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Intellectual Capital Reporting Accounting of the New Millenium

Dr. Neetu Prakash*

Abstract

The concept of intellectual capital is becoming popular at global level in recent era. Various forward-looking companies have started measuring and Intellectual capital of a firm is, its possession of knowledge, applied experience, organizational technology, customer relationships and professional skills that provides it with a competitive edge in the market. It is the intellectual material - knowledge, information, intellectual property and experience that can be put to use to create wealth. Intellectual capital is nothing, but the combined intangible assets that enables a company to function in a passionate way and simply we can call it as "packaged useful information". If these intangible resources, such as knowledge as well as professional skills of the employees, organizational technology, research and development are not properly identified and utilized, it may cause to the failure of the business. The importance of financial assets in the determination of a company's market value is decreasing fast, and it is equally recognized that non-financial (or intangible) assets are now the main drivers of performance and market value.

Key words: *Intellectual capital, relationship capital, Laliect 4 leaf model, intellectual audit*

Intellectual Capital: Brief Introduction

Intellectual capital of a firm is, its possession of knowledge, applied experience, organizational technology, customer relationships and professional skills that provides it with a competitive edge in the market. It is the intellectual material - knowledge, information, intellectual property and experience that can be put to use to create wealth. Intellectual capital is nothing, but the combined intangible assets that enables a company to function in a passionate way and simply we can call it as "packaged useful information". If these intangible resources, such as knowledge as well as professional skills of the employees, organizational technology, research and development are not properly identified and utilized, it may cause to the failure of the business. The importance of financial assets in the determination of a company's market value is decreasing fast, and it is equally recognized

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that non-financial (or intangible) assets are now the main drivers of performance and market value. In fact, traditional accounting measures do not describe where the changes in the organization need to occur. They only describe what happened in the past.

The particular focus is to measure the organization's intellectual capital, so that the contributions of intangible to the business are measured in their own right. It is generally seen that for many service intensive and knowledge-based companies, the market value is more than book value, this is because of intellectual capital. The growth of knowledge intensive organizations has highlighted that economic success is dependent less on traditional tangible-resources and more on knowledge and its useful applications For recognizing this, several forward-looking companies have started measuring intellectual capital.

2. Types of Intellectual capital

Intellectual capital may be categorized into three parts

- i. **Human Capital:** Human capital refers to know-how, skills, capabilities and expertise of an organization's member.
- ii. **Organizational Capital:** Organizational capital refers to the internal configurations of an organization, and comprises two components namely innovation (intellectual property and intangible assets) and process capital (organizational structure and operating structure).
- iii. **Relational Capital:** Relational capital refers to external capital of an organization that goes beyond the relationships with its customers, suppliers and other members of external community.

3 Role of Intellectual Capital

The role of intellectual capital has become so important that several forward looking companies have started recognizing their intangible resources since they help the companies under the following circumstances to understand what competitive advantage they truly have for value extraction.

To provide an in-depth knowledge of intangible assets of an organization that will be helpful to know better comparison and learning.

To provide an idea for assessing the value of an enterprise on a standardized way.

To make intellectual audit possible

Linkage of Intellectual Capital with Organizational Strategy

A study was conducted by **Ismail and Namzah** in 2004 of **Malaysian Service Intensive Industries**, which clearly shows that there is a linkage between **Intellectual Capital** and **Organizational Strategy** as explained in the following text

I Human Capital: Industries using differential strategy focused on personality development and fitness of their employees, their training and developments, etc. On the contrast, industries using cost leadership strategy put more focus on individual previous job profile, work experience, etc.

ii Organizational Capital: Industries using differential strategy put more emphasis on tacit elements of knowledge and encourage knowledge sharing among their employees whereas industries using cost leadership strategy, their focus is to achieve stability and efficiency. Knowledge generated are documented and stored in their manual and procedures only.

iii. Relationship Capital: Industries using differential strategy put more focus on developing good relationships with their customers where as industries using cost leadership strategy put more emphasis on developing good relationships with their franchisers.

5. Why to Need Intellectual Capital in a Standardized Way

It is observed fact that the if intellectual capital is not properly measured and utilized, it may cause to the serious failure to the business. We can cite the case study of **Chatzal** (2003), which clearly indicates that in collapse of **Enron**, the role of intellectual capital was also questionable at that time. This study shows that apart from the financial manipulations and fraudulent accounting practices, three major factors relating to intellectual capital were also responsible for the Enron failure such as

- adoption of intangible intensive trading model (which was not properly worked out) in the place of traditional trading model
- changes in the accounting framework to ensure the integrity of an intellectual/intangible-based organization
- the implications of the Financial Accounting Standard Board (FASB) which mandated changes in measuring and managing goodwill and intangibles in a standardized way

This case study clearly shows that if intellectual property is not properly analyzed and worked-out, it can cause serious mega meltdowns.

6. Models of Intellectual Capital

A model for identifying and quantifying intangibles as components for intellectual capital was developed by **Leliacet *et.al*** in 2003 . This 4-leaf model is based upon four parameters as given in following text:

- sources of added value in intellectual capital,
- competitive advantages of intangibles over the other companies,
- collaborative net work of IT systems that build their business models around the internet using minimum financial assets
- valuation of intangibles like as brands, intellectual property, technical know how, patents, research and development, etc.

This model has provided a guidance note as how and where management should put its attention to increase the organization's overall intellectual capital.

7. International Experience

The concept of intellectual capital is becoming popular at global level in recent era. Various forward-looking companies have started measuring and assessing the value of their organizations in terms of intellectual capital. According to **Morgan Stanley's World Index**, the average market value of the knowledge intensive as well as service intensive **on** the world's stock exchanges is two times of their book value. This is because of the intellectual capital which they possess. A Sweden based company known as "**Intellectual Capital World Specialist Sweden**" which was founded in 1999 has rated more than 270 organizations across the world (such as Sweden, Finland, Italy, Turkey, USA, New Zealand, China, Malaysia, Singapore, etc.) in a short span of just seven years.

8. Indian Experience

We have the examples of so many Indian companies whose market value is greater than their book value as explained in the following text.

<u>Particulars</u>	<u>Market Value</u>	<u>Book Value</u>
Pharmaceuticals Sector		
Nicholas Pirmal India Limited	5204.42	916.01
Sun Pharmaceuticals Limited	15517.59	1558.61
Dr. Reddy's Lab	143754.21	36221.81
Workhardt	4251.58	816.67
IT and ITES Sector		
Infosys	53476.29	4488.27
Satyam	106411.06	3725.98
Wipra	76137.09	6420.31

Source: Computed from the published annual reports

9. Conclusion

The intellectual capital is now replacing financial and physical resources as a strategic capital. Successful management of intellectual capital can lead to relatively higher business performance since all strategic frameworks are aimed at maximizing organization's performance. Intellectual capital is one of the organization's sources of competitive advantage, so to remain competitive, organizations must have the capability to retain develop, organize and utilize their intellectual capital properly. Intellectual capital is one of the most important drivers of knowledge management that's why innovative companies are spending a lot of amount on product development and innovation, which is helpful for them to remain as leader over their competitors. More over, in present era, organizations especially service and knowledge based have started assessing the worth of their organizations in terms of their human resources, technology, know-how, relationships, product development, client satisfaction, etc In fact, it is the need of the hour otherwise major business failures can take place.

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