From visible to hidden intangible assets

Gîju George Ciprian a,*, Radu Valentin b, GRIGORE (Iancu) Aurelia Mădălina c, Vlădaia (Vlad) Mădălina Lucia d

Abstract

In a society where the market value of a company is given in proportion of 75-85% of intangible assets value, we can say that the current accounting does not provide sufficient relevant information for a company in order to take long-term decisions. For Skandia, the company’s market value is given by two components: financial capital and intellectual capital. Accounting for intellectual capital is not exactly easy to achieve, both because of the assessment and viability in the accounting process in view of current legislation. This article aims to show what are hidden intangible assets (intellectual capital), what is their place in the classification of intangible assets, what are the components of hidden intangible assets according to different existing reference models and also the possible solutions such as submission of additional financial situations.

Keywords: intellectual capital; alternative accounting; visible intangible assets, hidden intangible assets.

1. Introduction

The global influence of information and the technological changes and communication changes have transformed our society favoring globalization of economy and innovation as key factor to global competition. Lately, economic, political and social environment suffered profound changes which have determined a higher level of globalization and higher competition, passing from the traditional accounting to modern accounting that on which day requires more information.

The evolution from the agricultural age to the industrial age is now very easy to understand. Instead, what is now happening in the new economy has an incredible impact in the evolution process. New Economy changes everything. Thus, according to a study published recently it can be seen the growing importance of intangible assets:

- In 1978, intangible assets constituted 5% of assets.
- In 1998, intangible assets constituted 72% of assets.
- Today, 75-85% of assets are intangible.

Most changes have to deal with vertical disintegration (eg, outsourcing of parts of the production process) and permanent innovation. Intangible assets constitute the fundamental determinants of the two factors: vertical
Intensification of competitiveness inducted by globalization and technological changes

Fundamental transformation of enterprises, accentuation of innovation, vertical disintegration, intensive use of information technologies

Intangible assets connected to innovation
Intangible assets connected to human resources
Intangible assets connected to organization

Figure 1: Intangible assets culmination

In Europe, the interest in this phenomenon is increased realizing numerous studies financed by the European Commission which include “Mobilizing the intellectual capital in Europe” (2005) and Meritum Project (The Meritum Project - 2002): Guidelines for managing and reporting on Intangibles - Intellectual Capital Report, European Commission.

1. Intellectual capital

The term of intellectual capital is not new, it’s just it hasn’t been considered from the very beginning under this concept. Thus, we may say that it existed from the moment when a seller established a good relationship with a customer. In literature, we meet both the term of intellectual capital and intangible assets, basically meaning the same thing. Intellectual capital includes however those “hidden” intangible assets not reflected into the current financial statements.

In the new economy, intellectual capital is the key factor of company competitiveness and long term value. Nowadays, as we are well aware of, the value is mostly given by intangible assets than physical.

What is intellectual capital? It is, as defined by a company, “what exits the gate at the end of the day”. People? Company’s know how? … it is the sum of ideas, investments, technologies, general knowledge, computer software, projection, data processing techniques, processes, creativity and company’s publications. Intellectual capital can be easily understood as knowledge turned into benefits (Sullivan, 2001).

Edvinsson and Malone (1999) define intellectual capital as the possession of knowledge, applied experience, organizational technology, customer relationships and professional skills that give a competitive advantage in the market.

Nevado and López (2002) talk about intellectual capital as total assets of a firm, even if not reflected in traditional financial statements, generate or will generate value for the company in the future, and consequence of the issues related to human capital and the structural: the capacity of innovation, customer relations, quality of processes, products and services, cultural and communicational capital, which allows a company or organization to take better advantage of opportunities, giving birth to generation of future benefits.

We also find many definitions of intellectual capital that is related to intellectual capital defined as the sum of its components, and definitions that make reference only to the human aspect.
3. Intellectual capital classification

In order to measure and evaluate the intellectual capital is necessary to know and to understand which its main components are. The distinction between different components of intellectual capital will help us to understand what intellectual capital is and will allow us to apply the concept to strategic and operational level.

In the past years there have been many attempts to make a classification of intellectual capital, but let’s take first a view of the classification of intangible assets in general. Nomen (Nomen, 2005) makes a classification of intangible assets according to their utility:

- With unique, superior, unsubstituted utilities;
- With substitutable utilities (using another asset);

A second classification divides intangible assets in:

- Identifiable intangible assets (separable) and controllable;
- Unidentifiable intangible assets (inseparable) and uncontrolled.

Both may come from acquisition or can be generated internally. The third classification refers to:

- visible intangible assets;
- hidden intangible assets.

Visible intangible assets are those that are legislated in different accounting standards. They may also be identifiable and controllable or not, or whether generated internally or through acquisition.

Hidden intangible assets or intellectual capital are those for which are no accounting standards and they are not listed in the financial statements. These are unidentifiable and uncontrollable, obtained through acquisition of other company or generated internally.

In the following scheme it is presented the classification of intangible assets (Nevado and Lopez, 2002):
Hidden intangible assets or intellectual capital consists of:
- Human capital;
- Structural capital.

Human capital refers to the body of knowledge, skills and training, skills and ingenuity, skill and attitude, learning ability and motivation of individuals who compose the organization. Company values, culture and philosophy are also included in the human capital.

Capital structure may be described as the infrastructure that incorporate, support and qualify human capital and made possible the labor development in the company (programs, databases, organizational structure, patents, trademarks). It also makes reference to customers, the company-customer relationships, organizational processes, management, production and marketing.

Further we follow some of the rankings made by the "parents" of intellectual capital:
1. After Kaplan and Norton (2004):
   - Human capital;
   - Informational capital;
   - Organizational capital.
2. For Skandia (Edvinsson and Malone, 1999):
   - Human Capital
   - Structural capital:
     - Customers capital;
     - Organizational capital;
     - Innovation capital;
     - Process capital.
3. For Brooking (1997) the intellectual capital of a company shall be divided in:
   - Market assets (partly derived from intangible assets related to the market);
   - Intellectual property assets (know-how, manufacturing secrets, copyrights, patents, trademarks and service);
   - Assets focused on individual (qualifications of persons);
   - Infrastructure assets (technologies, methodologies and processes that make possible the company operation)
4. For Stewart (1998):
   - Human capital;
   - Structural capital;
   - Clients capital.
5. For Euroforum (1998):
   - Human capital;
   - Structural capital;
   - Relational capital.

Most authors share the intellectual capital in almost the same groups: human, structural and relational, but with different names and not composing the same items. Most models have developed in recent years of the end of XX century because during this period began to see the importance of intangible assets. It is not fundamentally different regarding the concept of intellectual capital, even if they introduce some new concepts. The models do not assign a financial value to intellectual capital using financial indicators to measure and manage it. The financial perspective is included only in the Balanced Scorecard and not all models explicitly recognize the present / future perspective.

Regarding the classifications, most models divide intangible assets in almost the same components: human capital, structural (organizational) and relational, but with different names and does not integrate the same elements.

In all studied models we find that the human capital is the base of the richness, less in Balanced ScoreCard where it is considered from the education-training perspective and increased staff.

Structural capital (organizational), as is called in most models, we find it in the Balanced ScoreCard as internal process perspective and in Technology Broker as infrastructure asset.
Table 1: Classification of intangible assets according to described measurement models

| Balanced ScoreCard | Skandia Navigator | Intelect | Intangible Assets Monitor | Technology Broker | MERITUM |
|-------------------|------------------|----------|---------------------------|-------------------|---------|
| 1. Education-training and development perspective | 1. Human capital | 1. Human capital | 1. Employees skills | 1. Assets connected to individual | 1. Human capital |
| 2. Internal process perspective | 2. Structural capital | 2. Internal structure | 2. Assets connected to infrastructure | 2. Structural capital |
| 3. Customers perspective | b) Customers capital | b) Customers capital | 3. External structure | 3. Assets connected to intellectual property |
| 4. Financial perspective | | | 4. Market assets | |

The capital is called relational in Meritum and Intellect models. In Skandia Navigator it is integrated as customer’s capital in structural capital and in the Balanced ScoreCard it is considered as perspective customers. It is the most developed part in the intellectual capital. Thus we find it also by the following names: external structure, market asset.

4. Nevado and Lopez classification

Nevado and Lopez (2002) seek to propose a basic model to measure intellectual capital by mentioning that it is not very important to determine an exact value of intellectual capital but it is quite important to know its evolution by means of estimation. It starts from the classification of intangible assets into:

- visible intangible assets;
- hidden intangible assets.

Visible intangible assets are those assets enacted by different accounting regulations. They can also be identifiable and controllable or not, regardless if they were generated by purchase or internally.

Hidden intangible assets or intellectual capital are those for which no accounting regulations exist, and that are not included in financial statements. These are unidentifiable and uncontrollable, obtained by acquiring another company or generated internally.

As shown in table 2 (Nevado and Lopez) intellectual capital (hidden intangible assets) is divided into three main components:

- human capital;
- structural capital;
- undetermined capital.

Human capital includes knowledge, skills, motivation and training of company employees and also pay and contracting system that can create future benefits.
Table 2: Components of intellectual capital

| Components of intellectual capital       | Intangible assets that are part of intellectual capital components | Group of indicators                                                                 |
|------------------------------------------|---------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| Human capital                            | - pay system                                                        | - pay                                                                               |
|                                          | - contracting system                                               | - timing                                                                            |
|                                          | - social climate                                                    | - social aids                                                                       |
|                                          | - training                                                          | - professional dysfunctions                                                         |
|                                          | - motivation                                                        | - training                                                                          |
|                                          | - corporate flexibility                                             | - satisfaction and motivation                                                       |
|                                          |                                                                     | - productivity                                                                      |
|                                          |                                                                     | - external rotation (resignations)                                                  |
|                                          |                                                                     | - internal rotation (promotions)                                                    |
| Processes, products and services capital | - system of quality, processes, products and services assessment    | - cost of prevention and assessment                                                  |
|                                          |                                                                     | - cost of non-quality                                                                |
|                                          |                                                                     | - information technology                                                             |
| Commercial capital                       | - customers portfolio                                               | - market share                                                                       |
|                                          | - satisfaction and loyalty of customers portfolio                   | - customers satisfaction                                                             |
|                                          | - situation of suppliers portfolio                                  | - suppliers quality                                                                  |
| Communicational capital                  | - marketing                                                         | - product marketing expenses                                                        |
|                                          | - media potential contracted                                        | - distribution                                                                       |
|                                          |                                                                     | - media potential                                                                    |
| Innovation-development capital           | - investments in new technologies                                   | - research-development                                                               |
|                                          | - investments in new products and services                          | - productivity                                                                       |
|                                          | - investments in improving information system                       | - internal rotation                                                                  |
|                                          | - competences                                                       |                                                                                      |
| Undetermined capital                     | - intangible assets not considered in previous capital              | - other indicators not considered previously                                         |

Structural capital is composed of:
- internal processes capital;
- relational capital or customer capital;
- communicational capital;
- innovation-development capital.

Human capital includes knowledge, skills, motivation and training of company employees and also pay and contracting system that can create future benefits.

Internal processes capital refers to the quality of processes, products and services allowing company to gain competitive advantages.

Commercial capital focuses on relationships with customers and suppliers as well as on knowing their degree of satisfaction, the number of new customers or customers lost, market share etc.

Communicational capital includes those resources destined to communicate with the outside by means of marketing activities, such as promotion, advertising, public relations etc.

Innovation-development capital commensurate company’s potential to continue to innovate in future. In order to do so, it is necessary to have knowledge about investments in developing new products, new technologies, improvements bring to systems.

Undetermined capital includes those elements of human and structural capital non-included into it because of their low importance but taken as a unit, they must be taken into consideration.

The method serves to determine the components of intellectual capital absolute indicators (in monetary units) and relative indicators (efficiency). Based on this method, investments made into intangible assets are corrected with
efficiency indicators related to them, starting from the formula of determining capital used by Skandia but in this method it is made by components.

Conclusions

Intellectual capital is, as we saw, a term with many definitions but almost all it is defined as an intangible asset that is not reflected in current financial statements. It is knowledge, experience and intellectual force of employees, as resources and knowledge stored in the databases of the organization, in systems, in processes, in culture and philosophy, all managed and used to obtain services and products with the ultimate aim of obtaining benefits. Intellectual capital includes intangible assets and resources that can be used by the organization to create value transforming them in new processes, products and services. The model proposed by Nevado and Lopez is characterized by grouping intellectual capital into three components: human capital, intellectual capital and undetermined capital. Within each component, absolute indicators (investments) and efficiency indicators are established based on which it will be done an estimation of intellectual capital.

In the past years it has been questioned the quantification of value and explanation of the components of the organization intellectual capital. There are many companies that rely on intangible assets to achieve benefits and to gain competitive advantages but the current financial statements does not capture - and can not capture - key determinants of value that dominates the new economy. Critics suggest that companies should compensate this by extending reporting on intangible assets, especially non-financial reporting. Their reason is that this enlarged reporting will better communicate the economic situation of the company through the submission of additional information relevant to reflect the real value of the company.

Recommendations:
- Introduction of a generally accepted model for measuring intellectual capital worldwide and creating the necessary accounting frames in order to make comparisons.
- It’s necessary to develop some harmonized specific rules at the global level concerning accounting and auditing intellectual capital.
- Promote the development of new complementary information systems - alternative accounting.

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