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A longitudinal examination of intellectual capital reporting in Marks & Spencer annual reports, 1978–2008

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ABSTRACT

This paper examines the intellectual capital content of Marks & Spencer annual reports over a 31 year period from 1978 to 2008 using a content analysis instrument. Motivated by the gap among prior studies in respect of longitudinal samples, the paper also sets out to note the ways in which the annual report has changed over the three decades in response to the supposed change from the assumption that fixed assets and operations were the key driver of value creation to a belief that knowledge and the stock of intellectual assets had become a more powerful explanation of value-added. The paper finds an overall increase in intellectual capital reporting over the 31 years but notes a particular increase in relational capital reporting and a re-ordering of sub-categories over time. Narrative (as opposed to quantitative) reporting has increased and 'factual' (as opposed to opinion and judgement) reporting has decreased. The paper concludes that annual report narratives have reflected a wider change in the market for information among investors and other stakeholders. Whilst the exact nature of these market changes was beyond the scope of this paper, it is concluded that changing patterns of ICR reflect the increased complexity of the messages being conveyed in voluntary reporting. The increased reliance on IC in value creation has, we argue, created a need for narrative of less factual certainty and with more ambiguity and circumspection in describing increasingly complex knowledge assets.

1. Introduction

A key challenge in voluntary corporate reporting concerns the relevance and usefulness of the information being conveyed. Canibano, Garcia-Ayuso, and Sanchez (2000) and Yongvanich and Guthrie (2005) both convincingly argued that the relevance of traditional reporting has been challenged by the changing nature of the business environment and the different sources of business value creation. It is posited that in the competition of the 'new economy', there is a greater reliance on knowledge-based assets such as human knowhow, innovation, technologies and information. Physical and financial assets such as cash, machinery, land and labour have, accordingly, become less powerful explanations of business success.

This observation is, of course, not new. Seetharaman, Sooria, and Saravanan (2002) reported that the ratio of tangible to intangible assets in 1929 was 70/30 but this had shifted to 37/63 by 1990. Further, Seetharaman et al. (2002) pointed to

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a shift away from a dominant 'p-economy' (production oriented) to a 'k-economy' (knowledge-based) with the implication that knowledge assets have become structurally more important in value creation. The issue explored in this paper is how these knowledge assets have been reported and how this reporting has changed over time. Specifically, the paper seeks to examine how the annual report reflects this change and how annual reporting has changed over time in response to these changes.

Peppard and Rylander (2001) argued that accounting for intellectual capital is capable of providing a holistic view of value-adding in that it creates a framework that allows for describing all the resources at the firm's disposal and how they interact to create value. Indeed, Holland and Johanson (2003, p. 468) argued that 'companies… recognise that such intangibles are often at the heart of competitive advantage.'

Companies have chosen to disclose this information through a number of media, including in marketing literature, in labour market communications, through separate supplements to annual reports (such as the Danish intellectual capital statements from the mid 1990s onwards) or through dedicated intellectual capital disclosures within the annual reports themselves.

The main purposes of this paper are to examine the content of IC in the totality of annual report narratives (and not just in dedicated IC disclosures) and to show this over a lengthy time period where external changes may have driven changes in reporting patterns. For the majority of companies (that do not produce stand alone or dedicated IC reports), the only systematic source of IC information is the annual report and so the IC content of the annual report could conceivably be investment-material information to shareholders (Holland and Johanson (2003, p. 467) found that, 'capital market actors are intrigued by, and act on, information about intangibles.'). The nature of IC content in annual reports and an understanding of how this content changes over time will enable a deeper appreciation of its importance to reporting companies and its potential role in information conveyance.

These research objectives also fit with a larger stream of literature examining the materiality and usefulness of the corporate annual report more generally (Botosan, 1997; Campbell & Slack, 2008; Gray, Meek, & Roberts, 1995). As a document produced regularly, editorially controlled by the company and intended for a shareholder readership, the annual report has a crucial role in the conveyance of material information to a range of stakeholders including shareholders. Research suggesting that annual reports may not meet user's information needs (e.g. Campbell & Slack, 2008) have intensified the importance of this strand of research.

It is generally believed that changing reporting demands in the market for information drive changes in voluntary disclosure (Botosan, 1997). Although the measurement of user information demands is problematic, research in some areas of voluntary disclosure have found reporting responses to changing stakeholder demands. It is generally accepted, for example, that social and environmental disclosure in annual reports is a partial response for the need for reporting companies to legitimate themselves in the perceptions of key stakeholders (Campbell, 2004; Deegan & Gordon, 1996; Deegan & Rankin, 1996; Wilmshurst & Frost, 2000). The nature of the demand for IC content is less explored (although see Striukova, Unerman, & Guthrie, 2008) but the changing nature of value-adding, from the utilisation of fixed assets to an intellectual assets-based economy, is presumed to be a prominent driver of changing IC reporting practice. This has not hitherto been systematically tested and the longitudinal nature of the sample used in this study makes such an analysis at least partially tractable.

In contrast to prior studies that have mainly favoured cross-sectional content over longitudinal length, this study describes one company's IC reporting over a period of 31 consecutive years from 1978 to 2008. The value of this sample is that, whilst having the obvious limitation of cross-sectional narrowness, it enables patterns of reporting over time to be observed. The disaggregation of the totality of IC into sub-categories enables conclusions to be drawn about the way in which the company in question (Marks & Spencer plc) has constructed its reporting. This, in turn, may offer some insight into the manner in which value is internally perceived and how IC reporting changes in response to market demands.

Specifically with regard to the annual report, Hopwood (1996, p. 55) observed that, "the accounting data are now a mere technical appendix to a highly sophisticated product of the design environment." More recently, Campbell, McPhail, and Slack (2009, p. 908) argued that, "annual reports no longer just communicate simple financial data: they are designed to convey complex multi-messages to a number of different constituencies and are now 'used' by executives, sales representatives and personnel departments for a number of different purposes." A key point is that most of these users are not skilled in financial analysis, and these would arguably place a greater importance on the narrative sections of the report. The narrative reporting of intellectual capital would be a suitable vehicle for communicating value to such users and as value creation has changed over recent decades, the question is how these changes are reflected in annual report content.

This paper begins by defining intellectual capital as employed in this study. It then proceeds to review the literatures relevant to both IC reporting and the content analysis method employed in this study. The method is then described and results explained and commented upon. Finally, the paper, based on the findings, comments on Marks & Spencer's IC reporting over the 31 years and discusses findings in the context of how observed changes reflect the changing nature of the information being conveyed and the changing nature of the sources of value creation.

2. Defining intellectual capital

Intellectual capital is perceived as a hierarchy of nested concepts with synonymous terms often being used across studies (Beattie & Thomson, 2007). An agreed and universal definition is elusive, however, but most prior authors seem to agree that