



The use of intellectual capital information in investment decisions

An empirical study using analyst reports

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Abstract

Do financial analysts convey intellectual capital information in their recommendations? This study of a sample of analyst reports on large, listed Spanish companies provides some evidence on the question. Analysts usually report information regarding a company's strategy, customers, and processes; they less often provide information about research, development, and innovation. When controlling for endogeneity, we find that certain firm characteristics appear to influence the use of intellectual capital information. Analysts use this information in the case of highly profitable companies. The results also show a significant effect of growth opportunities on intellectual capital disclosure by financial analysts. © 2007 University of Illinois. All rights reserved.

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1. Introduction

Increasing competition, development of new business sectors, and technological advances have generated some frustration over traditional financial statements (FASB, 2001b). Financial statements suffer from a lack of timeliness, (some) inaccuracy, and a limited ability to convey prospective data and risks facing the firm. In this context, financial analysts, as information intermediaries, are increasingly aware of the importance of company information that is not directly reflected in financial statements. Intangibles have become an important source of corporate value and firm wealth in our era of globalization,

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technological change, and knowledge-intensive processes. We know little about the way financial analysts use this information.

The first objective of our study is to quantify the extent and type of disclosure of intangibles in financial analyst's reports. The underlying methodology is a comprehensive analysis of the disclosure of intangibles in 260 analyst reports for Spanish listed firms from 2000 to 2003.

Our results show that financial analysts focus on particular intellectual capital information. In more than 70% of the reports, they cite information about new investments, firm credibility, and consistency of strategy, as well as its strategic alliances and agreements. They do not place a great deal of emphasis on measures of innovation, research, and development, probably because it is difficult to obtain these data and there is also a risk that the release of such information could be beneficial to competitors.

After studying the intellectual capital information included in analyst reports, we analyze the determinants of these disclosures on intangibles. The second objective of this study is to evaluate to what extent international firm listing, profitability, firm risk, and type of analyst recommendation influence intellectual capital information use. The regression-based approach constructed in this paper takes into account the endogenous relation between the use of intellectual capital information by financial analysts and their recommendations. Since in the presence of endogeneity, ordinary-least-squares estimation yields biased and inconsistent coefficient estimates, we base our analysis on a two-stage-least-squares estimation.

We find that, as predicted, the firm's profitability influences the extent of intellectual capital information use. Analysts provide more intellectual capital information in reports on profitable firms. The empirical analysis also shows a significant effect of growth opportunities on intellectual capital disclosure. In firms with high market-to-book ratios, analysts tend to include more intellectual capital information to justify their recommendations. Some of the variation in the amount of disclosure of intangibles is also explained by year, type of analyst report, and industry.

Analysis of the content of reports provides some evidence of the role of analysts as intermediaries between managers and investors. These results may help to improve methodologies to assist investment decision makers. The findings also have direct implications for accounting and financial-reporting policy. The influence of intangibles in modern corporations has led policy makers and accounting standard-setting boards to consider proposals to enhance information on intangibles in corporate financial reports. In order to establish a policy, one needs to know how investment analysts, as sophisticated consumers of financial information, actually use both financial and non-financial information (Schipper, 1991).

The remainder of this paper is organized as follows: Section 2 provides background for the analysis of non-financial information used by financial analysts; the methodology and study design are discussed in the third section; the fourth section presents the test results; and the final section of the paper summarizes the conclusions, describes limitations, and discusses implications for future research.

2. Related research

Prior research has shown that non-financial information is relevant for making investment decisions, but there is little evidence to tell us how much importance financial analysts place on intellectual capital information.

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