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Intellectual Capital: Capital Market's Cinderella and Cassandra- In Retrospect and in Prospect

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Abstract:

Purpose—The purpose of this paper is to explore the practical implications of an epistemological approach to intellectual capital (IC) in the context of the capital markets. It draws on the theory of IC and the capital market actors. The purpose of this paper is to demonstrate that market capitalization (market cap) of many countries outweigh their GDP. This market cap is represented by IC but which deplorably is ignored by the stakeholders to a large extent – out of ignorance, indifference and lack of ethics, governance and compliance. The article drives home the point that the rules of business are being rewritten and the industrial era enterprise models are no longer adequate to meet the dynamic condition of a changing world market. Hence, the need for thinkers and thought leaders to chart new paradigms and new directions to view IC as strategic investments of organizations.

Design/methodology/approach—This paper through critical reflection addresses the content elements of the strategic nature of the holistic intellectual capital and how the capital market actors from the demand and supply side view it through the prism of financial market behavior. . It also for the first time comes out with an optimization model of Sustainable One World of Stakeholders juxtaposed with the raison d'être of IC-driven business framework wanting all those who matter to be on same page for a better, one world.

Findings— IC makes a strategic differentiation in contemporary business being the catalyst for market capitalization. Despite being an alchemist to transmute IC into business excellence and the realization by stakeholders of its stellar role in the world economy, it does not get a place of primacy it deserves by the demand-side and supply-side of the capital market participants. This paper highlights and provides fresh insights on the need to look IC as a game-changer by the capital market actors (demand-side and supply-side) and powers that be as gate-keepers and conscience-keepers to foster IC-driven business growth.

Originality/value— To the best of the authors knowledge so far there are no studies published that provide a detailed discussion relating IC to capital market participants. This paper by offering a critical lens through which to enrich extant IC literature for the first time extends the frontier of IC knowledge offering a new path and demonstrating that there is a need for scholars, practitioners and other stakeholders of IC to pursue possible avenues to further develop the visualization, management, measurement and reporting of IC. It also allows stakeholders to understand the barriers to implementing IC in organizations and do self-introspection. Given the exploratory, conjectural nature of this article relating to an optimization IC model and the capital markets and non-existence of research literature on the IC-driven one-world philosophy and practice, issues and ideas discussed in this article will inevitably require further conceptual exploration and fundamental research. The intent of the article is to further debate and research on IC-based business strategy aimed at improving the capacity-to-act both inside and outside the organization. The constructed heuristic tools serve as a basis for rigorous empirical testing through systematic investigation of the theoretical underpinnings of IC strategy thereby throwing up considerable potential for future research – both pure and applied bringing in its train green shoots to be bullish on IC.

Keywords: Intellectual Capital (IC), Intangibles, business strategy, capital market actors / participants, market capitalization, Enhanced business reporting, SHOW-TQBM, SOW-SEED Model

1. Introduction

Aligning business value propositions with a firm's assets and capabilities, strategic and financial objectives and assuring robust and sustainable differentiation across a firm's portfolio of businesses to optimize value is the key to corporate strategy. Because, truly free markets create competition, which undermines the position of established firms forcing them to prove their competence again and again (Rajan and Zingales, 2004, p. x). Identifying a firm's core competence, articulating the value chain / ecosystem, leveraging

differentiable advantage, optimizing investments, analyzing inorganic options differentiate the leader from the laggard. Core competence and sustainable competitive advantage (SCA) of an enterprise flow out of Intellectual capital (IC), the *sine qua non* of the firm and society at large. To explain the "true" value of the firm it is necessary to supplement the financial value of the firm, with a value of the firm's intellectual capital (Edvinsson and Malone, 1997). "Knowledge has become the primary ingredient of what we make, do, buy and sell." Thus; "managing it – finding and growing intellectual capital, storing it, selling it, sharing it, has become the most important economic task of individuals, businesses and nations" (Stewart and Stewart, 1987). Hence, the *raison d'être* of business enterprises is to win investors over (Lev, 2012) and build public trust (DiPiazza and Eccles, 2002) for building a sustainable stakeholder world (Figure 1). The Augustinian concept that "the world is one and all things are in it" (St Augustine, 1966) is relevant today like never before, if you like. Global village has no place for global pillage (Charlie, 2000). While globalization in finance and communication penetrates jurisdictions, cultures, markets, deep-rooted traditions and mores, and even our intimate lives, we find ourselves nowhere near fundamental agreement on an integrated agenda for the global commons, based on a global policymaking mechanism, a global law, a global economic and financial system, and a global culture (Bauman, 2008). To be juxtaposed with this wise proposition is the Brundtland Commission that produced the ground-breaking report, 'Our Common Future' (Brundtland Commission, 1987), positing that sound environmental conservation and management are peacefully viewed by vast majorities, across all continents, as moral as well as matter-of-fact imperatives.. Sustainability expert Peter Pedersen (2009) calls this an evolution from *homo sapiens* to *homo sociens*, that is, human beings linked by their ability and willingness to share and collaborate. Twenty centuries ago, Aristotle implicitly suggested that a society that



Figure 1: The *raison d'être* of business (Anthony, Thiagarajan and Utpal, Baul, 2014d, p. 156)

Cannot reach a practical agreement on its conception of justice – freedom cum responsibility – may lack the capacity to foster a political community (MacIntyre, 1984). To contextualize it to the contemporary world, a global society that cannot reach a practical agreement on a system of justice common to all – rationality cum fairness – is likely to lack the capacity to embody a civilized international community. Despite our natural reticence to engage in ethical conversations of this complexity, we cannot run away from the quandaries of environmental conservation and management because there is nowhere to run away to (Agatiello, 2009). Hence companies paradigm shift to use their corporate social responsibility (CSR) capital and skills to catalyze innovative solutions – by directly supporting social enterprises or leveraging distribution networks to improve access to products and services or developing a new product (Bhavnani, 2014)

Business models are "stories that explain how enterprises work" (Magretta, 2002, p. 4). As a corollary to this, let us cite an article entitled "The business of governance" featured in THE FINANCIAL EXPRESS dated August 31, 2014: A modified John Maynard Keynes is alive and well (read Indian Prime Minister, Narendra Modi) and living at 7 Race Course Road (the official residence of the Indian Prime Minister). Keynes believed that it was the role of the government to push the private sector into socially desired outcomes, but to leave it alone in terms of how those outcomes should be accomplished. The bottom line: in a time of economic crisis, business and government must come together. Though no government wants to be seen as being close to the moneyed fat cats, especially in developing countries where corruption is a major factor in elections, a recent global survey by McKinsey concludes that most CEOs expect government involvement in their industries to continue increasing. The survey shows that government actions – infrastructure and access to capital – have a significant effect on companies' economic value. What Modi basically seems to be pushing for is a variation on Keynesian economics with a dash of pragmatism (Bobb, 2014, p. 2).

Interestingly enough, business models show not only how the firm makes money but also how, by answering the fundamental questions: "Who is the customer? And what does the customer value?" (Magretta, 2002, p. 4). Moreover, a basic idea of the business model concept is that it should spell out what the unique value proposition of the firm is and how it should be implemented. For the customers the value creation could be related to "solving a problem, improving performance or reducing risk and cost" (Sandberg, 2002, p. 4), which might require specific value configurations (Sweet, 2001) including relationships to suppliers, access to technologies, insight into the users' needs etc. Value means not (only) to measure or calculate value, but to understand the creation and development of value (Guthrie, 2001; Mouritsen *et al.*, 2002a; Petty and Guthrie, 2000). Hence, the need to understand the value creation of a business. Because,

Value creation based on knowledge resources, i.e. intellectual capital, is complicated and more research into how knowledge intensive companies create value, how knowledge-based business models work and how their functioning and value creation could be disclosed is needed (Bukh, 2003, p. 54).

“Companies deal with investors’ money. Investors have a right to know each affair of the company.....Quality of governance adds to a company’s credibility...Only those companies who maintain the highest standard of corporate governance would succeed and eventually become the best in the system.....when we are in the take-off stage, it would be time for corporates to take advantage of these opportunities by way of credibility and adopting best practices”, said Arun Jaitley, Finance Minister of India, at the 13th Institute of Company Secretaries of India (ICSI) National Award for Excellence in Corporate Governance (THE FINANCIAL EXPRESS, August 25, 2014, p. 2). Because, there is a direct co-relation between foreign direct investment (FDI) inflows and brand image perception of a country (Sorrell, 2014). Little wonder, the International Advisory Board (IAB) of the Securities Exchange Board of India (SEBI) would bring significant changes in SEBI’s insider trading regulations to bring them at par with global best practices (THE FINANCIAL EXPRESS, August 26, 2014, p. 9). To give more teeth to the Securities Laws Amendments Act (counterpart of the Dodd-Frank Act of the USA), it is proposed to empower capital markets watchdog SEBI to take action (attach properties, arrest and detain defaulters, call data record or other information from any entity during probe and conduct search operations) against all unregulated money pooling scheme involving Rs.100 crores or more (THE FINANCIAL EXPRESS, August 29, 2014, p. 9). Character and competence (Covey, 1989) are central not only to individual but in public life. Talking about the competitive factor in India that has five crore small and medium enterprises (SMEs), logistics and supply chain management constitutes 12-13% of business cost in India against 6-7% globally (Subramanian, 2014)

2. Art and Science of Transformational Business Strategy

According to Rajan and Zingales, in the 1890s, the richest 10 percent of the population worked fewer hours than the poorest 10 percent. Today, the reverse is true. The idle rich have become the working rich. Instead of an aristocracy of the merely rich, we are moving to an aristocracy of the capable *and* the rich. Here, Human Capital-driven IC is the catalyst for synergizing execution (Bossidy and Charan, 2002), orbit-shifting innovation (Narang and Devaiah, 2013), building public trust (Dipiazza and Eccles, 2002), winning investors over (Lev 2012) and (creating a “Sustainable Humane One World through Total Quality Business Management” as a means to an end of chiseling a “Sustainable One World of Stakeholders Ethical and Empowered for Development”) by unleashing and leading change (Kotter, 2002) (parenthesis ours). The financial revolution is operating the gates of the aristocratic clubs to everyone. In this respect, the financial revolution is thoroughly liberal in spirit. Instead of capital, it puts the human being at the centre of economic activity because, when capital is freely available, it is skills, ideas, hard work, and inescapably, luck that create wealth (Rajan and Zingales, 2004, p. 92). A robust economy is always built on sound capital markets. But India has over-reliance on foreign portfolio investments as the nation lacks adequate flows of domestic household savings into capital markets.....which will bring back the confidence and trust of the investor in equity markets (Bajaj, 2014). That is why the art and science approach to organizational transformation approach is based on the understanding that successful (project) management requires not only the technical or “science” skills but also the softer “art” skills relating to human behavior and interactions (Harold, 2010, p. 35). IC is a key issue in strengthening a firm’s competitive position and in achieving its objectives (Guthrie and Petty, 2000). Knowledge assets represent the ‘Crown Jewels’ (Grant, 1991) of firms, and their strategic role for creating value and improving business performance has incited organizations to invest heavily in methodologies, processes, and technologies to enrich, nurture, and renew them over time (Moustaghfir, 2009). This requires an Art and Science approach based on the understanding that successful transformation requires not only the technical or “science” skills but also the softer “art” skills relating to human behavior and interactions. Here, a right balance is called for (Figure 2).

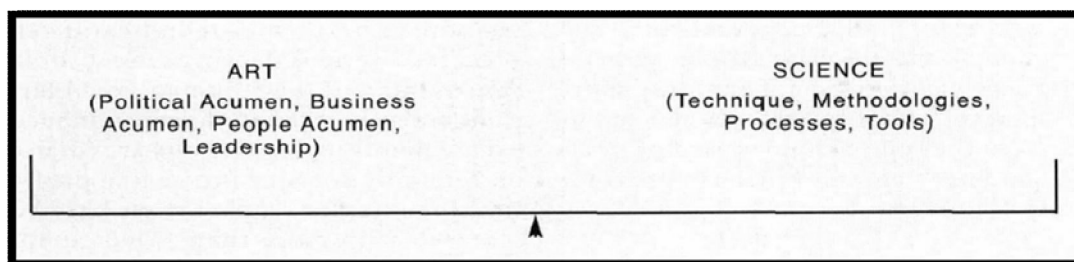


Figure 2: The Art and Science of Transformation Scale (Harold, 2010, p. 34)

The distinction between art and science (project management) skills can also be conceptualized in terms of “right brain” and “left brain” thinking respectively as illustrated in Figure 3.

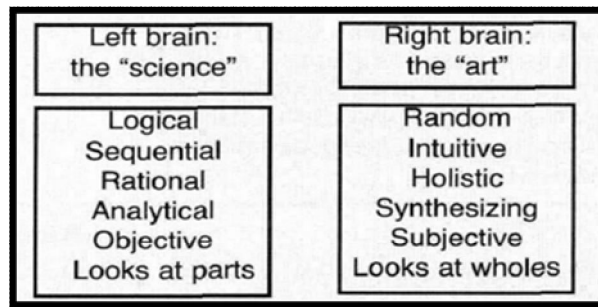


Figure 3: The Art and Science of Transformation Scale (Harold, 2010, p. 35)

IC is the futuristic game changer. Little wonder, IC research is theoretically well equipped to understand the knowledge economy through a "rainforest approach" (O'Donnell et al., 2003), emphasizing complex interrelations between market/price; hierarchy/power and community/trust, and by going beyond the previously dominant imperative of market and hierarchy (Solitander and Solitander, 2010, p. 37). Because, the creation of economic value, nowadays, is based largely on intangible resources and capabilities, i.e. intellectual capital (IC) (Drucker, 1993; Grant, 1996; Stewart, 1997; Sveiby, 1997a; Edvinsson and Malone, 1997) with the main company value drivers being considered to be intangible resources and activities (Lev, 2001; Zambon, 2003). That is why IC is increasingly seen as an integral part of a firm's value-creating processes (Cumby and Conrod, 2001; Sullivan, 2000). So, the new dynamics of strategy ask for new and different approaches making the function of the strategy "to give meaning and direction to the development of the company's business model" (Tikkanen et al., 2005). Business model innovation converts to economic value for the business, creating a sustainable competitive advantage in defined markets (Pohle and Chapman, 2006; Chesbrough and Rosenbloom, 2002; Markides, 1999).

Strategies according to Fink et al., (2005) can be approached in three ways depending upon the specific planning situation and the corporate culture of an organization (Makridakis, 1990; Courtney, 2001). They are:

- **Planning-oriented strategies.** This approach is based on the belief that there is a relatively certain future. Based on this assumption, planners do not have to wait and react, but can make decisions and take actions in anticipation of the change forthcoming.
- **Preventive strategies:** In this domain, the emphasis is on reacting to environmental changes. Uncertainty is accepted and the aim is to cope with unforeseen change.
- **Proactive strategies.** Strategies of this nature accept that a wide range of changes in the corporate environment are unpredictable. But nevertheless attempt to anticipate potential events and so are able to react ahead of time to exploit their arrival (if and when, they do). Moreover, action can be taken by the organization to bring about desired change that would not have occurred otherwise or would have happened later (Makridakis, 1990).

Though organizations of different hues practice these strategies depending upon their life cycle and maturity levels to compete for the future and cruise through the strategic inflection points, good to great contemporary enterprises assimilate proactive strategies and breath them spanning across generations. Here, an organization can be regarded as a bundle of resources (Barney, 1991) that are valuable, rare, imperfectly imitable, and organizational oriented (VRIO, Barney, 2001), according to the resource-based view (RBV). Here are a couple of illuminating illustrations aligned with proactive strategies in India: (a) Vision 2025 of Cyrus Mistry, the Chairman of the India's most valuable brand and salt-to-software Indian conglomerate Tata group viz., : (i) the conglomerate would like to be ranked among the top 25 companies globally by market value and (ii) a quarter (25%) of the world will experience Tata products or services by 2025 (THE FINANCIAL EXPRESS, July 30, 2014, p. 1). The Tata Group Vision 2025 unveiled by its Chairman to impact 25% of the world with its products and achieving market capitalization as one of the top 25 companies in the world (CNBC TV 18, 29th July 2014) speaks volumes of India's aspirations. and (b) The new billionaire club in India like that of the co-founder of Infosys Gopalakrishnan: keen on angel investing in startups in areas like e-tailing and digital marketing with the e-commerce industry expected to touch \$20 billion in the next five years. With this sector defined through technology, Amazon is cited an example as it started as e-commerce players and today it is a leading player in the area of cloud technology (THE FINANCIAL EXPRESS, August 5, 2014, p. 6). The inference here is that the competitive advantage of companies in today's economy stems not from market position, but from difficult to replicate knowledge assets (Teece, 1998). In the contemporary world, knowledge assets are leveraged into a firm's capabilities which in turn shape its products and services, and consequently impacting performance (Grant, 1991, 1996b; Rouse & Daellenbach, 2002) with resources that are valuable, rare, inimitable, and non-substitutable (VRIN) used to implement value-creating strategies consequently providing firms with a sustainable competitive advantage (Barney, 1991; Grant, 1991, 1996a, b).

All said and done, as strategic planning is under attack nowadays (Mintzberg, 1994; Hamel, 1996), organizations need to keep improving their innovation capabilities just to stay even in terms of performance (Hauser, et al., 2006). A classic example is, Infosys appointing Mr. Vishal Sikka, the former Chief Technology Officer of SAP as its Chief Executive Officer (CEO) and paying him the highest salary in the Indian IT services landscape as he has the reputation of being an innovator (THE FINANCIAL EXPRESS, July 3, 2014, p. 4). Little wonder, Moore (2005) described present-day business cycles as "Dealing with Darwinism". This is characterized by today's free-market economies as being driven by the following influences:

- Competition for consumer demand will stimulate innovation,
- Consumer preferences for one innovation over another create natural selection,
- Each new generation restarts the competition from a higher standard than the prior generation,
- Over time, successful companies must evolve their innovation competence or become marginalized. (Moore, 2005, pp. xiv, xv).

The mantra to be future-ready is : “Organizations need to change constantly”. This was the leading statement from the C-level executives’ survey performed by Meaney and Pung (2008) and McKinsey (2010, October) that examined the perspectives of more than 3,000 respondents from industries and regions around the world. “Willingness to cannibalize” is the critical driver of a firm introducing radical innovation (Chandy and Tellis, 1998) could be gauged from IBM donating over 500 of its software patents to the open source community to demonstrate its commitment to open innovation (Chesbrough, 2007). A CNBC 18 TV report dated September 08, 2014 said that Stanford Professors would train 25,000 employees of Infosys in design thinking. When future is to be dominated by top 5 technologies – big data, social media, cloud computing, robotics and mobility - such willingness should be coalesced with the performance culture based on three ‘Ss’ – scale, skill and speed – as advocated by the Indian Prime Minister Mr. Narendra Modi. This would strengthen the competitive forces in the market because according to Raghuram Rajan, the Governor of the Reserve Bank of India, “.....as gravity guides water through the shortest path, competition naturally guides the economy to the most productive route” (Kumar and Bose, 2014, p. 7).

3. Free Markets: The inevitable to be sanctified and leveraged

In their *magnum opus* “*SAVING CAPITALISM FROM THE CAPITALISTS: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity*”, Raghuram G Rajan and Luigi Zingales (2004, pp. 1-3) say that without vibrant, innovative financial markets, economies would invariably ossify and decline. The move by many countries in the last forty years from centrally managed, relationship-based economy with a heavily controlled financial sector to a free market economy with vibrant financial markets can be attributed to both the increasing trade and the increasing international financial flows across the world (Op. cit. p. 277). Because, much of the prosperity, innovation and increased opportunity we have experienced in recent decades should be attributed to the reemergence of the free markets, especially free financial markets. For the poor to have better access, financial markets have to develop and become more competitive. And when they do so, all that holds back individuals is their talent and their capacity to dream. After three decades of massive privatization, sweeping deregulation and widespread liberalization, it may turn absurd for us to claim that free markets could be in danger. In fact, events such as the collapse Enron are interpreted as evidence that markets have become too free. After all, in the “good old days” of regulated public utilities, such problems did not arise. The market is a fragile institution charting a narrow path between the Scylla of overweening government interference and the Charybdis of too little government support. We need a balance of forces that no single mantra will work (Op. cit. pp. 311-313). A competitive market is a form of public good (a good, like air, that is useful but hard to charge for) and somewhat paradoxically, collective action is needed for its maintenance. For, free enterprise capitalism is better thought of as a delicate plant, which needs nurturing against the constant attack by the weeds of vested interests. Capitalism’s biggest political enemies are not the firebrand trade unionists spewing vitriol against the system but the executives in pin-striped suits extolling the virtues of competitive markets with every breath while attempting to extinguish them with every action (Op. cit. pp. 276-277). No wonder, Jack Welsh, former CEO of General Electric, puts it more bluntly “shareholder value is not an objective. It is the product of great people doing great things, not consultants selling EVA calculators and all that crap”. Welsh, according to McSweeney (2008, p. 69), was also echoing John Stuart Mills’ recognition of the paradox that self-interested behavior does not necessarily promote self-interest (Mills, 1873).

With better financial markets, which give a people a chance, and intense political competition which keeps vested interests in check, in the last three decades, we have experienced the benefits of moving toward that ideal. Healthy and competitive financial markets are an extraordinarily effective tool in spreading opportunity and fighting poverty. Financial markets keep alive the process of “creative destruction” – whereby old ideas and organizations are constantly challenged and replaced by new, better ones. Without vibrant, innovative financial markets, economies would invariably ossify and decline. (Rajan and Zingales, 2003, pp. 1-3). The greater availability of capital is slowly redressing many of the evils of capitalism – the tyranny of capital over labour, the excessive concentration of industry, the unequal distribution of income in favour of the owners of capital, the lack of opportunity for the poor..... People have more opportunities to strike on their own, and even when they work within a firm, they are treated better, since firms have become less authoritarian places in which to work (Rajan and Zingales, 2003, p. 312).

Though there is no magic bullet, a set of proposals that Rajan and Zingales (2003, p. 294) call the four pillars, are adduced here for them to become a force to foster free markets and to bring greater structural stability to the market economy (Rajan and Zingales, 2003, p. 310):

- First, incumbents who are not overwhelmingly powerful and who are capable of being competitive are less likely to attempt to constrain market forces. So an important pillar of policy should be to ensure that the control of productive assets is not concentrated in a few hands and that those who do have control also have the ability to use the assets well;
- Second, competition will create losers. A safety net is essential for the distressed, one that does not simply help the distressed cope with business cycle downturns but helps them bounce back from the complete loss of a career;
- Third, the scope for political maneuvering can be limited if borders are kept open. Of course, in extremis, borders will be forcibly closed down by anti-market forces, but that is why all four pillars should be seen as mutually reinforcing and

- Finally, the public should be made more aware of how much it benefits from the market and what the costs of seemingly innocuous anticompetitive policies are, so that the public is less willing to remain passively on the sidelines. Hence, the suggestion of Rajiv Bajaj (2014) that in India the National Pension System (NPS) should replace the existing Employee Pension Scheme (EPS) to become the mandatory provision such as the superannuation plans of Australia and Section 401K in the US. Secondly, a national agenda could be promoted to grow the eq By this, we think that employees of both private and public sector firms in India would become partners-in-progress standing shoulder to shoulder with all stakeholders (Figure 18)

It is here that the philosophy of 'enlightened shareholder value' (ESV) is ensconced to the very heart of the business enterprise and the economy. The concept of 'enlightened shareholder value' (ESV) as adduced by the Department of Trade and Industry, UK (2000) could be viewed as a breakthrough thinking. For, the UK Company Law Review (CLR) published in July 2001 recommended as regards corporate governance that the law should be updated to reflect the shift from managerialism to shareholder value. But with the proviso that this legally mandated shareholder value would be 'enlightened' by two main mechanisms: an 'inclusive' statement of directors' duties, which would direct those controlling companies to take account of a range of stake holder interests as a means to achieving the primary goal of producing shareholder value, and an Operating and Financial Review (OFR), which would compel listed companies to disclose a range of 'qualitative' and 'forward-looking' information of a kind that is not normally found in traditional financial statements (Johnston, 2006). The view that maximizing shareholder-value (a stock market's valuation of a company's shares) should be the central aim of corporations is justified not merely on the basis of the shareholders' rights as owners but on economic efficiency and wider social wealth grounds. Deadbeat companies (and countries) can be transformed into innovative, entrepreneurial, efficient companies and countries if they aim every time and everywhere to create the greatest value for shareholders. This makes winners of us all: "the rising tide lifts all boats". (McSweeney, 2008, pp. 55-56). William Smithburg, Chairman of Quaker Oats, said that: "The best way to deliver enduring shareholder returns . . . [is to] focus on a concept called Economic Value Creation" and because of that he "slept better at night knowing that our divisions are clearly focused on the things that will contribute to shareholder value"(quoted in Enterprise Magazine, April 1993).

The power of the shareholder value model "has been amplified through its acceptance by a worldwide network of corporate intermediaries, including international law firms, the big accounting firms, and the principal investment banks and consulting firms – a network whose rapidly expanding scale give it exceptional influence in diffusing the . . . model of shareholder-centered corporate governance" (Ireland, 2005, p. 77). But, we are of the view that the world is in the clutches of two beasts – the bear and the bull. They rule the world rather. By this we mean the stock market space saturates the mind space, the real and virtual world. Hence, new paradigms and new directions are called for. In a world on a rollercoaster ride, if there is no breakthrough thinking, there will be breakdown. A thinking that is laced with understanding, belief, attitude, feeling and action for the good of humanity is the need of the hour.

4. Market Capitalization and GDP: The Siamese Twins of the Contemporary World

Independent studies of the degree of correlation of EVA (and other variants) with the absolute level of changes in stock market valuations of companies find it is at best miniscule and often negative (Biddle et al., 1999). For instance, a study of 582 US companies found a correlation in only 18 companies. In 210 companies the correlation was negative (Ferna'dez, 2003). Yet, historically speaking, Schumpeter (1912) avers that financial development causes economic development – that financial markets promote economic growth by funding entrepreneurs and in particular by channeling capital to the entrepreneurs with high return projects (Ake and Ognaligui, 2010). An efficient stock market contributes to attract more investment by financing productive projects that lead to economic growth, mobilize domestic savings, allocate capital proficiency, reduce risk by diversifying, and facilitate exchange of goods and services (Mishkin 2001; and Caporale et al, 2006). Little wonder, Levine and Zervos (1998) found strong statistically significant relationship between stock market development and economic growth. The ratio of stock market capitalization divided by gross national income (GDP) is taken from the *World Development Indicators 08*

- $MCGDP = MC/GDP$

Where MCGDP is the total stock market capitalization to gross domestic product and is equal to total stock market capitalization divided by gross domestic product (Kamiru and McGowan, 2013, p. 1132).

GDP is among the most commonly used macroeconomic indicator to measure total economic activity within an economy. GDP is expected to influence numerous factors related to the supply and demand for loans and deposits (Sufian, 2012). However, Chen, Roll and Ross test shows that the economic variables have more explanatory power beyond a stock market index or in the multiple regression of stock returns (Russell et al., 1987, p. 497) and Bragg, in his book, "Protecting against Inflation and Marketing Yield", Georgia State university, Business publishing division (1966) states that "a series of economic periods or cycles characterized not by economic indicators but instead by underlying moods or mass psychology" (Maturi, 1994, p. 5). Nevertheless, let us now do a reality check. One of the most significant ratios to measure the impact of reforms on the equity market is the stock market capitalization to GDP ratio (Sehgal and Mulraj, 2008, p. 219). As is amply evident in Figure 4, the equity markets play an increasing role in the Indian economy. How did they grow in India? Here are two classic model examples: (a) In one of Infosys' earlier analyst meetings, Murthy confessed that GE (its largest

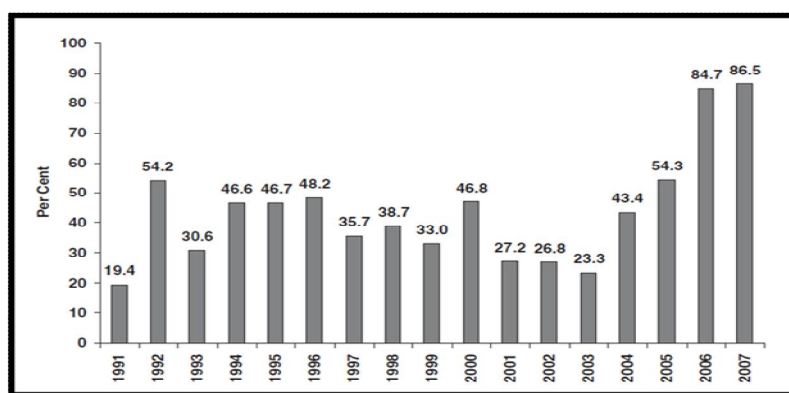


Figure 4: Market capitalisation as a percent of GDP in India (as at end March) (Source : Currency & Finance, RBI, 2005 – 2006)

customer, accounting for a major share of turnover) had walked out on them because Infosys refused to cut prices to get more business. More than the event, it was the honesty and the chutzpah of the disclosure that impressed analysts. The stock price never looked back and gave superlative returns to early shareholders. Shareholders were willing to pay a higher price for well-governed companies with good disclosures. (b) Dhirubhai Ambani, who founded Reliance Industries, now a FORTUNE 500 company. He was astute enough to appreciate the value of the equity market and clever enough to reward his shareholders so well that they subscribed to each new offering of the group. He financed his ventures through frequent tapping of capital markets, ensuring that he left enough on the table for his investors to want more ratio (Sehgal and Mulraj, 2008, p. 218). But in comparison to other countries such as the US and UK, and even Asian countries such as Singapore and Hong Kong, the size of market capitalization in India continues to remain small. It is, however, larger than other emerging economies such as Brazil (Figure 5).

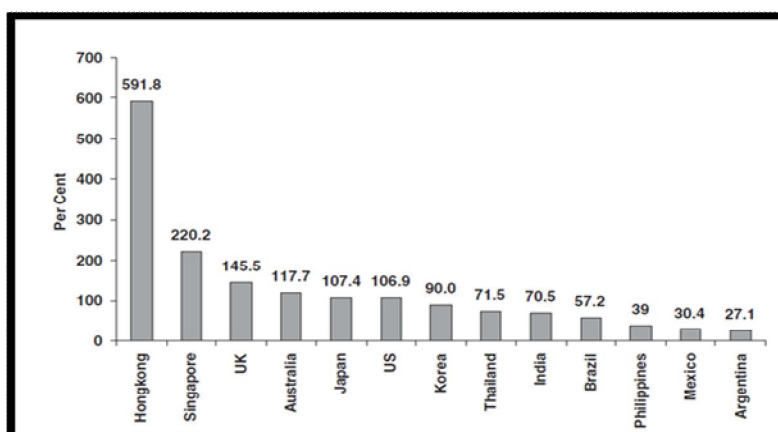


Figure 5: Market capitalization as a percent of GDP in select economies as at end 2005
(World Federation of Exchange and IMF; Currency & Finance, Reserve Bank of India, 2005-2006)

During the recent boom in 2007, the market cap / GDP ratio in India jumped up to 173 percent, and it was feared that the market was overheated. The turnover ratio (TOR) is measured by dividing the total value of shares traded on a country's stock exchange by stock market capitalization. It is a measure of trading activity or liquidity in the stock markets. The value traded ratio (VTR) is the total value of domestic stocks traded on domestic exchanges as a share of GDP. This ratio measures trading relative to the size of the economy. Between 1996 – 1997 and 2000 – 2001, the ratios reached high levels, largely because of the rise in stock prices due to the boom in IT stocks. The Indian National Stock Exchange (NSE) was a leader in the trading of single stock futures in 2006, according to the World Federation of Stock Exchanges (Sehgal and Mulraj, 2008, p. 218, p. 220).

According to 'CG Watch', a joint report by CLSA Asia-Pacific Markets and Asian Corporate Governance Association (2007) and a World Bank study (2004), 12 corporate governance standards in India have shown continuous improvement in the past four years. India is found to be observing a majority of the global best practices in corporate governance. Yet, both at the macro level of the regulatory framework and at the micro level of corporate compliance, India has to cross several milestones (Sehgal and Mulraj, 2008, p. 231).

5. Intellectual Capital a.k.a Intangibles

IC is the fundamental source of competitive advantage for business organizations (Edvinsson, 2000) as organizations operate in an environment mainly based on IC, both on the side of production and on the side of outcomes (Chong, 2002). The subject of the visualization, measurement, management and reporting of intellectual capital (IC) is gaining importance in academic managerial

literature (Petty and Guthrie, 2000). *Intellectual Capital (IC) in the management and legal literature, intangibles in the accounting literature and knowledge assets used by economists refer essentially to the same thing and are used interchangeably* (Lev, 2001, p.5). Well, do you want to be a 'Good to Great' company that is 'Built to last' to 'Compete for the future'? If your answer is an emphatic, wise affirmative, the silver bullet to wage the war (business is a war, metaphorically put) is intellectual capital (Anthony and Utpal, 2014a, p. 10).

As the world's economy relies more and more on knowledge in the creation of wealth, an organization's stock of intellectual capital (IC) has become increasingly important (Meritum Project, 2002). Hence, the development of the business society that is the key step in value creation has ascended an intellectual staircase" (Pike et al. (2002, p. 659). Three major publications were made in the same year by Stewart (1997), Edvinsson and Malone (1997) and Sveiby (1997a). The essence of these three publications is that a shift from the investment in fixed assets has occurred. As a result, next to financial capital, intangibles have become important value drivers (Bollen et al., 2005, p.1163). Averting that intellectual property (IP) is a part of IC, the authors opine that IP has a significant impact on market leadership, future outlook, overall performance and success of new products revealing a kind of 'interface' linking the four components of IC viz., Human Capital, Structural capital (internal capital), Relational Capital (external capital) and Intellectual Property (p.1182). A comprehensive theoretical and empirical model used in the Taiwan's Information Electronics Industry that captures the co-relation between corporate value leveraging IC to achieve financial performance and non-financial performance is captured in Figure 6. Applying the Sveiby (1997a) model, Human capital could be likened to the Human Resource Perspective, internal capital to the internal perspective and external capital to the external perspective.

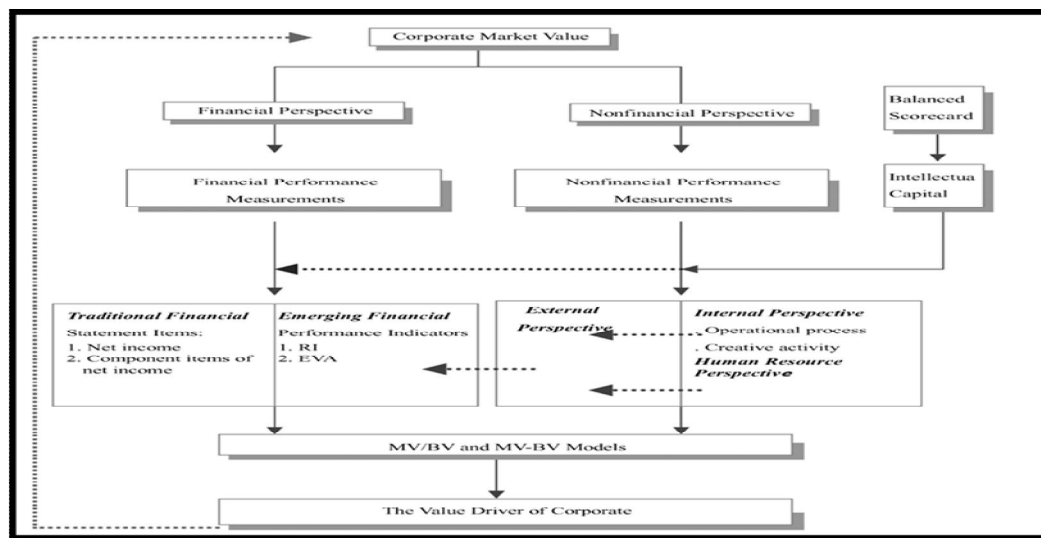


Figure 6: Correlation between corporate value and financial And nonfinancial performance measurements (Liang and Yao, 2005, p, 139)

6. Conceptual links between the many components of the corporate value creation model

Case Fund Managers (FMs) identified the primary qualitative factors and variables in the corporate value creation process. This was to explore (Holland, 2006a, p. 295) :

- A process based understanding of how value was created.
- Understanding how interactions between Human Capital (HC) and Structural Capital (SC) variables created value. Thus the FMs sought to develop conceptual links between real variables such as strategy and management quality (human capital), and between these and innovation and new product development (structural capital), and their combined impact on financial performance.
- The cumulative effect (left to right process) of HC and SC interactions on value creation.
- An important interaction between HC and SC involved key managers, profit drivers and pay schemes. Thus, they wished to know whether the above value addition or profit drivers were recognised and understood by the board and top management, and whether their incentive and pay schemes (a form of SC) were aligned to positive increases or improvements in these other HC and SC value creation factors and processes and hence with fundamental improvement in share prices or were merely moving up with the stock market. Thus for example, were improvements in HC and SC targeted? And who were the key individuals here? Was a score kept (as in score card approach) in terms of incremental improvements in HC and SC and their interactions, and subsequent improvements in the share price, and were pay schemes linked to both types of improvement? Here there is an interaction between one form of SC, the pay and incentive systems, and the rest of the HC and SC interactions. The fund managers wish to know if these schemes were being implemented with those key managers (HC) who were improving or able to improve brand strength, R&D effectiveness, product innovation etc. (SC) and hence value.

- How feedback from market price changes and from the core Financial Institutions (FIs) was used to signal the appropriate combination of IC and SC in the company.
- How conceptual links between variables such as credibility of management, confidence in management, were derived from an understanding of, and experience of the above variables over time.
- How a time based understanding of the value creation process was developed.
- How value was, and is created, and likely to be created in the future.

The ultimate aim of the exercise for FMs is to understand how all forms of intellectual capital could make a contribution to improved financial performance both in terms of increased profits and growing excess of share price over book assets (valuation of tangible assets). Once this was understood and observed, then a feedback corporate governance process was possible (Holland, 2006a, p. 295). Conceptual frameworks such as Porter's "5 forces" analysis, and VBM systems such as EVA allowed the case FMs to understand more about the strengths and weaknesses in the corporate value creation process. Frameworks such as the Porter "5 forces" provided a common language to discuss the qualitative factors. Over a stream of meetings over several years, the shareholder wealth focused questioning was extended out to other related intangibles such as product quality, suppliers relations, quality of marketing management, and then out to the wider IC and HC agenda. This was for a broader understanding of how these intangibles (profit drivers, competitive advantages) were connected and contributed to shareholder wealth, if at all. (Holland, 2006a, p. 295). Both earnings measures and VBM measures depended on high quality public measures of some of better known intangibles such as R&D, goodwill writeoffs, and exceptional items (O'Hanlon and Peasnell, 1998). The FMs view was that this combined public and private information on intangibles, their role in value creation, and their implications for value, were likely to be much superior to public information alone and to provide more insights into value creation than public performance measurement system alone (Holland, 2006a, p. 297).

7. The essence of IC variables

The best classification for intangible assets is from the International Accounting Standards Board (IASB). Within the standard IAS 38 - Intangible Assets, IASB defines the intangible assets as being "identifiable nonmonetary assets without physical substance." Furthermore IASB reminds the definition of assets: "An asset is a resource that is controlled by the entity as a result of past events (for example, purchase or self-creation) and from which future economic benefits (inflows of cash or other assets) are expected. Thus, the three critical attributes of an intangible asset are: identifiability, control (power to obtain benefits from the asset), future economic benefits (such as revenues or reduced future costs)." IASB's classification may be successfully used by practitioners because it is very accurate and the categories are very well delimited one from another. The main categories identified by IASB are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, licenses, import quotas, franchises, customer and supplier relationships and marketing rights (Dumitrescu, 2012).

8. Management is only as good as their last financial performance or broken promise

Now let us understand how value arose within a company and to assess what potential there is for added value. Both focused on difficult to value, and difficult to measure intangible assets. IC writers such as Brooking (1997), Edvinsson and Malone (1997), Stewart (1997), Sveiby (1997a) have generally adopted a three part framework for understanding IC. These include ideas of human capital, organizational capital or internal structural capital, and customer or external structural capital as the three main components of corporate IC. Human capital (HC) or employee competence is the thinking and doing capital and is the main source of corporate responsiveness to new events, of problem solving, as well as of innovation and invention of intangible and tangible assets. *These writers look beyond the conventional cash flow and share price valuation perspective of orthodox finance to a more complex picture of the people, and structural elements of corporate life and their impact on value as perceived by managers, employees, customers as well as investors. They have identified Intellectual Capital as the primary generator of share price value in the modern knowledge based organization, and especially as an important part of the share value excess over book value or the accounting valuation of tangible assets.* The company manager who has to create value and the fund manager who has to assess value. The regular contact with many portfolio companies meant that the case FMs were in a unique position to learn how elements of structural capital such as strategy and board structure, the character of innovation and various management practices all interacted with the elements of Human Capital such as share prices (Holland, 2006a, p. 288). This provides the means for FMs to develop a knowledge advantage concerning these qualitative factors and variables and their price impact. The stock market reaction to corporate performance management quality, to contribute to good financial performance in different ways across companies and industries. They could also observe the collective effect of these variables on joint effect on financial performance and performance arising from these HC and SC interactions, was a key stimulus for FMs corporate governance feedback to their investee firm. (Holland, 2006, pp. 288-289). Factors such as the quality of management, board and top management pay schemes, coherence and credibility of strategy, structure and functioning of the board, and the quality of public and private disclosure mechanisms, proved to be convenient points for private and direct corporate governance influence by FMs. *Qualitative factors determining corporate financial performance are changing current management or influencing management succession is seen as a longer term and more indirect means to change risk management, product innovation and customer satisfaction.* Each FM went into the company meetings with their own tailored list of questions exploring specific concerns on a company's share value and to understand which current issues were impinging on the company's share price value during good corporate performance. Critical to the case FMs understanding is how both tangible and intangible assets were coordinated in a purposeful way to create value. The FMs use the private meetings to probe strategy in depth. They are interested in the

board and top management's understanding of strategy, its coherence and credibility, the degree of commitment and consensus on strategy, and whether it made sense relative to the FMs view and the views of top-rated sell-side analysts and other external commentators. (Holland, 2006, p. 290). Scheduled (reporting cycle) meetings are used as distinctive sources of cumulative information concerning the quality and personality of directors and top management and for understanding how these characteristics contributed to financial performance. The dominance of individuals and cohesiveness of management teams were observed and assessed. Track record and the personality characteristics of key managers, such as sense of purpose, honesty, integrity, and reputation were very important in establishing Financial Institution trust, and confidence in the company. These personality characteristics are assessed at the level of individuals, and management teams. FMs sought information on management attitudes to risk and return, and to shareholder wealth and rights. Information on consumption of perks, or of a get rich quick attitude, was thought to be available only by direct observation. Interpersonal interactions in meetings were seen as central to understanding how management personalities and management qualities had contributed to historic financial performance. This track record plays a role in enhancing corporate credibility concerning management views on how to handle the future. The fund managers recognize the fragility and contingent nature of the concept, but still argue that they needed some feel for management quality in their investee companies as one means for them to assess value and expected performance and to influence the company (Holland, 2006, p. 291). FMs probe top management vision of human capital in their workforce and industry and how this was being upgraded. FMs wish to know who were the critical staff in the company, R&D or brand managers, and how were they retained, trained, and exploited to create shareholder value. This limited view of human capital reflected the fund managers specific focus on corporate changes or characteristics that were expected to create changes in the immediate share price (Holland, 2006, p. 292).

9. “Holistic value added” Approach (HVA) of IC

HVA methodology (Guthrie et al., 2003) is not only limited to the description of stocks of IC but can also describe the flows between various IC resources and between these and traditional capital resources (Pike et al., 2002). According to Roslender (2009, p. 346), while the Skandia Navigator and Balanced Scorecard have both attracted substantial attention, a third scoreboard approach is regarded by many in the field to be the most attractive. Developed by Sveiby, the Intangible Asset Monitor again incorporates four dimensions, designated: (parenthesis ours)

- Employee competence (aka Human Capital);
- Internal structure (aka Internal Capital);
- External structure (aka External Capital); and
- Financial (aka Financial Capital) (Sveiby 1997a, b).

The tripartite taxonomy of IC developed by Sveiby (1997a) when improvised with Roslender's (2009, p. 346) perspective could be explained by (Figure 7) a simple, yet a powerful strategy map to say that Human Capital *synergise* internal capital that *catalyze* external capital which in turn *galvanize* financial growth.

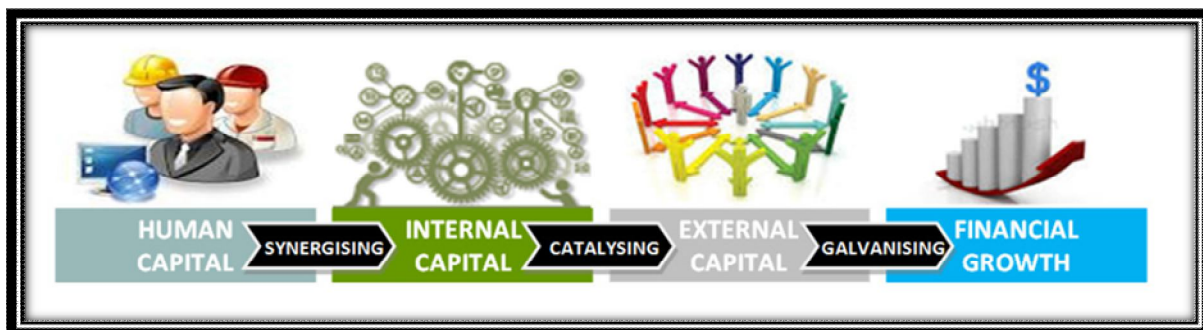


Figure 7: IC Strategy Map for contemporary organizations (Anthony, Thiagarajan and Utpal, Baul, 2014d, p.149)

Successful organizations are those that are able to co-evolve with their environments at the edge of chaos (Pina and Vieira da Cunha, 2006). As value lies in discovering new or applying different business models (Giesen et al., 2007; Markides, 2008) and strategic managers as managers have to convey their business model's meaning (Smirchich and Stubbart, 1985), a convincing approach is to define a business model by its building blocks (Chesbrough and Rosenbloom, 2002; Osterwalder, 2004), others by strategy maps (Kaplan and Norton, 2006) or by knowledge management representation of business models (Malhotra, 2000). People understand the world through bracketing and chunking experience into meaningful units (Schutz, 1967; Daft and Weick, 1984; Smirchich and Stubbart, 1985; Weick, 1995). Hence, the company's business model is seen as the experience of customers and stakeholders and meaning always refers to the business model perceived in its enacted context. An organization's business model is the result of a never-ending iterative and ongoing process (Shafer et al., 2005) for getting "everyone in the organization aligned around the kind of value the company wants to create" (Fraser, 2007; Magretta, 2002).

10. IC in Capital Markets

Lev and Zarowin (1998) demonstrate that ratios of market equity to book equity have doubled in the period 1973 to 1992. They attribute this to a decline in the value relevance of traditional accounting measures as well as radical change in the process of economic value creation. More specifically, Lev and Zarowin (1998) found that, in the US, over the 20-year period from 1977 to 1997, a decreasing share price informativeness of financial reporting numbers (for earnings, cash flow and book value). This decline was at its most sharpest in those companies that had increased their R&D intensity over this period. They argued that this was because company financial reports had not captured the changes in business over this period, especially the increasing role of intellectual capital in innovation and added value. The changes in innovation and in product markets have also coincided with changes in financial markets. Also, the postwar concentration of share ownership in the hands of UK financial institutions has created a more concentrated form of institutional influence and control over (UK) companies (Holland, 1995). In 1996, half of the (UK) equities in the (UK) stock market were owned by 50 financial institutions, the top 20 owned about a third of the market, the top ten about a quarter, with the largest, Mercury Asset Management owning 4 per cent in 1996 (Gaved, 1997). The changing nature of innovation, the concentration of institutional ownership, the perceived limitations of financial reporting, and the interests of politicians and regulators have all combined to increase the importance of private corporate disclosure channels (Holland, 1998) and encouraged a more sophisticated approach to private research by FMs based on private dialogue with UK companies (Holland and Doran, 1998).

Finance theory tells us (Markowitz, 1995) what is to be estimated in the form of future risk and return and how estimates for specific shares are to be combined to form estimates for the portfolio as a whole. However, the theory does not tell us how to make the estimates of return, variance and covariance. These parameters are not known with certainty and some form of estimation bias is inevitable, given that some combination of historic data and/or forward looking subjective or expectancy data has to be used. Markowitz also pointed out there is controversy as to which measure of risk to employ. In particular there has been a major academic dispute concerning the empirical validity of the Capital Asset Pricing Model and of betas in determining security returns and prices (Fama and French, 1992). The optimum portfolio solution found by such methods is very sensitive to small changes in model parameters. Parameters such as expected return, variance, and co-variance (at stock, sector and national level) have not been stable and this has created major parameter estimation problems for the (minority of quantitative) case fund managers when implementing this theory. No reliable sources exist for acquiring accurate expectation data and hence for developing continuously reliable future oriented estimates of return, variance and covariance). The international efficient frontier could be calculated on the assumption that expected returns were the historical means of the inflation-adjusted stock returns and their volatility was the historical standard deviation of these returns. Unfortunately, exchange rates, and stock returns seem to be highly variable and re-estimating expected returns, variances and covariance over a different time period gave quite different efficient frontiers and efficient portfolio results. Gorman and Jorgensen (1996) suggested the international efficient frontier has been extremely poorly estimated and it was difficult for a fund manager to know whether a chosen portfolio, was actually on this efficient risk return trade-off curve (Holland, 2006a, p. 283). In the international context the international risk-return trade-off itself varied over time and was rather unpredictable (Gorman and Jorgensen, 1996). Fama and French (1992) raised questions about using CAPM in portfolio management as they found that returns on small firms were higher than for large firms with the same beta, and that firms with low market to book ratios had higher returns than their Betas would justify. The significance of these non-theoretical asset pricing factors raised serious questions about the empirical validity of Beta in determining stock returns (Holland, 2006a, p. 283-284). Given these theoretical difficulties, none of the case fund managers felt they could construct a portfolio with the ideal risk/return tradeoff and diversification risk reduction benefits envisaged by theory. Finding a stable efficient frontier was problematic in the international context. Despite these problems with modern portfolio theory, the existing theory provided the sole conceptual guide for fund managers in their difficult asset allocation and stock selection decisions. There was still considerable agreement on the need to for FMs to diversify risk, and to try to identify the dominant risk/return portfolio. *Whilst theorists and empiricists continue to improve and test the theoretical framework, the best practitioners can do is to recognize these theory limitations and to draw on the best insights of theory to guide their decisions.* (Holland, 2006a, p. 284). For the quantitative case fund managers (16 FMs out of 40), public domain information on share prices provided the means to calculate historic average returns, variance, covariances and market weightings. Public domain sources such as financial reports, corporate disclosure and future looking data such as analysts earnings forecasts were important means to adapt these historic figures to estimate future returns, variances, covariance and weightings. In qualitative fund management (24 FMs), the view was taken that modern finance theory was too difficult to implement given information problems and time constraints. Portfolio theory and diversification benefits were accepted but constrained asset allocation optimization techniques were not. Public domain information on sectors and major companies were combined with macro-economic forecasts to arrive at asset allocation decisions within a more judgmental and intuitive collective decision process. These FMs also recognized that their judgmental skills were unlikely to produce above average performance on the basis of public domain information alone. The line between quantitative and qualitative FMs was difficult to draw in the case data given the common use of quantitative and qualitative data by both sets of FMs. (Holland, 2006a, p. 285). Both sets of problems were a major stimulus for all of the case fund managers to pursue the following *common FM themes* irrespective of other FM variety such as internal/external, QM vs qualitative, top down dominant vs bottom up dominant: (a) Some FM decision logic based on combination of finance concepts (diversification, dominant or model risk/return portfolio, and the latter adapted to client needs), the use of historic numbers within these concept, the use of judgment to alter expectations in these numbers, or the use of judgment with the finance concepts alone (b) acquire a special information edge by directly collecting information in private from their investee companies. They sought to combine this private information with public information to create a knowledge advantage. This reduced the effects of ignorance based on limited public sources alone (c) Create structured and cyclic fund management decision processes to maximise their means to collect and use many diverse sources of public

and private information in FM. More specifically they developed structured estimation, valuation and risk control decision processes at stock and portfolio levels (d) Make a choice as to the extent to which these structured decision processes were driven by numbers (return, variance, covariance, weightings plus) and the decision logic of MPT, or were driven by judgment and intuition and experience, or by a combination of these quantitative and qualitative approaches. Top down and QM approaches tended to be associated here (e) ensure that structured FM decision processes were responsive and adaptable to major external events such as a sudden stock market change or political event. Thus asset allocation, sector decisions, and stock selection were also designed to be compressed into a very short crisis period instead of a more normal monthly, weekly, and daily cycle (f) Use a home bias as a crude heuristic, based on perceptual, informational and cost barriers, as means to prevent major under performance. All of the above approaches can be seen as common means for qualitative and quantitative FMs means to cope with the major uncertainty and ignorance they faced in their asset allocation, sector, and stock selection tasks as FMs' problem could not be solved by numbers and MPT alone. However, the structured stock selection and asset allocation decision processes made full use of all available information and also provided a working base from which the insights of MPT theory could be implemented according to FM preferences. (Holland, 2006a, pp. 285-286). Fund manager directly contact senior management teams to discuss concrete and intangible sources of value like the recent financial results and statements and a continuing dialogue about corporate governance and other accountability issues. The FMs were also very interested in qualitative, non-financial factors that played an important role in value creation concerning intellectual capital and other qualitative matters. These provided the conceptual base to explore how these factors interacted with each other over time and hence how the value creation process functioned in investee companies. Identification of individual qualitative factors and their dynamic interaction was a major step forward in understanding the role of intangibles in value creation and hence in valuing the company. *This understanding of private qualitative information was combined with public sources to create a knowledge advantage within fund management teams. The latter "mosaic" process involved using public and private sources to build a knowledge advantage concerning individual portfolio companies, sectors, and the wider portfolio. This bottom up database on company valuation and strategy, and prospects for sectors and economies, was integrated with the top down data base on share prices, financial statements, and macro variables.* Creation of the knowledge advantage created a flexible asset that was usable at all times during stock level and portfolio level decisions and allowed FMs to interpret events and process stock and portfolio level information in an informed way before uniformed competitors. The case FMs made considerable efforts to create multiple sources of information, including private relationship (direct corporate contact) information, as input to their stock valuation, selection, and asset allocation decisions. These company sources were continuously live and involved the systematic build-up of the information and knowledge advantage until a periodic (normally reporting period) revaluation or until new events stimulated a rethink on value. The financial reporting cycle created the opportunity for FMs to set up an equivalent cycle of private 1:1 meetings between companies and financial institutions and to therefore acquire private information through this means. The corporate reporting cycle was the normal stimulus for arranging meetings on a regular annual or half yearly basis. The financial report also formed an important source for standardised corporate disclosure and as a basis for initial probing of the company during private meetings. The positive and symbiotic nature of these private and public disclosure interactions was central to FM research behaviour (see Holland, 1997). As a result, a key part (often initial) of the private meeting agenda, was the financial statement numbers (earnings, balance sheet and cash flow figures). These were normally known by the market and core FMs. After the earnings announcements they were extensively discussed in public and in the semi-private analyst and institutional networks. Thus the report numbers were not central to the private meetings. However an important part of the private discussions revolved around how and why the results were achieved and further explanations of the mechanics of (new) accounting methods. The flexibility of reporting such numbers was thought to have diminished since the implementation of stricter GAAP by the ASB in 1990s. In contrast, the private meetings were a means to expand on and to interpret this public domain data outside of normal accounting conventions. Public sources of information were increasingly being used by the case FM in value based measurement (VBM) systems such as EVA. These dealt with historic increments to shareholder value (and cumulative sums in the MVA measure) and provided a powerful diagnostic tool for fund managers and analysts. The existence of these commercial performance measurement systems had improved the case FMs ability to assess the extent to which value had been created or destroyed, and hence to articulate wealth creation questions in a clearer way. The fund managers used VBM systems such as EVA to ensure that their private agenda with managers focused on historic wealth creation, especially periods of major loss and gains in shareholder wealth. The learning that arose from the wider private agenda on qualitative, non-financial factors was a further means to rethink how these historic earnings and EVA figures had been achieved and to re-estimate next period earnings, cash flow, EVA, and hence valuation (Holland, 2006a, pp. 286-288). After the meeting, the FM was able to return to this explicit performance agenda and to revise their estimates and valuation using the qualitative information and new insights into the historic financial performance. The information collected from the cyclic reporting related meetings was stored on the case FM's financial data base and included textual analysis and adaptations to spreadsheet valuation model. The valuation model adaptations was normally based on analysis of existing public domain information such as analysts forecasts but the private information on qualitative factors was crucial to rethinking this information and valuation. The case FMs also contacted companies on an ad hoc basis, outside of the financial reporting cycle. In the ad hoc process, the case FMs were continuously monitoring company and industry specific events to assess their impact on company share prices. As expected events (earnings announcements and financial report publication) or unexpected events (new company announcements) occurred the case FMs exploited their relationship company access to ask the company what they thought the events meant. The latter ranged from highly specific to fragmented company, competitor, industry or economy wide events (Holland, 2006a, p. 288).

How is IC investigated: A stream of intellectual capital (IC) research has been focused on IC disclosure (ICD) of firms operating in capital markets (Chauvin and Hirschey, 1993; Johnson et al., 2002; Lev and Sougiannis, 1999). The rationale is that if firms are asked to report on their IC in the same standardised, auditable forms as facilitated by traditional accounting reports, then current asymmetries in information provision to capital markets can be limited and markets will therefore be less susceptible to unfair trading practices (Bukh et al., 2001; Holland, 2006b; Pakhus, 2000). The growing gap between market and book values has provided much of the impetus for this type of IC research. The so-called “intangible asset” gap (Stewart, 1997) has provided the opportunity for fund managers and stock brokers to exercise their private insights and expertise to their own advantage (Abhayawansa and Abeysekera, 2009). For these market actors, any change in the *status quo* in terms of greater disclosure would only be detrimental (Holland, 2001, 2003, 2006a; Johanson, 2003). Several studies have demonstrated the implicit use of IC factors in fund manager decision making (Ghosh and Wu, 2007; Holland, 1996; Johanson, 2003), though there is little evidence of market analysts making explicit use of IC reports (Johanson, 2003; Holland and Johanson, 2003; Abhayawansa and Abeysekera, 2009). The limited number of firms providing IC reports as a proportion of all firms that an analyst is covering could be one reason why analysts have not embraced IC reports. The challenge is, therefore, to provide IC information across the majority of firms attracting analyst coverage. To date this has not been possible using current research methods. IC reports have either been developed as a self-reporting voluntary initiative (Edvinsson, 1997) or third party IC assessments have been conducted through content analysis (CA) of annual reports or other reporting media (Guthrie and Petty, 2000; Guthrie et al., 2004; Guthrie and Ricceri, 2009). The challenge is, therefore, to provide IC information across the majority of firms attracting analyst coverage. To date this has not been possible using current research methods. IC reports have either been developed as a self-reporting voluntary initiative (Edvinsson, 1997) or third party IC assessments have been conducted through content analysis (CA) of annual reports or other reporting media (Guthrie and Petty, 2000; Guthrie et al., 2004; Guthrie and Ricceri, 2009). The loss of value relevance of financial accounting measures is based on the claim that the usefulness of earnings, cash flows and book values to predicting total shareholder returns has diminished over the past 25 years (Lev and Sougiannis, 1999; Ball, 1992). Analyst consensus on earnings forecasts and their accuracy has been found to be highly dependent on the level of intangibles a firm possesses. The higher the level of intangibles a firm possesses, the poorer the level of consensus and accuracy (Barron et al., 2002). Common intangibles, like R&D and advertising, have been shown to have a strong correlation with share price in certain industries (Chauvin and Hirschey, 1993; Johnson et al., 2002; Lev and Sougiannis, 1999). Investors inferred that by increasing the capitalisation of intangibles, the firms were overstating their earnings, resulting in a loss of relevance of earnings statements when high levels of intangible capitalisation had occurred (Ely and Waymire, 1999). Barth and Clinch (1998) found a positive effect on share price when the value of accounting intangibles is re-stated. ICReporting(ICR) is being promoted as a major vehicle for informing market actors of the value inherent in IC intensive firms (Boedker et al., 2007). The internal reporting aspects of the balanced scorecards and/or intangible asset monitors can provide support to effective management decision making (Kaplan and Norton, 1992; Sveiby, 1997a). From a market perspective, fund managers are seen to have a major influence over a firm’s market valuation (Abhayawansa and Abeysekera, 2009). Fund managers are competing for “private” information that might better inform their investment decisions. From an accounting perspective the financial reporting standards for intangibles are inadequate and lead to a gross understatement of their value (Lev, 2001). The lack of disclosure on intangibles is seen as facilitating insider trading through privileged access to information by some market actors (Holland, 1999; Lev, 2001; Wallman, 1995). However, what to disclose is somewhat problematic. There is general agreement that ICR should take a narrative form and describe the value creation story for the firm (Boedker et al., 2007). IC reports are now looking to lead with the value creation “story” supported by IC metrics, the reverse situation to the balance sheet and balance sheet notes (Mouritsen et al., 2002; Bukh, 2003; Pakhus, 2000). Marr and Chatzkel (2004) indicated that ICR, as it has been practiced to date, is at something of a crossroads. Awareness raising through active publishing in both the scholarly and business press has created a demand for intangible reporting methods and tools. Difficulties still exist with taxonomic definitions of IC and standard measures for IC (Abeysekera, 2006). Also, Lev (2001) argued that for IC measures to be useful for capital markets they need to exhibit several key criteria: be quantitative in nature; permit inter-firm comparison; be empirically linked to corporate value; and be representative of an agreed comprehensive formulation for IC.

An information item is “a single piece of information that is meaningful in its own right” (Beattie and Thomson, 2007, p. 142). To capture multiple facets of IC information communicated in analyst reports, the categorization scheme includes three communication dimensions (i.e. evidence, time orientation and news-tenor) (see Figure 8). Abhayawansa (2011) did this in three IC categories - external, internal and human capital. The 34 IC subcategories are divided among the three IC categories. These dimensions enable the researcher to investigate how different types of IC information are communicated by sell-side analysts in their research reports.

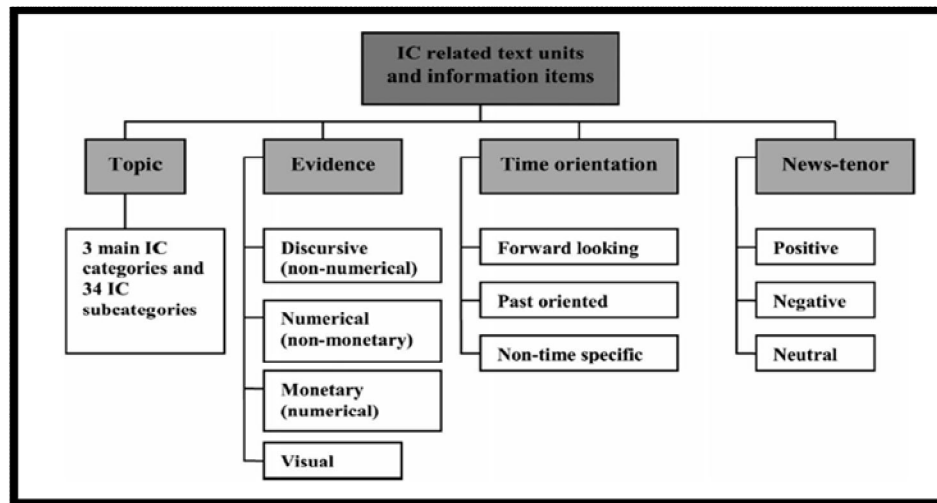


Figure 8: Main dimensions of IC investigation (Abhayawansa, 2011, p. 455)

Such a multidimensional investigation by all stakeholders who want to be sustainable is required since companies tend to use analysts for disclosure of voluntary information to the stock market. Analysts intermediate this information and/or analyze it further in front of clients. It can be concluded that analysts complement the companies' own disclosure of information and, thus, help to increase knowledge about companies and reduce uncertainties in company information. Analysts' receive value-added information needed, such as information on intellectual capital, through direct contacts with company representatives. This may help to explain a limited interest by analysts in mandatory regulation of disclosure on intellectual capital. Objective and independent information tend to be difficult to receive from analysts, because of the conflicting roles played by the analysts and their dependency, related to the relational capital connected to both companies and clients. Clients tend to deal with the ambiguity through personal contacts with the analysts, even though only a small part of the investors have access to such contacts. They do not access values added through the relational capital with analysts. It is important to remember that analysts' recommendations and services, provided to investors, have an impact on price levels, issue discounts, bid-offer margins, volatility, and liquidity of stock prices. Based on this, the analysts' recommendations should only be seen as one complement to companies own disclosure of information. (Johanson, 2007, pp. 49-50).

At the OECD conference in Amsterdam in 1999 a consensus was reached to take steps in the deployment of voluntary guidelines for measuring, reporting and managing intangibles (Johanson et al., 2006, p.474). With some years of delay compared with the OECD, the European Commission (EC) started a comparable process based on the idea that the key to future competitiveness and wealth was to increase the stock of knowledge among the European companies. The EC proposed an approach holding that training investments ought to be treated in the same way on the balance sheet as other capital investments (European Commission, 1995). At an OECD conference in Helsinki it was stated that intellectual capital seemed to be a more promising way forward than human resource accounting (Organization for Economic Cooperation and Development, 1997). In October 2004 the Japanese Ministry of Economy, Trade and Industry (METI) presented its thoughts and the *Guideline for Intellectual Property Information Disclosure* (GIPID) at an OECD conference. They issued a guideline in order to increase the acknowledgement of intellectual assets through an extension of corporate reporting (Ministry of Economy, Trade and Industry, 2004). The ambition behind the initiative is to promote a "nation built on intellectual property" by means of encouraging firms to practice an "intellectual property-backed management" (Johanson et al., 2006, p. 475).

At the end of the 1990s the European Commission encouraged a number of initiatives within the area of IC. One of these initiatives was the MERITUM (2002) Project, which was mainly directed towards research in three areas:

- Classification of intangibles;
- Management control of intangibles; and
- Capital market deficiencies related to intangibles. (Johanson et al., 2006, p. 480).

Our article addresses to a large extent all the above three variables.

In Tversky and Kahneman's (1992) terms, corporate financial gains and losses for various outcomes were identified relative to the expected central tendency of financial outcomes as a neutral benchmark. This could be conducted in two steps: In the *first step*, the prior framing and knowledge advantage, based on the mosaic of private and public information, was used to estimate numbers for important valuation variables. The included earnings and cash flows and hence expected values (and their risks or 'sensitivities') that were considered to be forecastable within a limited and defined horizon of say two to four years. Such forecasts were available from analysts and consensus forecast data also normally existed for at least the next period ahead. Thus the FMs had spreadsheet models with forecast earnings and cash flow, both derived from public domain sources. The function of the private information was to adapt these public forecasts using unique information. The contribution of public and private sources of information to valuation changed over time and depended on many factors. However, the case FMs crudely estimated that private information could contribute anywhere between 25 and 50 per cent of the information used in the final valuation of company before a decision to hold, buy or sell was made. This reveals the significance of private information for adapting spreadsheet forecasts of earnings and cash flows based on

public information alone. Thus qualitative data on human and structural capital were combined with publicly derived and internal sources of quantitative data to create a new basis for adapting and re-estimating numbers such as the size of valuation variables, their likely changes and the sensitivities of such estimates. Promises by the top management, their explanation of strategy, and their analysts of the competition were combined with external analysts forecast and reports and internal research, to arrive at new estimates for expected cash flows, earnings and other key valuation variables. Human capital such as management skills and track record were combined with macro forecasts to assess if the management team had the appropriate skills for the market contingencies they were likely to face. This involved rethinking the impact of macro changes on the perceived causal relationships in the value creation process linking factors such as management quality, product quality, and price power. If these value creation factors were considered appropriate and effective in the expected macro and competitive conditions then the FM would increase their estimates of variables such as prices and sales levels and hence increase cash flows and earnings estimates. In a similar fashion, if structural capital (such as a board with good governance practices, and exercising explicit control over risk management procedures), combined effectively with human capital (such as managers with good record in managing risk), in these macro and competitive conditions, then this also favourably altered FM perceptions of the riskiness of cash flow and earnings forecasts. Finally, corporate and management performance history and keeping of strategic promises played a key role in establishing FM confidence in these estimates of risk and return.

In the second step, and looking beyond this forecastable horizon, the knowledge advantage was the basis for an act of faith FM judgment concerning future value arising in the company beyond this horizon. In those periods and circumstances where it was difficult to estimate numbers for conventional valuation models, the FMs used their inside position on Intellectual Capital factors such as management quality, innovatory skills and R&D expenditure, to assess whether the company had the means to continue creating value beyond the forecastable horizon. Thus, at the level of unforeseeable futures, the FMs had to rely on variables such as management quality or privately derived expectations about R&D expenditure as a basis for a leap of faith concerning the corporate creation of value beyond the forecastable horizon. Management quality and other qualitative information on the effectiveness of the value creation process, acted as a proxies for formal estimates and forecasts beyond this horizon. This was used to translate into rough terminal number estimates of earnings and cash flows for the uncertain period beyond foreseeable horizon (beyond two to three years). This was the basis to make crude estimates of potential increments to value arising beyond the forecastable horizon. Fund managers therefore estimated the value they thought a management team would continue to create beyond the forecastable horizon. Stable and high quality human and structural capital were long term organizational responses to uncertainty and ignorance for both company and fund managers. The FMs were effectively predicting or betting that the human and structural capital that had created value in the past would continue to exist, and to continue to create value in the future. This fudge was added to their more formal estimate of value created within the forecastable period to arrive at a fair value for the company. The fund managers were also clear that this was much more a black art than a science (Holland, 2006a, pp. 305-306)

As a third step, stock selection and valuation was a collective decision, exploiting information and experiences from a larger fund manager and internal analysts' decision group. Time constraints were severe and stock valuation rarely involved the use of elaborate quantitative techniques. More specifically, the explicit number estimates (first stage) and fudges (second stage) were used in a valuation process using an in-house valuation model. Given the perceived current significance of intangibles or intellectual capital in share prices (and as a component of the excess over book value), private information on these areas was likely to be a significant contributor to the valuation process. Private FM use of intellectual capital information was therefore likely to be a significant contributor to the market value and book value difference identified by many external observers. The case FMs argued that their relationship knowledge and wide experience of companies in the same industry and economy, provided them with the means to develop superior translation models to process information on intermediate intellectual capital variables, such as management quality, track record, R&D and brand management skills, into number estimates for fundamentals such as forecastable earnings and cash flows, into valuation fudges beyond the forecastable horizon and into unique insights into corporate risks. These models for translating qualitative IC based information into numbers and risk assessments were essentially based on their collective experience of IC variables in their investee companies and their experience of how these companies used these advantages to react to and exploit macro and competitive conditions. These inside knowledge advantages were also expected to give FMs the means to exploit the range of valuation models in use by market participants. The translation models were not necessarily explicit and they could be seen as tacit knowledge (FM human capital) embodied in FM information collection processes, learning processes and the systematic way FMs exploited this knowledge within highly structured and regular stock selection and asset allocation decision processes (FM internal structural capital). They expected to use their information advantage with both their translation and their valuation models to check whether their information was different to that of the market, and to use this to identify cheap and expensive shares. In cases where time was very short, the FMs used their understanding of IC variables to make quick adaptations to simple valuation models such as market or sector relative P:E ratios. They therefore bypassed the judgmental processes (first and second stage using translation models) concerning how IC was likely to affect real variables such as prices, costs and volumes, and the subsequent impact on cash flows and earnings. Instead they went straight to the valuation issue and made immediate changes to P:E ratios or share prices to reflect perceived changes in IC variables, and the value creation process. According to Jonathan and Tony (1998), Ernst and Young innovative study *Measures that matter*, identify a similar set of qualitative factors effecting value. Their study focused on the key qualitative factors and the impact of unit changes in these non-financial factors on changes in valuation. The latter were expressed in terms of fund managers perceptions of changes in share price or P:E ratios caused by changes in factors such as quality of management. The FMs purchased consensus analysts' forecasts of earnings and financial results. They phoned around brokers

analysts to identify recent changes in each key analysts forecast. In all cases explicit attempts were being made to attempt to discover the short to medium market expectations likely to be behind the existing stock price. Market expectations were also probed by observing other FI shareholder movements. Traders and brokers were asked for their interpretation of why other institutional investors were trading in this way. The case FMs also periodically surveyed (monthly, quarterly) brokers salesmen and analyst to see how they viewed the company. The FMs were trying to find out from them the overall sentiment in the market to the sector as well as their views on the company. Secondly, they used various combinations of private and public information, plus an array of valuation models to see if their valuation was different and based on an information edge. They used a combination of public domain information and valuation models used by the market to check that they arrived at the same company valuation as the market. They argued that they were therefore able to confirm what public information by this test was. They also used their private company information sources and possibly valuation models used by company management to understand how the company management valued the company. If possible, share trading by directors and management was observed. All of this evidence was used to assess the quality of information from management. Fragmented public sources were also used to confirm these private sources. Finally, the FMs used a combination of private and public domain information on the company plus their own range of preferred valuation models to check if their FM information set and valuation was different to that of the market and of senior management. Major valuation differences were the basis for case FMs to assess whether they needed more private or public information to understand why the difference existed, or for the FMs to influence the company to further exploit or correct the reasons for the valuation difference (Holland, 2006a, pp. 307-308)

Quality of Management	Rank	Quality of Investor Communications	Rank
Execution of corporate strategy	1	Management credibility	2
Quality of corporate strategy	3	Accessibility to management	26
Management experience	7	Quality of guidance	29
Quality of organizational vision	16	Knowledge and experience of investor relations contract	31
CEO leadership style	24	Quality of published materials	34
Strength of Market Position	Rank	Effectiveness of New Product Development	Rank
Innovativeness	4	Research leadership	9
Market share	6	New product development efficiency	14
Brand image	13	New product development cycle time	17
Strength of marketing and advertising	21	Percentage of revenue derived from new products	20
Global capability	22		
Effectiveness of Executive Compensation Policies	Rank	Level of Customer Satisfaction	Rank
Alignment of compensation with shareholder interests	8	Customer satisfaction level	11
Performance-based compensation policies	12	Repeat sales level	19
Ratio of CEO compensation to workforce compensation	39	Number of customer complaints	32
		Quality of customer service department	33
Strength of Corporate Culture	Rank	Quality of Products and Services	Rank
Ability to attract and retain talented people	5	Quality of major business processes	10
Quality of workforce	18	Customer-perceived quality	15
Quality of incentive performance systems	23	Product defect rates/Service failure rates	25
Quality of employee training	28	Product durability	27
Employee turnover rates	30	Product quality awards	35
Environmental and social policies	37	Process quality awards	36
Use of employee teams	38		

Table 1: Non-financial factors ranked by investors (Adapted from Jonathan and Tony, 1998)

As long as this information had been acquired by legitimate FM access to the company and mosaic FM processing skills and it did not constitute price sensitive information, then the FMs were free to use this in their buy and sell decisions and to exploit their timing and trading advantages over less well informed investors. This information was then directly employed in share trading decisions, especially timing and scale of sale or purchase decisions. This occurred between asset allocation decision periods and the net effect of this across many portfolio companies (within this period of say a month) was to marginally adapt sector and portfolio allocations. This valuation also provided the basis for influence when companies were thought to be straying from a well understood and agreed strategy (Holland, 2006a, pp. 307-308)

11. Barriers limiting impact of IC in Capital Markets

“Madness is rare in individuals-but in groups, parties, nations, and ages it is the rule.” (Nietzsche, 1966). Despite the propriety or otherwise of the maxim, it has a grain of truth in the world of business. IC issues are pervasive within both corporate value creation and corporate disclosure activities. They also play a pivotal role during the information processing and use activities of capital markets (Holland, 2003, p. 39). The market for information consists of three primary participants: companies, financial analysts and fund managers (e.g., Barker, 1998; Holland, 2003) not to speak of the rating agencies and underwriters.

Capital markets are intrigued by and act on information about intangibles (Johanson, 2003, p. 31). But fund managers consider information on intangibles when making portfolio management decisions (Holland, 2002d). Eccles and Mavrinac (1995) say analysts when asked to rank different intangible indicators reveals that market growth and market share are highly ranked, whereas such indicators as training investments, employee and customer satisfaction received a low ranking. Human capital indicators, together with ethics, received the lowest rankings of all. The low ranking of human capital indicators is also apparent in Mavrinac and Siesfeld's (1997) study. An important exception to the perception of the low importance of human capital is management credibility. The latter is consistent with the findings of Holland and Doran (1998), who suggest that top management quality is an important issue for fund managers.

The exchange of corporate information can be conceptualised as a market, where the demand side consists mainly of investors and financial analysts and the supply side comprises firms and other information producers such as rating agencies and financial journalists. In the market there are both supply and demand barriers that reduce that impact of IC reports (Holland and Johanson, 2003). Figure 9 lists a tentative classification of the most relevant supply and demand barriers at stake which are closely connected to each other. This is the reason for the arrow connecting “supply barriers” and “demand barriers” on Figure 9. For example, analysts' distrust on the information's veracity (demand barrier 5) would be reduced if indicators contained on IC reports were audited or verified (supply barrier 5) (Guimon, 2005, pp.31-32).

Analysts do consider non-financial indicators when they publish prospects (Mavrinac and Boyle, 1996). Lev (1999a) and Deng et al. (1999) are of the view that R&D and patents affect shareholders' value. Analyst coverage, according to Barth et al., (2001), is significantly greater for firms with larger research and development and advertising expenses relative to their business. However, capital market actors lack interest or even ignore information about intangible (Eccles and Mavrinac, 1995; Catusus and Grojer, 2001b). The capability of understanding the role of intangibles in the firm's value creation process not only differs between firms and capital market actors but also among different capital market actors (Holland (2002d). The latter causes an information asymmetry within capital markets and, because of increasing efforts to obtain critical information on intangibles via private information channels, the informational asymmetry may result in significant insider gains (Aboody and Lev, 2002).

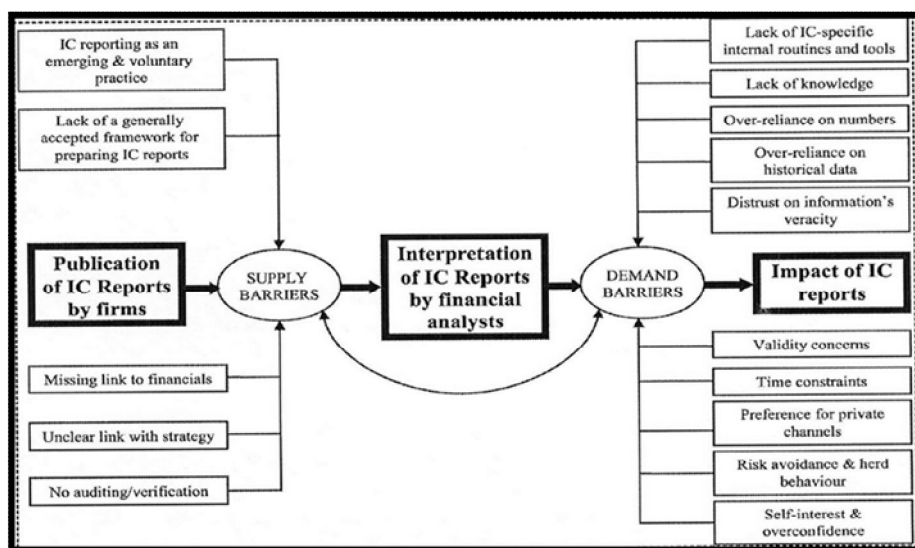


Figure 9: Barriers that limit the impact of IC reports in capital markets (Guimon, 2005, p.31)

If IC reports are to compensate the relevance problems associations with financial information, the existing barriers in Figure 9 would need to be alleviated through policies that promote:

- Improved reporting practices by the business community;
- An upgrading of financial institutions' internal routines and practices and
- A change in financial analysts' mindset (Guimon, 2005, p.39)

The barriers or problems to be cited in this article are seen as being at the heart of the information and valuation crisis faced by capital markets (during 1997-2003) which should be a new capital market research agenda on intangibles for the following reasons:

- to be of value in the management of these problems by market participants.
- in the training and education of market participants,

- in preparing guidance for them in the use corporate IC information
- in helping policy makers to remove some of the barriers to processing corporate IC information and
- to provide the eventual means to investigate how FMs and analysts are intermediaries between corporate IC value creation activities and financial market states such as volatility, liquidity and general stock price levels, and between capital market feedback and corporate IC related actions.

In a nutshell, such research would provide insights to alleviate the IC related capital market "information crisis" to be observed in the period 1997-2003 (Holland and Johanson, 2003, p.483).

11.1. General barriers - Supply side:

Difficulties have emerged with the information content of corporate financial statements or more specifically with the ability of financial number to explain cross-sectional variations in security returns, and this appears to be directly related to the growth of intangibles (Lev and Zarowin, 1998 and Schipper, 1991). Traditional corporate reporting practice, according to Eccles et al (2001) are inadequate because they do not capture the non-financial measures and intangible assets that now drive value. Their 'value reporting' approach calls on corporate executives to provide more, rather than less, of the kind of information on the intangibles they use to create value (Holland and Johanson, 2003). Moreover, knowledge intensive changes in corporate value creation processes have altered and increased the information asymmetry between the corporate users and FM suppliers of equity and bond capital. Because, the intangibles concerned are difficult to categorise (Johanson, 2002), to define, to set up indicators of, to measure, as well to measure costs and to assign benefits to (Holland and Johanson, 2003, 468). Though companies recognise that intangibles are often at the heart of competitive advantage (Johanson et al., 2001a, b), it is very difficult to assign property rights to patents or other contractual forms, and hence to the benefits which arise from intangibles. Companies prefer to keep their intangibles under wraps and do not disclose public information on them until they must. This information asymmetry arising from supply side changes has therefore increased the opportunities for moral hazard, their primary FM suppliers of (bond) debt and equity capital. Such opportunistic behaviour can be attributed to company and analyst information gap. Moreover, IC narratives can be manipulated and subjected to different interpretations (Abhayawansa and Abeysekera, 2009). The finding of Garcí'a-Meca and Martí'nez (2007) that more IC information is disclosed in buy reports than in sell reports is a food for thought.

11.2. General Barriers: Demand side

Johanson (2002) has cited four major problems on the demand side. The first two problems of knowledge and uncertainty are the fundamental problem of "bounded rationality" (Simon, 1969). The problem of ownership and of management can be called the outcomes and consequences of "bounded rationality" (Simon, 1969). Firstly, capital market actors may fail to understand the importance of a certain intangible, e.g. a human capital investment. This inability to comprehend the meaning of human capital could be conceptualised as a knowledge problem. They probably are not aware of the recent research on the profitability of human capital investments (e.g., Becker and Huselid, 1997; Bassi et al., 2002; Aldana, 2001). More specifically, they lack the necessary understanding of potential of human capital investment in a specific organisation. They have little or no appreciation for how human capital contributes to the value creation process. Secondly, even if capital market actors understand the link between human capital indicators and the vision of the firm, they are probably hesitant about human capital investments because they do not know if they could rely on the indicators. Validity and reliability issues like do the indicators of human capital transform adequate information, are they valid and are the methods of measure reliable are the uncertainty problem. Thirdly, this reluctance may be connected to the lack of ownership of intangibles related to people. For instance, because a company cannot own individual competence, the risk of losing this competence may be overly exaggerated. This could be called problem of ownership (Holland and Johanson, 2003, 469). Fourthly and lastly, the management problem. Capital market actors are hesitant and indecisive because they do not know if the measures in actual fact matter in the management control processes of the firm. The question is: does the management take the necessary action on data. Johanson et al's (2001a,b) study in 11 Swedish firm with more 10 years of experience with measuring, reporting and managing intangibles demonstrated that measuring and reporting intangibles are one thing, but to ensure that understanding and action are based on the information from intangible indicators, a number of supporting processes are needed. "Measuring without doing anything is worthless or even dangerous", many respondents suggested.

Fund managers (FMs) and analysts deliberately only select that part of the corporate information so that it is considered value relevant at a point in time. The market time pressures, changing market fashions and fads, periodic reporting cycles, and preferences for transient price sensitive information set, all reveal that market side pressures can narrow down FMs and analysts views of relevant information on intangibles. FMs immediate contact is with the senior management team and it is this aspect of human capital that dominates their thinking. Their portfolios focus, often with over 200 companies in their portfolio, leaves them with little time to explore how IC/intangibles play a detailed role in corporate value creation. Their preference for the corporate value creation story and their use of a limited number of indicators reveals their bounded rationality at work and the scale of their knowledge problem concerning corporate IC (Holland and Johanson, 2003, 470).

Figure 10 illustrates the key information flows between companies, analysts and fund managers in the market for information. Many two way and multiple flows of information occur between these parties in both private (one and one) meetings and semi-private (large group analyst, fund manager and company) meetings occurring after earning announcements. Holland and Doran (1998) reveal how on the demand side, fund managers placed pressures on companies to supply value relevant information. The second important information flow occurred from analysts to fund managers (Marston, 1993, 1996).

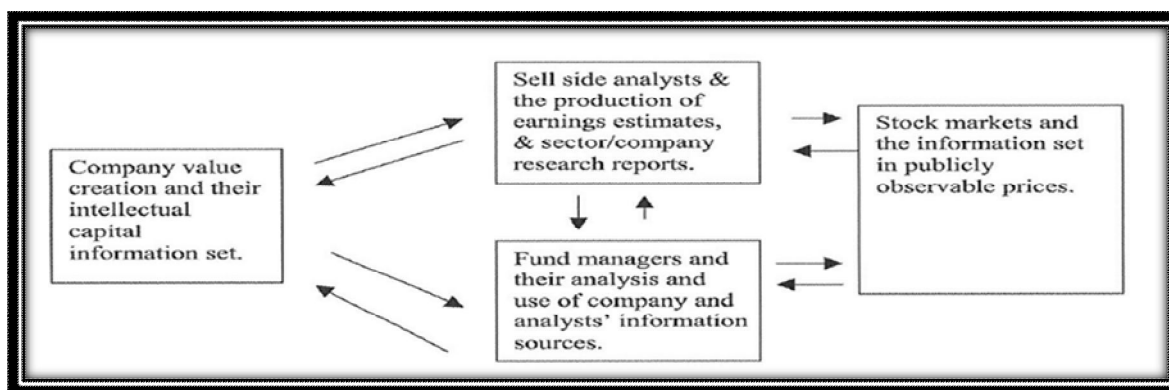


Figure 10: Flow of information between capital market agents (Holland and Johanson, 2003, p.467)

The specific emphasis of this will be on the flow of IC information from companies to fund managers and to analysts and the onto capital markets. These are considered to be the main information highways between companies and markets. Fund managers and analysts from 1990 onwards have become increasingly interested in qualitative information on intangibles such as top management quality or brand management skills (Holland and Johanson, 2003, 467). For example fund managers have learnt that the qualities of certain key executives and changes in top management have effected stock prices (Holland and Doran, 1998). These variables effect both the stock market perception of the company's ability to manage its base case (existing business) and the ability to generate growth. Fund managers have broadened their view of the range of intangibles they now believe have an effect on stock prices (Holland, 2001, 2002a). They realize they have to collect highly subjective information on corporate intangibles and then they have to connect this information to expected stockprice changes. They are aware that this is often a huge "leap of faith" but given the informational difficulties and the demands of the fund managers task they have little choice but to make such heavily subjective judgments.

The market for information can be conceived as the institutional means to connect corporate information supply activities to capital market information demand activities (Gonedes, 1976; Keane, 1983). . The supply side consists of many primary information producers or information disclosures in the form of listed companies. The market also consists of many other primary and secondary information processors, users and producers (disclosures) such as sell-side analysts, fund managers, credit raters, auditors, investment bankers and information specialists. The capital market is the means whereby new corporate capital is raised (primary capital market) or where existing ownership claims on corporate cash flows are priced and exchanged (secondary capital market). The information market is the key information channel to the capital market. Information market outputs, in the form of information and action, are intended to reduce the information asymmetry between companies and capital markets. The major (information market) corporate disclosure, information intermediation and output activities have an impact on capital market states such as price levels, issue discounts, bid-offer margins, volatility and liquidity of stock prices, as well as on the information set reflected in weak form and semi-strong form market efficiency. The capital markets states in turn provide control and feedback to the firm in the form of cost of capital, its ability raise bond and equity capital, and its vulnerability to take-over and litigation. This capital market feedback is often amplified and articulated by the information market. The information and capital market are one common connected phenomenon (Holland and Johanson, 2003). The market for information was a centrally important source for fund managers and analysts (Barker, 1997; Gaved, 1997; Holland, 1997; Holland and Doran, 1998; and Myners, 1995)

11.3. Barries among Fund Managers:

The company to fund manager route is perceived as the main information highway between companies and markets. The knowledge-intensive changes in corporate value creation processes (see Brooking, 1997; Sveiby, 1997a) have altered and increased the information asymmetry between corporate users and fund manager suppliers of equity and bond capital. The increasing significance of intellectual capital in value creation in the corporate enterprise has now also become critical in the areas of corporate finance, disclosure, and in the capital market. However, it is difficult to categorize, to define, to set up indicators of, to measure, as well as to measure costs of and to assign benefits to the intangibles concerned. Valuation of intangibles has therefore become problematic. Companies also recognize that such intangibles are often at the heart of competitive advantage. They prefer to keep their intangibles under wraps and tend not to disclose public information on them until they have to do so.(Holland, 2003, p. 40).Knowledge, uncertainty, ownership, and management problems related to corporate IC information are a primary source of FM and analyst company valuation problems. Further it has been suggested that the same problems also function as barriers in understanding the FMs and analysts own value creation chain. The latter intensifies the problems of understanding corporate IC information. Other market side pressures which can further exacerbate the problems of processing IC information can be broken down into financial pressures and social or cultural pressures. (Holland and Johanson, 2003, p. 479). The barriers, if elaborated, could be bifurcated into two major elements, viz., (a) barriers faced by FMs in understanding the corporate value creation chain and (b) barriers faced by FMs in understanding their own value creation chain .

11.3.1. Those faced by FMs in understanding the corporate value chain

These are with regard to the conceptualization and valuation process these capital market agents conduct but also within the capital market agent's own value creation chain. Firstly the barriers faced by the FMs in understanding the corporate value creation chain. Going by the 1997-2001 case of research of Holland (2002c), we understand how FMs used corporate-based intangibles in corporate valuation. The FMs were in a position to analyze macro and competitive changes in the company's environment and to assess their effect on the company and the likely response, once they acquired a knowledge advantage concerning the role of intangibles in the corporate valuation process. This paved the way to estimate corporate returns, their riskiness and corporate value. Derived from public domain sources and prior knowledge, FMs had spreadsheet models with forecast earnings and cash flow. *The case FMs roughly estimated that private information could, at times, contribute anywhere between 25 and 50 percent of the information used in the final valuation of company before a decision to hold, buy or sell was made. Thus qualitative data on human, structural (internal) and relational (external) capital was combined with publicly derived data and internal sources of quantitative data to create a new basis for adapting and re-estimating numbers such as the size of valuation variables, their likely changes and the sensitivities of such estimates* (Holland and Johanson, 2003, 470)..

Holland (2001) reveals how FMs sought strong influence over both corporate governance agenda and wealth creation agenda. The focus much on governance (influence and intervention) activity included intangibles such as management quality, coherence of strategy, effectiveness of R&D, effectiveness of brand management, alignment of executive pay, financial performance measures, executive qualities and strategy. However, the case FMs also faced great difficulties in governance because of the subjective nature of much IC information. The latter raises issues of validity and reliability and contributes to the uncertainty problem. Major governance failures can still to be observed and these are partially due to the problems in understanding and governing intangibles in investee companies.

FMs compensation, their lack of understanding of the value creation process by emphasizing a highly stable work force and top management team are a case in point. Yet, FMs are also acutely aware of the ownership and management problems. This is manifest in their interest in stable top management teams and in board structures and in succession policies. This interest in ownership and management problems with human capital does not normally extend to the rest of corporate employees. For instance, Eccles and Mavrinac (1995) found a very poor interest in disclosure of information regarding employee turnover. However, in Hollands's (2002a) study, FMs viewed stable and highly quality human (top management) and structural capital as a long term organizational responses to uncertainty and ignorance. The FMs were betting that the human and structural capital that had created value in the past would continue to exist and create value in the future subject to changing competitive circumstances. They used these insights to alter their valuation of the company. The private information on IC played a central role in FMs estimation of the numbers for valuation processes, in effecting FM confidence in these numbers and in FMs making an educated guess or "leap in the dark" regarding the uncertain element to company value (Holland and Johanson, 2003, 471).

11.3.2. Those faced by FMs in understanding their own value creation chain

One can conceive fund management as a complex value creation chain which makes extensive use of IC (Holland, 2002c) – made up of a tangible element, a hierarchical element and a horizontal element. In the FM *hierarchical value* (or top down management) creation process, there are a set value drivers including top fund management qualities (stars vs team qualities), coherence and credibility of FM strategy (active vs passive, internal vs external, retail vs pension fund strategies etc.), fund management pay (base vs bonus, single vs group) scheme and shareholder value-based FM performance systems. FMs too articulate a concept or idea of their "*horizontal value*" creation process consisting first of input decisions such as source of funds, of new information, of new FM staff, and value drivers. This horizontal process also includes FM decision processes, transformation decisions, and output decisions and processes. Knowledge intensive intangibles are 'wrapped around' a tangible value creation process which consists of structured and routine stock selection and asset allocation decision procedures. With these processes FMs exploit human capital such as the stock picking skills and experience of individual FMs and team of FMs and of internal analysts. Structural capital includes structured information collection and decision processes (knowledge embodied in daily stock selection and monthly asset allocation) and structured performance reporting. They also include the internal research capability of the FM group, and the means by which FM gained external access to public domain information sources, and external access to private information from companies and others. The internal FM knowledge intensive assets and processes were the primary producers of the financial outputs of FM in the form of risk, return and liquidity for portfolio wide savings services as well as financial performance of the FM overall. (Holland and Johanson, 2003, 472). These processes were also the means to produce other significant outputs such as investment advice to customers, the quality of disclosure by FMs and the corporate social and ethical performance of the FMs. Such financial services and other outputs were mediated to the marketplace through various reputational assets and distributed via various channels. There was considerable feedback from these outputs to the inputs. Thus success in producing the required risk, return and liquidity, or advice on these matters, effected FM reputational assets, and these together effected FMs ability and desire to attract new funds, new clients, new information sources, and new FM staff.

There is a large number of company side factors, both tangible and intangible, likely to be relevant to FM investment decisions. There are also many stock market side factors and political and economy wide events likely to impact on investment decisions. FMs must simplify this complex world. However, FMs as individuals have limited mental capabilities and cannot acquire, and cannot deal with all of company side (tangibles and IC) information or market side information available (or needed) to make a fully informed investment decision. FMs, according to Holland and Doran (1998) and Holland (2002c), used simple data and solution search

heuristics or 'rules of thumb' to identify sufficient information and to make a decision based on their view of the corporate and financial world obtained from that information. The heuristics reflected their 'bounded rationality' as a compromise between the demands of the investment problem, and the limited capabilities of the FM individuals, as well as the continuing time pressures to come to a quick decision.

The growing significance of IC in the corporate information set has intensified FMs needs to employ such 'bounded rationality' by using restricted categories of corporate intangibles as the perceived drivers of value. However, they sought to overcome such limitations at the level of individuals by operating in teams. The FMs explicitly sought to diversify their different information sources and their different decisions styles and cognitive styles. As a result, they sought to overcome the limitations of individuals and exploited the collective cognitive skills of the group. This was a key basis for the 'mosaic' approach of building a unique picture from fragments distributed within the FM team. One major outcome of this team activity was a consensus on the larger value creation picture for a company and hence a consensus on where problems lay in the value creation process. Their 'mosaic' view was at the heart of subsequent FM investment and corporate governance decisions about the company and its sector. (Holland and Johanson, 2003, 473)..

These facts reveal that there are many connections to be explored between issues of, understanding human and structural capital in corporate value creation, problems of FM (or analyst) processing such corporate IC information and human capital issues in FM (and analyst) value creation chains. Brydon (2002) is of the view that we do not know what the full nature of the FM value creation chain is. Holland (2002c) also says that there has been very little research on the role of intangibles in the production of financial services in areas like fund management. The exact role of FM humancapital in the value creation chain is not known. It is not clear what specific FM skills or knowledge are required for consistent FM success in the 'mosaic' information processing and valuation approach, in stock selection, and portfolio wide risk management, in internal research activities, and in exploiting external information sources especially from investee companies. Brydon (2002) says that there has been very poor humancapital development in the UK FM industry with a strong emphasis on 'craft-based' learning on the job. These implicit craft based approaches seem a contradiction when compared with FMs active search for explicit information on how intangibles (especially top management qualities) are rationally deployed in their investee companies. It looks odd in FMs who seek to make explicit this capacity for investee companies but cannot do it for themselves. The lack of understanding of their own IC knowledge, uncertainty, ownership and management problems might intensify the similar problems they face when processing corporate IC information (Holland and Johanson, 2003, 474). The sentencing of Mathew Martoma, an Indian-origin portfolio (fund) manager to 9 years in jail for his role in one of the "most lucrative" insider trading ever in the US involving a "staggering" \$276 million is "deeply corrosive to our financial markets" generating a cynicism among investors (THE FINANCIAL EXPRESS, September 10, 2014, p. 18). To sum up, the human capital issues are not just restricted to FMs. Pension Fund trustees have major limitations in their expertise to successfully monitor their FMs (Myners, 2001).

A key part of the private agenda of Fund Managers was a dialogue about public information sources, especially, quantitative financial information sources such as the financial report. In contrast, the unique private agenda included information on qualitative, non-financial company variables such as "quality of management", strategy and its coherence, investment and financing plans, recent changes in these and in corporate succession and management style. Information on competitors and the structure of competition is considered to be very important. Other information sources here included a supportive company climate for innovation and long term investment in productive and human assets, R&D expenditure, flexibility of company to technological change, and the role of internal financial resources. Customer and suppliers relations were important external intangibles. Management attitudes to these variables, to profitability, and to return to shareholders, were also central to this part of the agenda. The fund managers sought to understand how these company level IC factors (amongst other company factors) interacted with expected changes in macro economic conditions and competitive conditions. This information on external impact and internal responsiveness was only available by combining private and public sources within the mosaic process. New information here led the FMs to alter their perceptions of the riskiness of corporate plans, the up and downside range of financial returns, the potential for major losses, and hence to alter their views of corporate valuation (Holland, 2006a, p. 304). FMs were specialists assessors of risk and return, and this explains their more sophisticated and dynamic approach to framing of prior perceptions of gains and losses, (Holland, 2006a, p. 305).

The case Fund managers used a set of information to gain a more balanced picture of a company based on the past (past financial performance, financial policy, accounting changes, corporate governance history, management experience and track record), the present (current results, strategic changes, communication skills), and the future (management vision and promises, perceptions of risks and challenges, match between management quality and contingencies) to understand how the company could continue to improve shareholder wealth and to assess the implications of renewed and developed intellectual capital for the share price. (Holland, 2006, p. 298).

A recent major development is the key institutional investors participating in the "Enhanced Analytics" project agreed to allocate a portion of their brokerage commissions to long-term securities analysis that incorporates intangible or extra-financial measurements of performance and corporate measures of "success". The debate on stock market short-termism is long running, dating back at least 30 years to the time when a large number of corporate takeovers-both friendly and hostile- began occurring, often for reasons of "financial engineering" rather than for strategic and long term growth purposes. Takeover fever created massive change in the capital markets well into the 1990s. Short-termism became an entrenched phenomenon for corporations, investors and analysts. "Change can only be accomplished through a concerted effort and inter-related efforts by capital market participants, undertaken simultaneously on many levels" agreed the participants of the London summit in April 2006. This is in a world preoccupied by geopolitical crises, from Ukraine, Iraq and Gaza to the Ebola outbreak in West Africa and the main problem facing central banks being pillars of world

economic growth are not level and that economies are not working together, according to Jacob Funk Kirkegaard, a fellow at the Petersen Institute of International Economics (THE FINANCIAL EXPRESS, August, 21, 2014, p. 12).

11.4. Barriers among Analysts:

Institutional investors are represented by fund managers and buy-side analysts. Buy-side analysts are generalists and they prepare similar recommendations as the sell-side analysts but for internal use (Cheng *et al.*, 2006). Sell-side analysts are specialists on sectors and companies and work for different kinds of financial institutions, such as investment banks. The analysts provide independent analyses distributed through written and verbal recommendations and services to their target clients, i.e. institutional investors (Johanson, 2007). Analysts, both sell side and buy side, are stock level and sector specialists. Sell-side analysts are highly influential capital market intermediaries. Retail and institutional investors rely on analyst research for making trading decisions (e.g. Campbell and Slack, 2008; Fogarty and Rogers, 2005; Holland, 2006a). Yet, an analyst firms' relationship with its closest environment can be expected to influence the analysts' work and the output of this work, e.g. in terms of the analysts' capability to understand, analyze and make decisions (De Castro *et al.*, 2004)

Barriers faced by analysts could be bifurcated into two major elements, viz., (a) barriers faced by analysts in understanding the corporate value chain creation chain and (b) barriers faced by analysts in understanding their own value creation chain. This is in the midst of an environment where analysts play three complementing and contradicting roles:

- Intermediaries of company information;
- Knowledge-builders; and
- Businessmen for the investment bank organization (Johanson, 2007, p. 43 and 47)

Both non-professional and professional investors rely on information in analyst reports as an input to their own decision-making (Campbell and Slack, 2008; Core, 2001; Fogarty and Rogers, 2005; Galanti, 2006; Johansson, 2007). Yet, analysts are optimistically biased when writing reports (e.g. Das *et al.*, 1998; Dechow *et al.*, 2000; Dugar and Nathan, 1995; Fogarty and Rogers, 2005; Lin and McNichols, 1998) and different information in their reports are targeted at different users simultaneously due to the conflicting incentives they face (Malmendier and Shanthikumar, 2006). As a consequence, not only what information is communicated, but also how it is communicated by analysts has a significant bearing on a firm's market value (Dannhauser, 2009). Analyst reports include information used by analysts in arriving at their forecasts, valuations, and stock recommendations (Abhayawansa, 2011). However, Govindarajan (1980) argues that the content of an analyst report provides a formal explanation of the stock recommendation made in the report but not a record of the analysts' decision processes. Nonetheless, it is argued that cited information is both important and influential (Previts *et al.*, 1994; Rogers, 1996; Schipper, 1991).

Accounting researchers argue that measurement difficulty, non-specificity, complexity, and interdependence of IC are impediments for capital markets research on IC (Bukh and Johanson, 2003; Holland, 2003; Mouritsen, 2003). The specialised nature of their job, and skills and resources at their disposal make analysts the most informed, articulate, and sophisticated users/processors of corporate information (e.g., American Institute of Certified Public Accountants, 1994; Bence *et al.*, 1995; Hopkins, 1996; Schipper, 1991). Yet, analysts' self-insight – the ability to communicate one's own judgements – is found to be limited (Mear and Firth, 1987; 1990). Kassarian (1977) states that the element of subjectivity of deciding the correct news-tenor category is difficult to control and impossible to eliminate fully. The level of emphasis analysts place on various types of IC information, as measured by their relative frequency of disclosure, is better to be interpreted in the context of (Figure 8) their evidence, news-tenor and time orientation (Abhayawansa, 2011).

Analysts issue buy recommendations on stocks not because they expect them to outperform the market but because doing so will generate investment banking business and trading profits for their firms and increase their compensation (Michaely and Womack, 2005). Analyst optimism is easily observable by looking at the ratio of buy to sell recommendations, which is positively skewed. However, this insincere and manipulative behaviour is detrimental to analysts' reputation. By publishing biased research, analysts may lose credibility in the eyes of investors, and thus risk long-term career prospects. A substantial body of research documents that analyst recommendations are over-optimistic in general despite this risk (Chan *et al.*, 2007; Dechow *et al.*, 2000; Michaely and Womack, 2005). Investors recognise the bias in analyst research, although not its full extent. Compared to large traders, small traders are more ignorant of this bias (Malmendier and Shanthikumar, 2007). It has been shown that investors are sceptical about favourable recommendations and recommendation upgrades. For instance, Womack (1996) found that investors place greater value on a new sell recommendation than a new buy recommendation and they transact more vigorously in response to a recommendation downgrade compared to an upgrade. Due to the bias in analysts' stock recommendations and earnings forecasts, investors tend to consider other information as well as arguments provided in analyst reports in their decision making, conditional on the type of stock recommendation (Francis and Soffer, 1997; Morgan and Stocken, 2003; Ramnath *et al.*, 2008; Twedt and Rees, 2012; Winchel, 2011). Analysts use IC information as a mechanism to further their agenda for managing impressions. Markets react to information contained in arguments presented in analyst reports as well as the tone and level of detail in them (Asquith *et al.*, 2005; Twedt and Rees, 2012). IC information used in analyst reports is inconsistent with the corresponding recommendations and reliance on such information can have distorting effects on share prices. So there is a need to be aware of analysts' conflict of interests when reading analyst reports (Abhayawansa and Guthrie, 2012).

Bradshaw (2002) documented that analysts' earnings forecasts when incorporated into present value-based models provide valuations inconsistent with their stock recommendations. He submits that analysts rely on valuation heuristics in making stock recommendations. However, no relationship has been found between the type of stock recommendation and the valuation techniques

used by analysts (Demirakos *et al.*, 2004). “[...] stock ratings and target prices are just the skin and bones of analysts’ research. The meat of such reports is in the analysis, details, and tone” (Tsao, 2002, p. 1). This is because analysts need to convince their clients on the appropriateness and the basis of recommendations they issue (e.g. Nielsen, 2008; Previts *et al.*, 1994; Rogers and Grant, 1997). Analysts can exercise considerable freedom in interpreting IC information and easily manipulate it to suit their recommendation, partly due to the challenges associated with its acquisition and use (García-Ayuso, 2003; Holland, 2003; Mouritsen, 2003). This catch-22 situation is elaborated now in the form of barriers faced by analysts.

11.4.1. Barriers faced by analysts in understanding the corporate value chain creation chain

The analysts play an influential role in the stock market. Among accounting researchers, they are seen as a reasonable surrogate for the investors’ expectations of earnings in the market and a proxy for market uncertainty (Schipper, 1991; Stickel, 1995.) In a short time perspective, the analysts’ recommendations seem, to influence the price of a stock (Givoly and Lakonishok, 1984; Stickel, 1995), and, according to studies on the market level, their written recommendations tend to convey valuable and new information (Ho, 1995; Stickel, 1995; Womack, 1996). Prices also respond to analysts’ recommendation changes, and move up with upgrades and down with downgrades[3]. The responses and market adjustments tend to be spread over a longer period, starting before publication of the recommendation and ending after the publication (Bercel, 1994; Stickel, 1995; Womack, 1996). Analysts tend to create values in the stock market (Johanson, 2007)

The analysts tend to play a role in the disclosure of company information and direct contacts seem to be important for fulfilling this role. Analysts are seen as a key complement to a companies’ own disclosure of information to present and potential investors in the stock market. Findings on companies’ disclosure of information indicate that firms use direct contacts with analysts as a source of voluntary disclosure of information, e.g. on intangibles (García-Meca, 2005). Traded companies disclose information through different channels on a regular or irregular basis. Examples of formal channels of written, one-way character are: company reports, press releases and company home pages. For instance, the annual report is found to be of vital importance for information users, even though it is not sufficient for fulfilling their needs (Vergoossen, 1993). Information is also disclosed through verbal channels of a less open and more informal character, such as direct contacts with investors and analysts. Direct contacts include two-way communication and might involve one-to-one meetings, on-site visits, management presentations, conference calls and phone calls. The analysts direct contacts with company representatives is commonly rated as one of the most important information source by the analysts (Arnold *et al.*, 1984; Olbert, 1992).

Analysts are likely to have regular opportunities to see top management, middle management and some employees. They may also be ex-employees in the industry and thus have considerable expertise on individual companies and industries. As a result they may be able to acquire broader insight into the IC base of the company or sector than FMs and other information market participants. The picture that an analyst builds has often been described as a ‘mosaic’ (AIMR, 2001). Such information collection and mosaic or processing skills are exploited at individual analyst level and within teams of analysts. Analysts seek to solve four-fold problems (of knowledge, uncertainty, ownership and management) by the way they structure their inhouse value creation processes. The problems of processing corporate intangibles information are likely to be at their most acute at individual analyst and company analysis levels. However, analyst firms try to overcome such processing problems by employing the mosaic approach at analyst team level and sector (many company) levels. This can be seen as a response to bounded rationality problems faced at the level of individual analysts. The use of analyst teams that explicitly use a collective mosaic approach and where the multiple sources of subjective information on corporate intangibles are pooled, is an important means to overcome some aspects of these problems. Sector level analysis focuses attention on core intangibles in an industry and provides a more robust base to make the subjective judgements about relative rankings of intangible such as executive quality, coherence of strategy, R&D effectiveness and marketing skills (Holland and Johanson, 2003, pp. 475-476).

Nevertheless, despite collective ‘mosaic’ approach, the four-fold problems concerning IC, are likely to continue to be significant in the function of analysts. Analysts seek to construct or acquire novel and objective sources of information. Therefore, they use quantitative corporate IC indicators but also have to rely on subjective, relative indicators like quality of management measured relative to the sector. They are aware of these uncertainty problems. They are also aware that they do not ‘own’ their access to corporate executives. Given their role in the market for information they are also well aware of the risks of losing managerial access. They are aware that they have to ‘earn’ access by playing an active role in the feedback of information to companies in exchange for new information on intangibles. But, highly reputable analysts produce more accurate and less biased forecasts than less reputable analysts (Fang and Yasuda, 2009).

Analysts over time require a broad-based understanding of IC-based value creation information but at any point in time they only employ that part that is perceived to be price relevant and hence relevant to their current decisions (Holland, 2002c). Company management, on the contrary, requires a more stable view of the corporate value creation process and of the associated information set (Holland, 2002b). Such a view reveals the wide rift between company managers and analysts as to what is relevant information and at times this forms a serious barrier to communication between these parties. The ‘relevant’ information of company management is relatively stable and comprehensive, covering all of the value creation process, whereas analyst ‘relevant’ information is transient, seen as part of a ‘mosaic’ of information and often quite narrowly conceived. This is because of the different tasks faced by corporate managers and analysts. This could be because of the differences in understanding the corporate value creation process arising from task differences. The problem is closely related to the management problems i.e. the problem for an outsider to fully understand how management take adequate action upon IC indicators. The transformation process from information to action might partly be based on

tacit knowledge making it very difficult to reveal (Holland and Johanson, 2003, p. 476). Lastly, analysts also use subjective measures of management quality and track record to guess the likelihood of top management taking the agreed or promised actions. This guess may be wrong due to new circumstances not matching management skills or strategy or both. It might also be too optimistic because the analyst is also helping its investment bank in promoting securities business with the company. All the foregoing issues cited potentially contribute to the four-fold problems faced by analysts when processing corporate IC information in their value creation processes. There are likely to be similar problems in understanding the role of intangibles in the analyst's own value creation chain (Holland and Johanson, 2003, p. 477).

11.4.2. Barriers faced by analysts in understanding their own value creation process

Analysts produce detailed, sector specific, research reports that analyse the value creation capabilities of companies and their impact on expected earnings and on valuation. These outputs include buy, hold, and sell, recommendations. They also produce more transient information in the form of earnings forecasts and forecasts of other financial and strategic numbers. These outputs also include changes in prior buy, hold, and sell, recommendations. Both of these activities provide the informed base for analysts to provide ad hoc advice and information services in response to new unanticipated events (Holland and Johanson, 2003, p. 478). However, in the absence of detailed field research, we can use practical insights to interpret the sell-side analysts function as a complex value creation chain. Such analysts operate within a range of different types of financial institutions ranging from, financial conglomerates which include investment banking, to more specialised securities business, to more specialised financial information provision businesses. As such their hierarchical value creation process and value drivers (top managers qualities, strategy, performance measures etc) will differ, as will their incentives to produce accurate, unbiased public information in the form of forecasts and research reports. Despite this variety, sell-side analysts share a common 'horizontal' value creation process consisting of input decisions such as sources of new information, of new analyst staff, as well as the value drivers above. This wide-variety of sources include "databases, written public documents such as financial statements and regulatory filings, the media and people (AIMR, 2001). The latter specifically includes direct contact with company management in one to one meetings as well with suppliers, contractors, customers and competitors. This horizontal process also includes analyst decision processes, transformation decisions and output decisions and processes. With these processes analysts exploit their own human capital such as:

Diligence and inventiveness in information gathering, as well as analytical skill, perception and a keen intuition. Analysts must often "ferret out" data that, to the average investor might appear insignificant or immaterial, but when aggregated with other data is highly informative and relevant to investment decision-making. This process might be likened to putting together a jigsaw puzzle, where the final picture is unknown, but whose outline begins to appear as the pieces are assembled (AIMR, 2001)

Analyst structural capital includes structured information collection and decision processes concerning, short-term analysis cycles three to five days before, and after earnings announcements. And a very active but structured decision day during the announcement; a capability to immediately respond to ad hoc corporate events and internal institutional demands; and longer term in-depth research report production capability and its input to the latter two processes (Holland and Johanson, 2003, pp. 477-478).

These analyst knowledge intensive assets and processes can be interpreted as the primary producers of the information outputs of sell-side analysts. Given the different internal incentives faced by analysts many potential different conflicts of interest arise in terms of release of information. Or as the FSA (2002) comments:

These other functions can give the analysts diverse incentives and the interests of retail investors are likely to be forgotten. In addition there are the conventional (agency) possibilities of bias and opportunism in the production of public domain "information".

Such information and advisory services are mediated to the market place through various reputational assets and distributed via various channels. The former included information provision "brands" based on size, coverage, and aggregate analyst skills (sector and global coverage, specialisms etc.) as well as reputation (institution, and individual sector analyst) for depth of analysis, accuracy, lack of bias, efficiency, timeliness etc. Success in producing the required information and advice services effects analyst reputational assets in information markets and in institutional client markets. In relation to the knowledge, uncertainty, ownership and management problems when processing corporate IC information almost the same conclusions as was the case with the FMs could be drawn.

Financial analysts are goal-oriented, but there is no room for inner values; nor is there room for inner reflection. Aggressive behaviour and competition are attributes that are remunerated. Because of the technical development in electronic communication, the analyst's work becomes increasingly isolated. Physical contact with other people is attenuated. At the same time, the level of abstraction increases because of the development of financial instruments. According to Norberg, the distance between analysts and ordinary people increases. The distance from a firm's employees increases further because the same shares can be bought and sold within an extremely short time. It is difficult to understand and consider the thoughts and emotions of someone who is far away. The upper-middle-class background of many of the analysts also creates a barrier to understanding workers at the firm level. The physical as well as the mental distance between capital market actors and the blood, sweat and tears of individual human beings are further increased by the constant flow and use of numbers. Capital market actors are liable to risk a reduction of their personality. According to Norberg (2001), they see themselves as being more cynical and rational compared with most other people. Phenomena that are impossible to quantify are viewed as impossible to understand, disturbing or irrelevant. (Johanson, 2003, p. 35).

Impression Management by Analysts: Highhouse et al. (2009) submit that not only individuals, but also corporations as social actors, engage in impression management to enhance their respectability and impressiveness. One way in which companies engage in impression management is through their annual reporting practices (Neu et al., 1998) by strategically presenting narratives (Cho et al.,

2010), visuals (Davison, 2010) and graphs (Penrose, 2008). Company management influences the level of detail and complexity in annual reports to obfuscate poor performance (Li, 2008). Fogarty and Rogers (2005), highlight that financial analysts' work cannot be understood devoid of the social fabric that embeds professional claims. The analysts' social milieu includes the corporate culture of the stock broking firm for which they work, institutional investors and their buy-side analysts, and management of the companies they follow. These social actors exert pressure on analysts to act in ways that conflict with each other. On the one hand, analysts face pressure to issue optimistic forecasts and recommendations and on the other hand this behaviour threatens their reputation and career. Analysts' relative optimism is encouraged by a corporate culture that rewards behaviour resulting in attracting and maintaining underwriting relations and generating trading commission (Jackson, 2005; Mehrana and Stul, 2007). Such analysts are more likely to be promoted in their jobs (Hong and Kubik, 2003). It has also been argued that analysts have increased incentives to issue optimistic forecasts and recommendations to curry favour with management to obtain private information (Das *et al.*, 1998; Westphal and Clement, 2008) or information on a priority basis (Campbell and Slack, 2008).

It is the relationships and networks that analysts build and maintain with company personnel that drive their competitive advantage (Johansson, 2007). As a result, analysts are reluctant to issue sell recommendations and include negative statements about the company and its management in their reports (Fogarty and Rogers, 2005). They express such information "in less than direct terms and in terms capable of being overlooked or missed altogether" (Campbell and Slack, 2008, p. 7).

Analysts use IC information in their reports to communicate with their constituents in a self-serving manner so as to demonstrate optimism in subtle ways, even when the recommendations are unfavourable. By creating a level of optimism analysts attempt to build an impression of loyalty in the eyes of company management when they cannot issue favourable recommendations. From an impression management perspective, through the use of IC information, analysts are capable of moderating the market perception that they are optimistically biased. Also, analysts attempt to strategically use IC information in order to distinguish a "hold" from a "sell" recommendation. This is probably due to the tendency in the capital market of treating both these in the same manner. However, analysts' impression management motive to downplay the negativity may be driving these efforts (Abhayawansa and Guthrie, 2012, pp. 410-411).

Analysts "speak in two tongues" where stock recommendations are targeted at retail investors and earnings forecasts at institutional investors with each having different degrees of optimism (Malmendier and Shanthikumar, 2006). They adopt impression management strategies to protect their reputation and at the same time seem to be loyal to the stockbroking firm, investment banking clients and companies (Abhayawansa and Guthrie, 2012). Why do affiliated analysts provide optimistic recommendations but neutral earnings forecasts (Malmendier and Shanthikumar, 2005)? Why do active issuers of external financing receive higher consensus recommendations despite earning low future returns (Bradshaw *et al.*, 2006)? Why do analysts affiliated with M&A targets upgrade the acquirer's stock shortly after terms of stock deals are set (Kolasinski and Kothari, 2007)? All of these facts are hard to reconcile with a selection bias but are consistent with the conflict of interest.

Hence, there is a need for analysts to increase analysts' understanding of:

- Their human, structure, and relational capital contribute to their value creation process in creating new information sources for valuation and advice;
- Their value creation indicators (how human capital produced new information leading to new valuation insights) are produced in order to demonstrate that the indicators are valid and reliable;
- The ownership problem in analyst functions is addressed i.e. How the analyst group has secured a long term value creation capacity in terms of stable analysts teams, stable information processing and use activities, training programmes and independence of other conglomerate functions and
- How analyst managers ensures internal analyst action upon their own icintangibles data such as how they structure their human capital to optimally share internal information across company shares, sectors and portfolios and across various internal functions (holland and johanson, 2003, pp. 478-479).

One cannot ignore the fact that the financial analyst knows that the financial models are organizing devices. When evaluating intangibles and intellectual capital assets they attempt to grasp their dynamic character via a procedure for probing. This includes extending the concepts and methods used to identify the strength of ideas and intellectual capital and adding to them hypothetical conditions that show when the idea could be successful. The analyst has to convince not only her-/himself; s/he also has to convince a set of superiors that may favour the language of finance. In this way, the capital market minds intangibles, but this is a "hot" forum where lots of tacit knowledge are manoeuvred and mobilised. The rules used do not pass ordinary tests of rationality and are thus difficult to stabilise in public (Mouritsen, 2003).

11.4.3. Other barriers to FMs and Analysts use of corporate IC information

11.4.3.1. Financial criteria and time pressures

The common problems in financial markets faced by analysts and FMs include severe time constraints, the focus on a narrow shareholder wealth agenda, and changing market fashions and fads. Others include transient price sensitive information set, and their restricted attention on a small number of intangibles and related benchmark indicators effecting stock prices. These factors generate a fragile, changing value relevant information set, and are likely to aggravate the knowledge and uncertainty problems faced by FMs and analysts. The "value relevant" information perceived by FMs is only focused on part of the company information set which along with its intangible components contain a changing or contingent subset of the wider corporate value creation information set required

by managers. Capital market and economy wide information is also central to FM decisions. The extent to which the full set of such company side "fundamentals" information is used in FM valuation decision is transient, and changing with new events, emerging conflicts of interests within capital markets and financial institutions, with fashions such as the 1997-2000 "dot.com" experience, and with the variety of valuation models in use in markets (Holland, 2002b,c). This fundamental company level information is also placed within a unique holistic or mosaic stock valuation view employed by each FM and this in turn is placed in a larger portfolio view. Despite these attempts to make full use of corporate IC information, FM valuation decisions are likely to be further adversely affected by these factors as FMs continue to face significant problems of using company IC information in making subjective leaps of faith in corporate valuation. Time and fashion pressures often deepen these problems.

Such contingent and capital market factors continuously change FMs views of which part of the corporate IC information agenda is relevant to their current stock and portfolio level decisions. Analysts also face the same problems (as FMs) as to the contingent nature of value relevant information" at any point in time. They need to acquire a full understanding of corporate value creation processes and of the role of intangibles in such value creation. However, market fashions, unexpected corporate and market events, and many other transient factors, affect their view of which part of that corporate value creation and intangibles information set is value relevant at any point in time. These problems of narrow agenda, fragile information, high subjectivity in corporate valuation, and changing fashion were likely to be reflected in processing problems throughout analysts value creation processes. The special conflicts of interest arising in the analyst function may also exacerbate these problems. In contrast, the more specialized sector focus of some analysts, and their ability to work in teams, could alleviate these problems relative to FMs (Holland and Johanson, 2003, pp. 479-480).

Holland (2006a) conducted a research with 40 fund managers (the case FMs constituted 35 out of the 38 largest UK FMs by managed and own funds) and included Life Insurance, Pension Fund, and independent fund managers. The 1997-2000 and 1993-1994 research questions had a seven stage approach - familiarization, reflection on the contents, conceptualization, cataloguing of concepts, recoding, linking, and re-evaluation. The salient features of the research are:

Public domain information: Each case FM sought to exploit public domain sources of information, in stock selection and asset allocation decisions, by developing its own high quality internal research capability with respect to certain firms, industries, regions. This information could be company specific, industry or economy wide. Public sources of information included company announcements and financial results as well as government announcements. Major sources of FM information were the brokers through which the FM bought and sold shares. The broker's sell-side analysts, market makers, and their sales desks, were major information sources. FMs checked the quality of analyst research, by looking at how different companies' analysts were rated by many FMs. This type of information allowed FMs to rank sell side-analysts and select a small group to provide research, and weekly reports on companies and sectors. This information was often verbally communicated to the FMs on a priority basis. An important public source was the monthly Estimate Directory, which provided aggregate earnings and forecasts for about 1,300 UK companies covering the FTSE All-Share Index and the Alternative Investment Market. However, FMs faced a major problems in that all of the major information and data suppliers provided mainly historic, public domain information. Public sources such as financial reports and analyst reports were considered to be limited in specific ways. This announcement information was fully assimilated by the FMs before the (post announcement) private meetings with companies took place. As a result, the contents of the financial statements were generally well known by the FMs before the annual or semi-annual private company meetings and publication. In addition, the financial report was considered too complex, too large, and too cumbersome for many users. The financial report was also tightly constrained by ASB principles and by increasingly rigid GAAP. The financial report was dominated by financial performance output data and variables and did not provide qualitative data on important value creation areas such as management quality. As a result, it was not an effective mechanism for disclosing information on intangibles such as corporate knowledge assets and innovatory skills. The case FMs also identified problems with the quality of sell-side analyst information: unless this research material was available to FMs on a confidential "first call" basis and was not immediately published then there was little possibility that it had any value implications; the FMs perceived the analysts as having a bias towards sells or buys; only a select group of analysts could demonstrate special skills in company and industry specific analysis; there was an abundance of analyst research on certain large FTSE 100 companies and this quasi-public information was already in the market price. Given these limitations, the collection and processing of public information, by itself, was not expected to be useful in identifying cheap or expensive shares and hence in boosting fund management performance. The case FMs argued that they needed a special information edge for fund management roles and this was unlikely to be found with financial reports, public announcements, public domain analyst reports on companies and other public sources. As a result, the limitations of public sources provided the FMs with strong incentives to develop private corporate sources of information (Holland, 2006a, pp. 279-280).

However, there are five uses of primary sources of financial and quantitative information about corporate performance and focused on well-established financial output measures. *Firstly* and despite having little advantage in terms of buy and sell trading decisions, they did provide the FMs an important means to understand what was going through conventional ratio analysis to identify deviations from trend or to signal any emerging problems and through value-based measurement (VBM) systems such as EVA. *Secondly*, from public domain information, FMs develop first estimates of earnings and cash flows figures in their spreadsheet models and hence in their initial valuation of the company, prior to the private company meeting. The remaining information for valuation (and for asset allocation), was derived from private sources and this was used to adapt the initial estimates in FM spreadsheet models and to gain a competitive edge in company valuation. The contribution of private (qualitative information on intangibles) was increasing as the economy became more knowledge intensive and public sources declined in terms of informativeness on intangibles. *Thirdly*, the use

of the public sources was to identify important questions for the private meetings with company management and board members. *Fourthly*, public sources were also used to make judgment about company and management track record. And *fifthly and finally*, they were combined with private sources to create a knowledge advantage. Thus despite the limitations of public sources of information, they played a central role in *fund* management (Holland, 2006a, p. 281).

11.4.3.2. Social or cultural pressures: Though Financial analysts are not stupid persons. But Johanson (2002) cites the culture or the mentality among analysts as a group of professionals that restrict them to take notice of the company-based individual as a source of creating value. When addressing the mentality of analysts, Norberg (2001) suggests that high salary and materialism are important issues. High salary is an important factor because it is a form of acknowledgement of successful work. Analysts compete vigorously with one another regarding salary. From this competitive struggle, an abstract greed (Solomon, 1992) is developed. To afford their living, analysts do not really need all the money that they earn but as has been proposed by many authors money carries meaning (Furnham and Lewis, 1986). Money involves many symbolist functions among others security, appreciation and power. All these three symbolist functions appear to be relevant in the case of capital market actors such as analysts and FMs.

Financial analysts work exceedingly hard and long hours. They are often young men, well -educated and without wife and children. After work, they often meet with colleagues. Such restricted behavior tends to isolate them from others, which fosters a strong and homogeneous mentality. They become extremely dependent on each other, even though they are competing at the same time. They have secrets and they need to acquire secrets, but secrets related to the capital market and their special corporate IC information advantage. They have to learn to control their own emotions because a controlled behavior is needed when secrets are exchanged. Yet emotions are controlled not only within themselves but also within the capital market. Capital market actors are subject of risking a reduction of their personality. They see themselves as being more cynical and rational as compared with most other people. Phenomena that are impossible to quantify are viewed as impossible to understand, disturbing or irrelevant. They are not personally responsible; rather, they believe that the "invisible hand" will correct things. This creates a distance between analysts and employees in firms (Norberg, 2001). The physical as well as the mental distance between capital market actors and the blood, sweat and tears of individual human beings is further increased because shares can be bought and sold within an extremely short time and because of the constant flow and use of numbers (Johanson, 2002). It is easy to hide behind numbers. Numbers cannot really translate fear or happiness. But nevertheless, numbers are often regarded as more real than reality. But, human beings are real. When trying to represent human beings with numbers one has to be cautious and not forget what the numbers stand for (Holland and Johanson, 2003, pp. 480-481).

Unconscious processes are continuously going on between different capital market actors as members of a closed social system. And, unconscious defence mechanisms are developed in closed social systems in a constant attempt to repress anxiety (Obholzer, 1994). Capital market actors are probably not completely unaware that their behavior can have serious consequences for single employees but this awareness is certainly often subject to repression. In closed social systems anxiety has to be contained inside the system. Opening the system for external influence is a risky affair. It is dangerous in the way that the balance within the system could be disturbed. Such processes may be at work in relatively closed social systems within the market for information and affect a wider range of non-analyst participants. Senior company managers, top analysts and FMs in major financial institutions seem to accept many aspects and practices of a larger social institutional structure or social order which combines companies, financial institutions, and financial markets and which incorporates a common culture within these systems (Holland, 2002a). Scott (1993) refers to this environment of financial relations between the analysts, FMs and the UK (large) corporate sector as a "constellation of interests" in UK finance capital. Not surprisingly, finance researchers are of the view that users of analyst reports interpret hold recommendations as sell recommendations as they perceive sell-side research as being biased (e.g. Bradshaw, 2002; Fogarty and Rogers, 2005; Malloy, 2005). Here is yet another example. Analysts having issued a sell recommendation may use IC discursively and visually to lessen the degree of negativity surrounding an unfavorable recommendation. Poor performing companies attract sell recommendations as the market values are expected to fall in the future. Arguably, such companies lack IC that drives future company value. Viewing this finding from the lens of "analyst optimism" it can be argued that when a company lacks IC with future implications, analysts may be relying on past investments in IC to portray it less negatively. (Abhayawansa and Guthrie, 2012).

Companies, analysts, and FMs make common (unquestioned) use of larger market accepted constructs and a common financial language. These includes element such as, numeric consensus for earnings, a restricted choice of forecast variables, common forecast horizons, a limited range of valuation techniques, the use of applied rate of return, and concepts of accounting quality (Hellman, 2001). Confidence in these constructs is buttressed by the central role of trust and continuing exchanges in *a trio of information market relationships involving company-FM relations, company -sell side analysts relations, and FM-analyst relations*. This institutional order may explain company management, analysts, and FMs preferences to focus on narrow shareholder wealth aims, a narrow range of valuation models, the numbers associated with the models and a small number of forecast variables, and to design their reward systems around these common aims, models, information agenda, and numbers. This may also explain why management quality is central and why so little attention is paid to employee human capital by these information market and capital market participants. The preference for a small contingent set of IC indicators may explain why the wider corporate intangibles agenda identified by IC researchers does not yet play a stable and comprehensive role in their private dialogues. In a second example, there appeared to be a matching of structures across the market for information and this is a manifestation of the institutional structure identified by Scott (1993). Corporate disclosure behavior and FMs (and analysts) information receipt/search behavior appear to match in terms of structures, timing, content. This has the appearance of one linked system in which both opposing participants (say companies and FMs) have evolved as matching (niche) systems and in which some kind of bureaucratization or "institutionalizing" is

occurring in information and capital markets. This could play a role in all parties developing a narrow conservative agenda in which information on a few intangibles is the focus of the attention. The consistent focus of the participants on intangible constructs such as management quality, coherence of strategy, effectiveness of brand management may reveal these preferences (Holland and Johanson, 2003, pp. 482-483).

However, analysts' research contributes to market efficacy by impounding information about a security's fundamentals on its price (Frankel et al., 2006). Among the numerous sources of information used by retail investors, analyst reports are considered highly influential (Hirst et al., 1995; SRI International, 1987). Retail investors either directly or through stockbrokers utilise analyst reports for making security evaluation decisions. Analyst reports are also used by buy-side analysts and fund managers as an input to their decision-making processes (Fogarty and Rogers, 2005; Holland, 2006b), and are considered as one of their most important information sources (Vergoossen, 1993). Analyst reports commonly include three key indicators: an earnings forecast, a price target and a stock recommendation in the form of buy/hold/sell (Asquith et al., 2005; Malmendier and Shanthikumar, 2007). As documents in the public domain, these arguments tend to be well thought out and carefully worded (Campbell and Slack, 2008). Twedt and Rees (2012) found that the level of detail as well as the tone of arguments in analyst reports is considered as important by investors. Institutional investors and buy-side analysts – the main clients of sell-side analysts – can exert pressure to align analysts' incentives with accurate and unbiased forecasts and recommendations. The trading business allocated to a stockbroking firm by large institutional investors depends on the quality of research produced by them and as a consequence analysts' remuneration and career prospects depend on the quality of their research (Frankel et al., 2006). Hence, over-optimism can put their reputation and career at risk. It has been found that highly reputable analysts produce more accurate and less biased forecasts than less reputable analysts (Fang and Yasuda, 2009). Within analyst reports with unfavorable recommendations a greater variation in the extent of IC references exists between those with sell (35.13) and hold recommendations (60.59) (Abhayawansa and Guthrie, 2012). Impression management motives may underpin the greater use of IC information in analyst reports with hold recommendations compared to sell recommendations. Prior researchers demonstrate that investors interpret hold recommendations as sell recommendations because analysts rarely issue sell recommendations (Bradshaw, 2002; Morgan and Stocken, 2003). According to impression management theory analysts who are compelled to issue an unfavorable recommendation (given the circumstances facing the company relative to its market valuation) may use arguments in their reports to reduce the level of negativity in order to manage their reputation among groups that provide incentives for optimistic analysis (Abhayawansa and Guthrie, 2012). Winchel (2011) argues that provision of negative information together with positive information in favorable analyst reports increases credibility of the recommendation by increasing the perceived trustworthiness and competence. *Going by the foregoing reality-check, the authors of the present article opine that analysts are a mixed-bag, a mixed blessing rather. But metaphorically put, imagining the capital markets without analysts - despite their peccadilloes and foibles - would tantamount to playing The Hamlet without the Prince of Denmark. No wonder, the bulls and bears hold the world to ransom through the analysts' forecast model in a world of make – believe if the yawning gulf between book value and market value is a yardstick to go by – for the management guru or the man in the street alike.*

11.5. Investors and credibility of Management disclosures

Managing money is an art as well as a science. It is science because investing is a process and art because of the manner in which it is executed (Damodaran, 2014). Financial investors are seen as greedy capitalists who do not understand the beauty of conceiving brilliant ideas and have no passion for science (Baker and Smith, 1998). Investors concerns about disclosure credibility appear to be increasing as high-profile financial scandals like Enron and Worldcom have shaken investors confidence in the trustworthiness of financial disclosures (Barrett, 2002) because in a real world negative news disclosures tend to be more credible than positive news disclosures (Williams 1996; Hutton et al. 2003). This is despite the fact that investors are sensitive to variations in the credibility of a firm's individual disclosures (Williams 1996; Hutton et al. 2003). Management credibility is a more enduring trait of a firm's managers, referring to investors' perceptions of managers' competence and trustworthiness (Hovland et al. 1953, 21). *If the accounting scandals damaged the perceived trustworthiness of auditors and financial analysts, investors may rely less on these parties' conclusions about the credibility of management disclosures* (Mercer, 2004, p. 194). Empirical studies on disclosure credibility tend to use either archival or experimental studies / data. Four factors influence credibility of a disclosure – situational incentives, management's credibility, the degree of internal and external assurance and characteristics (precision, venue, time horizon, amount of supporting information and inherent plausibility) of the disclosure (Mercer, 2004, pp. 186-187). This is a simple framework for thinking about when investors will rely on management disclosures (Mercer, 2004, p. 194).

- *Situational incentives:* Managers tend to have greater incentives to provide overly positive disclosures than overly negative disclosures (McNichols 1989). Thus, bad news disclosures are expected to be more credible than good news disclosures, *ceteris paribus*. Several archival studies support this claim; management disclosures containing bad news result in larger analyst forecast revisions (Hassell et al. 1988; Williams 1996) and larger stock price reactions (Cairney and Richardson 1999; Hutton et al. 2003) than management disclosures containing good news. Koch (1999) argues that management has greater incentives to provide misleading disclosures when a firm is financially distressed because financially distressed firms have lower costs and greater benefits associated with inaccurate disclosures. He predicts and finds that analysts rely less on management earnings forecasts as a firm's financial distress increases. Frost (1997) reports that stock market reactions also reflect the lower disclosure credibility of distressed firms. She finds that disclosures issued by financially distressed U.K. firms result in smaller stock price reactions than disclosures issued by non-distressed U.K. firms. The results of Koch (1999)

and Frost (1997) suggest that investors are sensitive to the incentives of management when assessing a disclosure's credibility.

- *Management Credibility:* Research from social psychology suggests that an important factor in a message's credibility is the credibility of the messenger (Birnbaum and Stegner 1979). Williams (1996) hypothesizes that managers are able to form reputations for credible disclosure that increase the believability of their subsequent disclosures. Williams (1996) finds that the size of analysts' forecast revisions for subsequent management earnings forecasts are a function of management's prior forecast accuracy. Hodge et al. (2000) find that investors are more likely to agree with management's decision to classify a hybrid security in the equity section of the balance sheet when analysts believe management is more reputable.
- *Levels of External and Internal Assurance:* Such assurance can be provided by external sources such as auditors, financial analysts, and journalists, or from internal sources, such as the firm's board of directors, audit committee, and internal auditors. Leftwich (1983) and Blackwell et al. (1998) provide archival evidence that external assurance from auditors increases disclosure credibility because both bankers (Libby 1979) and financial analysts (Hodge 2001) rate audited disclosures as more credible than unaudited disclosures. Information intermediaries such as business journalists and financial analysts are another potential source of external assurance for management disclosures. Business journalists affect investors' perceptions of disclosure credibility. Likewise, financial analysts' reactions to a management disclosure also can affect the disclosure's credibility with investors. However, evidence that analysts' reactions to management disclosures affect investors' reactions to those disclosures is, as yet, largely anecdotal. Evidence implies that firms whose boards and audit committees are independent, diligent, and expert provide higher quality disclosures. Investors consider the composition of a firm's board of directors and audit committee when assessing disclosure credibility. The heightened scrutiny on boards of directors due to recent accounting scandals may result in boards of directors playing an even greater role in disclosure credibility in the future. Another potential within-firm source of assurance is the firm's internal audit department. Internal auditors often serve as the first line of defense against disclosure errors, ferreting out unintentional errors caused by weaknesses in a company's internal controls and intentional errors due to fraud. Consequently, if investors can assess internal audit quality, then firms with a strong internal audit department may have higher disclosure credibility. (Mercer, 2004, pp. 189-190).
- *Disclosure Characteristics:* As regards *precision*, imprecise disclosures signal management's uncertainty and will be viewed as less credible than more precise disclosures (Hassell et al. 1988; King et al. 1990) because according to Hirst et al. (1999) investors are more confident relying on point forecasts than range forecasts. Baginski et al. (1993) report confirming results based on archival data, finding that more precise forecasts result in a stronger relation between unexpected earnings and unexpected returns. However, precise forecasts are not risk-free. Managers who fail to deliver on their forecasts will be perceived as inaccurate and suffer reduced credibility with investors. With regard to *venue*, managers disclose information in numerous venues, including audited financial statements, meetings with reporters, conference calls with analysts, annual shareholders' meetings, and special press releases. Research in psychology suggests that disclosure venue matters and will interact with other variables to affect a disclosure's credibility. For example, face-to-face disclosures such as conference calls may be more credible for managers who are already perceived as trustworthy, whereas written disclosures such as press releases are more credible for managers who are less obviously trustworthy (Mercer, 2004, p.191). Regarding *time horizon*, short-horizon disclosures such as interim earnings forecasts generally should be perceived as more credible than longer-horizon disclosures such as annual earnings forecasts. For example, interim management earnings forecasts generate larger stock price reactions than annual management earnings forecasts, even after controlling for the amount of new information contained in the forecast (Pownall et al. 1993). With regard to *amount of supporting information*, firms often provide explanations to support their disclosures. For example, a firm that issues an unexpectedly positive earnings forecast also may note that the company expects an increase in sales or a decrease in administrative costs. Such supplementary statements should increase the credibility of the earnings forecast for several reasons. Givler (1994) notes that disclosure decisions often reflect a tension between providing investors with share-relevant information and providing competitors with proprietary information. If investors realize that disclosing proprietary information is costly, then they should perceive disclosures that contain proprietary information to be more credible. In support, Cairney and Richardson (1999) find that the credibility of management earnings forecasts increase when the firm has high proprietary information costs. A second reason that supplementary statements should increase disclosure credibility is that these statements increase the *ex post* verifiability of the disclosure (Hutton et al. 2003). By making specific statements about forecast components, managers reduce their ability to take subsequent opportunistic actions to realize forecasts or to rationalize unexpected results. This extra commitment from managers may increase the disclosure's credibility. Studies by Hutton et al. (2003) and Baginski et al. (2004) support this argument, as they find greater stock price reactions to management earnings forecasts when the forecasts are accompanied by explanations. A final factor influencing a management disclosure's credibility is the *inherent plausibility* of the information it contains. Koehler (1993) finds that even scientists' judgments are influenced by their prior beliefs-when a research paper's conclusions disagree with a scientist's prior beliefs, s/he rates the study's methodology to be relatively lower in quality. A disclosure that deviates significantly from investors' expectations will be less credible than one that does not. For example, an earnings growth forecast of 10 percent is probably less credible coming from a firm that reported three consecutive years of negative earnings growth than one that reported three consecutive years of positive earnings growth. The greater the gap between analysts' expectations and a management disclosure, the less plausible the disclosure seems, and the less likely analysts are to believe it (Mercer, 2004, pp. 192-193). Hansen and Noe (1998) report that management earnings forecasts that

conflict with previous management disclosures result in smaller analyst forecast revisions than forecasts that are consistent with previous disclosures. Similarly, Koch (1999) finds that good news management forecasts result in larger analyst forecast revisions for financially sound firms, for whom good news is more likely, whereas bad news management forecasts result in larger forecast revisions for financially distressed firms, for whom bad news is more likely.

The above four factors also have interactive effects on disclosure credibility. For example, investors are more skeptical of management disclosures that are consistent with situational incentives, and they use additional cues such as management credibility when assessing disclosure credibility. Hutton et al. (2003) report that supporting information is more likely to increase credibility when management has greater incentives to mislead. Hirst et al. (1999) report that the effect of forecast precision on disclosure credibility increases as management credibility increases, as they observe larger credibility differences between point-estimate earnings forecasts and range earnings forecasts when management has a reputation for accurate reporting. Perhaps the most important future research on disclosure credibility will consider interactions *among* the various disclosure characteristics, as well as interactions *between* these disclosure characteristics and the other three factors that affect disclosure credibility. In summary, when incentives to mislead are low, disclosures are so inherently believable that management credibility and other credibility-enhancing mechanisms do not provide much incremental benefit. But these interactions are less well understood (Mercer, 2004, p. 194).

11.6. The world of Credit Rating Agencies

Firms can utilize reputational intermediaries such as auditors, underwriters, or credit rating agencies that can credibly certify the quality of the firm's securities. The global accounting – auditing industry is an approximately US \$ 138 billion business dominated by the Big 4, which dwarfs the \$ 3 billion dollar global credit rating industry. Estimate of total revenues of the Big Three, Moody's, S & P and Fitch Ratings and other second-tier rating agencies in 2009. This makes the Big 3 appear vulnerable in the face of potential competition with the Big 4. (Hu, 2011, p. 323-324). A 'well-ingrained analytical pattern' in Moody's rating methodology contain the following: (a) The risk factor that entails weighing weaknesses and strength of each debt investment (b) Examining the inconsistencies (c) Stress on fundamentals, sovereign or country risk, Industry outlook, Management quality, Accounting practices, Financial position, Short term liquidity and Ratio analysis (d) Structural factors and (e) Global changes. There is no uniform standard in the credit rating industry for the ratings. However Fitch and S&P have the same rating symbols. A distinction is made between high quality and low quality grades. High quality grades range from AAA to BBB and are known as investment grade bonds. Low quality grades range from BB to D and is referred to as speculative grade bonds or junk bonds. With its approach akin to Moody's methodology, S & P's stress on information needs for different types of clients provides clue to specialization. Apart from the general and confidential information on company's general industry background, historic, financial and operating data, and management philosophy, strategy and goals, S & P's requires clients which are non-US banks or non-US industrial companies to furnish information in required formats. For international rating, S & P's have special requirements on accounting, legal system, and sovereign rating. The methodology followed in the US and in India by the credit rating agencies is similar (Table 2) in many respects. (Sudha, 2006). CRAs have failed to notify investors about the gradual deterioration of creditworthiness on the part of the issuers they were rating. Some of the mistakes that have been made by the CRAs are:

- Enron was rated investment grade by the CRAs four days before they went bankrupt.
- The California Utilities were rated A- by the CRAs two weeks before defaulting.
- WorldCom was rated investment grade three months prior to bankruptcy.
- CRB Capital market in India was given a AAA grade a couple of months before defaulting on its payments (Sudha, 2006, p. 315).

	CRISIL	ICRA	CARE		S & P	Moody's
Highest Safety	AAA	LAAA	CARE AAA	Best Quality	AAA	Aaa
High Safety	AA	LAA	CARE AA	High Quality	AA	Aa
Adequate Safety	A	LA	CARE A	Upper Medium grade	A	A
Moderate Safety	BBB	LBBB	CARE BBB	Medium grade	BBB	Baa
Inadequate Safety	BB	LBB	CARE BB	Non-investment grade	BB	Ba
High Risk	B	LB	CARE B	Highly speculative	B	B
Substantial Risk	C	LC	CARE C	Defaulted or close to it	CCC to D	Caa to C
Default	D	LD	CARE D			

Table 2: The rating scale for the Credit Rating Agencies (Sudha, 2006, p. 315)

While the value addition of credit rating agencies cannot be underestimated, the flip side is that agencies are deemed to have a propensity to up-rate rather than down-rate (Larrimore, 2001) since the power of the rating agencies in the financial market is too great and supervisory authorities are unable to enforce rules that reduce the risk of collusion between the rating and rated entities (Sinclair, 2005). The risks are comprehensively represented in Figure 11. The rating process entails the frequent exchange of information and in the medium-to-long term the interests of the two parties may converge leading the agency to support its client by assigning a particularly favorable rating (Butler & Rodgers, 2003). One of the solutions proposed to reduce the risk of collusion is multi-rating (Matarrocci, 2005). Hiring more than one rating agency, in fact, can greatly diminish the likelihood of collusion between the rating

and the rated entities and a concordant evaluation by different agencies could enhance the significance of the rating assignment (Ellis, 1998). All said and done, Standard & Poor's and Moody's today wield remarkable power, as 'gatekeepers' to capital markets, over sovereign and private issuers alike (Kerwer 2002 and Sinclair 1999, p. 161). And yet ironically, this is incompatible with the agencies' own views regarding how ratings should be used in arriving at investment decisions. The agencies continually emphasize that a rating is just an 'opinion', that it is a relative rather than absolute measure of credit risk, and that as such, a rating is only one of many variables that an investor should consider before arriving at a decision to buy, sell or hold a debt security (Bruner and Abdelal, 2005). Credit Rating and Information Services of India (CRISIL), Investment Information and Credit Rating Agency of India (ICRA) and Credit Analysis and Research Limited (CARE) are the credit rating agencies in India

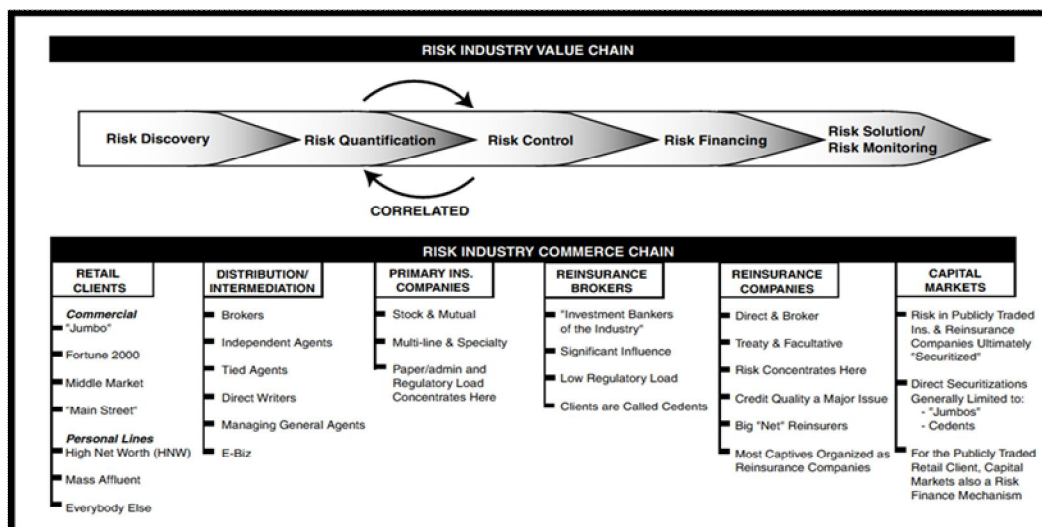


Figure 11: Risk industry value chain (Hutchin, 2005)

In August 2008, the Securities Exchange Commission (SEC) in the US noted that the 'Big Three' agencies – Fitch, Moody's and Standard & Poor's – had failed in their efforts to cover the subprime market, with then-SEC chairman Christopher Cox condemning "a lack of disclosure to investors and the public, a lack of policies and procedures to manage the rating process, and insufficient attention to conflicts of interest". (Source: <http://www.centralbanking.com/central-banking/news/2362622/rating-agencies-must-report-on-controls-under-new-sec-rules>; accessed on 30th August 2014). Also, underwriters who price issues that they sell also make profit if a manipulation raises prices and furthermore the issues may be easier to sell which is another source of profit due to lower costs (Herve and Gaetan, 2004)

12. Spotlighting the road ahead for the capital market participants

The uncertain information theory (Brown *et al.*, 1988) concurs that the greater the uncertainty surrounding the valuation of an asset, the greater the underpricing of the assets. There are many players (Figure 12) in the game of manipulating accounts (Herve and Gaetan, 2004). In a study conducted by Johanson (2007) with 20 sell-side analysts working at a big Swedish investment bank, discussions were held around 80 situations using "snowball" research design. This is a technique helpful when approaching actors groups difficult to access and to access information of a sensitive nature, such as the content of the analysts' recommendations (Miles and Huberman, 1994). The research was performed during 2000 and 2001, in time with a deep recession in the stock-market. However, the analysts' value creation chain has not changed much. (Johanson, 2007, p. 49). Analysts' see official information as basic information, while information received through direct contacts is seen as value-added information. The value-added information and knowledge gained through direct contacts with representatives, help the analysts to provide original analyses and distinguish from other analysts. This information is frequently received on a daily basis. Company representatives tend to be a support in the analysts' decision process and in their argumentation in front of clients. Complex companies with many lines of business, are difficult to understand for the analysts. Representatives familiar with the companies make them more comprehensive by providing value-added information. Analysts receive value-added information which complements the publicly disclosed information and makes it less ambiguous. Phone, personal meetings and competitors to get up-to-date information is found. Analysts build up competitive knowledge through the value-added information from the companies in order to be able to draw novel conclusions and distinguish themselves from other analysts (Johanson, 2007, pp. 34-36). It is not the one who has the most information it is the one who can use the information smartest and has so much associated knowledge that one can draw the right conclusions, that's the winning analyst (Johanson, 2007, p.37)..

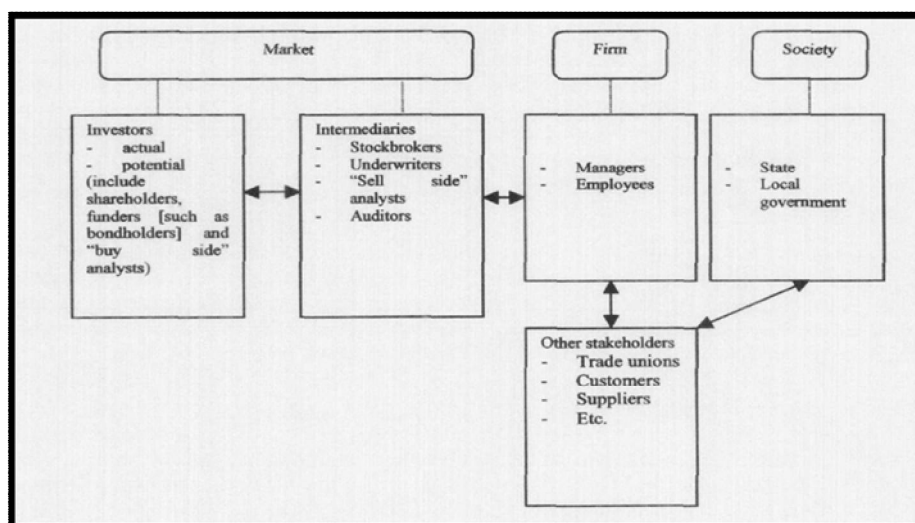


Figure 12: Players in the field of Accounts Manipulation (Herve and Gaetan, 2004)

Analysts tend to have a responsibility to build up relational capital and to access value-added information through direct contacts. The closer the relation the better is the likelihood of accessing high qualitative, relevant, timely information adjusted to the analysts' needs. Information is also received faster when the relation is close. Relations with many representatives are valuable in order to access the value-added information.

You have to have a well established network, and you have to talk with people, so our work is a little to get through the gatekeeper as the IR [Investor relation person] are, and build up a network, and understand some differences in nuances

The relational capital connected to the analysts' direct contacts, is a central part in the analysts' value-creation chain because of its possibilities to gain access to value-added information, produce new knowledge and identify businesses for the investment bank (Johanson, 2007, p.38). Investors want to know, whether a company is well managed? Does company have the right strategies? What can be improved [in the company]? Analysts supply clients with both financial information and non-financial information. Non-financial information, for instance, supports the analysts' conclusions on their estimated prognoses. Analysts' primary clients, i.e. institutional investors, want information and knowledge that add value to their own, already informed, decision process. (Johanson, 2007, p.39). The values provided to clients vary between clients because (a) value-added information and knowledge is successively distributed to prioritized clients; and (b) the distribution of value-added information takes place through exclusive personal contacts. This shows that small private investors, the indirect clients, do not access the value-added information and knowledge from personal contacts with the analysts who produce the recommendations (Johanson, 2007, p.41).

Analysts play a role in their firm acting as salesmen and generating trading business for the firm. Written recommendations serve as a basic concept sold to all clients. Personal contacts are used to convince clients to act in accordance with the recommendations. However, analysts adjust to the situation they are faced when meeting clients. Shares other than the ones discussed, are suggested as potential trading business. The analysts' clients indirectly pay for the analysts' services through the commission generated when trading. The analysts act as salesmen. International clients are also provided with written recommendations of a basic character and value-added information through personal meetings (Johanson, 2007, p.41).

Marketing of the analysts' recommendations and services to clients is done through personal contacts with clients, for example, through phone calls and meetings. The analysts, in their work, want to tie the clients' organization to their own organization by satisfying their needs, both on the organizational and the individual level. The selective and exclusive distribution of value-added information and knowledge to prioritized clients may be an expression of how analysts tie clients to their own organization. Here is the voice of analysts: .

Big institutional clients want to do business with several firms to receive information from several firms. But there are no agreements or such contracts, it is really like, everyday is a new day in that sense. The way to get clients to make a lot of business with us is to have good analyses, a high level of service, both from our analysts and brokers. It is really important to know the client very well and know how the client is organized, what needs every individual at the particular institution has.

According to analysts, personal contacts with clients are important in order to understand and to be able to take care of the clients' needs, and also to tie the clients to their own organization. The environment has become more competitive. It is important for the analyst firm to be among the few selected actors which the clients' institutions trade with. Here is the voice of analysts: .

The clients concentrate their business on fewer and fewer suppliers. ... earlier they spread out their businesses on one tenth [of all broker firms] now it is three [firms] that receive the main part of it [business]. It is a trend one sees.

The competition is intense among sell-side analyst firms and clients constantly evaluate the service provided. The size of the analyst organization tends to influence what category of player the analysts need to belong to. A large organization tends to be dependent on being among the few selected analysts who provide clients with the main part of their business. Here is the voice of analysts:

The clients constantly evaluate us, annually or more frequently... they tell us what category of suppliers we belong to, if we are top-three or if we are in fourth, fifth place, or where we are. It is our goal to be among the top three ranking and that is important since most clients distribute 60-70% of their commission on the three biggest suppliers. Then it may be six to eight players that have to fight for the remaining part. That is a too small a share for us with such a big analysis department that we have.

It can be concluded that relational capital is central for the analysts' role as businessmen for their own organization, generating commission for the firm. It is a highly competitive environment and gaining access to clients is vital for the firm. The relational capital adds value when analysts' manage to tie clients to their firm. It also helps the analysts to identify and fulfill the clients' needs. Finally, the relational capital adds value by improving the analysts' possibilities to succeed (survive) in a highly competitive market. Here is the voice of analysts. Client relational capital seems to be vital when analysts want to make business for the investment bank. (Johanson, 2007, pp.42-43). The vital importance of the relational capital implies a high dependency by the analysts on company representatives and clients in order to gain access to the competitive advantages needed. The analysts' dependencies on company representatives tend to influence the content of the information in the analysts' written recommendations as well as in verbal discussions with clients. They often checked their own conclusions with company management before the disclosure. When a client had recently bought a particular share, the analysts hesitated to argue for a sell, so as not to question her/his authority (Johanson, 2007, p.43).

Previts *et al.* (1994) found that contemporary financial reports form an important, but incomplete base for sell-side analysts' forecasts for company performance. In different studies, direct contacts have often been rated as one of the analysts' most important information source (Olbert, 1992). Studies of analysts' clients also indicate that their personal contacts with analysts are important for their work (Holland, 2006b). This supports the central importance of the relational capital, generated between key actors in the stock market. Relational capital generates competitive advantages in the form of value-added information and knowledge, possibilities for analysts and firms to be among the top-ranked ones, and makes the analyst firms profitable and long-term surviving organizations. This is in line with Holland (2006b) (Roos and Roos, 1997). Earlier studies found that direct contacts give financial analysts an opportunity to obtain timely and relevant information about qualitative factors. In many studies; direct contacts are found to be the most important information source used by analysts (Arnold *et al.*, 1984; Olbert, 1992; Johansson, 1998). A model of investor relations and the value added by sell-side analysts in a continuum is shown in Figure 13.

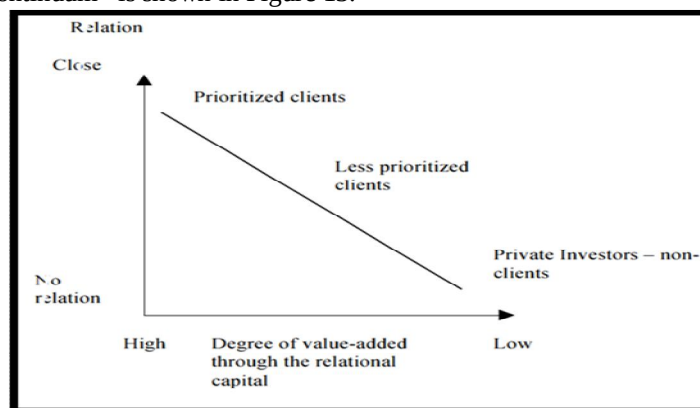


Figure13: Investors relational capital (Johanson, 2007)

The analysts' selective providing of value-added information to prioritized clients may help to explain earlier findings on the market level. A time lag for price adjustments to the analysts' revisions in earnings expectations has been identified (Green, 2006; Bercel, 1994; Stickel, 1995; Womack, 1996). Green (2006) also suggests that the time lag may be due to the time when selected clients receive information, to the time delay of interpreting and acting by others. This indicates that analysts' add value to the clients by increasing their possibilities to increase their financial values. It can be concluded that the degree of values added through relational capital may be related to information, knowledge and business.

Values are added, but the analysts' dependencies make information and knowledge ambiguous. Williams *et al.* (1996), are of the view that buy-side analysts perceived information from their own direct contacts with company representatives as less important than opinions by sell-side analysts. Bricker *et al.* (1995) found that analysts' reports in some cases, were mere transcriptions of management presentations. This indicates that companies' voluntary disclosure, through direct contacts, is intermediated to investors. However, it also questions the analysts' role as independent knowledge builders, providing value-added information for the companies' own disclosure. The fact that company representatives are both suppliers of information and knowledge, as well as potential clients for corporate finance business implies that this type of relational capital refers both to the client capital (Edvinsson and Malone, 1997; Stewart and Stewart, 1987) and the supplier capital (Sveiby, 1997a). Multiple values are generated through the same relations and this indicates a particularly high dependence on the representatives, and increases the risk for ambiguous information. Analysts' responsibility to identify corporate finance business, they are also salesmen who are supposed to generate trading businesses. Clients pay for the analysts' services, by paying a commission to the firm. The analysts' role as businessmen has also received attention in earlier studies (Holmes and Sugden, 1991; Holland, 2006a). Proimos (2005) identified conflicts of interest at an Australian investment bank. In a study by Holland (2001), fund managers perceive that the analysts were selling agents for

corporate finance and an arm of the larger investment banking business. This made the analysts' information and knowledge ambiguous. The analysts' transcriptions of management presentations found in analyst reports may be an expression of the dependency, causing ambiguous information in the reports (Johanson, 2007, p.47).

Analysts hesitate to reveal negative information on the companies, since this may damage the relationship with company representatives and, thus decrease access to company information (Holland, 2001; Johansson, 1998). In line with the discussion above, Sedor (2002), found that analysts unintentionally issued optimistic forecasts on losses when information on managers' plans were received in form of scenarios. A study by Jackson (2005) also indicates that optimistic analysts generate more trade for the firm. Analysts' clients are aware of biases in the recommendations (Holland, 2006b). Little wonder, portfolio managers, for instance, tend to rely more on information received from their own buy-side analysts than from sell-side analysts (Cheng *et al.*, 2006). Analysts and clients dealing with dependencies through relational capital increases the value for both parts. Findings on ambiguous information because of dependencies can be interpreted in terms of bounded rationality (Cyert and March, 1963; March and Simon, 1958). In a study by Holland (2001) on fund managers, only a selected group of analysts demonstrated special skills in company and industry specific analyses, i.e. added value to their investment decisions. Hence, analysts' skills and the firms' reputation would be of interest in order to improve the understanding of the value-creation chain in the stock market. A model on investors' relational capital is suggested to get a better understanding of how values are added. This could be done through studies on different groups of investors, i.e. direct (institutional investors) and indirect clients (private investors), and groups in-between the prioritized and non-prioritized clients. Companies do not disclose written official information and hope for the best. Getting institutional investors and analysts to understand and to convince them, companies voluntarily disclose additional value-added information through direct contacts with their company representatives. Pretty much the same takes place regarding the sell-side analysts' disclosure of written recommendations to clients. The deeper understanding and the convincing part, where analysts sell the recommendation, take place mainly through verbal discussions with clients. Written information of public character is limited and ambiguous in nature, and the relational capital tends to be vital for receiving value-added information. (Johanson, 2007, pp.47-49).

Market communication on IC will influence the demand from investors to get access to the future cashflows of a firm. An investor decides what he/she thinks a share is worth. A trading decision will then be based on whether the current price is above or below the estimate of the intrinsic value. This intrinsic value is based on the future cash flows or earnings power of the firm (Copeland *et al.*, 2000). IC investments and IC assets will therefore be evaluated by the capital markets on the basis of their estimated capacity to generate future cash flows. Using discounting cash flow techniques when valuing companies, investors need to translate the descriptions of structural, relational and human capital communicated by the firm into how these assets will affect the future cash flows (Johanson *et al.*, 2006, p. 485). Sakakibara *et al.* (2005) found that Japanese analysts hold significant differences in attitude with respect to the value relevance of IC items between small and large firms. Whereas human capital measures are more important in small firms, top management quality, corporate strategy, brand power and R&D investment are considered to be more important in large firms. The influence of IC on the value of a corporation will vary depending on the size, history and nature of the business. This is supported by Guthrie *et al.* (2005) that IC reporting from large firms is more common than reporting from small firms. However, the reader of an IP report needs to know how these IC categories are inter-related (Johanson *et al.*, 2006, p. 487). And also should know if it possible to obtain consensus about the need to report, what to report, and how to report it (see, for example, Guthrie *et al.*, 2005).

Capital market participants are analysts and fund managers who make extensive use of new information sources on the role of knowledge intensive corporate intangibles in corporate value creation. Financial analysts (sell- and buy-side) and fund managers are the considered to be most influential capital market participants (Schipper, 1991). However, the 1997-2000 "dot.com" boom and the subsequent dramatic fall in share prices post-2000 suggest that capital market participants face major problems partially arising in the processing of corporate IC information in the new knowledge economy. Enron and Worldcom in the USA, and Marconi in the UK, are examples of how rapid change in company value creation processes has created systemic problems in the market for information. Company accountants, auditors, credit raters and investment bankers clearly all have problems of understanding company knowledge-intensive value creation processes and their valuation effects (Holland, 2003, p. 46). *It appears that only when FMs and analysts become competent and sophisticated at valuing intangibles will volatility begin to decline in world stock markets. This may eventually prove a more effective control over corporate opportunism, and provide the means for accountants, auditors, and bankers to improve their own means to understand and value such intangibles* (Holland, 2003, p. 47). The significance of this is revealed by the attempts of the Italian (Loro, 2002) and Norwegian (Roberts, 2002) analyst associations to improve their collective ability to demand more structured information on knowledge intensive intangibles from companies (Holland and Johanson, 2003).

- a. *International Harmonisation* would aid in the diversity in reporting practice. Harmonization may involve the creation of international communities of practice, which bring together practitioners, policy makers and thought leaders from around the world. For instance, the World Intellectual Capital Initiative by the OECD and others provides one example of an appropriate vehicle for facilitating debates, mediating knowledge and practice, and improving international collaborations and harmonization. International collaborations of this kind can aid harmonization and provide opportunities to bring reporting practices "closer together". Finally, harmonization could incorporate greater involvement from, and collaboration between, standard setters, such as the International Accounting Standards Board, the US SEC etc., Such forums may facilitate a sharing not only of techniques of Enhanced Business Reporting (EBR) but also facilitate dialogue about the purposes and usefulness of EBR, just as they may develop "critical cases" from around the world.

- b. *Accounting technology* is a key driver of the interest in EBR. The vast diversity in measurement and reporting models also suggests the need for consolidation and simplification of EBR techniques. Flexible accounting technologies, such as XBRL, provide an opportunity to do so. XBRL is a flexible technology, which introduces consistency in reporting format and content, yet also allows enough flexibility to accommodate diversity. It may benefit business by simplifying and streamlining reporting practices
- c. *Practical experimentation* through EBR consortium tests the practical use and effects of new accounting technologies, such as XBRL. Diverse stakeholders (such as US financial analysts, chartered accountants, policy makers and researchers) can be brought together to collectively examine what works in practice and also to develop credible criteria for what good accounting of intangibles will look like (ie criteria such as reliability, objectivity, identifiable). Collaborative projects can also provide more empirical insights into the cost and benefits of EBR to business and others and bring forth more evidence to support investments into EBR and the development and measurement of intangibles as strategic resources. Again, experimentation at one level may serve to develop practical solutions. But more importantly it also teaches participants what the idea – EBR – is and can be.
- d. *Management Education*: Inclusion of curriculum on EBR and intangibles in management education programs (ie MBAs, financial analysis and chartered accountants) can help improve awareness and practice. Curriculum can focus on business innovation more broadly and also, more specifically, on how to measure, manage and report on business performance in a knowledge-based economy.
- e. *Research in Harmonization*: This would lead to inquiry into how the diverse frameworks differ theoretically and empirically is needed: The key questions are:
 - Are the differences between frameworks cosmetic or substantial?
 - How do the frameworks consider and define the referent of their representation?
 - What is actually measured?
 - How do the measurements in the frameworks suggest justifying decisions about investment in knowledge and innovation?
 - How would quality criteria of EBR measurement look? Are they similar to those favoured by (e.g. FASB)? (Boedker, et al., 2008, pp. 21-23)
 - The market for information can be thought as the institutional means to connect corporate information supply activities to capital market information demand activities (Gonedes, 1976; Keane, 1983)

Besides the positive emerging changes, one more shot in the arm are the following dynamic changes underway in corporate financial reporting (Boerner, 2006, p. 42):

- No market participant “fully believes” that traditional corporate annual reports now add value to the decision-making processes of investors. Market players gather information through sources like corporate-investor conference calls or discussions with investor relations officers.
- Approaches like the use of economic value added (EVA), balanced scorecard and cash flow return are real efforts by forward-thinking executives to provide more information to the markets
- Self-regulating organization (SROs), public sector regulators, accounting organizations, and rule-making bodies, among others, are making progress in improving disclosure principles and methods to encourage a “more complete and reliable representation of where the business stands and where it intends to go”. Some advances are voluntary and some others are promulgated by government(s).

Williams (2001) points out, IC disclosure might attract unwanted attention, which could have negative consequences to the company, especially for the company owning a strong IC base.

So, managers may determine not to disclose their IC adequately for this reason (Yi and Davey, 2010). Evidence in Australia indicates share-market investors and analysts focus on value realization in financial terms, rather than longer-term value creation (Morris, et al., 1998).

13. The Future is here in Enhanced Business Reporting

Capital market players are increasingly asking question about the “gaps” between accounting and market value of the company. They look for information beyond the P/L and balance sheets to assess company performance and share price value (Boedker, et al., 2008, pp. 16-17). Regrettably enough, Buffini (2005) argues that the IFRS has done little to improve the situation. A survey of 1,016 company directors by McKinsey Consulting (2005) shows a shift in company directors’ information requirements (Table 2) and that there may be a demand for enhanced business reporting (EBR) information. According to the survey, company directors are looking for more information about intangible resources including, for example, customer relations, employee satisfaction and network and operating health. The survey also points out that the current lack of information about intangible assets may compromise the ability of company directors to fully understand the objectives and risks of their companies. This shows that there may be a demand for information (Boedker, et al., 2008, p. 16). Accenture’s (2003) global survey shows that only 5 per cent of companies have in place “a robust system that measures and tracks the performance of intangibles”. This contrasts to 49 per cent of company representatives who said that intangible assets are what their companies primarily rely on for shareholder wealth creation. Deloitte (2004) survey warns that traditional financial indicators found in financial statements are not enough to capture their companies’ strengths and weaknesses and call for increased disclosure of EBR information. Studies by McKinsey, Accenture and Deloitte pose a question as to whether financial statements provide sufficient information for business decision making in a changing economy. This is consistent with

academic research, which has started to question the relevance of financial statements in the knowledge era (Mouritsen et al., 2003; Lev and Daum, 2004 for a US perspective). Ballou et al. (2004) explain that a lack of accounting for intangibles has resulted in a gap between market and book value. In 1980, the book value of the S&P 500 was 80 per cent of market capitalization, whilst in 2003 it was less than 33 per cent. Consider also that, in 2008, Google's market capitalization is approximately US\$125 billion while its net tangible assets are worth US\$9 billion. Amazon.com has a market capitalization of US\$13.6 billion and a net tangible asset value of US\$76 million. Microsoft has a market capitalization of US\$271 billion and its net tangible assets are worth US\$36 billion. (Boedker, et al., 2008, p.16).

1. Market health	Customer profitability/satisfaction, competitors' market share and products, suppliers, brands
2. Organisational health	Employee retention/satisfaction, capabilities and skills, organisational structure, culture, values
3. Network health	Regulatory changes, government policies, public opinion, community views
4. Financial performance	Cash, costs, EBITDA, margins, return on capital
5. Operational health	Buildings, inventories, patents, product pipeline, production rates
Note: Items shown are the 1,016 company directors surveyed in the McKinsey survey wanted to know more about, in order of importance	
Source: McKinsey (2005)	

Table 2: Changing information requirements of a company directors: facts at a glance (Cited by Boedker, et al., 2008, p. 15)

To help firms to account for the business combination, the appendix to IFRS3(IASB, 2008) incorporates a list of examples of intangible assets which meet the recognition criteria and that are possible to report as intangible assets apart from good will. The list of intangible assets and the classification proposed are summarized in Table 3.

Intangible asset category	Examples of intangible assets
Marketing-related	Trademarks, internet domain names, non competition agreements, etc.
Customer-related	Customer lists, customer contracts, order backlog, etc.
Contract-based	Licensing, royalty, standstill agreements, etc.
Technology-based	Patented technology, computer software and mask works, etc.
Artistic-related	Video and audiovisual material, music, books, video, etc.
Source: IASB (2008)	

Table 3: Examples of recognizable intangible assets presented in IFRS3 appendix (Brannstrom et al., 2009, p. 66)

What is called for is "New Era in Company Evaluation" (Figure 14). This analysis demands more information about intangible resources by capital market players and may have a "pull-effect" possibly resulting in more companies measuring and reporting on their intangible assets (AMP, 2005). This is to translate conceptually between financial models and elements of EBR. Research of capital market impacts of disclosure of EBR information has found that can disclosure can reduce information asymmetry and improve company valuation. For example, find that information about product development, R&D and the competitive environment, reduces information asymmetry and assists IPO pricing (Guo et al., 2005). Thomas (2003) examines the impacts of intellectual capital reporting with financial analysts in the UK using an experimental design. She finds that an increase in disclosure of intellectual capital information leads to a tighter range of share price estimates and a reduction in beta, resulting in a lower cost of capital. A 2003 Deloitte survey of 388 fund managers and 80 investor relations officers finds that EBR information is increasingly important to investment decision making, with an anticipated surge in demand for such information over the next three years. Amber et al. (2001) study of the UK capital markets likewise calls for heightened levels of disclosure of EBR information, emphasizing also the interest in disclosure of comparable and consistent data across organizations and time periods.

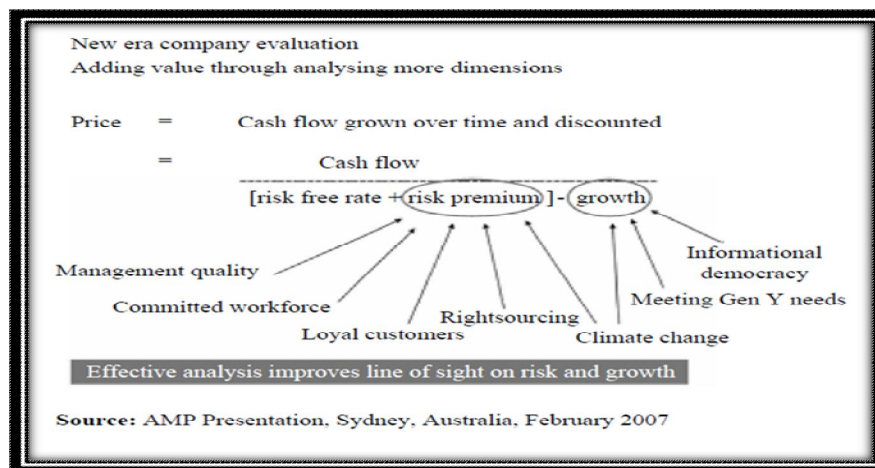


Figure 14: Changing information requirements of capital markets (cited by Boedker, et al., 2008, p. 17)

14. Sustainable Humane One World through Total Quality Business Management (SHOW-TQBM)

We cannot solve our problems with the same level of thinking that created them”, according to Albert Einstein. Hence contemporary world thinks about *One World*. Though it is a one world, we are of the view that it is an unforgiving world that consistently rains Strategic Inflection Points (Grove, 1996) nudging organizations to fanatically and passionately pursue every nano second blue ocean strategy (Kim and Mauborgne, 2005) laced with competitive strategy. Is it a world still a village than global? If yes, it is high time to prevent global pillage in a global village. Some of building blocks for total quality business management are pieced together. Viz., *Holistic IC*: Our model in Figure 16 is a food for thought for stakeholders. For, we need more theories – in particular theories which do not only explain the management of intangible resources in a functionalistic or technological manner but address more fundamental problems from a critical and differentiated perspective such as, for which purposes or ends are intangible resources (allegedly) being used or should be used? (Diefenbach, 2006). The development of indicators can be a complex process. Thus, it should be designed using a systematic and holistic perspective (Searcy et al., 2005:35).

Supply side of capital markets: Board of Directors, corporate executives, Corporations are the key players in this space. Though IC narratives can be manipulated and subjected to different interpretations (Abhayawansa and Abeysekera, 2009), according to stewardship theory, managers are honest rather than opportunistic in taking care of the wealth of the firm (Muth and Donaldson, 1998). They can leverage *One-Page, Integrated Reporting* as we are challenged to find improved metrics which reflect outcomes (New South Wales Department of Lands’ 2009, p. 14). The comments of the Director General of New South Wales Department of Lands (2005b) is apt and pithy:

... the best application of the Balanced Scorecard is not to implement it chapter and verse, ala Kaplan and Norton, but to take the framework and apply it and modify it to your own organisational needs (Dumay and Rooney, 2011, 348)

In fact, it’s very easy to write a word essay on intellectual capital. It’s much harder to document it and define it and to quantify it within the performance structure of an organization. Dumay and Rooney (2011, p.350). Warren Buffett looks for three things in his managers: hard working, smart and honest. The first two without the third is disastrous! (Wellum, 2007, p. 1392). Intellectual knowledge should be replaced or augmented with the notion of wisdom. Wisdom in the Bible refers to “masterful understanding,” “skill,” and “expertise.” The possession of wisdom enables humans to cope with the ups and downs of life and to achieve what would otherwise be impossible. It is far reaching in terms of its importance and impact! Wisdom is also inseparable from knowledge. In the Book of Proverbs, the term denotes mastery over experience through the use of both the mind and heart. Wisdom entails knowledge, insight, prudence, cunning, discretion, learning, and guidance. It includes counsel, understanding or competence and resourcefulness and heroic strength. All these virtues are packaged with the concept of wisdom! Wisdom equips one to rule, to show broad leadership, enables one to acquire wealth and subsequently manage it wisely. Most importantly the concept of wisdom presupposes that all these capacities are exercised in the realms of righteousness, justice, and equity which gives wisdom a moral dimension to be exercised in the public square at all levels of society/culture (Waltke, 2004). There are four commonsense steps to take if executives want to join IC reporting (Eccles et al, 2001, p. 11):

- Construct a business model that shows the cause-and-effect relationships among key value drivers; then identify the most meaningful measures for them;
- Develop new measurement methodologies if they do not already exist;
- Validate the business model and the measures through testing and use; and
- Compare management’s view with the market’s view on what measures are important

Moreover reporting ought to be 3-level Reporting. Traditional financial reporting, due to the rules of its construction, cannot correctly represent intangibles, thus presenting an incomplete account of a firm’s value and its business activities (Guthrie et al., 2007). Moreover, the regulated reporting model has a backward looking focus on financial measures and tangible assets which says nothing about the size of the case flows the company expects to generate and the risk attached (PricewaterhouseCoopers, 2001). This at a time when the granularity of reporting is going strong with the social media spotlighting brands (Lakshminarayanan, CEO, Unmetric, on

CNBC TV 18 on 29th July 2014) The quality of information disclosed to stakeholders has driven several researches in the scope of management reports utility. Based on the *Contingency* (Reid and Smith, 2000; Thomas, 1991), *Institutional* (Chapman *et al.*, 2009; DiMaggio and Powel, 1991) and *Legitimacy* (Dowling and Pfeffer, 1975; Guthrie *et al.*, 2004) theories, the information dissemination is stilted by multiple stakeholder's expectations and requirements. Thus, several restrictions on the information dissemination can be explained in the framework of agency theory, especially the dissemination of non-mandatory information. The new management approaches require a new set of indicators, duly integrated in a cause and effect chain, which allows companies and individuals an integrated outlook at the macro and micro economic levels (Lopes, 2012, 273).

Demand side of Capital markets: The specific efforts inferred out of the extant research literature are the following:

- Shareholder Activism
- Good governance
- Pay for performance
- Extra-financial performance is critical
- Consider the impact of sustainability on long-term performance
- Securities research industry needs restructuring
- Improving financial reporting
- Hope rests with the new analysts
- Eschew short-termism (Boerner, 2006, pp. 36-40)

Both Sveiby (1998) and Chareonsuk and Chansa-ngavej (2008) indicated that the companies with abundant human capital could not only boost the operating efficiency, but also accumulate solid structural capital. Responsible leadership, as “transforming leadership” (Burns, 1978), depends on the mutual pursuit of business leaders and stakeholders alike to achieve higher-level goals based on a shared vision of the role of business in society (Maak, 2007). This is important while balancing different stakeholder claims, including those of the natural environment, future generations, and less privileged groups “at the bottom of the pyramid” (Prahalad, 2005) creates social, ecological and humanitarian challenges.

15. A maximization Model for future consideration

In the case of *Dartmouth College v. Woodward* (1819), United States Supreme Court Chief Justice John Marshall defined a corporation as “... an artificial being, invisible, intangible, and existing only in contemplation of law.” This jurisprudence of yore has gone the way of the dinosaur, so to speak. While contemporary organizations are on a never-ceasing journey to navigate from being good to great (Collins, 2001) aspiring to build institutions built to last (Collins and Porras, 2002) knowing in their of heart of hearts that only the paranoid survive (Grove, 1996) to compete for the future (Hamel and Prahalad, 1994), the mind of the strategist (Ohmae, 1982) with the fond hope to ever innovate and build IC-driven learning organizations through the fifth discipline (Senge, 1990, p. 6) are the in thing, according to Anthony and Utpal (2014d) This is for reengineering management (Champy, 1995), reengineering the corporation (Hammer and Champy, 1993) rather and to ‘accelerate’ for building agility for a faster-moving world (Kotter, 2014). Because, X-engineering the corporation to reinvent business in the digital age is the need of the hour for industry leaders to shape the market in which their followers will compete (Champy, 2002).

Intangible assets are aligned with organizational success and are a by-product of ‘organizational design’ (Sullivan, 1998). Yet, “the key components of intellectual capital are not reported within a consistent framework when reported at all” and “the next major step is either to refine the reporting models in use or to develop new models” (Guthrie and Petty, 2000, p. 249). Because, to be a knowledgeable researcher is to be able to relate one's own findings to those of others by asking analytical questions that help researchers to become knowledgeable about things they did not know beforehand (Kreiner and Mouritsen, 2005). This calls for a “fundamental rethinking and radical redesign of business processes to achieve dramatic improvement in critical, contemporary measures of performance.....” (Hammer and Champy, 1993). With this business philosophy in mind and having extensively reviewed extant IC research literature from scholarly, peer-reviewed international journals, we attempt building on Figure 7 an optimization model based on the popular works of thought leaders (Sveiby, 1997 a, b; Lev, 2012 and DiPiazza and Eccles, 2002). We designed (Figure 16) a framework chiseled on global IC thought leadership (M'Pherson and Pike, 2001, p.252; Pulic, 2000, p. 714; ; Lev, 2001, p.111 ; Daum, 2002; Eccles *et al.*, 2001; Tovstiga and Tulugurova, 2009, p. 72; Eccles and Krzuz, 2010; Delaney, (2011, p.62); Abeyesekara, 2013, p. 233; PwC, 2013, p. 12).

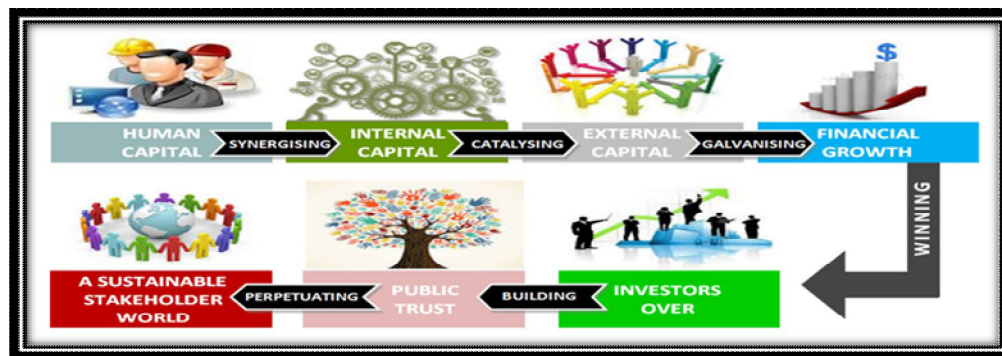


Figure 16: A Bird's eye-view of an Optimization Business Model for IC-centered integrated value reporting (Anthony and Utpal, 2014d, p.156)

Leveraging the different dimensions of organizational capital on an *input-output-outcome-impact-value of impact continuum* (Figure 17) built on the PwC (2013, p. 12) model for measuring and managing total impact as a new language for business decisions and to value the future (Mouritsen et al., 2001).

What IC is and how it can be better managed in the new economy (Dumay, 2012), the practitioner-consultant-researcher triad (Sankaran, 2006) framework would make a pragmatic and powerful impact on the IC domain in organizations and institutions (Anthony and Utpal, 2014d, p. 45). Such a framework could leverage value reporting and one reporting (financial and sustainability) the *sine qua non* of the business world in which IC would catalyze strategy, operations, governance and sustainability for a seamless value creation calling from IC perspectives of both competitive strategy and blue ocean strategy. A global approach would enable and empower the thought leaders, regulators, accounting world, business leaders and governments to come on to a common platform to streamline IC management, measurement and reporting (ICMMR) to unleash the power of IC for a golden morrow of humanity (Anthony and Utpal, 2014b, p. 325).

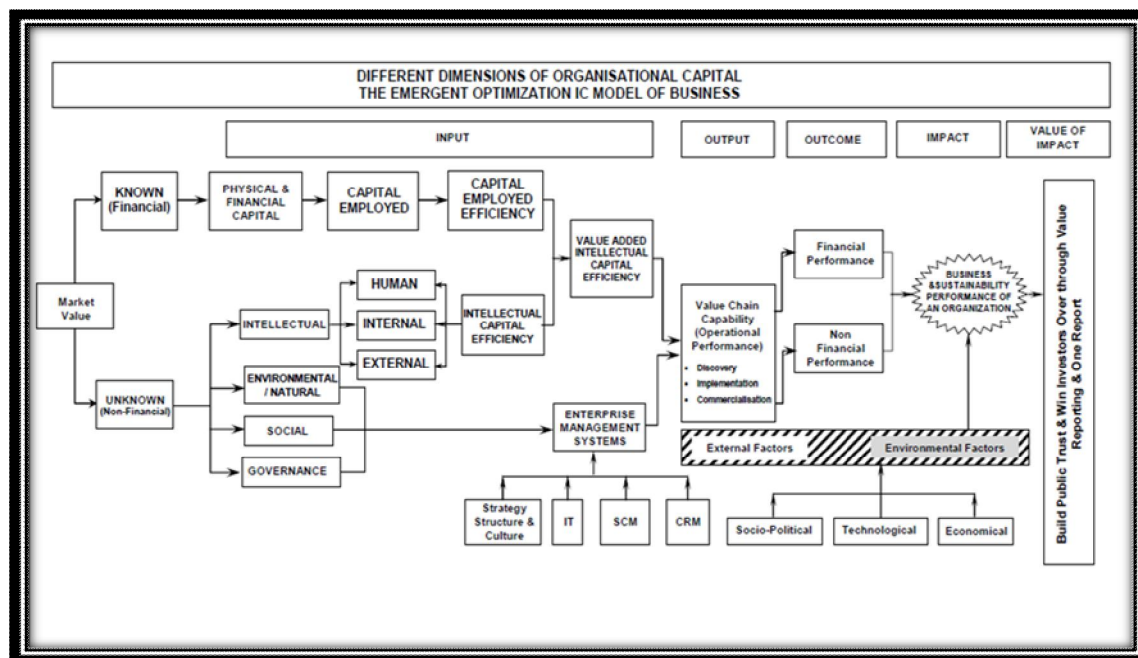


Figure 17: A Decomposed View of the Modified And emergent IC model of Business (Anthony, Thiagarajan and Utpal, Baul, 2014d, p. 152)

When one is striving to achieve or maintain a position of relative superiority over a dangerous competitor, the mind functions very differently from the way it does when the object is to make internal improvements with reference to some absolute model. It is the difference between going into battle and going on a diet (Ohmae, 1982, p. 37). Such a model is sought to be stitched up here since organization capabilities represent what the organization is known for, what it is good at doing, and how it patterns activities to deliver value (Ulrich et al., 2013, p. 263). These motley but pragmatic models that have their genesis in the path-breaking works of scholars and practitioners could be dovetailed with the latest path breaking work of the International Integrated Reporting Council (IIRC)(Anthony and Utpal, 2014c) working with the International Accounting Standards Board (IASB)to develop an integrated corporate reporting framework (International Financial Reporting Standards Foundation, 2013).

The IIRC is a global coalition of regulators, investors, companies, standard setters, the accounting profession and non-governmental organizations that have come together “to create a globally accepted international integrated reporting framework that elicits from organizations material information about their strategy, governance, performance and prospects in a clear, concise and comparable format” (International Integrated Reporting Council [IIRC], 2013a, p. 1). On February 13, 2013, a Memorandum of Understanding was signed by the International Accounting Standards Board (IASB) Chairman and IIRC Chief Executive Officer that will enable the two organizations in improving cooperation on the IIRC’s work to develop an integrated corporate reporting framework (International Financial Reporting Standards Foundation, 2013). Integrated reporting has occupied the domain of IC reporting, i.e. explaining the value creation story, but it is broader and comprehensive than IC reporting. Value creation extends beyond IC to natural, financial, manufactured and social capital, all of which have been captured in integrated reporting. In addition, the distinguishing feature of an integrated report is the connectivity it demonstrates among financial and non-financial information – connectivity that provides a holistic view of firm value creation. The challenge is how to integrate IC with everything else (Abhayawansa, 2014, p. 120). Studies of Swedish firms with several years of experience with measuring, reporting and managing intangibles indicate that the development of an IC system is more to be considered as a long learning process based on trial and error (Johanson *et al.*, 2001a, b).

The OECD Report of May 2001 (OECD, 2001) sets out a menu of options for obtaining beneficial ownership and control information (of the corporations), in three broad categories:

- Primary reliance on up-front disclosure to the authorities.
- Primary reliance on intermediaries to maintain the information.
- Primary reliance on an investigative system

The data base for these need to be authentic and authoritative. A typical one as it is in India, the registration data of 250,000 companies available with all the Registrars of Companies (RoCs), Department of Company Affairs, Ministry of Finance, Government of India, and compiled by the Centre for Monitoring of Indian Economy (CMIE), according to Singh (2010).

16. Creating a mosaic of understanding from private and public sources and constructing the knowledge advantage

Managers sometimes have greater incentives to report *negative* news. One example is managers' attempts to lower the strike price of their employee stock options by advancing negative news disclosures or delaying positive news disclosures near stock option award dates (Aboody and Kasznik 2000). According to Holland (2006a, pp. 299-300), the following are noteworthy factors:

- a. *Building a bottom up data base on companies, sectors and economies:* To bridge the many gaps of understanding existed surrounding the nature of the corporate SC and HC variables and concerning their interactions. Firstly, the fund management team sought to understand the company story or narrative. This larger context and connecting logic was understood through key word, phrases, metaphors, and visual employed by investee companies in the private meeting. Secondly, they sought to build up a jigsaw, mosaic or picture of corporate economic life, using a mix of private and public sources. The company narrative and models connecting key economic variables to value, were jointly exploited in this systematic and explicit picture building process. These were two important internal means for continuous learning and for developing the knowledge advantage
- b. *Developing a holistic view of the private agenda:* The FMs collected copies of slides and made notes on the private narrative and dialogue and these were checked and analysed after the meeting by the FM and internal analysts team involved in the private meeting. Informal impressions of management, and the way they explained the slides were important parts of the post company meeting agenda amongst the FM teams. The narrative, metaphors, and visuals employed by companies, were all recognised as key means for company managers to communicate how they intended to create the company future. They provided the context to the specific items on the qualitative agenda (mainly intellectual capital) such as management succession, management of innovative processes, and further fleshed out details of strategy. The story, visuals and metaphors were required to fill in the gaps between these variables or specific item agendas. The latter were often linked through explicit models. A credible story, a coherent narrative, clear visuals or slides, all contributed to a confidence context for FMs to accept and believe the set of promises companies made to FMs about how they expected to produce performance and what that performance was expected to be. Management qualities and personalities also contributed to this confidence context (see previous section). If the FM accepted these promises after the dialogue, they became part of the historic record of company promises and formed the basis for future dialogues and perhaps disputes. This subjective, qualitative track record was as important as the more objective profitability and share price track record of the company. Thus last years slides were often used by FMs as the basis for an initial dialogue in new meetings. Last years' promises were introduced into the dialogue. Last year's impressions of management's story and their competence were built into the meetings and observations in the current year. In this way the case FMs sought to gain some control over private meetings stage managed by companies and their brokers.
- c. *Mosaic or picture building approach:* Pooling of qualitative and quantitative information amongst the FM's fund management and analyst team, during post company meeting analyses and during regular internal FM stock selection and asset allocation meetings, was central to the mosaic approach. These were matched by the case FMs access to the external network of multiple relations with investee companies and to other networks involving suppliers and customers of these companies, as well as the network of external (sell side) broker based analysts, each providing small portions of new information. These pieces of information, when placed in the context of other fragments of information from other investee companies, from external analysts, and from financial reports, were used to produce a new company (or competitor) picture

or insight. This in turn was employed in structured valuation, stock selection, and asset allocation decision. The picture was then checked against the company story in subsequent meetings. Such mosaic information was then fed into a process to estimate the values of key variables such as next period *earnings*. *These estimates were then used in a valuation process using an in-house valuation model.*

- d. *Stock estimation and valuation:* In the fund management context, there were four stages involving, analysis of external change, prior framing, estimation and valuation. These played a role throughout the short decision process consisting of the pre-meeting diagnosis, the meeting dialogue, and the post meeting analysis and decision. Once the case FMs acquired a knowledge advantage concerning the corporate value creation process, they were in a position to analyse macro and competitive changes in the company's environment, and to assess their effect on the company and the likely corporate response. This in turn, provided the means to estimate corporate returns, their riskiness and corporate value. As a result the case FM posed five main questions of their investee companies, concerning external threats, exposure, risk, corporate responsiveness and impact on value. These questions according to Holland (2006a, pp. 301-302) were:
- What are the external sources of risk and threats to the companies? In order to pose this question the FMs developed or purchased new macro economy information on forecast changes in macro variables such as GDP, interest rates, inflation rates and exchange rates. This information was primarily generated for asset allocation decisions but was also used extensively at stock selection level. They also analyzed expected changes in product markets, industries, and competitive positions (e.g. via a Porter 5 forces conceptual structure). Most of this information was available from analysts and other external sources. The late 1990's change to a low inflation, low growth economy, and its impact on the relative competitive position of UK companies, was a major concern of the case FMs. The growth of IT and Internet stocks and the threat of major revolution in communications and selling, were major concerns.
 - What corporate assets are exposed these risks and threats? These questions focused on both tangible and intangible assets and exposures and changes in these in the value creation process. In sections 2 and 3, we have seen how the FMs sought private information on company specific human and structural capital, and their role in the corporate wealth creation process. Most of this information on the vulnerability of exposed intangible assets was only available by direct contact, dialogue and observation in the company. The FMs tried to assess if intangibles such as brands or R&D were restricted to one or two dominant areas and subject to rapid change. Similar concerns were expressed about conservative management in changing markets, and risk taking management in volatile environments.
 - What is the likely impact of changes in macro/competition conditions and other events in the risky environment on the company, especially its tangible and intangible asset (IC) exposures? In particular, how are these external changes likely to impinge on the corporate value creation process and the risk and return generation process? Hence what kind of risks are expected to occur at the level of the company? More specifically, how do these change systematic and unsystematic risks? And how do these create major downside risks? Thus intellectual capital factors were important in this first stage framing. Structural capital, such as the existence of good practice in the areas of brand management, innovation and financial risk management, were important contextual factors. Human capital in the form of "management track record" in generating returns and managing risk, corporate culture and management attitudes to risk and shareholder wealth, were important. Many proxy sources of information were sought on these including consumption and remuneration behaviour of management, as well as the use of foreign exchange and interest risk management practices as proxies for general risk management attitudes. Track record was based on the last (and previous) period corporate performance and private meeting promises. The above provided data on both intangible exposures and the responsiveness of these intangibles to changing conditions. They provided another important historic frame or informed reference point for the current period meeting.
 - How can the company and its management (i.e. the SC and HC elements in the value creation process) deal with the forecast macro conditions, and expected competition? The quality and coherence of corporate strategy was central to understanding how a company was expected to respond to these external threats and opportunities and to purposefully direct the exploitation and development of IC related assets (note Strategy was also an intangible asset in its own right) More specifically, the question were, how can structural capital (such as good practice in the areas of brand management, in R&D and innovation be directed by strategy to) interact with human capital (such as management track record in these areas, corporate culture and management attitudes to risk and shareholder wealth) to deal with the competitive and technological changes and to create or maintain value? How are these intangible assets renewed in this changing environment? How can formal techniques of risk control (internal structural capital such as the quality of foreign exchange risk management or the internal control system) (directed by strategy to) interact with informal controls such as a responsive and capable management team (quality of human capital, attitudes to risk and shareholder value) when dealing with these external sources of risk? Arie Lewin (of Duke University, paper on "Knowledge, knowing and organization adaption" at May18-19, 2000, New York University, Stern School of Business, Conference on "Knowledge: Management, Measurement, and Organization") refers to this as the central idea in the knowledge intensive, wealth creating organization. The idea is to simultaneously manage the rate of improving existing IC capabilities (exploitation) and innovation and self-renewal (exploration) to match or exceed the rate of change in the environment. This is the basis to generate excess returns and to control risks and to outperform competitors.
 - How are these external threats, internal exposures and risks, and internal corporate responses likely to affect expected corporate cash flows, earnings and their risk and hence the value of the company? How sensitive are expected levels of

corporate cash flows and earnings and their risks, to external threats, and how can these sensitivities be managed and exploited by the company to create or maintain value?

As a result of this probing, the aggregate, bottom up data on the responses of investee companies, and sectors within economies provided an alternative perspective on the top down macro views. There was evidence in the cases of downside risk avoidance at all three major decision levels of asset allocation, equity portfolio construction and stock selection. The FMs removed perceived risk concentrations at all levels. The FMs used private (qualitative data on intangibles) and public data to avoid asset categories considered risky at the current time period (e.g. more gilts less equity), sectors considered very risky at certain points in the economic cycle (e.g. less manufacturing and more utilities at the start of recession), and companies with potentially disastrous financial outcomes (avoid black holes). Thus a form of top down risk control was based on qualitative bottom up information (Holland, 2006a, p. 313).

Posing the five questions (on threats, exposure, risk, response, value changes) and the framing process outlined provided the means for FMs to gain many more insights into corporate risk. The case FMs were particularly interested in how a company was expected to perform in step or out of step with prevailing economic conditions such as a recession. The fund managers were also very interested in the range of downside outcomes and the possibility of any outcomes with very large losses. Information on this upside and downside risk context and more specifically on *'black hole' outcomes (meaning very risky companies)* was central to stock selection and portfolio wide fund management decisions. The special role that private information on financial risk, especially information derived from the qualitative aspects of the value creation process (Intellectual capital components), played in bottom up and top down risk controls over the whole portfolio of shares. The FMs considered such risk controls to be central to fund financial performance (Holland, 2006s, p. 309).

The case data thus provided some insight into how the book value and market value gap arose and the special role of information on intangibles and intellectual capital in valuing the company. Private information, the knowledge advantage and prior framing were also key inputs to bottom up and top down portfolio risk control and asset allocation by fund managers. The private information sources were used to remove black holes or very poor performers from the portfolio. In addition, they were used to understand which companies and sectors were likely to be winners and losers under forecast macro conditions. Both bottom up and top down risk controls were expected to boost fund performance. This fund management behavior has important implications for regulatory policy issues on insider information, on corporate disclosure, the corporate governance role of financial institutions, and for the governance of financial institutions. In the case of insider information, the FMs were clearly acquiring an inside knowledge advantage through their regular direct contact with companies. The policy question is, should the market information benefits, arising from FMs being informed in this private way about intangibles, be restricted in the interest of fairness to small investors in financial markets? Secondly, can the private disclosure process offer ideas on how to improve the public disclosure process?. Thirdly, should the informed FMs be asked to pursue wider governance aims in the interests of many savers, stakeholders and citizens? Finally, who governs the governors? These questions are likely to become more urgent in the knowledge decades ahead as the information asymmetry based on intangibles becomes acute, and an increasingly concentrated and global FM industry continues to exploit their knowledge and power in the interest of their favored groups of savers and shareholders.(Holland, 2006a, pp. 313-314).

FMs understanding of investee companies value creation processes is based on the private company level information, on qualitative elements of the value creation process to estimate the riskiness of financial returns. This learning process created the means for FMs to frame their perceptions of corporate financial risk and return, prior to using this information in estimation and valuation decisions at stock level. FMs used public information on corporate foreign exchange and interest rate risk management as proxies for overall risk capability and attitudes of management teams. This was a form of corporate structural capital in that it revealed the internal structures, formal processes and practices that had developed over time. They also used ideas of human capital such as management's track record in dealing with risk over time as an important source of information on risk management capabilities. Both forms of structural and human capital revealed much about corporate attitude to risk, as well as corporate responsiveness to financial risks and business risks and hence corporate vulnerability. The case FMs insured against high risk management teams by preferring to invest in companies that adopted good financial risk management practices. In case of real business risk, good financial risk practices and board and top management understanding of these practices, were used as a general proxy for management ability to handle many financial market and real business risks. The combined private and public sources thus formed a means to reduce estimation error arising by using public or private sources alone. This did not alter company risk but it did improve FMs understanding of this risk and of management ability to handle and exploit the risk (Holland, 2006a, pp. 309-310).

- *Bottom up risk avoidance, "black holes" and surprise management: A micro process:* Fund managers used direct contact with relationship companies to identify high risk, low return companies and to drop them out of their portfolios. They also questioned and probed their key investee companies in an interrogative and informed way in order to persuade management to avoid getting involved in operational and strategic risk areas outside of their competence. A major concern of the fund managers was to avoid black holes or major corporate losses. Close contact and influence with relationship investee companies was one means to do this. The fund manager's prior framing of corporate financial outcomes was based on regular relationship contact and was the means to identify and to avoid such black holes. Potential surprise is an anticipatory measure of how surprised a decision maker imagines he would be if a possible outcome did, in fact, occur (Stephen, 1986, p. 46). Similar concepts seemed to be informing the fund managers in their attempts to influence their investee companies not to surprise them, and to create knowledge or awareness conditions within the FM such that they are not easily surprised by events. Fund managers employed safety first rules and sought to avoid investing in companies with a possibility of large losses despite this being an unlikely event. Information on corporate intellectual capital (poor track record in managing risk)

and structural capital (poor risk management systems) were the means to understand corporate economic performances. Shared structural capital in the form of the company and fund manager relationship was the means to exchange expectations on surprise and to disclose information to reduce the likelihood of surprises. The FMs used this information, from companies or their competitors, to rule out investments with unacceptable downside possibilities despite the upside possibilities being very attractive. Relationship contacts with companies were seen as a vital means to identify and avoid black holes before they occurred. The large majority of the fund managers (those who were either quantitative or qualitative at portfolio level) adopted a qualitative rather than quantitative approach to bottom up risk control. The time pressure in stock valuation was severe, and there was little time for such analysis. Mean variance data was more likely to be used with optimization techniques for asset allocation, and this usage was only likely with the minority of quantitative FMs. Pro-active fund managers with a large proportion of their pay based on bonus schemes were particularly sensitive to individual corporate risks. Such fund managers were highly exposed to the performance of a few overweighed companies in their portfolio. Black holes were more important to these fund managers as they sought to avoid the adverse effects on their fund performance, their pay and reputation. If they were poorly performing active fund managers, their incentives were even stronger. In contrast, indexer fund managers, with little in the way of bonus pay, were less sensitive to such companies. Their interest lay in identifying them and influencing them to improve their performance. Unless they were a sampling indexer they had little choice but to hold the shares (Holland, 2006a, p. 311).

- *Use of private information in top down risk control:* In the majority of FM cases mean-variance and optimization approaches, were not employed or were only used a supplementary source of information at the top down level. The bulk of these qualitative fund managers argued that at various times, they found themselves too information constrained, or too ignorant, to find robust and stable optimal portfolio solutions for periods three to 12 months ahead. A small number argued that experience and intuition alone were much better guides than these quantitative models. Commercial data base companies did provide updates (on returns, and their averages, variances, covariances and weightings) based on new public information such as new financial reports and earnings forecasts. However, this information was public. The FMs wished to update their expectations of risk, return and diversification benefits based on their own special information. Unfortunately this information arrived from private sources in both ad hoc and cyclic ways and the information flow was often restricted to a few companies in the portfolio at any one time. Thus it was very difficult, at any one time, to adapt the full set of historic numbers; revise expectations across the portfolio, recalculate the efficient frontier, and compare the actual portfolio with an forward looking efficient portfolio. It was difficult for the case fund managers to gain an information edge by only processing public domain information on the macro economy, industry sectors, or by competitive analysis of individual companies. Macro model uncertainty factors, the limitations of top down information and forecasts, and FM concentration of share ownership all played a role in encouraging fund managers to use direct contact with investee firms to collect additional information on macro and competitive conditions and corporate responses (Holland, 2006a, p. 312).

Information on questions 1 to 4 were important in "framing" fund managers perceptions of riskiness of company plans, potential corporate outcomes especially major losses, their relative financial gains and losses, and hence the eventual basis for valuation. The above set of questions and analysis is similar in principle to that proposed by Oxelheim and Wihlborg (1997). The case FMs were also very interested in risks associated with competitive changes. They were also concerned about the impact of the combined macro and competitive changes on the combined human and structural capital of investee companies and the role of these intangible assets in responding to and exploiting these sources of risk. There have been major developments in improving public disclosure on these questions. The ICAEW in 1999 published a study (Disclose or Perish) on how companies could improve the financial reporting of a wide range of business and financial risks. They used the Arthur Andersen (1998), "Business Risk model", as the basis for recommending that improved risk disclosure would allow companies to differentiate themselves and secure a competitive advantage in capital markets. Despite these attempts to improve public domain disclosure of risk, the case FMs argued that they had to acquire private company information to understand corporate attitudes to financial risk and to broader company risk management, and to "complete the picture" and assess how individual companies and sectors were likely to respond to these macro risks and competitive conditions.

17. IC pitch forked onto the pragmatist epistemology platform

Having dealt at length the capital market actors, the vitality of IC in today's business and their concomitant, natural interdependence for business and societal synergy and progress, we adopted in this article the pragmatist epistemology as a viable methodological avenue for addressing the challenges associated with the dominant approaches to organizational management (please read IC). This is one avenue for the rethinking of dominant assumptions guiding organizational research (Powell, 2002; Tsoukas and Cummings, 1997). At its core, a pragmatist epistemology highlights the experiential and reflexive orientation of research, which is central in understanding social activity (Bourdieu, 1991; Bourdieu and Wacquant, 1992). Exploring worldviews is an essential precursor to understanding the alternate philosophical orientation required for scholarly engagement in organizational research and practice. It is in this sense that one can say that the pragmatic worldview is value rational because of the need to be concerned about the consequences of concepts on action and the consequences that stem from these actions (Ruwhiu and Cone, 2010).

The explanatory realm of organizational analysis has changed dramatically from an ontological, epistemological and methodological point of view (Deetz, 1996, 2000; Denzin and Lincoln, 2003), where new forms of organization and management thought and practice have come into being. Pragmatism offers a more diverse and interpretive approach to the study of organizations. Pragmatism sees all

knowledge as best acquired through reason and the use of concepts and methods that are freed as much as possible from the fallibilities of our senses or the context of given situations (Chia, 1997; Cook and Brown, 1999). The conceptualization of an indigenous paradigm, oriented by a pragmatic epistemology, is one such example of the many different frameworks that are more inclusive and organic that has emerged as a counter to the dominant approaches to organizational research. As a consequence, by shifting our mode of thinking from within the dominant orthodoxy in organizational literature, we are prompted to ask more diverse and meaningful questions about organizations and management (Ruwhiu and Cone, 2010, p. 123). The art and science of business (Figure 2) is a case in point.

Historically, the corporations were expected to serve the public good. Joel Bakan observed that in seventeenth century England, and eighteenth and nineteenth century USA, corporations were formed “to serve national interests and advance the public good” and suggested that as a creation of the state, corporations as institutions supporting public goals can be restored (Bakan, 2004). Corporations enjoy status as legal entities just as humans do; unlike human, however, corporations are soulless. The world has long recognized the difficulty in punishing the “artificial person” of the corporation, which has “no soul to be damned, and nobody to be kicked” (Coffee, 1981). Corporations commit crimes just as humans do; unlike humans, corporations cannot be damned. In an earlier study of illegal corporate behavior, Clinard et al (1979) concluded that “approximately, two thirds of large corporations violated the law” (Ramirez, 2005)

India has seen many a corporate fraud in the recent past – the most recent being the Satyam Computers scam (January 2009). Some of the others worth recalling included the Ketan Parekh stock market scam (March 2001), which followed the “Big Bull” Harshad Mehta lead stock market scam (1992). When the corporate frauds were showing their ugly face on Indian front, the Western world, too, was not far behind. In fact, the westerners lead innovatively in corporate crimes involving “accounting frauds”. Advancement in application of technology prominently showed in corporate frauds, as well. Some of the well-known names included the WorldCom, Tyco International, Adelphia Communication, Xerox Corp and the Enron Corporation. With effective investor protection laws and stringent securities regulations in place, the trend and *modus operandi* in the West were different. The corporations opted for camouflaging the financials to defraud the investors by circumventing the regulations. Yet, another sad example in India is the Usha group cases that highlight the use of shell companies in perpetrating the fraud against the banks, financial institutions, shareholders and the company itself by the promoters/directors (Singh, 2010, p. 461). It is here that the services of analysts and law firms are increasingly being used by (Indian) banks as they try to recover their bad loans (THE HINDU, September 14, 2014, p. 13). Moreover, India has a rosy morrow because “by leveraging its strengths in human capital and information and communication technology (ICT) services, India can become a major global knowledge economy” according to Bindu N Lohani, Vice President for Knowledge Management and Sustainable Development of Asian Development Bank (THE FINANCIAL EXPRESS, September 13, 2014, p. 17). A missionary zeal towards our models *supra* would aid governance and mitigate the “fraud triangle” (ACFE, 2009) viz.,

- *Motive (or pressure)*. The need for committing fraud (need for money, etc.).
- *Rationalization*. The mindset of the fraudster that justifies committing fraud.
- *Opportunity*. The situation that enables fraud to occur

SEBI in India set up in 1988 (granted legal status in 1992) to regulate the functions of securities market is doing a laudatory work meeting the needs of three groups, viz., (a) For issuers it provides a market place in which they can raise finance fairly and easily, (b) For investors it provides protection and supply of accurate and correct information and (c) For intermediaries it provides a competitive professional market. SEBI’s objectives are to (i) regulate the activities of stock exchange (ii) protect the rights of investors and ensuring safety to their investment (c) prevent fraudulent and malpractices by having balance between self regulation of business and its statutory regulations and (d) regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc. (<http://www.yourarticlelibrary.com/education/sebi-the-purpose-objective-and-functions-of-sebi/8762> accessed on September 01, 2014).

18. Suggesting and spotlighting the Obvious for all Stakeholders

This article of ours is the result of our intellectual inquisitiveness and obligation towards the most potent, yet invisible and orphaned resource (read intangibles) sadly, inadvertently and unwittingly subjected to inquisition by those who must nourish it *summumbonum*. This IC debate comes at a time when India’s share of the global industry will be only 1.6% but India being the third largest country behind US and China in internet penetration. With E-commerce expected to touch a whopping \$30 billion by 2016 and the expected growth in the space in India to be over 50% outpacing the rest of the global industry, ‘Digital India’ needs to build new talent for the e-commerce era (Ganesh, 2014). In a world of internet Governance (IG), which impacts all 7 billion people on the earth – 3 billion online and 4 billion yet to be connected to the web – India with 1.2 billion people out of whom 800 million are mobile subscribers, 220 million internet users – half of whom use social media (Chandrasekhar, 2014). In a world In the light of this, IC gets centre stage in the Indian milieu. For example, according to Marry Barra, CEO of General Motors, “many predict that by 2020 India will be the third-largest auto market behind China and United States (THE FINANCIAL EXPRESS, September 12, 2014, p. 1). Hence, transforming corporate and capital markets’ behaviors should become the ‘urgent and important’ mission at a time when paradoxically enough today, generally accepted accounting principles (GAAP) financial reports often suffer from “information asymmetries and other shortcomings.” Investments on intangibles are expensed, not capitalized (such as for fixed assets) and as expenses increase, earnings per-share (EPS) decrease. Not an appetizing situation for today’s senior managers who are being judged on short-term metrics and their meeting of shareholder expectations (Boerner, 2006, p. 42). We aver that the think-tank to create the golden morrow are: the Regulators, analysts, technologists, accountants and accounting firms, individual investors, institutional

investors, all other stakeholders, board of directors, corporate executives, everyone (Eccles et al., 2001). In other words, the stakeholders in the model that we have thoughtfully rustled up to be a seed for the future thought leadership. In this context, we are in consonance with Dr. Carolyn Kay Brancato, Director of the Conference Board's Global Corporate Governance Research Centre (New York city) who observed, "We have been looking at the issue of how to get companies and investors to focus on long-term growth for more than 10 years. Now, several important, new developments make change more possible...than at any time in the past". She cited the following trends (Boerner, 2006, p. 36.) as part of a new climate in which reforms are possible:

- More leaders in the corporate and investor communities recognize and acknowledge the need to restore investor confidence in the international capital markets; market players recognize the need to restore credibility; the recent wave of corporate scandals in the US and EU (and elsewhere) has eroded investor confidence and market credibility
- Institutional investors are now taking dramatic steps to monitor more closely corporate management for the companies in their portfolios; "accountability" has become the watchword, with investment increasingly being directed with a long-term focus.
- Executive compensation has become a perplexing issue and increasing areas of risk; investors are now focusing on the "pay-for-performance" issue, demanding that companies in their portfolios develop compensation schemes based on a better balance of financial and extra-financial performance metrics and indicators.
- Accounting principles are converging on at least one major area: development of models of corporate reporting based on true value drivers and inclusion of extra-financial performance measurements and intangibles. (Examples cited include data on customer satisfaction, registration of patents and encouragement of employees' professional development)
- Recent empirical research projects support the linkage between sustainable ability – i.e., serious considerations of environmental, social and corporate governance factors- and improved stock market performance (share prices) and enhanced shareholder value. A "better company" is a "better investment" of the long-term, avers Dr. Matteo Tonello, the author of *Revisiting Stock Market Short-Termism*.
- Regulators, financial intermediaries, institutional investors and other third parties –"stakeholders," including company's stockholders - are demanding more sell-side research focused on a long-term corporate value.

We opine that stakeholders would further do well by evolving a cognitive model with the following building blocks. Though it is a brick by brick, patient, labyrinthic work to right a historic wrong vis-à-vis IC, this passionate endeavour is worth its effort:

18.1. Systems

Map IC-oriented management system could be amalgamated with existing mandatory certification like ISO 9001-2008 anchored in Capability Maturity Model (CMM) approach to suit life stages of organizations

18.2 Accounting bodies

In India the premier accounting body Institute of Chartered Accountants of India could work the with Big 4 Audit Firms. The Institute of Company Secretaries of India (ICSI) and Institute of Cost Accountants of India have to be other pillars in this odyssey.

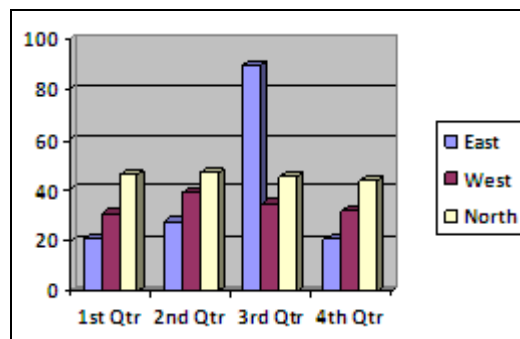
18.3. Regulatory bodies

The Securities Exchange Board of India (SEBI) can oversee Companies Act, 2013 & IFRS and work closely with Ministry of Corporate Affairs and Ministry of Industry and Commerce, Government of India for policymaking and compliance with focus on both financial and non-financial performance. SEBI can seek greater synergy with global peers including the International Organization of Securities Commissions, the is a global body of market regulators from across the world (The Financial Express, June 24, 2014, p. 11)

18.4. Organisations

Managers must ask themselves whether the benefits of not reporting information to the market are really worth the price they pay for not doing so (Eccles et al., 2001, p. 141). Because, the benefits for better disclosure (as outlined by Eccles et al., 2001) are:

- Increased management credibility
- More long-term investors
- Greater analyst following
- Improved access to new capital and
- Higher share values



More specifically, better disclosure results in more institutional ownership and greater and increased stock liquidity (Healy, et al., 1999). When an economy liberalizes, new competition squeezes profits. New skills are need to lend in a world where business acumen rather than collateral or connections matter. Moreover, new infrastructure – better accounting, more information gathering and reporting, better contract writing, and better debt-collection mechanisms – is needed. When new skills are acquired and the new infrastructure is created, lender will be able to make better loans than they did in the past ((Rajan and Zingales, 2003, p. 106). The other simple formula for growth is to (a) chase more opportunities (b) increase the size of those opportunities (c) improve win rates and (d) improve demand fulfillment (N.R.Narayanamurthy in THE FINANCIAL EXPRESS, May 29, 2014, p.6)

18.5. Industry bodies

Confederation of Indian Industry (CII), Federation of Indian Chambers of Commerce and Industry (FICCI) and Associated Chamber of Commerce and Industry of India (ASSOCHAM) can educate and guide its member companies in IC-driven business in domains like intellectual property, transfer pricing, capital gains. And also enable companies to adopt Holistic-IC focused business.

18.6 Non-Governmental Organisations (NGOs)

These can have symbiotic relationship with industry and business as partners-in-progress.

18.7. Applying Einstein's famous Relativity equation to IC

Even people with no background in physics have at least have heard of the equation or notation and are aware of its prodigious influence on the world we live in. That is the famous $E=MC^2$: (Energy (E) = Mass (M) times Celeritas(C)(The Speed of Light squared). Before Einstein, mass and energy were separate. Mass was never lost, it was always conserved. In a flash of genius, Einstein realized that mass and energy are interchangeable - matter can be converted into energy and energy can be converted into mass. The basic explanation of the equation is simple: E equals energy, M equals mass and C^2 is the speed of light in a vacuum. This equation points out how a small amount of matter can release a huge amount of energy, as in a nuclear reaction. In average human terms, $E=mc^2$ basically represents the amount of energy you'd get if we totally converted an object's mass into pure energy. To find out how much energy an object has, one must multiply the mass of the object by the square of the speed of light. The authors of this article are of the view that Einstein's simple, elegant equation should be harnessed for IC-driven business. *When IC optimization (mass of the object represented in Figure 16) is coalesced with the interdependence ecosystem of the IC elements (Figure 17) and multiplied by global standards of business ethics, compliance and governance (the square of the speed of light), one can transform IC (mass of the object) into the pure energy of one sustainable world (Figure 18) as picturized by our Hub-and-Spoke Model of a Sustainable One World of Stakeholders Ethical and Empowered for Development (SOW-SEED).* We opine that the stakeholders sketched in Figure 18 can nourish the green shoots irrigated by world bodies particularly the International Integrated Reporting Council (IIRC,) and the IFRS. This could be juxtaposed with our two more frameworks (Figure 15 and Figure 16). Let us explain the rationale behind these mental models of ours. The power of the pragmatic perspective central to our vision of an indigenous paradigm stems from Kant, in that he:



Figure 18: Sustainable One World of Stakeholders Ethical and Empowered for Development (SOW-SEED): The Proposed Model for Sustainable Stakeholder Capitalism (Anthony, Thiagarajan and Utpal, Baul)

[...]established a distinction between the pragmatic and practical. The latter applied to moral laws that he deemed to be a priori. The former applied to rules of art and technique which were based on experience (Dewey, 1998, p. 3).

Our optimization frameworks in this article could be taken as plug-and-play models by stakeholders. Such models we think should be cherry-picked by the trailblazers to comply with canons of financial propriety. Though we do not claim that these would be cast in stone and these interdependent models (the result of our sanguine, scholastic endeavor) will be a panacea for every stakeholder, yet, these would strategically differentiate the leaders from the laggards of enterprises in their 'good to great' intellectual odyssey. McKinsey & Company, Inc. et al. (2000) claim that: "shareholder-orientated economies perform better". As a consequence of both logic and experience, there is a consensus that the best means to this end (that is the pursuit of aggregate social welfare) is to make managers strongly accountable to shareholder interests" (Hansmann and Kraakman, 2001, p. 441). Successful companies attribute their achievements to their commitment to maximizing shareholder-value (see Rappaport, 1998; Ehrbar, 1998; Grant, 2002). Maximizing shareholder value, we are told, also maximizes social wealth. "Trickle-down" and other processes improve the lot of everyone. It's a "virtuous cycle" (Bughin and Copeland, 1997). Yesterday's model of emulation is today's model of aversion (McSweeney, 2008). As Jim Meenan, then Chief Financial Officer of AT&T, stated "when you drive your business units towards EVA, you're really driving correlation with market value" (Walbert, 1994) (see also McKinsey & Company, Inc. et al., 2000). The calculative shareholder value enhancing techniques presume the availability of information which, as King (1975) states: "only God could provide". Forecasting is difficult if it really is about the future (McCloskey, 1991). As Gigerenzer et al. (1989) observe "no amount of mathematical legerdemain can transform uncertainty into certainty" and as Albert Einstein noted: "Not everything that can be counted counts, and not everything that counts can be counted." As Lee states: "empirically we find that news about fundamentals explains only a fraction of volatility in returns . . . stock prices move for reasons that have little to do with fundamentals . . . smart investors need to consider 'fashions' and 'fads' as well as 'fundamentals'" (Lee, 2001) (see also Shiller, 2000; Summers, 1986). In the U.S., the wealthiest 10 per cent owned two-thirds of total wealth (Kennickell, 2003). A corporate purpose focused on providing value to customers not only is competitively superior to a purpose of maximizing shareholder wealth, but also typically produces greater long-term returns to shareholders" (Ellsworth, 2002, p. 27).

18.8. Facilitate Shareholder Activism

The public does not fear or resent the market overly (Rajan and Zingales, 2003, p. 313). Little wonder, David et al. (2007) found that a shareholder activist's share size had an impact on corporate decisions. Proffitt and Spicer (2006) considered a corporation's response to be positive in terms of supporting a resolution when the resolution was withdrawn voluntarily by the activist shareholder group. Sharma and Henriques (2005) note several examples where environmental NGOs have been able to exercise this strategy effectively. It is a common response for managers to resist shareholder. Another point raised by Reid and Toffel (2009) is that a corporation may not want to signal to shareholder activists that it is willing to acquiesce because the corporation may then become a popular target for all types of other shareholder resolutions activists' demands and be defensive to maintain the status quo (David et al. 2007; Reid and Toffel 2009).

According to resource dependency theory (Meznar and Nigh 1995; Pfeffer and Salancik 1978), firms with more resources will be less vulnerable to external pressures though larger firms may be more likely to be targeted by activist shareholders (e.g., Eesley and Lenox 2006; Hendry 2006; Rowley and Berman 2000; Rehbein et al. 2004). Yet, according to resource dependence theory (Pfeffer and Salancik 1978; Meznar and Nigh 1995), larger corporations will be in a better position to resist social pressure or control. Eesley and Lenox (2006) note that activists are more likely to target larger firms to portray themselves as the underdog fighting against entrenched corporate interests. Larger firms will have more resources available for interacting with activist groups and more expertise for navigating negotiations with share holder activists (Eesley and Lenox 2006). The increase in equity held by institutions has made it more difficult for institutional investors to divest their holdings. As a result, many institutional investors have become more interested in pressuring corporations to think about their long-term financial performance (Johnson and Greening 1999). According to Kacperczyk

(2009, p. 266), “resource dependence theorists suggest that a stakeholder-friendly orientation will have long-term corporate success because stakeholders possess the key resources that firms depend on for their survival.” Corporations that collaborate with NGOs to address social issues differentiate their brand from their competitors and have access to newmarkets (Peloza and Falkenberg 2009). In essence, firms that strengthen their relationships with key stakeholders can reduce their risks and create value for the firm (e.g., Mirvis and Googins 2006).

According to resource dependency theory, there are incentives for a firm to form linkages with external actors (Pfeffer and Salancik 1978; Hillman 2005). In the context of shareholder activism, when top managers feel more uncertain about how future events will unfold, they should be more likely to respond proactively to shareholder activists and more willing to negotiate with them to keep activists from escalating the issue into a negative public campaign against the corporation (Burchell and Cook 2006). The organization should reduce the likelihood of a broader stakeholder coalition evolving and exerting more pressure on the corporation to undertake change (Rehbein et al. 2004). Barnea and Rubin (2010) mention that top managers may enhance their reputations and have higher levels of life satisfaction by being responsive to stakeholder concerns. With increasing scrutiny of corporate responses to specific issues and to CSP in general, executives are under more pressure to respond positively to stakeholder concerns. This trend supports the position to accept legitimate demands from the external environment and collaborate to achieve benefits for the firm and for its stakeholders. More profitable firms are also likely to accommodate activist concerns. With respect to dialogue, larger firms with a CEO as the board chair and a relatively lower percentage of institutional investors are more likely to pursue this option.

David et al. (2007) examined the relationship between corporate responses to shareholder activists and the impact on overall Corporate Social Performance (CSP). However, they found empirical evidence that, when corporations respond positively to shareholder activists, it is only a symbolic gesture rather than a substantive change in corporate social policies. Though, the strategies that corporations pursue with regard to relations with activist shareholders cast light on their more general philosophies of response when confronted with social pressures from the external environment and merit further study (Rehbein et al., 2013), organizations would do themselves and the stakeholders a world of good if they are guided by the twin-focus of this research – building investors over and winning public trust. This focus assumes primacy because based on research carried out by Edvinsson and Malone (1997), Roos et al. (1997), Sveiby (1997) and Stewart (1997), it is assumed that:

- $\text{MARKET VALUE} = \text{BOOK VALUE} + \text{INTELLECTUAL CAPITAL}$

However, Accountants are unable to measure the intellectual capital of a company (Stewart, 1997) considered to be the arithmetic mean of all the capital components in play (Edvinsson and Malone, 1997, p. 187). But, this hidden treasure is today what really matters in a society in constant turmoil (Joia, 2000). Hence, the need for the Government of India and SEBI as market regulator / watchdog to encourage shareholder activism, perhaps with a proviso in the Companies Act, 2013.

18.9. Educate Investors

The stock market has not helped an investor who has said he likes to wait for the “fat pitch”, an opportunity to buy a company at a price promising favorable returns (Bloomberg quoted in THE FINANCIAL EXPRESS, August 5, 2014, p. 22). The upshot is orbit-shifting innovative thinking in business. The strategic approaches of Mark Mobius, investment guru and the father of Emerging markets (EMs) funds are (a) finding companies with good earnings prospects for the next five years and selling at low prices. Long-term value investment (b) diversity - many eggs and many baskets and (c) For, global investing, choose companies, not countries. Bottom-up approach. The key to his success in emerging markets is based on his practice of making on-site visits to companies (source: <http://www.amazon.com/Manga-Mark-Mobius-Illustrated-biography/dp/4775930400> accessed on August 02, 2014). Dubbed ‘the Pied Piper of emerging markets’ and ‘the Indiana Jones of the investment world’, Mobius says “The kind of questions we ask are, how do you count your earnings, and what is your plan for the future?” When derivatives are now valued at \$600 trillion, which is 10 times more than global GDP, Mobius says: The biggest problem in our business is that as we are looking at data, we are always tending to look through the rear-view mirror. And if you’re driving a car, that’s not a very good idea. You don’t know what’s coming, so you have to make reasoned guesses as to what you think might happen in five years’ time. The challenge that we have is that our clients are looking at one year, or maybe six months. So the biggest challenge we have is not only finding good investments, but convincing people to be patient. Secondly, one cannot buy a stock unless it’s been reviewed in the last six months. So we often won’t be caught off guard by some new events that can impact the company.” (source: <http://www.arabianbusiness.com/interview-investment-guru-mark-mobius-542555.html>, accessed on August 02, 2014). The futuristic game changer is IC.

18.10. University education to be IC-based

With a tsunami of new digital technologies all converging simultaneously-social, mobile, cloud, analytics and embedded devices..... to enable the digital transformation of businesses, ideal (information technology) person-a kind of “*Homo Digitus*”-needs to combine excellent digital specialist skills with deep functional business knowledge (Bonnet, 2013). Research has identified generations as a cause of long waves of economic development (Alexander, 2002; Papenhausen, 2008). Much has been written about the emergence of a four-generation workplace (i.e. Matures, Baby Boomers, Generation X and Millennials) the challenges that it presents to managers (Crumpacker and Crumpacker, 2007; Kupperschmidt, 2000; Twenge and Campbell, 2008). Contemporary generational archetypes are given in Figure 15. This generation archetypes will change Human Capital like never before. For that matter IC will never be the same again and it would not be business as usual for organizational managers and leaders especially in knowledge industry. More so in organizations where these four generations co-exist, the authors of this article with their industry

experience opine. The triple helix paradigm of university-industry-government networks (Datta and Saad, 2008) study illustrates how university-industry-government networks and the social capital of the firms involved have played a central role in India's success in the export of knowledge-intensive services. Institutions of higher education should take international surveys seriously as active participation in the rating process would help their development in the right direction. Indian institutions do not figure in the top 200 places in prominent international surveys, according to Pranab Mukherjee, the President of India (The Hindu, July 20, 2014, p. 4).

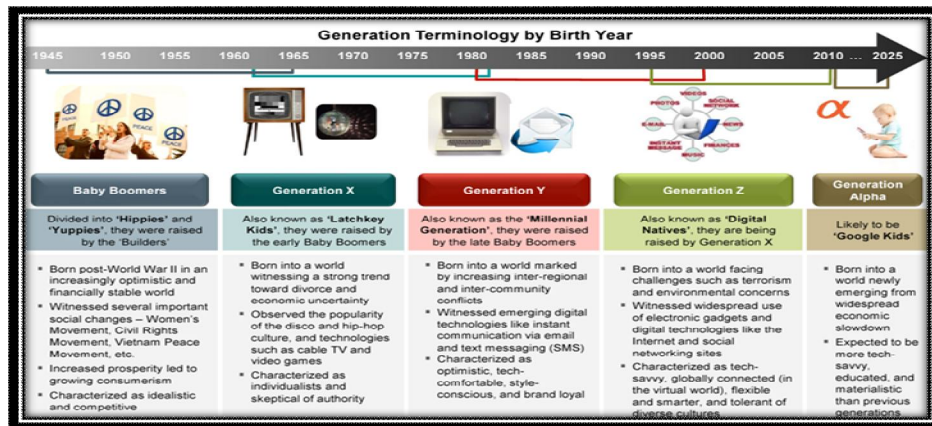


Figure 15: Generational Archetypes (Grail Research, 2011)

18.11. Enterprises strategy behaviors to be mapped per life stages of organizations

To gain strategic insights, the generational archetypes ought to be juxtaposed with organizational life cycles and the strategic behaviors (Table 4) as it is behaviors of the human capital that unlocks profits. To capture the evolution of organization, the notion of lifecycle has been a useful metaphor to describe the maturational and generational processes driven by mechanisms of reproduction in natural populations (O'Rand and Kreckler, 1990). Organizations in different stage of life cycle would implement different internal structures and processes in the hope to respond to change in the environment. This process of organizational evolution corresponds to the scientific metaphors "punctuated equilibrium" or "phyletic gradualism" in evolutionary biology that organizations adapt to new environmental challenges over the course of organizational life and gradually becomes what they are today. Owing to the fact that their criteria of effectiveness change over different life cycles, behaviours of younger organizations are thus perceivably different from mature ones (Cameron and Whetten, 1981; Quinn and Cameron, 1983). Managerial priority varies in different life stages (Smith and Miner, 1983; Smith et al., 1985).

Organizational life stages	Strategic behaviors
Stage one: Birth	In this period, a new firm is attempting to become a viable enterprise (Miller and Friesen, 1984). The focus is on viability, or simply identifying a sufficient number of customers to support the existence (Churchill and Lewis, 1983) of the organization. Organizations in this stage tend struggle to enact or create (Bedeian, 1990) their own environment.
Stage two: Growth	As firms move into the Growth stage they seek to grow, develop some formalization of structure (Quinn and Cameron, 1983), and establish their own distinctive competences (Miller and Friesen, 1984). The centre is upon achieving rapid sales growth based on formalized structure and amassing resources in an attempt to realize advantages accruing to larger scale.
Stage three: Maturity	Maturity represents an organizational form where formalization and control through bureaucracy are the norm (Quinn and Cameron, 1983). The companies in maturity stage have passed the second stage, growing to a point that they may seek to protect what they have gained instead of targeting new territory.
Stage four: Revival	The revival organization displays a desire to return to a leaner time (Miller and Friesen, 1984), where collaboration and teamwork foster innovation and creativity.
Stage five: Decline	Even though firms may exit the life stage at any stage, a decline stage can trigger the demise. A final stage that companies' profitability drops because of the external challenges and because of the lack of innovation.

Table 4: Strategic behaviors and organization life-cycles (Chang and Hsieh, 2011, p. 2347)

Companies place different weights and distribute intangible resources to certain IC components across different life cycle stages (Miller and Friesen, 1983, 1984). The history of organizational changes depicts the progress of organizational life. Firms invest in different proportions of IC across life cycle phases as reported in the life cycle literature. That is, firms in the birth stage have a greater structural capital and lower human capital, efficiency of the financial employed and technological capital, a higher debt ratio and growth profit margin with lower current ratio as opposed to firms in the growth stages: (a) human capital and technological capital provides the positive value-driven information while birth, growth, and impasse stages are significant (b) efficiency of financial capital employed provides companies with the highest value-drive information in the maturity stage and the lowest value-driven information in the birth stage; and (c) technological capital efficiency provides the positive influence when companies move into the growth and maturity stages to maintain/develop their competitive advantages while human capital is more important in birth and growth stages (Chang and Hsieh, 2011, pp. 2350-2351).

18.12. Zero tolerance to Insider Trading and front-running

India ranks #10 in the world in terms of market capitalization, according to a Bloomberg Report published in May 2014. Paradoxically enough, the Satyam scam in India probes Insider Trading where sources reveal that high-ranking executives including top management officials had sold Satyam shares before Satyam made its headlines (IBN Live, 2009). More than 2 crore shares were traded by investors indicating that they had an absolute idea that Satyam will be facing financial crisis in the coming weeks. Besides the top management officials, 16 vice presidents were reported to have sold their shares. This questions the ethical corporate governance practices in India (Suyampirakasm, 2010). Yet there was no immediate probe or action taken by SEBI, regarding the World Bank declaring Satyam ineligible to receive any direct contracts for eight years. The reasons stated by the World Bank, for their decision were: □ improper benefits to staff, improper documentation and malicious attacks on Bank's information system. The reasons were quite indicative of the allegations of poor corporate governance (Ribeiro, 2008). Closing its five-and-a-half-year probe into India's biggest corporate fraud, the market regulator, the Securities Exchange Board of India barred Ramalinga Raju, the founder and former Chairman of Satyam Computers and four others from the markets for 14 years and asked them to return Rs.1,849 crore worth of unlawful gains with interest levied at 12% per annum (THE FINANCIAL EXPRESS, July 16, 2014, P. 1) At the global level, the two-year prison sentence slapped by the U.S. Court of Appeals on the 65-year old, Harvard-educated, former Managing Director of McKinsey, Rajat Gupta from June 7, 2014 for insider trading (The Hindu, May 31, 2014, p.16) is a case in point. Gupta passed confidential information that he had at Goldman board meetings including news about results and a crucial investment from Warren Buffet's Berkshire Hathaway to Raj Rajaratnam, founder of the Galleon Group hedge fund firm. Rajaratnam is serving a 11-year prison term for insider trading. (THE FINANCIAL EXPRESS, July 16, 2014, P. 12).

The need for insider trading was felt way back in the 1970s in India. In 1979, the Sachar Committee said in its report that company employees like directors, auditors, company secretaries, etc. may have some price-sensitive information that could be used to manipulate stock prices which may cause financial misfortunes to the investing public. The company recommended amendments to the Companies Act, 1956 to restrict or prohibit the dealings of employees/insiders. Penalties were also suggested to prevent the insider trading [3]. In 1986, another high-powered committee known as the Patel Committee in its final report also took a serious view of the absence of specific legislation in India curbing misuse of insider information and recommended stiff penalties for the offence of insider trading [4]. The Abid Hussain Committee (Government of India, Planning Commission, 1989) [5] also suggested that there should be appropriate regulatory measures with civil and criminal liabilities to combat the menace of insider trading [4]. It was in the wake of these recommendations that the need of a regulation was felt and the Securities and Exchange Board of India (SEBI) passed SEBI (Prohibition of Insider Trading) Regulations, 1992 to prevent prohibit and penalize insider trading in India. The SEBI (Insider Trading) Regulations, 1992, define an insider to mean as amended by Section 3(i)(a) of The Prohibition of Insider Trading (Amendment) Regulations, 2008 that "any person who is or was connected with the company or is deemed to have been connected with the company and who is reasonably expected to have access by virtue of such connection, to unpublished price sensitive information in respect of securities of a company, or who has received or has had access to such unpublished price sensitive information" (Misra, 2011). According to 'CG Watch', a joint report by CLSA Asia-Pacific Markets and Asian Corporate Governance Association (2007) and a World Bank study (2004), corporate governance standards in India have shown continuous improvement. Insider trading is prohibited under SEBI (Prohibition of Insider Trading) Regulation, 1992. The finance ministry of the Government of India has included insider trading and market manipulation (all offences covered under Section 12A, read with Section 24 of the SEBI Act) within the ambit of the Prevention of Money Laundering Act (PMLA). Punishment under PMLA is strict and it is hoped that it will act as an effective deterrent to end this market practice. Along with insider trading the fixing of a fair transfer price between companies and their subsidiaries also remains a problem (Sehgal and Mulraj, 2008).

Beasley (1996) found financial fraud less likely in firms with higher percentages of outside directors, higher levels of stock ownership by outside directors, longer outside director tenure and smaller boards of directors. He found that the existence and composition of audit committees did not matter when the other board factors were considered. Dechow et al. (1996) found that companies with fraudulent financial statements tended to have weaker corporate governance structures, such as boards of directors with a higher percentage of management and no audit committees. For many people, scandals taking place in companies such as Enron and WorldCom in the USA (and Satyam in India) are synonymous with "fraudulent financial reporting". These and other major financial frauds of the late 1990s and early 2000s are most notable and were prominent in bringing about passage of the Sarbanes-Oxley Act of 2002. Confidence in financial reporting needed to be restored for investors and other stakeholders of corporations. Perhaps this need was even greater for the psyche of the public, whose investments in financial markets are wide and varied, and often indirect and arcane. Academic research shows that significant regulation comes after the damage has occurred (Kalbers, 2009). Front-running refers to an unethical practice of someone trading in shares on the basis of advance of information given by a broker, analyst or other executive as a market intermediary before the trades are conducted by that entity. This practice increases the cost of acquisition of shares or reduces the realization from the sale of shares for the concerned fund house or other market intermediary, thus, adversely affecting the interest of common investors (THE FINANCIAL EXPRESS, July 26, 2014, p. 9)

18.13. Government Activism

Free markets, perhaps the most beneficial economic institution known to human kind, rest on fragile political foundations. In a competitive free market economy, the decisions of myriad anonymous participants determine prices, which, in turn, determine what is produced and who is rewarded. The invisible hand of the market substitutes for bureaucrats and politicians in all these decisions. This

has engendered the misperception that markets do not need governments. Markets cannot flourish without the very visible hand of the government, which is needed to set up and maintain the infrastructure that enables participants to trade freely and with confidence (Rajan and Zingales, 2003, p. 293). Economic institutions neither arise nor flourish unless there is political will to back them (Rajan and Zingales, 2003, p. 313). Capitalism's biggest political enemies are not the firebrand trade unionists spewing vitriol against the system but the executives in pin-stripped suits extolling the virtues of competitive markets with every breath while attempting to extinguish them with every action. Free enterprise capitalism is better thought of as a delicate plant, which needs nurturing against constant attack by the weeds of vested interests. A competitive market is a form of public good (a good, like air, that is useful but hard to charge for, and somewhat paradoxically, collection action is needed for its maintenance (Rajan and Zingales, 2003, pp. 276-277).

Markets need political support as it is a fragile institution charting a narrow path between the Scylla of overweening government interference and the Charybdis of too little government support. The greatest danger for the market democracy today is not that it will lapse into socialism, but that it would revert to the relationship system, suppressing competition under the excuse of reducing risk. But we cannot avoid this by preaching a hands-off attitude of the state. Not only will we risk leaving the necessary infrastructure underdeveloped so that the market works poorly and access is limited to the privileged few, but we will also leave the market exposed to the political backlash from the inevitable market downturn. Here, we need a balance of forces that no single mantra will work (Rajan and Zingales, 2003, p. 313). Politicians disregard the public interest because the public is often unaware of what that interest is (Rajan and Zingales, 2003, p. 314). After two decades of massive privatization, sweeping deregulation and widespread liberalization, it may seem absurd for us to claim that free markets could be in danger. In fact, events such as the collapse of Enron are interpreted as evidence that markets have become too free. After all, in the "good old days" of regulated public utilities, such problems did not arise (Rajan and Zingales, 2003, p. 311). For the political foundations of free markets to become stronger, society has to become more cognizant of how much it owes them. Because, free financial markets are the elixir that fuels the process of creative destruction, continuously rejuvenating the capitalist system (Rajan and Zingales, 2003, p. 25). A classic example is the revolution that has taken place in the U.S. financial markets in the last thirty years already enhancing economic freedom greatly, placing the human being rather than capital at the centre of economic activity (Rajan and Zingales, 2003, p. 28). "Men may differ as to the particular form of governmental activity with respect to industry and business, but nearly all are agreed that private enterprise in times such as these cannot be left without assistance and without reasonable safeguards lest it destroy not only itself but also our processes of civilization" (Roosevelt, 1934). This historic comment goes well with the advice of U.K. Sinha, Chairman, Securities and Exchange Board of India while addressing the 178th Annual General Meeting of the Madras Chamber of Commerce and Industry who said: "it is better to spend time on compliance than in defending violations later". Raise capital on long term basis and investors' interest has to be taken into account, advised Sinha the India Inc. (The Hindu, July 25, 2014, p. 16).

One of the factors that cause stress to the private equity (PE) industry across the spectrum is poor corporate governance and increasing susceptibility to frauds. Since PE companies are typically minority shareholders, promoters are inclined to deal with such investors as collaborators but merely as 'money pool'. Which is why PE funds, in various occasions, have failed to keep a tab on the performance of portfolio companies and consequently exposed to financial frauds. The companies Act, 2013 would offer huge respite to the investors. For example, Section 447 of the Act extends the ambit of culpability by inserting the word 'person' that has a bearing on any person who is related to affairs of the company and is guilty of committing fraud; Section 147 makes auditing firms and their partners liable, jointly and severally, for abetting, colluding or double-dealing in any manner whatsoever; Section 245 will further fortify shareholder interest, following which PE investors will be able to sue promoters and auditors for any financial subterfuge (Shankar, 2014)

According to a World Bank Group report, India in 2014 ranks the 134th position in "ease of doing business" in a list of 189 countries, three steps below the 2014 rank. Singapore tops the list. (Reddy, 2014; <http://www.doingbusiness.org/rankings> accessed on September 11, 2014). A CNBC TV 18 report dated September 11, 2014 says that India wants to get into top 50 vis-à-vis the above list in the next 2 years. Other indices of the report are tabulated in Table 5.

Topics	Doing Business 2014 Rank	Doing Business 2013 Rank	Change in Rank
Starting a business	179	177	-2
Dealing with construction permits	182	183	1
Getting electricity	111	110	-1

Registering Property	92	91	-1
Getting credit	28	24	-4
Protecting investors	34	32	2
Paying taxes	158	159	1
Trading across borders	132	129	-3
Enforcing contracts	186	186	No Change
Resolving insolvency	121	119	-2
Source: IFC-World Bank			

Table 5: Ease of doing business: The India scorecard (Reddy, 2014, p. 11)

The report, we say, has to be read with the averment of Beauchamp and Bowie (1988) who say that Immanuel Kant's "categorical imperative", a moral principle, by which to guide one's actions in life should be burned into the psyches of people everywhere:

"I ought never to act except in such a way that I can also will that my maxim should become a universal law."

The brevity is compelling, the call to action clear (this is after all an "imperative"), and no exceptions allowed. If this then is the ethical grounding from which intermediaries should operate (Hutchin, 2005), let us be seized of the indubitable and incontrovertible fact that:

... unethical behaviour of market participants [may be] the most suitable source of inefficiencies ... Managers, auditors and analysts must undertake efforts aimed at improving their credibility in the eyes of investors. Codes of good governance and codes of ethics in audit and financial firms are not sufficient. Market regulatory frameworks and accounting standards must be improved to ensure the efficient functioning of capital markets and any that guarantee conduct causing damage to the financial system is identified and punished (Garcia-Ayuso, 2003, p. 65).

In this context, let us face reality squarely. Growth is painful. Change is painful. But nothing is as painful as staying stuck where you do not belong (N.R.Narayanamurthy, Executive Chairman and Co-founder, Infosys in THE FINANCIAL EXPRESS, May 29, 2014, p.1). Hence, the inevitable need to "think big and act boldly" and "earn the goodwill of our clients, employees and investors" (N.R.Narayana Murthy, Executive Chairman and Co-founder, Infosys in The Hindu, May 31, 2014, p.18 and THE FINANCIAL EXPRESS, May 31, 2014, p.8). To make this a reality, the real litmus test is to reboot the economy and hit the ground running through market-friendly, pro-growth economics (Arvind Panagariya, Professor and Columbia University and former Chief Economist of the Asian Development Bank, in THE FINANCIAL EXPRESS, May 26, 2014, p.1).

18.14. View Economic growth and stock market capitalization as two sides of a coin: In India, corporates are already taxed at the highest effective rate in the world. The effective tax rate paid by corporates in India in 2014-15 is the ratio of tax paid (Rs.4,50,500 crore) to income (Rs.15,26,000 crore) or 29.5%, i.e. by far the highest in the world! This is a full 11 percentage points higher than most of India's East Asian competitors (18%) and 15 to 20 percentage points higher than Germany (16%) and Sweden (a super-low 10%) (Surjit S Bhalla in the THE FINANCIAL EXPRESS, June 7, 2014, p. 6). This is further bolstered by AT Kearney's FDI Confidence Index for 2014 where India from being the second-most favoured FDI destination beginning 2005 till 2012 (barring 2010), its ranking slipped to 7 this year among 25 countries analysed by the global consulting firm. US and China are No. 1 and 2 in the list (Data Drive, THE FINANCIAL EXPRESS, June 7, 2014, p.7). Needless to say, the capital markets are buffeted by myriad contemporary developments. For example, a year ago, in India, the rupee seemed to be hurtling towards 70 to the dollar. To be precise, it hit the lowest every point of 68.825 against the greenback on August 28, 2013. Foreign investors pulled out money from the bond markets as the US Federal contemplated the tapering of its bond-buying programme and the widening fiscal and current account deficits added to the currency's weakness. Let us compare this with a miraculous revival. With the BJP winning a clear majority in the Indian Parliament, foreign investors have been buying into India's stock and bond markets keeping the currency stable. India attracted \$34 billion through FCNR deposits and Tier I capital with the Reserve Bank of India (RBI) offering banks a concessional swap rate. RBI also moved to remove the dollar purchases of oil marketing companies from the market and announced that these bills could be settled in rupees if necessary (THE FINANCIAL EXPRESS, August 28, 2014, p. 1). Yet, on the other side foreign investors are pulling out their funds from India because of transfer pricing issues (Arun Jaitley, Finance Minister of India on CNBC TV, 18-July-2014).

18.15. Catalytic, yet cataclysmic Global Bodies

These are the International Integrated Reporting Council, World Federation of Exchanges, the International Organization of Securities Commissions (IOSCO) that regulates more than 90 percent of the world's securities markets, Global Reporting Initiative, Green Peace (A common forum to aid policy making by national governments), World Bank, World Trade Organisation, OECD, WTO, World Economic Forum, Congregations like G-20, the Financial Accounting Standards Board (FASB) has issued those standards as U.S. GAAP and the International Accounting Standards Board (IASB) has issued them as IFRS. The Securities Exchange Commission

(SEC) in the US has directed the FASB to consider international convergence as it develops new accounting standards. The FASB and IASB remain committed to improving US GAAP and IFRS and achieving their convergence. (<http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156245663>, accessed on September 11, 2014)

19. Epilogue

In this context, we are aware that the “struggle” or “space of competition” in research is apparent in the field of organization studies, which has a long and distinguished history, with research and practice based upon a well-established philosophy of science (Burrell and Morgan, 1979; Kuhn, 1962/1996; Nola and Sankey, 2000). Hence, we view this space as a useful starting point to articulate a conceptualization of alternative “views” and “realities” (Deetz, 1996; Morgan, 1980) that our mental models consistently mirror. The best guarantee for trust in the objectivity of science has usually been thought to be the separation of the pursuit of truth from the pursuit of mammon. Like other teachers and scholars, scientists should not be motivated by personal gain or ideological interests (Wise, 2006). As Jacques Loeb of the Rockefeller Foundation put it early in the twentieth century, “if the institutions of pure science go into the handling of patents I am afraid pure science will be doomed,” (Weiner, 1986, p. 35; Bok, 2003, p. 139). Hence, a shift necessitates a reconceptualization of subject matter in terms of meaning, interpretation, ambiguity, conflict, context-dependence and reflexivity (Tsoukas and Vladimirou, 2001). It is in this context that we offer an approach grounded in the emerging conversation that supports a diversity of viewpoints and provides an avenue for “respectful interaction” (Pratt, 2002, p. xiii), which evokes the pragmatic response. We aver that practitioners, consultants and researchers (P-C-R) perspective (Sankaran, 2006) have to have ‘execution and laser-focus’ on IC that makes a strategic differentiation between market value and book value of modern resulting in gravity-defying market capitalization leaving GDP of countries by the way side. When much of the prosperity, innovation and increased opportunity we have experienced in recent decades should be attributed to the reemergence of free markets, especially free financial markets (Rajan and Zingales, 2004), sadly enough, nevertheless, the calculative shareholder value enhancing techniques signally presume the availability of information which, as King (1975) states: “only God could provide”. While knowledge has boundary and wisdom has no limit, is this not an opportunity and challenge for the third millennium *homo sapiens* who live the aphorism of American-born English editor, playwright, poet and critic (1888-1965):

- Where is life we have lost in living?
- Where is the wisdom we have lost in knowledge?
- Where is the knowledge we have lost in information?

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