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The Need for Intellectual Capital Disclosure

by Musliha Musman & Dr Salwa Muda

Recent global economic changes have ushered in a new economic era and had a significant impact on how businesses are managed, and competitive strategies are implemented. The business management changed their basic principles of strategy by emphasising the value of knowledge assets, also known as intellectual capital, which are a type of intangible asset (Konno & Schillaci, 2021). Knowledge assets refer to intellectual resources such as human resources, competence, research and development, customer-based creation, organizational development, and relationships which are more significant in creating a corporate value (Garcia-Perez et al., 2020).

Traditional reporting systems have become obsolete because of the knowledge-based economy's revolution. Traditional accounting systems typically produce reports based on financial or quantitative accounting that are focused on material resources, which can be expressed in monetary or quantitative terms. Hence, it measures only the value of the financial and physical assets and offers little information on intangible resources (Dana et al., 2021)) such as knowledge or employees' competence which cannot be expressed in monetary or any volume, length, weight measures. Consequently, it lacks an adequate accounting mechanism for measuring and reporting intellectual capital assets to external stakeholders and this results in an information gap between the managers and stakeholders (Garcia-Perez et al., 2020; Mouritsen et al., 2004) and it does not provide the relevant information for the managers or investors to understand how their resources which are in the form of intangibles can create values in the future.



As a result, most of the companies are calling for a voluntary disclosure of these knowledge-based resources. This is because organizations believe that they have provided the relevant information for managers, investors, and stakeholders in understanding their resources, many of which is intellectual capital which can create a value in the future (Alvino et al., 2021; Garcia-Perez et al., 2020;). In addition, the investors and stakeholders would also like companies to be more transparent by providing more information on their intellectual capital. This is proven where they now request more reliable information like, managerial qualities, expertise, experience and integrity, customer relationship and personnel competencies whereby these

factors are related to intellectual capital. The accessibility of this relevant information helps these investors and stakeholders in various decisions making.

Detailed information on the intellectual asset provided by an organization could give relevant internal information to the company's management (Hutahayan, 2020; Martín-de Castro et al., 2019). This intellectual capital information might be used by management in monitoring the implementation (indicator), and to further develop the company's knowledge-based strategy. An example of a knowledge-based strategy includes planned action that will result in giving a crucial competitive edge to an organization such as low costs, nice products or services and regional presence. Through the indicator, it enables the management to take wise actions to change the current strategy to a new one as well as looking at other aspects that need more attention (Martín-de Castro et al., 2019). A study done by Mohd Saleh et al. (2010) found that the intellectual capital information is a tool that can be used by management to look in depth and to be used as a follow up method for stage evaluation of its intellectual capital.

Besides functioning as a management tool in developing a specific strategy, the intellectual capital disclosure is also constructive as external information for stakeholders such as investors, partners, and clients (Mourtisen et al., 2004). By putting extra focus on its employees, relationship with clients and partners, this intellectual capital could effectively gauge the work efficiency by the respective parties within the company. Besides making a company more attractive for investors, future partners, clients as well as to the employees, this information helps them to assess a company's potential for future earnings. According to Salvi et al. (2020) intellectual capital has a positive impact on market value and financial performance. This finding shows that the investors place a higher value for a firm that has better intellectual capital efficiency, because firms with better intellectual capital efficiency yield greater profitability and revenue growth.

Failure to provide relevant information on intellectual capital externally may lead to the deterioration of the company's financial position and loss of competitiveness in the long run (Brüggen et al., 2009). It might happen when the potential investor fails in valuing the company's worth due to restriction of these knowledge resources. Lack of reporting on intellectual capital externally will result in lack of information to investors on the development of a company's intangible resources. Consequently, it makes the investors' perception of risk higher. Companies with large intellectual capital resources may have problems in finding funds on attractive conditions, as lack of information about investment in intellectual capital could lead to an underestimation of future earnings.

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