers. Furthermore, the managerial perceptions investigated in these studies were from interviews in the years 2000 to 2002.

The research study reported upon in this research report is distinct from the above studies, and adds valuable insights to the literature, in that it:

1. Analyses ICDs in a broad range of corporate reports.

2. Conducts a systematic analysis of the ICDs from a structured sample of large UK companies across four distinct sectors.

3. Investigates and reports upon managerial perceptions regarding the motives underlying their specific ICR practices based on interviews which mainly took place in the year 2005, thus providing more recent insights in this rapidly developing area than those gained in interview-based studies from earlier years.

The next chapter explains the main research methods that have been used in this study to address its aims and objectives, and thereby to add to the academic literature in the manner outlined above.
3. Research methods

3.1 Introduction

Achievement of the aims and objectives of this study has involved two main empirical stages. The first of these was a content analysis identifying, recording and analysing all the ICDs in a broad range of corporate reports produced by each of the 15 sample companies. The second stage comprised conducting and analysing an interview with one or more senior financial executives from each of the sample companies, in order to ascertain the perceptions of the preparers of corporate reports regarding a variety of issues connected with ICR. The content analysis of each company’s ICDs was used to inform the interview subsequently conducted with the senior financial executive(s) from that company. Guthrie and Abeysekera (2006), in a recent review of research methods in the social and environmental accounting area, indicated that content analysis should be supplemented with interview and other data sources.

This chapter is structured as follows: section 3.2 explains the manner in which companies were selected for inclusion in the sample for this study. Section 3.3 then discusses the content analysis methods employed in the study, while section 3.4 explains the process used for conducting and analysing the interviews. The chapter concludes with a discussion of the limitations inherent in the research methods used, and the implications of these limitations for the findings of this study.

3.2 Sample selection

The sample selection was based on two criteria. First of all, as the study involved interviewing senior financial executives, willingness of corporations to participate in the interview part of the study was one of the key factors in selecting companies.

The second criterion was based on sector and company size. Before selecting individual companies for analysis, four different sectors were chosen. Following Bozzolan et al. (2003), these sectors were selected to cover industries with an expected range of emphasis on IC, from a more traditional reliance on tangible assets to an extensive reliance on knowledge resources. Specifically, two sectors were chosen where, \( a \ priori \), it was expected that there would be a substantial reliance on a range of IC value drivers – these sectors being software/information technology and pharmaceuticals/biotechnology. One sector was chosen where, \( a \ priori \), it was expected that there would be relatively little reliance on IC, with value being driven primarily by tangible resources – this sector being real estate/utilities. Finally, the fourth sector was chosen to reflect a likely moderate reliance on IC – retailing. The selection of the retail sector as the ‘medium’ intellectual capital sector was based on recognition that while retailers do rely on a number of intellectual capital value drivers (such as brands, brand management, customer satisfaction, service quality, logistic and supply chain management, and so on), they also rely extensively upon a number of more traditional tangible value drivers.\(^3\)

\(^3\) This \( a \ priori \) view that the retail sector was a ‘medium IC reliance’ sector was subsequently reinforced by our interviewees from the retail sector who explained that, in their views, their sector did not rely on intellectual capital value drivers to such a great extent as many companies in the pharmaceutical, biotechnology, and ICT sectors, while recognising that several aspects of intellectual capital were significant for them.
A number of companies listed on the London Stock Exchange from each chosen sector were contacted to ascertain their willingness to participate in the interview part of this study. To secure sufficient companies in each sector, the sectors had to be broadly defined – sometimes covering what may appear to be more than one conventionally defined sector. Four companies were selected from each of the two high and the one low IC sectors, and three companies from the medium sector. Companies were also selected to cover a range of different sized companies whose shares are traded on the London Stock Exchange – from the largest 100 UK listed companies (FTSE 100, seven companies studied) through the 101st to 350th largest UK companies (FTSE 250, four companies studied) to smaller capital companies (FTSE Small Cap, four companies studied).

As anonymity was guaranteed as part of the interview process, it is not possible to name or otherwise identify the companies studied.

3.3 Content analysis

In common with previous ICR studies, this study has used content analysis to collect the empirical data about ICDs (Guthrie & Petty, 2000a; Guthrie et al., 2004). Content analysis is a research technique which enables information to be extracted in a structured and consistent manner from a range of different documents, each of which may be structured differently from the others (Holsti, 1969; Krippendorff, 1980). It thus facilitates the systematic analysis of information disclosed within a range of corporate reports, and has been applied widely within the academic literature to analyse voluntary disclosures in corporate reports (Unerman, 2000).

While organisational ICR represents a relatively new field of research, the limited amount of research conducted to date indicates that, for both financial and non-financial measurement, data on the reporting of IC needs to be consistently gathered using a coherent framework. For this reason, specific content analysis research questions and classifications were adapted from techniques developed by Guthrie and Petty (2000a) to conduct IC content analyses amongst large Australian companies. These techniques have subsequently been, and are continuing to be, used to conduct such research in other countries (see, section 2.2 for more details). According to these definitions of IC (as set out in the attached extract from Guthrie and Petty (2000a) (see, Appendix A)), it seemed likely a priori that all organisations would rely, to some extent, on IC to generate value.

Use of these research techniques and definitions enhanced the comparability of the results of this project with those of studies conducted elsewhere, thus facilitating present and future international comparative evaluations of the state of ICR in the UK.

The Guthrie and Petty (2000a) techniques were adapted to the specific circumstances of UK companies through the conduct, in 2003, of a UK pilot study. This pilot study was carried out on a small sample of UK company annual reports in three sectors (telecoms, retail and property) and showed that all companies in the sample made disclosures about several aspects of their IC, with the specific areas disclosed varying from company to company. While conducting the pilot study, slight amendments were made to the Guthrie and Petty (2000a) recording instructions/definitions, which (following these amendments) classified IC disclosures into 20 detailed sub-categories, under the three main categories of:

- Internal (Structural) Capital [seven sub-categories];
- External (Customer/Relational) Capital [eight sub-categories]; and
• Employee Competence (Human) Capital [five sub-categories].

According to Krippendorff (1980), there are several key stages involved in designing and executing a content analysis study. These are: deciding upon what units of analysis to use; defining themes of analysis; deciding what types of reports to analyse; identifying and recording relevant disclosures; and, finally, analysing these disclosures. Key decisions taken in respect of each of these stages are discussed in the following sub-sections:

3.3.1 Quantifying units of analysis

A major decision in the area of units of analysis is the manner in which each disclosure is to be quantified. A key assumption underlying much content analysis is that either the number of times an item is disclosed, or the amount of space devoted to a particular disclosure, signifies the importance of the item being disclosed (Deegan & Rankin, 1996; Gray et al., 1995; Krippendorff, 1980; Neu et al., 1998). There has been some debate around this quantification issue within the large body of corporate social reporting content analysis studies (Unerman, 2000). Most of these studies have either counted the individual instances of relevant disclosures (i.e. disclosures of the nature being researched), or have measured volume of disclosure in terms of number of words, sentences or paragraphs that contain relevant disclosures, or the proportion of a page taken up by each disclosure. A case for the preferability of the latter was made by Unerman (2000), in that measuring volume of disclosure in terms of the proportion of a page occupied by each disclosure was likely to reflect the importance accorded to that disclosure by managers when they wrote the corporate report. For example, given a finite length to most corporate reports, Unerman (2000) argued that if managers decide to use a much larger font to disclose one item (such as in a large caption or heading) than they use for another item, this may indicate that managers consider this first item to be more significant. Quantification using word, sentence or paragraph counts cannot capture this difference in emphasis. Neither can such quantification capture graphics or pictures – which can be powerful media to convey some information.

However, such arguments for the preferability of different measurement metrics rely upon the factor that space within printed reports is limited, with managers having to make choices whereby more space given to one disclosure results in less space being available for other disclosures. As a considerable amount of ICDs examined in this study have been on corporate websites, where space constraints are not usually significant as costs for additional space are marginal, such measurement metrics would have risked producing content analysis results that could not be readily or credibly compared between the different media used for ICR. Instead, this study has quantified ICDs in terms of the number of instances of disclosures, with each instance of disclosure within each IC category or element in each report being counted as 1. This is consistent with the measurement metrics used in many prior ICD content analysis studies.

In addition, to facilitate more detailed future possible analyses of the data collected for this study (for example a comparison of ICD within particular types of reports) all ICDs were also quantified using proportion of an A4 page as a measurement metric, following Unerman (2000).

3.3.2 Defining themes of analysis

This study has defined and analysed IC in terms of a number of narrowly defined elements within the three broader IC categories, as shown in Table 1.2 in Chapter 1.

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*A single accepted definition and meaning of the term ‘intellectual capital’ has yet to emerge. Petty and Guthrie (2000) argue that an appropriate definition is the one developed by the OECD, which defines intellectual capital as ‘the economic value of two categories of intangible assets of a company: (a) organisational (“structural”) capital; and (b) Human Capital’ (OECD, 2001). The classifications developed by Guthrie and Petty (2000a) draw on a number of models that have been proposed for measuring and reporting on intellectual capital.*
and in Appendix B. As noted above, this use of narrow elements is consistent with most prior empirical ICR studies, with the definitions of elements used in this study being an adaptation to the UK context of the widely used definitions developed and used by Guthrie and Petty (2000a).

This adaptation process involved one of the authors of this research report and two postgraduate students each independently using the Guthrie and Petty (2000a) category and element definitions to identify the ICD in the annual report and review of a large UK company, and then comparing and discussing their results. The definitions were then amended slightly as a result of this discussion, following which the exercise was repeated with the annual report and review of another large UK company. This process was repeated until agreement was reached that the revised definitions adequately reflected the UK business context (this stage was reached after three rounds). This process was designed in such a way that it should have helped to ensure the reliability of the content analysis categories and definitions (Krippendorff, 1980; Milne & Adler, 1999).

3.3.3 Types of reports analysed

The types of corporate reports analysed were determined by the study’s objectives of examining ICD in a broader range of corporate reports than just the annual report and/or IC statement. However, for pragmatic reasons, it was necessary to place limits on the scope of documents analysed – if this were not done then the number of documents to be analysed for any single organisation could have been overwhelming.

In this study, boundaries were set at all documents that were on the corporate website of the companies being examined, including all web pages but excluding any consumer direct-sales web pages. Thus, for example, where the ICD of a large retailer was being examined, all of the documents hosted on the retailer’s website (including annual reports in .pdf files, analysts briefings, web pages, social and environmental reports and so on) were downloaded in hard copy on one day, with the exception of any web pages used as part of the company’s on-line retailing operations. These latter sections of websites contained a vast number of pages describing individual products and prices – unrelated to corporate decisions on communication of IC value drivers.

3.3.4 Methods of identifying and recording relevant disclosures

Having selected a quantification metric (individual instances of disclosure), defined the IC content analysis categories and elements, and determined and collected the corporate reports to be analysed, the next stage in the content analysis was to identify, measure and record each disclosure which met the definition of any of the elements of IC in each of these reports.

To increase the reliability (in terms of consistency) with which ICDs were identified (Milne & Adler, 1999), one of the authors of this research report initially read all of the corporate reports to be analysed, and marked each relevant disclosure. For the first few reports analysed, another of the authors also read and classified the reports independently of the analysis undertaken by the first researcher. These two sets of analysis were then compared and discussed and, after two or three reports, there were very few differences of opinion regarding the classification of ICDs. Having reached a shared understanding in this manner, the second researcher then only double checked a random sample of the corporate reports analysed by the first researcher, and this exercise revealed an insignificant number of differences.

Once the relevant disclosures had been identified, each disclosure was recorded in an electronic database, with one record in the database used to record the following information about each separate disclosure:

- company name;
• document in which the disclosure was made (annual report, analyst presentation, web page etc);

• element of IC;

• tone of disclosure (good, neutral, bad);

• type of disclosure (quantified in monetary terms; quantified other than in monetary terms; narrative);

• volume of disclosure (percentage of an A4 page);

• location in document (page number – for double checking of analysis);

• brief summary of the message conveyed in the disclosure.

Recording disclosures in this manner enabled a range of data to be captured about each disclosure, and it also enabled the data to be summarised and analysed in terms of many different combinations of variables. It also enabled disclosures to be quantified in terms of number of disclosures (1 record = 1 disclosure), in addition to volume of disclosures, as discussed in sub-section 3.3.1 above.

3.3.5 Analysing the IC disclosures

The previous stage in the content analysis (i.e. identifying, measuring and recording the relevant disclosures) took by far the most amount of time in the research process. While restricting analysis to one or two documents (the annual report and/or IC report) results in, perhaps, between 100 and 200 pages being analysed for each company, the broader range of corporate reporting media analysed in this study resulted in between one and two lever-arch files full of downloaded pages being analysed for each of the 15 companies. Within these documents, 2,676 disclosures were identified that met the definitions of IC.

3.4 Interviews

The second stage of this study involved 15 in-depth interviews with the finance directors (or other senior executives responsible for determining the non-mandatory contents of annual reports) of the companies whose ICR had been analysed in the first stage of this project. The content analysis helped to identify ICD patterns for each company, and these were investigated further during the interviews.

Two of the authors of this research report together conducted all of the face-to-face interviews. The interviews lasted between 31 minutes and 1 hour 19 minutes each, with an average length of 56 minutes. An interview guide was used to ensure some standardization of topics addressed across interviews (Welman & Kruger, 2001). The list was revised after each interview to include more topics that had arisen from the interview; in particular participants were asked whether they would add any questions. However, not all interviews addressed the same detailed topics, or addressed the topics in the same order. The interview guide was used by the interviewers as a prompt to ensure all the issues in the guide were addressed at some point during the interview, but often the discussion led into areas not covered in the guide, but which were relevant to issues of ICR for the organisation whose ICR practices were being investigated.

Thus, during the interviews, the interviewees were allowed to speak freely, with the researchers guiding them from time-to-time to ensure that the main topics were covered. The researchers often rephrased and repeated what was said during the interviews to

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5 For logistical reasons, one of the 15 interviews could not be conducted face-to-face, so was conducted instead by telephone by just one of the authors of this report.

6 This interview guide is available from the lead author.
ensure that the interviewees had been understood correctly. The researchers also regularly asked interviewees to clarify or to elaborate on some points.

3.4.1 Coding and analysis of interviews

One of the disadvantages of in-depth interviews is that free responses are difficult to analyse (O’Dwyer, 2004). All interviews were recorded using a digital recorder with the permission of the participant (always following the offer of anonymity). The researchers also took some notes during the interviews. The interviews were transcribed and then checked for accuracy by one of the researchers who had attended the interview. They were then read by the other researcher who had attended the interview, while listening to the audio recording of the interviews. This second researcher then began the process of coding the issues discussed in all the interviews.

At the first coding stage, all the interview transcripts were re-read and issues of potential relevance and interest were identified and classified (or coded) freely. In other words, if an issue fell into a category that had already been identified in the same or a previous interview, then the passage in the interview transcript that dealt with this issue was coded to the same code as previously used for other discussion of this issue. However, if a relevant and interesting issue was identified on a topic that had not been previously coded in the same or another interview transcript, then a new code was allocated to this issue. There was no limit on the number of codes that could be constructed in this manner. This process resulted in 32 codes, indicating that there were 32 different issues within the interview transcripts overall that were potentially of interest and relevance to further analysis.

All the coded passages from each interview transcript were highlighted using a qualitative data analysis software package – NVivo – which helped keep track and collate electronically all the passages from all the interview transcripts that had been classified to each code. A particular passage (or part of a passage) could be, and often was, allocated to more than one code, where it dealt with more than one issue of relevance and interest.

The passages within each code were then re-read and the codes collected into larger groups sharing a common theme. This process is commonly referred to as ‘collapsing the codes’ and at this stage the researchers looked for common themes and patterns, and key issues emerging from the vast amount of initial interview data (O’Dwyer, 2004). The purpose of this stage of analysis was to start theorising and focusing upon the factors driving ICR practices within the large UK companies studied.

A further stage of code-collapsing resulted in the allocation of selected passages coded in previous coding rounds being collapsed into six key ICR themes from the preparers’ perspective which had emerged from the interview analysis. These were:

1. The role of ICR in annual reports.
2. The range of media used to communicate ICR information.
3. The relative impact of different media in communicating ICR.
4. The relative aptitude of analysts from different sectors to engage with and understand the effect of IC value drivers, along with other non-financial information provided to them regarding these value drivers.
5. The desirability or appropriateness of standardisation of ICD.
6. The drawbacks and difficulties associated with publicly reporting IC information.

Each of these six key themes are discussed and analysed in Chapter 5, with the insights being illustrated with quotes from the interviews where appropriate.
3.5 Limitations arising from methods employed

As is the case with all forms of research methods, there are several limitations inherent in the above methods. These will be discussed in this concluding section of the chapter.

Firstly, as the sample selection was based on the willingness of corporations to participate, the selection was potentially biased. However, as no statistical generalisations are being drawn from the data, this is not considered to be a major issue (for many of the detailed content analysis insights, the sub divisions of the sample make it too small to draw statistically significant results in any case), although this limitation needs to be borne in mind when interpreting the data.

Secondly, the researchers also encountered the usual issues associated with content analysis concerning reliability. The reliability of content analysis depends upon the ability of the researchers to recode the same data in the same way throughout the analysis process (Milne & Adler, 1999). Reliability of identification and recording of relevant disclosures by one of the researchers was maintained through a process of blind replication of a sample of report sections, whereby the principal researcher independently analysed a sample of the report sections analysed by the other researcher, compared the results of both analyses and identified and resolved the causes of any material discrepancies. Sections 3.3.2 and 3.3.4 above discussed how reliability was sustained.

The third limitation associated with content analysis relates to the use of electronic data, because the contents of a website may be changed on a regular basis. To partially address this problem, for each company studied the entire contents of its website were downloaded on a single day. While this provided a ‘snap-shot’ of ICR practices for each company studied, there was still potentially a problem with making direct comparisons between the different companies studied – as each company was studied/downloaded on a different day. But given that many documents on the websites were pdf files of published corporate reports, and the period of empirical content analysis data collection for this whole study was only approximately eight months (from December 2004 to July 2005), this is not considered to be a major limitation in this study.

Fourthly, similarly to content analysis, the analysis process which involved coding the semi-structured interviews and then collapsing the codes into themes or patterns, needed consistency. The researchers had regular meetings and email exchanges to ensure a degree of consistency on this matter. But ultimately, as the insights provided in this report are a distillation of many hours of interviews, and many hundreds of pages of interview transcripts into six overarching key themes, it is unlikely that any issues of consistency would have resulted in a substantially different set of overarching key themes arising from the interview analysis.

Finally, it is not possible to identify the organisations whose ICR practices have been studied in the research report because of confidentiality agreements with the interviewees. This places limits on the ability of other researchers to independently replicate the findings of this study. But this is a drawback common to all studies that conduct empirical investigations with the guarantee of anonymity for participants, and has not affected the acceptability of the results of many such studies.

Having discussed the key research methods used, this research report now proceeds to provide and analyse the key empirical findings from this study. This analysis is covered in the next two chapters. Chapter 4 covers analysis of the content analysis data, while Chapter 5 covers analysis of insights from the interviews.
4. Analysis of IC disclosure practices

4.1 Introduction

This chapter reports the results of the empirical content analysis investigation into the ICD practices of the UK companies studied in the four distinct sectors. It differs from prior ICD studies in that it analyses a wide range of corporate media for their IC content. Section 4.2 reports the voluntary ICDs by category and elements for the total sample, whilst section 4.3 reports ICD by company size and sector. It finds major differences between the IC elements reported in each sector studied, but surprisingly finds the highest average volume of ICD to be in a sector which does not appear to rely on IC value drivers to the same extent as in two of the other sectors investigated.

In section 4.4, ICD is analysed by reporting media. The study finds that a range of corporate media were used for communicating ICD, and that the proportion of disclosures devoted to different IC elements in the annual report were not a good proxy for the proportion of disclosures across all corporate media. In section 4.5, a brief discussion of ICD by type of information is undertaken and the findings indicate that 80% of ICD takes a narrative form rather than monetary or quantified in other terms (broadly consistent with one of the findings of Beattie et al., (2004) regarding UK narrative reporting more generally). Finally, in section 4.6, a summary is provided, including analytical commentary upon the ICD data. In addition to providing analytical insights based on the content analysis data, the material presented in this chapter sets the context for discussion and analysis of the interview data in Chapter 5.

4.2 ICD by category and elements

As shown in Figure 4.1, the study found that the external relational capital category accounted for 61% of ICD reported. By comparison, employee competence (22%) and internal structure (17%) were significantly less frequently reported. The pattern of reporting external relational capital is consistent with previous national studies in a number of different countries (Guthrie, et al., 2006). This skewing towards external relational issues is unsurprising considering that this is voluntary external disclosure and the elements that make up this category are important for external stakeholders (for example, customers and distribution channels).

Figure 4.1: Proportion of total of IC disclosures by category
In analysing disclosure of the individual elements which comprise the three broad IC categories, Table 4.1 indicates that all 20 elements in the detailed tripartite model were used by at least one company in the sample. This is surprising, as several other national studies of annual reporting in other countries have indicated that some IC elements are not disclosed by any companies (see, for example, Abeysekera & Guthrie, 2005; Bozzolan et al., 2003; Guthrie & Petty, 2000a). However, this current study, which encompasses a number of media other than the annual report, indicates that all elements were reported to some extent.

As indicated in Table 4.1, the total number of ICDs found across all reporting media in the sample of 15 companies were 2,676. It should be noted that as these disclosures were via a variety of different reporting media, some could represent similar disclosures within one company duplicated in more than one type of report.

Table 4.1: Total number of disclosures per element, from most to least reported elements

<table>
<thead>
<tr>
<th>Category of disclosure</th>
<th>Number of companies disclosing</th>
<th>Number of disclosures</th>
<th>% of total disclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.2 Customers (inc: new product development)</td>
<td>15</td>
<td>546</td>
<td>20.40%</td>
</tr>
<tr>
<td>2.5 Distribution channels</td>
<td>7</td>
<td>270</td>
<td>10.09%</td>
</tr>
<tr>
<td>3.4 Work-related knowledge</td>
<td>15</td>
<td>257</td>
<td>9.60%</td>
</tr>
<tr>
<td>2.4 Company reputation</td>
<td>15</td>
<td>224</td>
<td>8.37%</td>
</tr>
<tr>
<td>2.3 Customer satisfaction and loyalty</td>
<td>10</td>
<td>199</td>
<td>7.44%</td>
</tr>
<tr>
<td>2.6 Business collaboration</td>
<td>14</td>
<td>183</td>
<td>6.84%</td>
</tr>
<tr>
<td>3.1 Employee</td>
<td>13</td>
<td>170</td>
<td>6.35%</td>
</tr>
<tr>
<td>1.1 Intellectual property</td>
<td>6</td>
<td>131</td>
<td>4.90%</td>
</tr>
<tr>
<td>1.2 Management philosophy</td>
<td>13</td>
<td>125</td>
<td>4.67%</td>
</tr>
<tr>
<td>3.2 Education and vocational qualifications</td>
<td>14</td>
<td>99</td>
<td>3.70%</td>
</tr>
<tr>
<td>1.4 Management processes</td>
<td>6</td>
<td>97</td>
<td>3.62%</td>
</tr>
<tr>
<td>2.7 Favourable contracts/licensing agreement</td>
<td>9</td>
<td>93</td>
<td>3.48%</td>
</tr>
<tr>
<td>2.1 Brands</td>
<td>8</td>
<td>73</td>
<td>2.73%</td>
</tr>
<tr>
<td>3.3 Training</td>
<td>9</td>
<td>58</td>
<td>2.17%</td>
</tr>
<tr>
<td>1.6 Networking (communication systems)</td>
<td>13</td>
<td>48</td>
<td>1.79%</td>
</tr>
<tr>
<td>1.3 Corporate culture</td>
<td>10</td>
<td>46</td>
<td>1.72%</td>
</tr>
<tr>
<td>2.8 General research and development issues</td>
<td>3</td>
<td>46</td>
<td>1.72%</td>
</tr>
<tr>
<td>1.5 Information systems</td>
<td>4</td>
<td>4</td>
<td>0.15%</td>
</tr>
<tr>
<td>1.7 Financial relations</td>
<td>1</td>
<td>4</td>
<td>0.15%</td>
</tr>
<tr>
<td>3.5 Innovativeness of employees/teams of employees</td>
<td>3</td>
<td>3</td>
<td>0.11%</td>
</tr>
</tbody>
</table>

Table 4.1 shows that the most reported element was customers, with 546 mentions across all 15 companies, and the least reported element was innovativeness of employees/teams of employees with only three mentions, one by each of three companies.
Table 4.1 indicates that within external relational capital, the two most reported elements were customers and distribution channels, which together accounted for 30% of total IC disclosures across all categories. Although all companies in the sample reported ICDs in the customer element, only slightly less than half reported ICDs in the distribution channels element (all three retail companies, two of the ICT/software companies, and one company in each of the pharmaceutical/biotechnology and property/utilities sectors). Within employee competencies, work-related knowledge (all 15 companies reporting) and employee information (13 companies reporting) together accounted for 15% of total disclosures across all categories. For internal structure, the two most popular elements were intellectual property and management philosophy, which together accounted for nearly 10% of total IC disclosure across all categories. Although 13 companies reported ICDs on the latter element of management philosophy, only six reported ICDs in the intellectual property element (all four pharmaceutical/biotechnology companies plus two of the software/ICT companies).

The least reported elements in the internal structure category were financial relations and information systems which together only accounted for a total of eight out of the overall 2,676 disclosures. Only one company reported on the financial relations element, while four companies reported on the information systems element. This low level of reporting on these two elements may be considered surprising as Holland (2004; 2006) indicates that managers consider their relationships with financial markets (in particular financial analysts and fund managers, especially in terms of their reputation and credibility among these financial market players) to be an important element of IC in helping to reduce their cost of capital, and as information systems could be considered to be vital in giving competitive advantage in terms of the efficient processing of information.

In the employee competencies category the least two reported elements were innovativeness of employees/teams of employees (three companies with one disclosure each) and training (with nine companies reporting ICDs), which together accounted for a total of 61 disclosures. Again this was surprising because innovation is an area where companies might be considered to derive competitive advantage in IC terms, and a highly trained workforce is likely to be more effective in generating value than a less well trained workforce. Finally, in the external relational capital category, the two least reported elements were general research and development and brands which accounted for a total of 46 and 73 disclosures respectively, with three companies reporting ICDs on general research and development issues and eight companies reporting ICDs on brands. The finding on general research and development disclosure ICDs may initially appear to be a surprising result, given that in other studies managers have recognised research and development as an important IC element to report to the capital markets (Holland, 2004, 2006). However the apparent low disclosure level on research and development is partially a function of the research definitions (shown in Appendix B) used to conduct the content analysis, in which development of new products is captured under the ‘customers’ element, where the disclosure of this element is in the context of gaining or maintaining competitive advantage, (consistent with Guthrie & Petty, 2000a). So the general research and development element (2.8) only comprises general commitments to research and development, as most specific research and development was categorised in element 2.2 (customers). Nevertheless, the finding on brand disclosure is surprising given that other studies have found that managers perceive that capital markets are interested in this factor (Holland, 2004, 2006). Perhaps this is an element that is communicated more in private briefings with analysts, an issue addressed in the interviews analysed in Chapter 5.
4.3 ICD by company size and sector

4.3.1 Company size

Figure 4.2 highlights that company size is a factor that may explain the frequency of ICDs, although the small sample size in each ‘size category’ means that no statistically generalisable conclusions can be drawn on this point. The largest companies in our sample (FTSE 100 companies) provided considerably more ICDs than the smaller companies, although IC is reported in all size companies.

Figure 4.2: Average IC disclosures per company by size of company

From a theoretical point of view, previous studies of voluntary disclosure of social and environmental elements, as well as IC, indicate that size is a significant explanatory factor in voluntary disclosure levels (Guthrie & Abeysekera, 2006). That is, larger companies tend to disclose more than smaller companies and the observations from this study reinforce these previous insights and add further support for large company effects noted in the previous literature.

4.3.2 Sector

As indicated in chapter one, certain industry sectors would be expected to form part of the ‘knowledge economy’, and therefore the elements that make up IC would be expected to be more significant as value drivers for these companies (see also Roslender & Fincham, 2003). Such companies would therefore be expected to be more active in communicating the intellectual value drivers of their businesses to the capital markets and other interested stakeholders. As discussed in Chapter 3, four industry sectors were selected for this study (software/information technology; pharmaceuticals/biotechnology; real estate/utilities; and retailing). These were selected because successful management of IC is likely to be a more important factor in success for companies in the pharmaceutical/biotech and ICT/software sectors than in the other two sectors, with property/utilities expected to have low reliance on IC and retailing a moderate reliance (for reasons discussed in section 3.2). It might, therefore, be reasonable to assume that a greater proportion of management time in the pharmaceutical/biotech and ICT/software sectors is spent managing IC, and that ICR is likely to be a more significant and important activity in informing capital markets of the key value drivers of these businesses, than in the other two sectors. Prior research studies in ICR have shown that there has been such a ‘knowledge economy’ industry effect (Bozzolan et al., 2006; Petty et al., 2006).
As indicated in Figure 4.3, companies in the sample from the two ‘knowledge economy’ sectors were not the main reporters of IC information. The average for these two sectors each accounted for about 24% of the total disclosures overall in this study. The sector which most frequently reported IC was retail, with an average of about 33% of total disclosures. This was a surprise because, while the retailing sector does rely on IC, it was expected that these businesses which also rely to a great extent on more traditional tangible value drivers would report less about IC than ‘knowledge economy’ businesses. Also the real estate/utilities sector, which relies on a much larger proportion of tangible assets, reported a similar level of IC as that reported in the software/ICT sector.

Unlike previous studies, it was decided in this study to explore at a deeper level the pattern of disclosure via each industry sector and the three categories of disclosure. Figure 4.4 shows that the external relational capital category has the highest number of disclosures in each of the four sectors. In the retail and ICT/software sectors, the number of disclosures in the external relational capital category far outweighs the number of disclosures in the other categories. In the real estate/utilities sector, external relational capital disclosures also outweigh the number of disclosures in the other categories, but not by so much. In these three sectors it is clear that voluntary ICR of elements in the external structural capital category is very important as it outweighs the other categories substantially. However, for the pharmaceuticals/biotech sectors there is a much greater balance between the different categories.
4.4 ICD by reporting media

As indicated in chapter two, many of the previous ICR national studies have restricted analysis to annual reports (Guthrie & Abeysekera, 2006). Similarly, the overwhelming majority of social and environmental reporting studies have relied on annual report disclosures (Guthrie & Abeysekera, 2006; Unerman, 2000). Unlike previous ICR studies, as discussed in chapter three, this study has examined ICD in several forms of corporate reporting media, as shown in Figure 4.5.

Figure 4.5: Proportion of total IC disclosures by media

As indicated in chapter two, many of the previous ICR national studies have restricted analysis to annual reports (Guthrie & Abeysekera, 2006). Similarly, the overwhelming majority of social and environmental reporting studies have relied on annual report disclosures (Guthrie & Abeysekera, 2006; Unerman, 2000). Unlike previous ICR studies, as discussed in chapter three, this study has examined ICD in several forms of corporate reporting media, as shown in Figure 4.5.
Figure 4.5 illustrates convincingly that a wide variety of reporting media were used for ICD. Furthermore, the largest number of disclosures were on web pages (36%), with disclosures in the annual report accounting for slightly less than a third of the total disclosures. Thus annual report disclosures in this study’s sample only provide a small, but still potentially very important, part of the overall picture of ICR.

This raises interesting questions about the balance of disclosures in annual reports (in terms, for example, of the split between different categories of disclosure, different sized companies or different industries) compared to those in other external ICR media. That is, do the annual report disclosures reflect disclosures in the other documents? The next two graphs (Figure 4.6 and Figure 4.7) examine this important issue.

**Figure 4.6: Number of disclosures in different reporting media by category**

![Bar Chart]

Figure 4.6 illustrates that the different reporting media have differing proportions of disclosures in each IC category. Therefore a reliance on analysis of ICD in the annual report alone is unlikely to provide an accurate picture of overall ICR practices.
Figure 4.7 shows that the different size companies seem to place a different emphasis on different reporting media in their ICR strategies.

However, the results shown in Figure 4.6 and Figure 4.7 need to be interpreted with caution. It may be inappropriate to assume that there is an actual ICR strategy, rather than simply ad hoc reporting which we happen to regard as ICR. This is potentially an important caveat in interpreting ICDs on websites, as there is much more scope for ad hoc reporting via websites, which can have information added and deleted continuously, than with a planned and constrained annual report – this issue is explored further in the interview analysis in Chapter 5.

4.5 ICD by type

Figure 4.8 shows that IC disclosures are overwhelmingly narrative. Previous studies have tended to indicate that monetary expression of IC elements in corporate reports is a relatively rare practice (see, for example, Beattie et al., 2004). This current study of UK ICR practices reinforces this observation.
4.6 Summary of ICD content analysis

The ICD content analysis data presented and analysed in this chapter indicates that, for the sample used in this study of 15 large UK companies across four sectors:

- Consistent with ICD analysis in other countries, disclosures in the external relational capital category predominate. In the sample for this study they accounted for 61% of all ICDs overall across all reports studied.

- Disclosures in the external relational capital category were much higher than disclosures in the other two categories for each of the sectors examined, other than the pharmaceutical/biotechnology sector where there was a more even balance between each of the three categories.

- Within the external relational capital category, the customers (including new product development related research and development) and distribution channels elements together accounted for about half of the ICDs (with these two elements therefore accounting for about 30% of overall ICDs across all three categories).

- The largest companies in the sample (the seven FTSE 100 companies) on average had a much higher frequency of ICDs across all media types than smaller companies. Again, this is consistent with other content analysis studies which have tended to find a size effect.

- Counterintuitively, companies in the retail sector, which does not rely on IC value drivers to the same extent as the two ‘high’ IC reliance sectors, had a higher frequency of ICD than each of the other sectors. Furthermore, the ‘low’ expected IC sector (property/utilities) had approximately the same frequency of ICD per company as one of the ‘high’ IC sectors (ICT/software).

- A wide range of media were used to report ICDs, with the annual report accounting for less than a third of total ICDs across all reporting media. Furthermore, the pattern of ICDs in the annual report did not reflect the pattern of ICDs in other reports, so examination of ICDs in annual reports was not a good proxy for overall ICD practices across the sample.

Given the small sample size (which is partially a factor of the in-depth manner of the research method for each company in the sample) these findings cannot necessarily be generalised. But they do provide several useful and novel indications regarding UK ICR practices, which are further explored in the interviews analysed in the next chapter.
5. Analysis of interview data

5.1 Introduction

This chapter analyses insights obtained during the interviews with senior financial executives of the sample companies. As would be expected, there was considerable diversity in the detailed points raised and discussed between each interviewee. As explained in the methods chapter, an exhaustive analytical process was followed of reading, re-reading, and coding the interviews, and then re-reading and collapsing the codes. From this process several key themes emerged.

This chapter focuses on the following six key themes which were identified from this analytical process, and each of which contribute new insights to the academic literature on ICR from the preparers’ perspective:

1. From the preparers’ perspective, the annual reports have very little, if any, information content beyond confirming information that has already been released to the stock markets during the year. Although this confirmatory role of audited annual accounts is important in adding credibility to information that has already been released into the public domain (and the discipline this imposes may also be seen to increase the credibility of new information released via other media given an anticipation that it will be covered in future audited reports), the annual report was not seen as a particularly useful medium for communicating complex and/or new information about IC.

2. Preparers used a diverse range of media in their IC communication strategies.

3. Different media were regarded by the preparers of IC accounts to play different roles in communicating ICD, with the most effective media from the preparers’ perspective being face-to-face meetings with investors and analysts (where information already in the public domain could be discussed and explained in a more interactive manner), and the least effective being disclosures in the annual report (primarily because these are considered static, dated and unidirectional), reinforcing finding 1 above.

4. Preparers perceived that there was a differential aptitude of analysts from different sectors to engage with and understand the effect of IC value drivers, along with other non-financial information provided to them regarding these value drivers.

5. Preparers’ generally considered that the standardisation of ICR was neither desirable nor appropriate.

6. Preparers’ identified several drawbacks and difficulties associated with publicly reporting IC information.

Each of these six key themes are discussed and analysed in separate sub-sections in this chapter, with the insights being illustrated with quotes from the interviews where appropriate.

However, before embarking on this discussion and analysis, one important factor should be made clear. At the beginning of most of the interviews, the researchers were asked by the interviewees to clarify what the term intellectual capital encompassed. It became
apparent during much of these discussions that the term *intellectual capital* was not widely used by the senior financial executives being interviewed. But once its scope had been explained, it became equally clear that each of the interviewees was acutely aware of the components of IC upon which their company relied (these observations are consistent with Roslender & Fincham, 2003). Each interviewee was also aware of their company’s distinctiveness in terms of what we term *intellectual capital*, although they may not have previously used this expression. Thus it was found that while the terminology of *intellectual capital* was not widely used within the UK companies studied, all were acutely conscious of what we (and fellow academics, along with practitioners in other countries) term their IC value drivers, and how their particular IC value drivers were distinct from (and gave them some form of crucial competitive advantage over) the IC attributes of other companies. This observation, which is consistent with the findings of other ICR interview-based studies (Holland, 2004, 2006; Roslender & Fincham, 2003), applies to companies in each of the sectors studied, even companies in the real estate/utilities sector where we (and the companies themselves) recognised that IC was proportionately not a major source of shareholder value1 as evidenced, for example, by the following quotes from interviews:

I think we have a reputation for being very straight in our dealing, very quick in the way that we manage things, give people very honest answers, and very quick answers. And when we say that we’re going to do something we do it, and we do it quickly. So I think that’s important. [Co. L – real estate/utilities]

We’re slightly different in so far as a lot of property sector, a lot of property companies, actually farm out their management. We don’t. We do it all in-house and we think there is a tremendous value attached to the people who are employed in the company. [Co. N – real estate/utilities]

I think to be able to distinguish us from others in our sector, probably one of the critical success factors is the ability to manage the regulators. And so putting a lot of effort into recruiting, training, retaining the right people in regulation teams. Actually sensitising everybody, certainly from lower middle management upwards. [Co. M – real estate/utilities]

5.2 IC and the annual report

The role that ICD in the annual report played in providing ‘new’ information to stakeholders was considered by interviewees to be very limited. Although the interviews aimed to uncover views regarding the role of ICD in providing information to a broad range of stakeholders, the interviewees tended to focus in their responses on information provision to financial stakeholders (particularly shareholders and the capital markets), with the dominant view being that such stakeholders would not, and should not, discover important new information via disclosures in the annual report and accounts. There were a variety of reasons given to support this view. Principal among these reasons was that the annual report was primarily an important summary of information that had been disclosed to the capital markets during the course of the previous year, and therefore does not contain information with any news value:

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1 One caveat to this observation derives from the difficulty we experienced in obtaining interviews from companies in the real estate/utilities sector. Many companies in this sector turned down our request for an interview by explaining that they did not regard their company as relying on, or using, intellectual capital (even after we carefully explained what we meant by the term *intellectual capital*). So it could be that the companies in our sample were self-selecting, on the basis that those real estate/utilities companies which agreed to participate were those which were more aware or more active in terms of intellectual capital management than many other companies in this sector.
There should be no new information in those report and accounts, other than information which has been communicated to investors, analysts, over the last 12 months anyway. So that they don’t, in themselves, attract a great deal of attention from the investing community. [Co. B – ICT]

The annual report… comes out once a year and it’s historic and it’s not very real time, where our industry moves so fast and things change very quickly on a day-to-day basis…. I’m sure people do read it, but… if you talk to the average investor they’ll say most of what’s in here I know already, we’ve already discussed it throughout the year, so it’s dead and it’s gone. [Co. F – pharma]

Another reason given was that investors may become concerned or alarmed if there was important ‘new’ information in the annual report about value drivers, as this information should have been provided to the capital markets on a more timely basis, rather than waiting for the annual report to be published:

We know, because we ask them, we know that the analysts do look at the annual report. But they don’t, I think… look in it for something which is absolutely brand new to them. I think they’d be quite worried if they were reading a lot of stuff in the annual report which they hadn’t heard through either [drug] trial results coming out earlier on, or some press release… I think we would be in some difficulty if we put a lot of new news into the annual report which we’d been sitting on for three to six months prior. Because we wouldn’t then be communicating on a real-time basis to the market. [Co. E – pharma]

If you’re going to talk about a new product launch [in the annual report] you’d better make sure it’s already been discussed, and communicated somewhere in the results slides or the notes. [Co. B – ICT]

Given that the annual report and accounts is only published annually, it was considered an unsuitable medium through which to convey information about dynamic value drivers because such information would quickly become outdated. Thus it was widely regarded that the annual report has been superseded in usefulness for ICR by more dynamic media such as websites:

You get a little bit constrained, you find, when you’re writing report and accounts because the stuff goes out of date so quickly. [Co. H – pharma]

I think [the annual report] is devalued greatly, with modern technology. The whole wave of the world has become much more instantaneous in terms of its reaction to information very quickly. [The annual report] seems to me to be a somewhat outmoded form of communication. [Co. F – pharma]

Furthermore, interviewees considered that the format and statutory contents of the annual report and accounts made it a dense and therefore very difficult document to comprehend:

The point about putting too much detail in there, and making the report too big, is that people won’t read it, they’ll skim it. What we want people to do is to read it.… So we want to get the right detail in there that communicates what we want to communicate about our business, and what we don’t want people to do is to fall asleep while reading it. [Co. H – pharma]

However, information could be presented in a manner in the annual report to distinguish and thereby clarify the unique value drivers of a particular business:

It probably is only, the front… it’s not even 20 pages, that will be really important in terms of what distinguishes us from everyone else. Pretty much most of the rest is just description. [Co. M – real estate/utilities]
Reinforcing the above perceptions of reasons for disclosures in the annual report not being a key source of new information (IC or other) to stakeholders, one interviewee (a CFO) explained:

I almost never take any questions about the annual report, no one hardly phones me about [it] when we issue the annual report, it’s a total non-event. [Co. F – pharma]

However, despite the general consensus that ICDs in the annual report do not, and should not, have any substantive news or information value, many of the interviewees did regard such disclosures as playing an important role in other respects. Principal among these roles were provision of some basic information about IC value drivers to stakeholders who were perhaps less familiar with the business:

I think really the role where it adds value, rather than just offers the same information we would give in our results briefings, is for those relatively unfamiliar with our philosophy drivers. [Co. A – ICT]

Absolutely critical. The role of the corporate report is basically to communicate to the shareholders… what we’re doing and what our plans are. In it’s simplest form… we’re never going to give sort of real strategic information… I think the public report is meant to guide investors in terms of what our core business is all about and what our plans are. [Co. I – retail]

Interviewees also considered a role of the annual report was to act as an important and credible source of reference, to confirm or back-up information provided via other sources:

I think the published material is back-up. You kind of point to that and say ‘look there it is, that’s statutory information’ so you can rely on that. But… I don’t think anybody wades through [the whole of our annual report]. [Co. L – real estate/utilities]

I think the report and accounts is clearly absolutely essential, it is the basic building block. But I think that in itself does very little. I think the value, or the assessment of value, is much more done by the analyst. [Co. O – real estate/utilities]

The annual report was also considered useful in providing information to a broader range of stakeholders than just the shareholders and analysts in capital markets (despite the predominant focus on these financial stakeholders in the responses of many interviewees):

It’s an update from a year ago in many respects as well. So it’s a clear document that gives both soft information about the business, and numbers which we can deliver to investors, potential investors, stakeholders of all kinds basically. So I think the annual report’s, relatively speaking, quite a wide communication tool, not just for investors in capital markets. [Co. G – pharma]

I think I remember one or two comments where people say they do read it. In fact our new marketing director… said that it was one of the best reports that he’d read… and it was one of the things that attracted him to the company. He saw that as a positive thing, not quite a shareholder or whatever, but somebody coming into the business. So the annual report is a positive thing. [Co. G – pharma]

Thus, ICD in the annual report was perceived to play a useful but very constrained information provision role by the preparers interviewed for this study. As the annual report was generally considered to contain information of very limited (if any) news value, the question arises regarding what other forms of media are perceived by the preparers as useful and effective in disseminating information about the IC attributes of a company. Views on this issue are discussed in the next section.
5.3 Diversity in media used to communicate IC information

The content analysis in Chapter 4 demonstrated that IC was disclosed in a variety of media. However, this content analysis could only analyse published documents, so could not ascertain whether there were any non-documentary media which were used in the dissemination of IC information. This section presents the insights from the preparers who were interviewed regarding the variety of media used in their ICD strategies, and the type of IC information appropriate to each type of media.

Indicating that the results in section 4.4, showing ICD in a variety of media, were the outcome of deliberate managerial decisions, rather than a coincidental result of the way the content analysis was conducted, the interviewees explained that the annual report was just a small part of their ICD communication strategies. For example:

The annual report is just part of it. I think that in terms of how we communicate, we definitely have a multi strand communication model. [Co. M – real estate/utilities]

[We communicate information about our intellectual capital value drivers in] a number of ways. One way is one-to-one meetings with analysts and investors… Then you've got other documents of course, like the annual report. That goes into a lot of detail about the [drug development] pipeline and the projects that are coming, talks a lot about the sales and the sales force and how they market it, and the sales model that we pursue, and again we talk generally about the business model… We've got the quarterly reports, and we've got the four quarterly press releases where again we go in to quite a lot of detail and we do a presentation around all of that. And then you've got all the ad hoc meetings… the banks run various investor conferences.  
[Co. F – pharma]

Websites and face-to-face meetings with investors were generally regarded as being key elements in this ‘multi strand communication model’:

With the web you can go to more depth, you can keep it up to date. [The annual report] is a once a year communication, the web is live, sort of living, breathing. And the web also plays other roles as well from the point of view of product placement, things like recruitment… [Co. J – retail]

[The annual report is] one bank of information which, if you like, is statutory. And then we go a bit further… [through] the website, which is accessed pretty aggressively, pretty actively, and contains all of the information in the corporate report and accounts and a lot more. But then thirdly there is a very intense programme of investor relations… and with other stakeholders there are regular meetings… in terms of the modes of communication those would be the principal three. And I would say that... the intellectual capital plus points, if you like, are communicated in different ways on each one. [Co. L – real estate/utilities]

This notion of IC information being presented or packaged in a different manner through each of the media was also reflected in the comments of many other interviewees. For example:

I think the information you give to analysts through the… annual results presentation, or through any other analysts presentation, it’s slightly deep… we’ve got to be very careful, we don’t actually give any more financial information… It is packaged differently… for a different audience [Co. I, retail]

I think the website and the annual report we evolve in parallel. We see the content as pretty much the same content, we just package it up a little bit differently for the website, perhaps break it up into more easily digestible bits. [Co A – ICT]
The website and annual report go to a wider detail, because it’s meant to be a complete factual information, with views on the company. When in the presentations… you perhaps have more emphasis on a particular area that’s either something that you think is particularly apt to that period, or that’s an area where the capital markets or the analysts are particularly concerned about or want to have more information on. So you can perhaps tailor the emphasis more in direct communications.

[Co. L – real estate/utilities]

However, it was recognised that while the tone of content of the disclosures would vary between different media, it was important that the overall IC message was consistent across the various media:

I think the overriding principle would be that they should be consistent. And therefore the messages that are contained within them should be consistent.
[Co. J. retail]

We try to make sure that… the website and the accounts and the investor presentation are all consistent in their themes and the information that is provided.
[Co. L – real estate/utilities]

These findings are consistent with Holland (2006), who found that private disclosures to analysts and fund managers were often used to provide more detail on the issues which had already been disclosed in broader terms via public disclosure media such as annual reports.

One of the developing roles of corporate websites in the effective communication of IC information was considered to be their ability to make information which may previously have been restricted to a small number of people much more widely accessible. A good example of this is the use companies make of their websites to either webcast their annual general meetings and results presentations live, and/or to make this content available to download after the meetings, and/or to make the content of presentations to analysts available on-line (for example, in the form of the PowerPoint presentation slides and notes):

I think that modern technology has helped the fair disclosure of information a lot. Because nowadays any investor presentation you have, it’s webcast and at least recorded and put on the website. And in our case we actually do it [as a] live webcast as well, so if a retail investor wants to… they can listen, they can’t ask a question but they can do everything else. We [also] have an investor question website.
[Co. B – ICT]

By recording our analyst presentations on our website, we’re saying… there should be no difference from what we’re telling the analyst, and what we’re telling the ordinary shareholders and what we’re telling everybody else. [Co. N – real estate/ utilities]

However, not all the interviewees considered that ICDs on their website were of major use to investors:

[Our] website is definitely not there for investors. It’s there for customers and prospective recruits. And the reason it’s not there for investors is because frankly investors don’t bother to read websites…. because we’re a small company, and because we’re newly listed, and because we do everything by the book, when a broker calls us and says I’ve got… someone who’s potentially interested in investing in your company, they will almost always get an hour with me or [the CEO], so they’re not actually interested in reading…. some of the junior buy-side analyst guys may do a bit of research on the website. [Co C – ICT]
This perspective was not widespread, and might be more applicable to small companies which are relatively new to the capital market and have a small shareholder base, while not being applicable to larger and more well established (in stock market terms) companies.

Having established that the preparers of accounting information regard a variety of media as useful for disseminating information about their IC value drivers, the next section analyses the preparers’ perceptions of the relative role and effectiveness of each of these media.

### 5.4 Role of different media in communicating IC information

This section focuses upon an analysis of preparers’ perceptions regarding the relative role of the different ICD media discussed in the previous section in providing effective information (principally) to the capital markets. Consistent with Holland (2004; 2006), the overwhelming view was that discussion and explanation (of information already in the public domain) in face-to-face meetings with investors and analysts was the most effective medium through which to communicate information about a corporation’s IC value drivers and distinctiveness, and the manner in which these IC attributes enhanced the future economic sustainability of the business. The annual report was generally regarded as having minimal impact in effective communication:

I would say that the report and accounts was the least important…. in terms of communicating to the investors the intellectual capital, it is done by the results presentations and by… seminars in each of the business. And that's where we get the major chance to put our foot forward in terms of explaining why we think we can create value and why there is a value in [our company]. That’s supported by those presentations being on the website both as full video… [and] slides… But in terms of driving the intellectual capital, it’s those investor presentations which I think is where we would view ourselves as creating the most communication and value…. if we were to have a new product launched through the year, we would then put our press release out and again that would find its way to the analyst and investor community through the normal stock exchange channels. That would certainly be a driver. [Co. A – ICT]

The return on 200 investors sitting in a room where you give a very bland presentation is probably minimal, very low, compared to sitting and spending an hour having a very detailed discussion one-to-one with maybe two or three people. So we tend to spend more time doing that than some of the other activities. The other activities we see as necessary, and have to do them. Some of them are regulatory in the sense of quarterly results and annual reports etc. The website is more of a choice, and I think I’d rank them then probably as saying: the one-on-one is probably first, the healthcare conferences are useful… and then I’d say the website is a good tool in terms of communicating very specific information. And then I think… the annual report is an okay document. The trouble is it comes out once a year and it’s historic and it’s not very real time where our industry moves so fast and things change very quickly on a day-to-day basis. [Co. F – pharma]

We can’t go telling an analyst something that isn’t in the public domain. So pretty much everything we would talk about would be somewhere in [the annual report]. Sometimes explanations won’t be…. [In face-to-face meetings] we’re allowed to give explanations for what’s gone on, provided what’s gone on is in the public domain. [Co. M – real estate/utilities]
This section now explores four of the factors contributing to this view on effectiveness of ICD in different media that were most prevalent in the interviews. Firstly, reinforcing some of the issues examined in section 5.2 above, there were issues of timeliness of information produced and disseminated through different media, with ICD (and other information) in the annual report considered to be outdated almost before the report was printed, and becoming more outdated as time passed before the publication of the following year’s annual report. Conversely, ICD via websites and some other documentary media could be updated regularly:

Report and accounts are an annual thing, and you have to write them in the context that they can be read any time between now and a year’s time… whereas if you’re doing a presentation you can much more talk to the point of this week. You see, again, you get a little bit constrained… when you’re writing report and accounts because the stuff goes out of date so quickly. [Co. B – ICT]

Secondly, many of the preparers interviewed for this study regarded some of their IC value drivers to be both complex and unique. They considered face-to-face interaction a more effective medium than unidirectional documentary communication to effectively communicate and explain the impact on their business of these complex and unique value drivers.

In other words, face-to-face meetings enabled the communicators to gauge how effectively the message they were communicating was being received by their audience, to instantaneously tailor the manner in which they delivered their message in light of reactions (both verbal and non-verbal) from the people to whom they were talking at the time, and to respond to questions and requests for clarification from these people regarding IC data that was often more complex and subtle for analysts and investors to understand than more conventional financial metrics:

One of the issues with this kind of description, intellectual capital…, if you’re starting from a zero base with somebody to try and justify your position, you haven’t got time in a results announcement, interim, final results to do that. So those tend to concentrate solely on the actual financial performance. And for those who are very familiar with the company and what are the drivers, they will see some bits of evidence as further support for the intellectual value. But it’s playing to an audience where you’re presuming knowledge… the investor presentations… will start with much lower expected knowledge. In fact most people in the room will be very knowledgeable but we take their memory back, and remind them about the building blocks as to why we have the position that we have. [Co. B – ICT]

You can see where they’re coming from, exactly what their issues are, and therefore you can direct your communications to be more interactive and actually give substance and give examples and talk them through it in a lot more detail. [Co. L – real estate/utilities].

We’re then putting much more flesh, and they’re asking many more questions, than are generally available in [the annual report]. Quite simply because you can’t have a conversation in your an annual report, and nor frankly would I want to. [Co. C – ICT]

It’s just the interaction with someone, the fact that they can have a two-way conversation. [Co. O – real estate/utilities]

Thirdly, and building on the ability of communication in face-to-face meetings to be adapted to the reactions of the audience, there was a widespread perception that IC (among other types of) information could be communicated in a more focused and in-depth manner in face-to-face meetings than in written documents. Although careful to ensure that IC issues which were not already in the public domain were not discussed...
in these meetings, this greater focus and depth was perceived to enable fuller explanations to be given regarding IC value drivers of which the market was already aware, and the possible impact of these drivers on future economic performance and sustainability:

I think the most effective is one-on-one meetings, I mean because by dint of that you’ve got the time, you’re focussed, you’re on that one subject. [Co. F – pharma]

I guess a lot of the generalists tend to wait for the meeting for the reasons I just said. That they’re probably going to find a lot of it quite technical and they need it interpreted, perhaps the opportunity to ask us some questions so they get a better understanding. [Co. F – pharma]

You can’t give examples in the straight written word in many cases. I think we try constantly to, in answering someone’s question, illustrate it with what we’ve done to prove the point. [Co. D – ICT]

Fourthly, there was a perception among some of the interviewees that face-to-face meetings were a medium through which the trust of investors and analysts in a company’s managers, and in the information provided by the managers, could be more effectively developed than through impersonal documentary communication:

Most of the confidence the market gets, or anyone, the press, government, will be from one-on-one communications or presentation. And we do put a significant effort into developing our presentations and making them impactful. [Co. M – real estate/utilities]

The trust builds up on a one-to-one. It’s people knowing you, and they talk to other people in the city and they say ‘what do you think of these guys’. If they’re always getting the positive message… then it builds up the confidence. [Co. O – real estate/utilities]

Despite the overwhelming view that annual reports were not a particularly effective medium for communication of complex and/or new IC information, there was some recognition that these perceptions needed further research to verify them:

There's a lot of myth and anecdote, and we assume for example that the annual report is pretty much used by shareholders and perhaps isn’t used as a decision making tool by new shareholders. We assume the website is for people trying to get an initial understanding of the company rather than those who know us well… you know we may just be not quite spot on in our assumptions. [Co. A – ICT]

Despite this caveat on the need for further research to demonstrate whether managerial perceptions were realistic, the overwhelming view was that communication of information about IC drivers through the interactive medium of face-to-face meetings was much more effective than communication through written documents. One further important factor, from the preparers’ perspective, in the effective communication of ICD was the aptitude of recipients of this information to understand and evaluate the information. The next section discusses views among some of the interviewees regarding how well equipped analysts in their sectors were to appreciate the importance to corporate value of specific IC factors.
5.5 Perceptions of relative aptitude of analysts in different sectors

Preparers’ perspectives analysed in this section indicate that the manner in which companies regard analysts engaging with and assimilating corporate disclosures regarding IC value drivers is dependent upon the amount of time they believe the analysts have available to devote to analysing a particular corporation. In essence, it appears that analysts in relatively high value and high performance sectors may have more time to develop a deeper understanding of ICD than analysts in less wealthy sectors. Also smaller companies believe they receive less analyst time than larger corporations, with a consequent impact on the quality of analysis of IC information, for example:

One of the issues we have is we’re a small cap tech business, we’re not particularly loved or wanted, and consequently we only have [a very small number of] analysts who write regularly about us, and we have [a few more] that come to the presentation. [Co. D – ICT]

Sector wealth was regarded as perhaps a more important factor in the level of engagement of analysts with ICD than whether a sector had high or low reliance on IC value drivers. Thus, analysts in sectors where IC factors are a major source of economic value were not always (as perceived by the senior financial executives interviewed) deeply engaged in understanding information regarding IC. For example, in the ICT sector there was some concern that since the bursting of the internet/e-commerce speculative stock-price bubble at the beginning of the decade, reductions in resources (especially in terms of time) available to analysts in the sector precluded a proper understanding by analysts of the IC distinctiveness of each ICT company:

The IT boom has gone cerchung, through a bit of an up and a down, which comes back to the resource. Because when it was at the peak, IT as a total was a large part of the market, and therefore they could afford to invest in numbers of [analysts] because the volumes could justify it. Now they can’t. And that’s not only true of the sell side but also the buy side. Even in the institutions we go to, we’re finding that the analysts who are following us have got a huge range, and they really struggle. If they’ve got, what 4 or 5 days a year focussed only on us, we’d be doing extremely well. [Co. B – ICT]

If you look at sell side analysts, in particular those following the software and services sector, they’re having to follow more and more stock. It’s the same amount of time, [but] a lot of their colleagues have departed the organisation, so they don’t have the ability to go in-depth into any organisation now, in terms of understanding the drivers and perhaps the detail that they would have been able to understand it five years ago. Which is why it’s necessary for us to go and effectively spoon-feed them the information. [Co. B – ICT]

And often we go to meetings, we went to one yesterday, where they haven’t done any research at all, which is fine, it just allows us to you know have a free reign. [Co. C – ICT]

Conversely, in the relatively wealthy pharmaceutical sector, analysts were regarded as having a generally good quality understanding of IC value drivers:

Historically it’s been a wealthy sector too, so probably can spawn the various research groups that hang off it. [Co. E – pharma]

The analyst community for pharmaceuticals is very active and a lot of them are scientists by background, they understand the business, the industry is very well researched. [Co. E – pharma]
Where the sell sides in our sector add a lot of value in my experience [is] in terms of their ability to analyse the pipeline and talk about the various opportunities there. And it’s become much more now…. I think it was an easy job for them 20 years ago, they could just pick any pharma stock and they pretty much all did well because it was a young industry, everything was growing very rapidly, everybody was doing pretty well. That’s not so much the case now and I think that’s been a big shock to the investment community in the last two or three years…. they want to know so much more about the intellectual property issues in our industry in the way which they never really delved into that in the past. [Co. F – pharma]

If you talk to a lot of people, they’ll say one thing that the analysts do bring to bear, the sell side analysts, is this in-depth analysis of the [drug development] pipeline, and the intellectual property, in that that is such a complicated area you almost can’t get enough reference points and differing views. [Co. F – pharma]

However, there was still some concern in the pharmaceutical sector regarding the extent of analyst understanding of distinctive IC value drivers, if the business model upon which they were based was somewhat different from the norm for the sector:

I think they haven’t given us the right value. And I think that goes back to a more fundamental question which is: I think we’ve struggled to explain [our distinctive] business model to get an understanding. We try to explain it,…. but the buy-in to the business model hasn’t been there…. I think it’s the belief in the model that really hasn’t been there up until now. There’s been a lot of scepticism born out of: it’s a non-traditional [model] and whenever you change and you’re a bit of a leading edge in this regard,… you’re going to get a lot of scepticism about whether it will work or not. [Co. F – pharma]

Furthermore, the positive views of the pharmaceutical companies in the pharmaceutical/biotechnology sample were not fully shared by the senior financial executives from the biotechnology companies in this sector:

I don’t think company investors would understand [our intellectual capital value drivers] very well, and that would include the capital markets. I think probably, in principle, we’re quite a long way away from making it transparent and organising it in such a way that people running capital markets can make investment decisions based on intellectual capital, that’s my own feeling. I think they do understand the intellectual property and the effort that goes in to R&D, but I’m not too sure that they understand it deeply. [Co. G – pharma]

There were mixed views regarding the efficacy of analysts’ understanding of IC value drivers from interviewees in the other sectors in this study. For example:

Some analysts will have a modelistic [approach] and would be very analytical, they will be very quantitative, they’ll analyse everything to the last degree. Another guy will have it all on the one piece of paper, he’ll just know the business, will ask different questions. I think it just all depends on the individual. [Co. I – retail]

When you actually see analysts, some of them are fantastic and really [understand] your business… And others, it doesn’t matter how much you sit and talk to them, they’re just never going to get you. And in the retail business there’s an obsession with like-for-like sales, an obsession amongst analysts, and if you can get an analyst away from like-for-like sales to talk about something different it’s a real result. [Co. K – retail]
I think you’re talking to an educated audience that understands, and then they will then be able to pass that information on. And if they’re good analysts, they have more influence than anything else. [Co. O – real estate/utilities]

The analyst is very blinkered. And they look at this and they say ‘well that’s actually very different to the kind of thing that we do already’. [Co. N – real estate/utilities]

Thus, there were mixed feelings regarding the ability of analysts to engage with and understand information about the IC value drivers of different businesses. This tended to be linked to sector, although perceptions were varied in some of the sectors.

Perhaps one way to help analysts and other recipients of ICD to understand this information would be to present it in a standardised format, facilitating an ‘easier’ reading of IC for report users. The next section explores preparers’ perceptions regarding the desirability of ICR standardisation.

5.6 Standardisation of ICD

Given the apparent variability in the quality of analysts’ engagement with, and understanding of, the IC information provided by companies, this short section explores whether preparers who participated in this study believe such information provision should be standardised. The emphatic response to this question was resoundingly negative, particularly in terms of attempting to reflect IC value drivers quantitatively in financial terms:

If you’re trying to get to a position where the balance sheet reflects what the quotes ‘market value’ is, I think that’s just going to be a step far too far. [Co. B – ICT]

Well my own personal view frankly, is that you can’t value any of this, and I think that a lot of shareholder value is wasted in people making attempts to do so. [Co. C – ICT]

Valuing… our intellectual property would be very hazy and we’d probably just roll our eyes in exasperation if it happened. I think if we then said, ‘oh and by the way you should be communicating more and more about some of the other types of intellectual capital’, I suppose our reaction would be again ‘for God’s sake, let’s not try and value it because that’s even more ephemeral than trying to value [a patent]’. [Co. E – pharma]

I couldn’t see any point at all in trying to come up with some mathematical formula which would put a value on the balance sheet… because I think that would just be a meaningless exercise. [Co. O – real estate/utilities].

When asked about the desirability of standardisation of narrative disclosures about IC, the general feeling was that the value drivers for each business would be so distinct that standardisation would result in bland and meaningless disclosures:

If there was a degree of discretion for us to focus on what we think really matters, then we’d say that sounds okay. And we think we’re talking about the things that really drive the value of a pharmaceutical company. [Co. E – pharma]

There’s room for probably more differentiation across sectors, but the regulations tend to apply across the board and therefore you end up with generic reports, or generically organised reports with generic content. [Co. G – pharma]

There was also a view that requiring too much disclosure would impose too great a burden on reporters, with the implicit message being that the preparers believed the costs of information provision would outweigh the benefits:
We believe that we communicate pretty adequately on what our intellectual capital issues are. To the extent that people, for academic or political reasons, want us to do more and more and more, bearing in mind that there are hungry lawyers out there who… are lining up to have goes at companies who are deemed to have got it wrong, it’s not a direction, I think which we feel desperately comfortable with – to be asked for more and more…. Everything ratchets up a little bit further and [it] just means there are more things to watch and more things to be careful about…. there are probably better things for us to be spending our effort on. [Co. E – pharma]

The above opposition to increased regulation is, perhaps, not surprising given a general tendency for companies to argue against increased reporting regulations (Deegan & Unerman, 2006). However, there was limited recognition among the interviewees that guidance on how to effectively disclose information regarding IC in narrative terms might be of some help to companies.

In addition to the perceived dangers of attempting to standardise ICD in either quantified or narrative disclosures, interviewees highlighted several other drawbacks of increased ICR. These are set out in the next section.

5.7 Drawbacks in ICD

ICR was not regarded as entirely unproblematic by the interviewees. The main problems, drawbacks or difficulties which the preparers regarded as being associated with making ICDs were two-fold. Firstly, consistent with the findings of Holland (2004; 2006) there was a perceived need to ensure that an appropriate balance was struck between informing the capital markets (and other stakeholders) of ICD vital to developing an adequate understanding of the business, and the need to ensure that competitive advantage was not compromised by giving away too much proprietary information or other information which might be copied or used by competitors:

I think you have to give the markets enough without giving away price sensitive information, which lets them determine for themselves how successful the company is. [Co. J – retail]

It’s a very fine line between saying ‘look this is how we operate and this is what we do, which drives our business’, and giving away the…the crown jewels of the business. [Co. K – retail]

The tricky bit, of course, is that the stuff which is really important is stuff we’re not going to tell anybody anyway. Because to the extent that you have something coming up which is going to take a leap forward, then you don’t want to go there… there will be bits which we deem that it will be [too] commercially sensitive to have [in] the public domain. And clearly in some of those situations there will be things you’re doing which you know are going to add to the value of the company long term, but for whatever reason you don’t want to go live with it. [Co. B – ICT]

Secondly, some interviewees were concerned that information should be communicated in a manner to ensure that it did not lead investors and analysts into developing inflated (or underestimated) expectations of the impact of these IC value drivers on future levels of performance:

When do you time a piece of news, and how do we get the balance right and not be overly optimistic or overly pessimistic about it and just get that balance right? [Co. E – pharma]
[If], in getting from the coal face to my presentation something goes wrong somewhere, and I’m telling people that ‘this’ is happening where actually it isn’t quite that, it’s ‘this’. So making sure that we have got a very effective true and accurate chain of communication… Companies do get sunk when people mislead the market either, or particularly, deliberately but also inadvertently. [Co. M – real estate/utilities]

If you put too much [information] out then you’re going to inflate your value, and I don’t think that’s right. Any board of directors has to be very careful that it doesn’t think its shares are over priced. [Co. K – Retail]

A further potential problem associated with this was the risk that a recipient of ICD might interpret it in a manner different to that intended:

The more you spell out what you consider to be an advantage, the more chance you have to run into someone else’s different interpretation, that what you think is a virtue is actually a vice. [Co. L – real estate/utilities]

A further issue was the recognition of the need to avoid information overload through over-frequent provision of information about changes to IC value drivers:

The other problem might be, if every minute you think you’ve got something, and you put it out to the market, you just confuse them, just flood them with information. There’s just too much noise at the end of the day. [Co. E – pharma]

As this section has demonstrated, ICR was not considered to be an unproblematic activity. However, overall there was recognition of a real and important need to effectively communicate key IC value drivers through a mixture of corporate reports – both publicly available reports and private briefings with investors and analysts (consistent with Holland, 2004; 2006), and the drawbacks identified by the interviewees were not considered to be significant obstacles to this necessary provision of key information about a company’s IC value drivers.

5.8 Summary of interview analysis

This chapter has analysed the perceptions of the preparers of ICR information within the six key themes that emerged from the interviews. In summary, the findings from this analysis were:

• Managers believed that ICDs in the annual report had little, if any, information content beyond an important confirmatory value in confirming information that had been released to capital markets through other media during the preceding year. Indeed, there was a view that if an annual report contained new, unexpected key information, this may lead to concerns among analysts that the company had been withholding important information which should have been released to the market in a more timely manner.

• ICR strategies incorporated the use of a variety of media.

• Each of these different media were considered by managers to have different levels of effectiveness in communicating information about their IC value drivers. The most effective media was generally considered to be face-to-face meetings with analysts and investors (where information already in the public domain could be discussed and explained in an interactive manner), with the least effective being the annual report and accounts.
• Managers had varying faith in the abilities of analysts from their sector to engage with and understand the importance of their IC value drivers. This level of faith seemed to depend partially upon how successful the sector was in stock market terms (with analysts in more ‘wealthy’ sectors having more resources to devote to understanding each company’s value drivers).

• Managers were strongly opposed to the regulation of ICR, other than possibly at a very broad level.

• There were perceived to be some drawbacks and trade-offs in the provision of ICR information, but these were not considered to be major obstacles to the provision of some key IC information through corporate reports.
6. Summary, conclusions and policy implications

6.1 Summary and conclusions

ICR is considered to be an important area for practice and research because, in the knowledge economy, IC is becoming an ever more important value driver for many companies. If corporate reports do not effectively communicate aspects of this key value driver to investors and other users of corporate reporting, they risk communicating an increasingly incomplete picture of companies’ assets and operations and will therefore risk becoming ever less relevant.

ICR is a largely voluntary practice, and there has been little systematic research into ICR practices of UK companies, or of the factors motivating preparers of corporate reporting in the UK to voluntarily report on their IC value drivers. Through its Information for Better Markets campaign, the ICAEW has recognised the need to ensure effective ICR and the need for research to establish the current state of voluntary ICR (among other corporate reporting practices), thereby helping to inform debates about the future shape of accounting and reporting. This ICAEW campaign has also recognised that it is important to identify potential problems in developing new reporting models, and that useful information for markets is not restricted to information provided in financial form, but that other non-quantified discursive information is also important.

This research report, and the study upon which it is based, has addressed these and other issues by aiming to add to our understanding of UK ICR practices. This aim has been addressed through analysing the ICDs in a range of corporate reporting media of a sample of companies in four distinct sectors quoted on the London Stock Exchange, and interviewing senior financial executives from these companies to ascertain the key factors and motives which appear to drive such practices.

In addressing its aims, the detailed objectives of the empirical analysis in this study have been to:

1. provide an in-depth assessment of the nature and extent of ICR practices among a sample of UK quoted companies;
2. analyse ICR practices of the sample of UK companies in a manner, and using specific research methods, which will facilitate international comparisons with studies of reporting practices in other countries;
3. identify key motivating factors underlying voluntary external reporting of IC by the preparers of corporate reports; and
4. make recommendations regarding possible future directions for ICR, both in the UK and in an international context.

In addressing these objectives, this study has both added to and reinforced a number of insights from prior research studies which have addressed aspects of ICR.

While exercising caution to not imply that the results of the ICD content analysis in this study were necessarily generalisable (because of the relatively small sample size necessitated by the in-depth methods), it was found that:
1. Consistent with ICD analysis in other countries, disclosures in the external relational capital category of IC predominate. In the sample for this study they accounted for 61% of all ICDs overall across all reports studied.

2. Disclosures in the external relational capital category of IC were much higher than disclosures in the other two categories for each of the sectors examined, other than the pharmaceutical/biotechnology sector where there was a more even balance between each of the three categories.

3. Within the external relational capital category, the customers (including new product development related research and development) and distribution channels elements together accounted for about half of the ICDs (with these two elements therefore accounting for about 30% of overall ICDs across all three categories).

4. The largest companies in the sample (the seven FTSE 100 companies) on average had a much higher frequency of ICDs across all media types than smaller companies. Again, this is consistent with other content analysis studies which have tended to find a size effect.

5. Counterintuitively, companies in the retail sector, which does not rely on IC value drivers to the same extent as the two ‘high’ IC reliance sectors, had a higher frequency of ICD than each of the other sectors. Furthermore, the ‘low’ expected IC sector (property/utilities) had approximately the same frequency of ICD per company as one of the ‘high’ IC sectors (ICT/software).

6. A wide range of media were used to report ICDs, with the annual report accounting for less than a third of total ICDs across all reporting media. Furthermore, the pattern of ICDs in the annual report did not reflect the pattern of ICDs in other reports, so examination of ICDs in annual reports was not a good proxy for overall ICD practices in the sample. This has significant implications for future ICR research studies, which should no longer focus exclusively on ICD in one type of statement, such as the annual report.

The interview-based part of this study provided many diverse and interesting insights into the motives of preparers of corporate reports to engage in ICR practices, and how these practices were shaped. In summary, the key findings from this analysis were:

1. The senior financial executives who were interviewed generally believed that ICDs in the annual report had little, if any, information content beyond an important confirmatory value in confirming information that had been released to capital markets through other media during the preceding year. Indeed, there was a view that if an annual report contained new, unexpected key information, this may lead to concerns among analysts that the company had been withholding important information which should have been released to the market in a more timely manner. Preparers therefore did not consider the annual report to have IC news information content other than by omission/exception. This is supported by the content analysis of the various reporting media which indicates that forms of communication other than the annual report far outweigh IC disclosures in the annual report.

2. ICR strategies incorporated the use of a variety of media, confirming one of the findings of the content analysis.

3. Each of these different media were considered by managers to have different levels of effectiveness in communicating information about their IC value drivers. The most effective media was generally considered to be face-to-face meetings with analysts and investors (where information already in the public domain could be discussed and explained in an interactive manner), with the least effective being the annual report and accounts.
4. The senior financial executives had varying faith in the abilities of analysts from their sector to engage with and understand the importance of their IC value drivers. This level of faith seemed to depend partially upon how successful the sector was in stock market terms (with analysts in more ‘wealthy’ sectors having more resources to devote to understanding each company’s value drivers). The executives therefore considered that analysts did not always systematically understand their business in terms of IC value drivers.

5. The senior financial executives were strongly opposed to the regulation of ICR, other than possibly at a very broad level.

6. There were perceived to be some drawbacks and trade-offs in the provision of ICR information, but these were not considered to be major obstacles to the provision of some key IC information through corporate reports.

Drawing upon these findings, the next section explains some policy implications and recommendations based on the above research.

6.2 Policy implications and recommendations

Among policy-oriented questions posed in the ICAEW Information for Better Markets campaign were the following issues, each of which is addressed to some extent in this research study:

1. Can corporate reporting be used to communicate to a variety of stakeholders rather than solely addressing the information needs of investors?

2. Can traditional forms of corporate reporting provide all the information investors need upon which to base their investment decisions, or are a variety of channels of communication needed for this purpose?

3. Can voluntary reporting initiatives can be relied upon to provide effective levels of information on new aspects of business performance, or does such information provision need to be mandated through regulation?

4. Can and should corporate reporting be adapted to place a financial value on intangible value drivers, which are of growing importance in many businesses?

Drawing out policy implications from this study in these key areas identified by the ICAEW’s Information for Better Markets campaign has led to the following recommendations:

1. In addressing issues of whether corporate reporting can effectively be used to communicate to a variety of stakeholders, it was notable that most of the interviewees focused on the role of ICR in disseminating information about key IC value drivers to analysts and investors. If this focus is representative of the focus of report preparers in other companies, then any broadening of the use of corporate reports to communicate about IC to a broader range of stakeholders will require a substantial shift in the focus and relative priorities of preparers of accounting reports.

2. Results from both the content analysis and the interviews indicate that, while still playing an important confirmatory role to enhance the credibility of information that has been released during the accounting period, traditional forms of reporting via the annual report are becoming ever less relevant and significant in communicating new and complex information about IC value drivers. Rather, use of analyst briefings was generally considered to be the most important medium, because this interactive medium was considered to be the most effective in communicating and explaining current information (already in the public domain) about conceptually more difficult
value drivers. Websites were considered to be more effective than the annual report, and therefore a more important medium for ICR. These findings could apply to many other areas of corporate reporting, and might reflect a shift in accepted media for corporate reporting more generally, a shift which the accounting profession and accounting regulators will need to take into account in shaping future practices and regulations.

3. In respect of the voluntary versus mandatory status of ICR, the interviews found overwhelming reasoned (although perhaps not surprising) opposition to ICR regulation at anything other than a very broad general level. The principal reason for this seemed to be that as every company’s key IC value drivers were specific to that company, detailed mandatory reporting would be far too restrictive to result in effective communication of these IC value drivers. This accords with one of the points raised by Beattie et al., (2004) when they argued that as ‘there may be good economic reasons for cross-sector variation in practice… the DTI [the UK government ministry which regulates accounting] is right not to seek to impose a uniform set of disclosures, even at sector level’ (p. xiv).

4. The senior financial executives who were interviewed considered a good understanding of IC to be important in understanding their business and the value of their business. Possibly because of this concern with effective communication of IC value drivers, the interviewees also expressed considerable opposition to any attempt to try to capture complex IC value drivers in quantified form, and recognised that such complex and company-specific issues are most effectively reported in narrative terms rather than attempting to reduce them to a common currency of a single monetary measure.

6.3 Limitations and further research

The key limitations of this study have been those inherent in the research methods used, as discussed in section 3.5 in Chapter 3. Principal among these was the lack of statistical generalisability of the findings. This is a common limitation shared by all studies that examine a small scale sample in greater depth, and should not detract from the key insights obtained from the analysis.

The findings of this research highlight a number of issues which need to be researched in other studies. One research focus could be on IC ‘inside organisations’ at the level of the organisation, and its impacts on, and interactions with, other organisational functions, organisational structures and other aspects of organisational behaviour.

The objectives of projects of this nature could be to investigate the following questions:

1. What are the issues driving strategy in the organisation, and how do IC management, measurement and reporting practices address these issues as they evolve over time?

2. How are IC management, measurement and reporting practices adopted and integrated into the organisations’ current management, measurement and reporting practices?

3. How does an organisation evaluate the success of its IC management, measurement and reporting practices in the eyes of both internal and external stakeholders?

4. Who are the people driving the IC practice in an organisation and what are their motivations for doing so?

5. How effective is a ‘championship’ of IC management, measurement and reporting practices, and are these practices becoming embedded to the extent that they can continue in this ‘champion’s’ absence?
Appendix A: A definition of intellectual capital


What do we mean by intellectual capital?

In recognition of the limitations of the existing financial reporting system, there has emerged a ‘new dialogue’ on the significance of finding new ways to report on a company’s intellectual capital. The product of this dialogue is a myriad of different measurement approaches and reporting philosophies that all have the aim, to a greater or lesser extent, of synthesising into one report the financial and non-financial value generating aspects of the company (Petty and Guthrie, 2000; Brennan and Connell, 2000).

In conducting the empirical aspects of this research we have chosen to use one of the more popular frameworks for understanding Intellectual Capital – that developed by Karl Erik Sveiby (1997: 8-11). Sveiby classifies intangibles into three parts: internal structure; external structure; and employee competence.

The three parts are explained here in greater detail:

(a). Internal structure (structural)

This consists of such items as patents, concepts, models, research and development, and computer and administrative systems. These are usually created by the employees or are brought in. Decisions can be made to invest in or replace these intangibles. Organisational culture and spirit is also considered part of the internal structure, as are organisational structure and legal parameters.

(b). External structures (relational)

This consists of relationships with customers and suppliers, brand names, trademarks and reputation. Some of these can be considered to be proprietary, but only in a temporal sense and, even then, not with any degree of confidence. For instance, a company has some influence over the value of its customer relationships, however reputation and relationships can change over time and a company cannot control the behaviour of customers or suppliers if they are not compliant. The tenuous nature of the supplier-firm-customer nexus complicates the measurement process. Hence, the economic value of this relationship is at present not determined by any generally accepted definition or measurement system.

(c). Employee competence (human)

This refers to the individual’s education, skills, training, values, experiences, and so forth. The non revenue generators are called support staff. As is the case for customers and suppliers, these cannot be owned by an organisation. However, from a value-based perspective they should be measured and placed on the balance sheet, as one cannot envisage an organisation without employees. Employee competence requires the capacity to create both tangible and intangible assets in a wide variety of situations. In knowledge organisations there is little ‘machinery’ other than the employees.
Appendix B: Definitions of intellectual capital elements used in the content analysis in this study

1. **Structural (Internal Organisational) Capital**: General definition (from Guthrie & Petty 2003 draft p. 15): ‘properties derived from the mind that has the protection in law (intellectual property) as well as infrastructure assets owned/used by the organisation. The latter consist in: systems and processes used in the day to day activities; values that guide the behaviour of the individuals and of the entire organisation; and innovation projects that have been undertaken (some of them can be in the next future part of the intellectual property dimension). Elements of this category can be developed internally or acquired.’

1.1 Intellectual Property

1.1.1 Developing or protecting patents, copyrights or trademarks.

1.1.2 Earning income or other benefits from patents, copyrights or trademarks.

1.1.3 Specific mention of patents, copyrights or trademarks.

1.2 Management Philosophy

1.2.1 Reference to a set of mutually reinforcing principles that guide management processes.

1.2.2 Guiding principles in any particular area.

1.2.3 BUT NOT at the level of business strategy or strategic objectives.

1.3 Corporate Culture

1.3.1 Anything referring to following definition – ‘Corporate culture is the series of employee beliefs, attitudes and modes of behaviour that collectively define a company’s character and which determine its ability to achieve optimal operational efficiencies and sustainable growth.’

1.3.2 ‘values, rites and rituals that are recognised and shared by the employees of a company’ (Guthrie & Petty 2003 draft p. 17).

1.4 Management Processes

1.4.1 Reference to an explicit set of practices and/or techniques that support, and enable the practical implementation of, management philosophy.

1.4.2 Systems and structures through which management deal with day to day problems.

1.4.3 BUT NOT marketing techniques or strategy, or the roll out of processes to additional sites unless referring to the benefits derived from the roll out.
1.5 Information Systems

1.5.1 Anything that transforms data input into usable output.

1.5.2 Refers to Information Technology (other than communications related IT).

Note from Guthrie & Petty (2003 draft p. 19): ‘Businesses are expected to become increasingly relying on information systems to capture and report transactions and also to track, build, and share the collective knowledge of the organization (Stivers et. al. 1997).’

1.6 Networking (Communication) Systems

1.6.1 Referring to communications within organisation (‘sharing and dissemination of information’ Guthrie & Petty 2003 draft p. 19).

1.6.2 Referring to communication between organisation, business partners and any others outside the business.

1.7 Financial Relations

1.7.1 Referring to favourable financial relationships between organisation and its long term funders (banks and shareholders) (‘because they can provide… financial backing… when needed’. – Guthrie & Petty 2003 draft p. 20).

2. External (Relational) Capital – connections with external stakeholders, from which the organisation can derive value or advantage The value of customer base, customer relationships and customer potential. A component of Relational Resources.

2.1 Brands:

2.1.1 Any explicit reference to the word ‘Brand’ (as owned by the company).

2.1.2 Reference to competitive advantage derived from ownership or development of brands – including position of brand(s) in specific markets.

2.1.3 Reference to active management of a brand.

2.2 Customers:

2.2.1 Reference to status or development (by the company) of customer relations [but not relating to customer loyalty or satisfaction].

2.2.2 Market research aimed at identifying the wants or needs of potential customers.

2.2.3 Reference to value of customer base.

2.2.4 Reference to market share IN THE CONTEXT OF competitive advantage – also indicated by claims to market leadership in the absence of reference to brands (IE: brand mention puts it in 2.1).

2.2.5 Any reference to ‘per customer’ profitability.

2.2.6 New Product Development IN THE CONTEXT OF competitive advantage.

2.2.7 Winning new customers/contracts.

2.2.8 Any mention of a specific customer by name

2.2.9 BUT just claiming to be customer focused is not enough to include a disclosure in this category.

2.2.10 Advertising
2.3 Customer Satisfaction and Loyalty (RE EXISTING CUSTOMERS ONLY):

2.3.1 Reference to levels of customer satisfaction.

2.3.2 Reference to continuing relations with customers.

2.3.3 Reference to repeat contracts.

2.3.4 Reference to policies and systems to retain customers.

2.3.5 Reference to customer loyalty and retention rates.

2.3.6 Market research directed at identifying the needs of existing customers.

2.3.7 BUT just claiming to be customer focused is not enough to include a disclosure in this category.

2.3.8 Customer's trust

2.4 Company Reputation

2.4.1 Protecting company names.

2.4.2 Any explicit reference to reputation or perception of the organisation in eyes of external stakeholders.

2.4.3 Product reputation

2.4.5 Awards

2.4.6 Sponsorship

2.4.7 BUT NOT in the context of market share.

2.5 Distribution Channels:

2.5.1 Developing or improving distribution channels between company and suppliers or customers.

2.6 Business Collaborations:

2.6.1 A close (long term) relationship which ‘enables partners to pursue an opportunity together that they may not have been able to pursue independently’ (Guthrie & Petty 2003 draft p. 23).

2.6.2 Discussion of specific (or specific groups of) Joint ventures and strategic agreements.

2.7 Favourable Contracts/Licensing agreements:

2.7.1 Licensing Agreements.

2.7.2 Franchising agreements.

2.7.3 Reference to a contract with special conditions that would not have been available to all potential ‘bidders’.

2.8 Research and Development (excluding new product development R&D, covered in 2.2)

2.8.1 General research and development
3. **Human Capital** – Include the knowledge, competence, intellectual agility, relationship ability and attitude of the employees that are used in the value creation process. These resources are by definition not owned by the firm.

3.1 **Employee**

3.1.1 Dedication and commitment of employees.

3.1.2 Employee satisfaction.

3.1.3 Related to Human Capital but not covered by below sub-categories.

3.2 **Education and Vocational Qualifications:**

3.2.1 Reference to education that is not specifically aimed at a certain career.

3.2.2 Qualifications relating to a specific career but not to a specific job or task at a specific company/organisation.

3.2.3 Technical qualifications not related to a specific company or organisation, such as GNVQ's; HND's.

3.2.4 Training that relates to the work area but not specifically to the job or company/organisation situation.

3.3 **Training:**

3.3.1 Technical, job specific training.

3.4 **Work Related Knowledge:**

3.4.1 Reference to knowledge or experience that relates specifically to the worker's past, current or potential future position.

3.4.2 Combining knowledge and or experience held by members of groups or teams to benefit the organisation.

3.4.3 Reference to softer skills such as ‘communication’ and ‘teambuilding’.

3.4.4 Not derived from individual training.

3.5 **Innovativeness of employees or teams of employees:**

3.5.1 Ability to input ideas.

3.5.2 Ability to affect practises.

3.5.3 Reference to ingenuity or innovativeness of employees.

3.5.4 Proactive and reactive abilities of employees, and adaptability to change.
References


Guthrie, J., & Ricceri, F., (2002), Quantify intellectual capital: Measuring and reporting to demonstrate value of knowledge management to stakeholders, Paper presented at the Knowledge Management Australia: Building and Improving on Knowledge Management Initiative for Commercial Proficiency Conference, Sydney, Australia.


