

## Chapter 7.13

# The Conundrum of Valuing a Company's Intellectual Capital: The Role of Taken-for-Granted Indicators

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### ABSTRACT

Since the early 1990s, research has been conducted in an attempt to establish a viable and reliable manner of measuring the intangible assets, also referred to as the intellectual capital, of companies. Several models have been devised, most of them using indicators to evaluate the intangible assets of a given undertaking. In this chapter, exploratory field study methodology is used to analyse the behaviour of the “customer retention” indicator, which has been widely used to evaluate a company's relationship capital. Two of the largest Brazilian e-retailing groups are analysed in order to obtain an in-depth insight into the behaviour of their frequent customers via their digital channel. Conclusions are presented, indicating that the role of frequent customers in e-retailing companies can sometimes be widely divergent from that presented in existing academic literature. Finally, recommendations are

made in order to reach a clearer understanding of the conundrum of valuing a company's intellectual capital via taken-for-granted indicators.

### INTRODUCTION

The consolidation of intellectual capital as an actual knowledge field is still in progress. It should be remembered that years ago, some mavericks foresaw the importance of intangible assets for a company, laying down the initial foundations for this very recent discipline.

In 1945, Frederick Hayek presented research about the use of knowledge in society (Hayek, 1945). In a seminal work, Fritz Machlup from Princeton University produced an eight-volume work in 1962, under the general title: “Knowledge: Its creation, distribution, and economic significance” (Machlup cited in Stewart, 1997, p. 11). In this work, using data gathered in 1958, it was established that 34.5% of the gross national product of the United States

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could be ascribed to the information sector. In 1993, Peter Drucker analysed the new knowledge economy and its consequences (Drucker, 1993). Consequently, academics, researchers, and practitioners have increasingly highlighted the importance of the intangible assets of a corporation and even those of both countries and other organisations, including nonprofit entities.

A watershed was reached in July 1994, when a meeting took place in Mill Valley with a view to establishing how the knowledge of an organisation could be measured. Knowledge may be intangible, but that does not mean that it cannot be measured. Markets do precisely that when they value the stock of highly knowledge-intensive companies way above their book value.

In 1995, Skandia, the largest insurance and financial services company in Scandinavia, released its Intellectual Capital Annual Report, based on its Navigator framework (Edvinsson & Malone, 1997). Some other companies, like Dow Chemical, the Canadian Imperial Bank of Commerce, Posco, and so forth, to name but a few, also entered this new era.

Several research articles have been published, and timely *praxis* has been developed to measure the intellectual capital of an enterprise, such as Sveiby (1997); Roos *et al.* (Roos, Roos Dragonetti, & Edvinsson, 1997); Bontis *et al.* (Bontis, Keow, & Richardson, 2000); Guthrie and Petty (2000); Low (2000); Sánchez *et al.* (Sánchez, Chaminade, & Olea, 2000); Guthrie (2001); St Leon (2002); Rodov & Leliaert (2002); Hunt (2003), among others.

In order to understand the peculiarities associated with the measurement of intangible assets better, this chapter sets out to prove that some indicators used to measure the intellectual capital of a company cannot be taken for granted as effective measures for doing so, nor can they be adopted in these valuation models as a rule of thumb. This chapter posits that more rigour is required to verify whether or not these indicators are truly valid, that is, if they really contribute to

explaining the final results of a company, namely its financial performance. The “customer retention” indicator, widely used in several methodologies to measure intellectual capital, is specifically analysed in this chapter in order to verify whether it can always be considered a valid measure for assessing intangible corporate assets.

The chapter is organised as follows: firstly, a bibliographical reference section is reviewed in order to elucidate the rationale used for this study; secondly, the research design, based on an exploratory field study, is described, as well as the hypothesis to be tested; thirdly, the data-set collected is presented and analysed, which leads to several findings. Lastly, conclusions are drawn and recommendations made in order to reach a clearer understanding of the conundrum of valuing a company's intellectual capital via indicators.

## BIBLIOGRAPHICAL REFERENCES

### Intellectual Capital Taxonomy

Based on research carried out by Edvinsson and Malone (1997), Roos *et al.* (1997), Sveiby (1997), Stewart (1997) and Joia (2000), it is proposed that corporate capital taxonomy be used in this chapter.

The taxonomy adopted is based on the following equation:  $\text{MARKET VALUE} = \text{BOOK VALUE} + \text{INTELLECTUAL CAPITAL}$

This equation shows that stock value has a tangible portion (book value) in addition to an intangible component. Hence, assuming that the intellectual capital is greater than zero ( $\text{IC} > 0$ ), the market value/book value is greater than 1 ( $\text{M/B} > 1$ ); the more knowledge-intensive the company, the greater the M/B value.

The book value (also called financial capital) is then calculated using the following formula:  $\text{BOOK VALUE} = \text{MONETARY CAPITAL} + \text{PHYSICAL CAPITAL}$  and intellectual capital, formerly called goodwill by accountants, is calculated using the

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