



## Intellectual capital disclosures by South African companies: A longitudinal investigation

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### ABSTRACT

Most of the previous studies on intellectual capital disclosures have been conducted from developed countries' context. There is very limited empirical evidence in this area from the context of emerging economies in general and Africa in particular. This paper is one of the early attempts in this regard. The main purpose of this study is to examine the extent and nature of intellectual capital disclosures in 'Top 20' South African companies over a 5 years period (2002–2006). The study uses content analysis method to scrutinise the patterns of intellectual capital disclosures during the study period. The results show that intellectual capital disclosures in South Africa have increased over the 5 years study period with certain firms reporting considerably more than others. Out of the three broad categories of intellectual capital disclosures human capital appears to be the most popular category. This finding stands in sharp contrast to the previous studies in this area where external capital was found to be most popular category.

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### 1. Introduction

Intellectual capital (IC) refers to the resource base of an organisation which relates to, inter alia, knowledge and skill set retained by the organisation. It also includes important organisational relationships with the outside world. In today's global knowledge economy perhaps more attention needs to be given to the intellectual capital to maintain competitive edge. As a result, organisations are attaching increased importance to the recognition, measurement and reporting of intellectual capital. This emerging practice has attracted attention of the academic researchers and a significant literature has evolved in recent times. A strand of this literature has examined the extent and nature of intellectual capital disclosures (ICD) within the corporate reports. Within this strand of ICD literature, researchers have mainly examined the ICD within the annual reports (subject to some exceptions) by the use of content analysis procedures (see for example, Abeysekera, 2008a; Abeysekera & Guthrie, 2005; April, Bosma, & Deglon, 2003; Bozzolan, Favotto, & Ricceri, 2003; Burgman & Roos, 2007; Goh & Lim, 2004; Guthrie, 2001; Guthrie & Petty, 2000; Pablos, 2003; Petty & Cuganesan, 2005; Seetharaman, Sooria, & Saravanan, 2002; Striukova, Unerman, & Guthrie, 2008; Sujan & Abeysekera, 2007; Vandemaele, Vergauwen, & Smits, 2005; Vergauwen & Alem, 2005). The purpose of this paper is to contribute to this strand of ICD literature from an emerging economy perspective.

Most of the previous studies on ICD have been conducted from the developed countries' context. There is very limited empirical evidence in this area from the context of emerging economy in general and Africa in particular (but see, Abeysekera, 2008a; Abeysekera & Guthrie, 2005; April et al., 2003; Goh & Lim, 2004). This paper is one of the few early attempts in this regard. The main purpose of this study is to examine the extent and nature of ICD in 'Top 20' South African companies over a 5-year period (2002–2006). There is only one ICD study available from the South African perspective which is conducted by April et al. (2003). The current study builds on the work of April et al. (2003). They used only 1 year data (2001) which is nearly a decade old. Moreover, they focused mainly on the mining sector of South Africa. The current study extends this previous work by using more up to date data and differs in some other significant aspects. For example, it provides a longitudinal perspective of ICD in South Africa over a 5-year period using cross sectional data rather than concentrating on a single sector and a single year. Moreover, our current work is based on a robust sample of 'Top 20' companies as per 2006 ranking of South African companies by the Financial Mail (FM) which looks beyond corporate size and financial numbers.

### 2. Prior research

As indicated earlier, most of the previous studies on ICD have focused on developed countries such as Canada, Australia, Ireland, United Kingdom and other continental European countries. Bontis (2003) conducted a content analysis of the annual reports of 10,000 Canadian corporations. The study used a list of 38 intellectual capital related terms, searched electronically within the annual reports.

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Significantly, small levels of disclosure were found with only 74 occurrences by 68 companies across the 10,000 reports.

Guthrie and Petty (2000) examined the ICD practices of the largest 19 listed companies in Australia and one other company that held itself out as being best practice in the field of intellectual capital reporting to act as a benchmark. Their intellectual capital framework consisted of 24 separate intellectual capital items across 20 companies. Their findings suggested that intellectual capital was poorly understood, inadequately identified, inefficiently managed and inconsistently reported. This also included the 'best practice' firm. They concluded that Australian companies did not compare favourably with European firms in their ability to measure and report intellectual capital.

Brennan's (2001) study looked at the extent of ICD in 11 knowledge-based firms in Ireland. The study compared the firms market and book values and also conducted a content analysis of the annual reports. Brennan's study concluded that, with the exception of two firms, there were significant differences in market and book values suggesting these firms had a substantial level of intellectual capital. However, the study found that the amount of disclosure by the firms was substantially low. She concluded that there appeared to be little interest in, and progress towards, measuring and reporting of intellectual capital by the Irish companies.

Striukova et al. (2008) have provided an empirical understanding of ICD practices of the UK companies. However, to develop this understanding the study considered a range of media in which ICD was made including annual reports, website, CSR reports and other reports. Their sample included 15 companies from the FTSE index covering four sectors, viz. information technology, pharmaceutical, real estate and the retailing. The key findings of the study include variations in ICD with company size and industrial sectors. Contrary to a priori expectations the study reported that knowledge intensive sectors (e.g. information technology and pharmaceutical) did not disclose most of the intellectual capital items. Consistent with the previous studies they confirmed that external capital was the most popular category amongst the firms. Striukova et al. (2008) extended the previous UK study on ICD by Williams (2001) which mainly concentrated on the annual reports and a range of companies irrespective of sectors.

Within the continental Europe Bozzolan et al. (2003) performed a content analysis on the 2001 annual reports of 30 non financial companies listed on the Italian Stock Exchange. Their framework consisted of 22 intellectual capital items across three categories: human, external and internal capital. Their results remained consistent with other researchers in Europe showing extensive disclosure on external capital of around 49%, 30% related to internal capital and the remaining 21% concerning human capital. They also found that the size and industry of the firms had a significant effect on the level of disclosure. In a latter study Bozzolan, O'Regan, and Ricceri (2006) compared the ICD practices of Italy and the UK. They could not support the hypothesis that country of origin had an influence on ICD practices. Other comparative studies, however, showed differences in ICD practices in different countries. For example, in a comparative study Vandemaele et al. (2005) showed that UK and Dutch companies made less ICD than the Swedish companies.

While a great deal research has been undertaken on ICD practices in developed countries a substantially less amount of research can be found on ICD practices in emerging economies. Only a handful of studies are available from the emerging economies' context. The most noteworthy here is the study conducted by Abeysekera and Guthrie (2005) over a 2 year period (1998/1999 to 1999/2000) into ICD practices of the top 30 Sri Lankan companies listed on the Colombo Stock Exchange. Informed by Guthrie and Petty (2000) their framework consisted of 45 intellectual capital items classified into external capital, internal capital and human capital items. Their findings showed that there was a notable increase in the frequency of disclosure over the 2 year period with external capital as the most reported category. Internal capital was the least disclosed

category and it actually decreased over the period in terms of line count. In a later study Abeysekera (2008a) compared the ICD practices of 20 Sri Lankan firms with that Singaporean firms over a 3 year period of 1998–2000. He found differences in the ICD practices between the two countries and attributed those differences to various social, political and economic factors. In a study of the Indian ICD practices in the information, communication and technology sector Kamath (2008) observed that the level of ICD is very low and there is no significant relationship with the firm size. Goh and Lim (2004) in their study of 20 Malaysian companies found that external capital was the most dominant category and most of the ICD was made in a narrative form.

From the African perspective, April et al. (2003) investigated intellectual capital measurement and reporting in South Africa's mining industry. Their research methodology was based on Guthrie and Petty's (2000) intellectual capital framework consisting of 24 items across three categories of human, internal and external capital. Their study involved content analysis procedures and examined the annual reports of the 20 largest listed companies, combined with interviews with senior individuals in mining companies. Their results showed that mining companies in South Africa tend to report less on intellectual capital attributes than the other companies and that they focused more on external attributes such as business collaborations and favourable contracts. It also concluded that although the companies valued intellectual capital they lacked appropriate systems and structures to measure it meaningfully. As far as we know this is the only study available from the African perspective.

Most of the previous studies of the ICD are descriptive in nature and did not employ theoretical perspectives to understand corporate motivations behind ICD (but see, Abeysekera, 2008b). Guthrie, Petty, Yongvanich, and Ricceri (2004) have called for theoretically informed ICD research and argued that stakeholder theory and legitimacy theory might help in this regard. Legitimacy theory, according to Guthrie and Parker (1989), is based on the notion that firms are bound by the social contract in which they agree to perform various socially desired actions in return for approval of their objectives and this ultimately guarantees their continued existence. This would suggest that companies disclose intellectual capital information to appear legitimate in the eyes of society and to avoid the potential costs that arise from non-legitimacy. Alternatively, stakeholder theory suggests that all stakeholders have a right to be provided with IC information. The theory is based on the premise that management is expected to take on activities expected by their stakeholders and to report on those activities to the stakeholders (Guthrie et al., 2004).

The above review suggests that most of the previous studies focused on single year's data while only a handful of studies used longitudinal data. Several researchers (Abeysekera, 2008a; Bozzolan et al., 2003; Guthrie & Petty, 2000; Kamath, 2008) called for longitudinal studies for detailed examination of ICD practices. Amongst the few studies available from the emerging economies' context most of them concentrated on the Asian countries. With the exception of April et al. (2003) there is no study available from the African context. This study is an attempt to bridge the gap in the literature identified above by providing a longitudinal perspective of South African ICD practices. South Africa is an emerging nation in Africa with robust economic growth since 2004. 63% of its GDP is derived from the service sector (<https://www.cia.gov/library/publications/the-world-factbook/geos/sf.html>) which implies the dominance of knowledge based firms holding significant intellectual capital related assets. Hence, the issue of ICD might be very significant for the South African firms. We consider the socio-political context of South Africa in the next section.

### 3. The South African context

South Africa is a nation of over 47 million people of diverse origins, cultures and beliefs ([www.safrika.info](http://www.safrika.info)). According to World Bank classifications South Africa is classified as an upper middle income

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