Chapter 39
Relationship between Company's Intellectual Capital and Performance:
A Study of Indian IT Industry

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ABSTRACT

This chapter examines the relationship between Financial Reporting of Intellectual Capital and Company's Performances in Indian Information Technology Industry. The sample consisted of 60 companies listed on NSE for a time period of 1999-00 to 2008-09. Value-Added Intellectual Coefficient (VAICTM) method developed by Pulic (1998) was used for the analysis of the data. The chapter uses VAIC^TM model and regression equation for the evaluation of intellectual capital and their relationship with productivity, profitability, and market valuation of the companies. The result of the chapter supports the hypothesis that profitability of the company can be explained by the intellectual capital. However, there is no significant association of intellectual capital with productivity and market capitalization of the companies for the selected time period of year 1999-00 to 2008-09.

INTRODUCTION

Financial reporting of intellectual capital is one of the most debatable issues among the accounting professionals because of its intangible nature. Many researchers have tried to define it and developed different models to identify the accurate value of it. The information provided in the financial statements of the company was not able to capture the intellectual assets of the company. Different measures were used to calculate the amount of intellectual assets present in the company's annual reports particularly the balance sheet. Various scholars and researchers have divided intellectual capital into three groups. These were human capital, structural capital and

relationship capital or customer capital. Relationship between intellectual capital of the company and its market value of the companies has always gathered the attention of the academician and corporate.

Seleim, Ashour & Bontis (2004) investigated Egyptian software firms to know the components of the intellectual capital i.e. human, structural and relational capital present in them. These components were essential for the proper development of the theory and the model. The study found that intellectual capital which was widely present in software firms can be measured and utilized. Oliver & Porta (2006) developed a cluster model to analyze the components of the intellectual capital namely Intellectual Capital Cluster Index (ICCI®). It was developed to measure the intellectual capital in clusters. Many conceptual, exploratory and empirical studies have been carried out (Roos, 2005; Pike & Roos, 2004; Guthrie, 2001) to enhance the awareness of the concept. Intangible and tangible assets cannot be treated separately as both are necessary for the proper functioning of the organization. In fact intellectual capital is gaining importance over the physical assets of the company. This study is a modest attempt to analyze the relationship of intellectual capital with profitability, productivity and market valuation of the companies.

The chapter is divided into five sections. Section 1 gives overview of Indian IT Industry, Section 2 reviews literature of the exiting studies.

Section 3 presents the methodology followed in this paper. Section 4 discusses the results and Section 5 concludes the paper.

1. AN OVERVIEW OF INDIAN IT INDUSTRY

Information Technology (IT) industry is one of the growing sectors in India making its presence well felt all over the world. The IT industry sector is one of the many knowledge based industries. The growth of the IT industry may be due to the presence of intellectual capital in it. Table 1 shows industry size of IT and IT enables services (ITES) from the year 2007 to 2012 with compound annual growth rate (CAGR).

IT industry is major contributor to Indian economy in terms of foreign exchange services and employment opportunities. Indian IT companies are expanding their business at the global level by various mergers and acquisitions done by these companies. In terms of Gross Domestic Product (GDP), IT sector has increased its share from 1.2% in Financial Year (hereafter FY) FY98 to 5.2% in FY07. Export earning was also approximately USD 40.0 billion with a growth rate of 36% in year FY08. This sector is also providing employment to a large part of the population. In the year 2006, out of total merger and acquisition, 23% were in IT industry. This industry is also one of the largest distributors of dividends to shareholders.

Table 1. India IT/ITES Industry Size (2007-2012) (value in Crores)

	2007	2008	2009	2010	2011	2012	CAGR 07-12
Domestic IT/ITES Market	90,014	110,177	133,100	158,053	182,991	209,698	18.4%
IT/ITES Export Revenue	156,594	186,142	218,104	250,087	284,666	320,278	15.4%
India IT/ITES Industry Size	246,609	296,319	315,207	408,139	467,657	529,976	16.5%

Source: NASSCOM

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