Financial Reporting of Intellectual Capital and Company’s Performance in Indian Information Technology Industry

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ABSTRACT

This paper examines the relationship between Financial Reporting of Intellectual Capital and Company’s Performances in Indian Information Technology Industry. For the purpose of this study, sixty companies listed on NSE were taken for a period of 1999-00 to 2008-09. Value Added Intellectual Co-efficient (VAIC<sup>TM</sup>) method developed by Pulic (1998) was used for the analysis of the data. The present study uses VAIC<sup>TM</sup> model and regression equation for the evaluation of intellectual capital and their relationship with productivity, profitability, and market valuation of the companies. The result of the study supports the hypothesis that profitability of the company can be explained by the intellectual capital. However, there is no significant association of intellectual capital with productivity and market capitalization of the companies for the selected time period of year 1999-00 to 2008-09.

Keywords: Intellectual Capital, IT Sector, Market Valuation, Productivity, Profitability, Value Added Intellectual Co-Efficient (VAIC<sup>TM</sup>)

INTRODUCTION

Financial reporting of intellectual capital is the most debatable issue among the accounting professionals because of its intangible nature. Researchers have defined and measured various models to know the exact value of intellectual capital. Different measures are used to calculate the amount of intellectual assets present in the company’s annual reports particularly the balance sheet. For the convenience in its measurement, intellectual capital is divided into three major groups. These are human capital, structural capital and customer capital. Researchers have always been interested in knowing relationship between presence of intellectual capital in the company and its impact on the market value of the companies.
Many researches were carried out to assess the relationship between intellectual capital and its consequences with market valuation of the companies. Seleim, Ashour, and Bontis (2004) investigated Egyptian software firms to know the components of the intellectual capital i.e. human, structural and relational capital present in them. These components were very essential for the proper development of the theory and the model. The study found that intellectual capital which was widely present in software firms can be measured and utilized. Oliver and Porta (2006) developed a cluster model to analyze the components of the intellectual capital namely Intellectual Capital Cluster Index (ICCI®). It was developed to measure the intellectual capital on clusters. Intangible and tangible assets cannot be treated separately as both are necessary for the proper running of the organization. In fact intellectual capital is gaining more importance over the physical assets of the company. This study is an attempt to analyze the relationship of intellectual capital with profitability, productivity and the market valuation of the companies.

The paper is divided into five sections. Section-1 gives overview of Indian IT Industry, Section-2 reviews literature of the exiting studies. Section-3 presents the methodology followed in this paper. Section-4 discusses the results and Section-5 concludes the paper.

1. AN OVERVIEW OF INDIAN IT INDUSTRY

Information technology industry is one of the growing sectors in India making its presence well felt all over the world. The IT industry sector is one of the many knowledge based industries. The growth of the IT industry may be due to the presence of intellectual capital in it. Table 1 shows industry size of IT and IT enables services (ITES) from the year 2007 to 2012 with compound annual growth rate (CAGR).

IT industry is major contributor to Indian economy in terms of foreign exchange services and employment opportunities. Indian IT companies are expanding their business at the global level by various mergers and acquisitions done by these companies. In terms of Gross Domestic Product (GDP), IT sector has increased its share from 1.2% in FY98 to 5.2% in FY07. Export earning was also approximately USD 40.0 billion with a growth rate of 36% in year FY08. This sector is also providing employment to a large part of the population. In the year 2006, out of total merger and acquisition, 23% were in IT industry. This industry is also one of the largest distributors of dividends to shareholders.

Contribution of IT sector in the foreign earnings showed remarkable growth of 32.6% in FY07. This industry also became the largest employer in private sector having a growth.
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