

The disclosure of intangible assets in entertainment companies

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Abstract

Opportunities for creating value are shifting from managing tangible assets to deploying intangible assets. Nevertheless, the present financial accounting framework is criticized as inadequate and failing to communicate the most important assets and resources of today's business. So investors have an incomplete picture of them, calling for greater intangibles transparency. This paper aims to analyze the intangibles disclosure quality (IDQ) of listed entertainment companies by applying the content analysis method to their annual report.

Keywords: intangible assets, entertainment companies, annual reports, disclosure, content analysis.

1. Introduction

Nowadays, researchers and practitioners consider intangible assets to be key factors for company success and important levers for value creation. Since the early Nineties particularly, the differential between market value and book value of many companies has grown (Stewart, 1997; Bontis et al., 1999; Lev, 2001; Mouritsen et al., 2005).

The reason for this phenomenon is related both to the fact that some intangibles, like customer loyalty or employee competences, cannot be considered “assets” to be recognized in the financial statement, and also because, occasionally, some intangibles are assigned a lower value on the balance sheet than their recognized market value.

Consequently, companies have felt the need, on the one hand, to dispose of specific *ad hoc* tools to measure and control their intangibles in order to manage them, such as intellectual capital measurement systems (ICMSs) and, on the other, to communicate information on the extent and the features of their intangible assets to satisfy the information needs of stakeholders and, in particular, of their investors on the outside (Marr et al., 2003; Chiucchi, 2008).

Companies could have many reasons for disclosing information on their intangible assets (Andriessen, 2004):

- ∞ To improve information to stakeholders about the real value and future performance of the enterprise;
- ∞ To reduce the information asymmetry between management, shareholders and investors;
- ∞ To increase their ability to raise capital;
- ∞ To enhance their corporate reputation and affect the price of their stock.

Furthermore, the communication gap between companies and the stock market seems to be larger in knowledge-based industries than in consolidated industries (Eccles and Mavrinac, 1995). So, the pressure on companies to disclose the value of their intangible assets is growing.

Considering that many intangibles are not recognized in the financial statement, highly innovative companies where intangibles play a significant role have much greater difficulty attracting investors and banks. In these cases, voluntary disclosure of intangible assets can help reduce the uncertainties of investors and banks and, at the same time, it allows companies to have greater access to funds (RICARDIS, 2006).

Companies have chosen to disclose information on their intangible stock 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 (Campbell, 2010).

Within accounting literature, there is an increasing interest in the role informative external reporting plays in the effective functioning of the capital market (Healey and Palepu, 2001), for its positive effects on the reduction of the cost of equity (Botosan, 1997) and for the reduction of the cost of debt (Sengupta, 1998). Relative to the positive effects on the capital market ascribable to intangible assets disclosure instead, explorative empirical research has shown contrasting results (Abdolmohammadi, 2005; Vergawen et al., 2006).

Another stream of research empirically studies companies' intangible reporting practices in order to analyze the intangible disclosure quality (IDQ). Some of these studies analyze annual reports of cross-industry firm samples of a single country (Guthrie and Petty, 2000; Brennan, 2001; Olsson, 2001; Bontis, 2003; Bozzolan et al., 2003; Goh and Lim, 2004; Abeysekera and Guthrie, 2005; Oliveira et al., 2006), while other studies concern cross-industry firms from at least two countries (Vandemele et al., 2005; Vergawen and van Alem, 2005; Bozzolan et al., 2006; Guthrie et al., 2006). Some Authors have identified the need for industry-focused research on the quality of intangible asset reporting (Holand, 2004; Bozzolan et al., 2006; Nielsen et al., 2006; Oliveira et al., 2006) and some studies have already been carried out (White et al., 2007; Gerpott et al., 2008). None of this is focused on the entertainment industry. This kind of research is able to detect industry-specific patterns of intangibles and analyze the quality of the information disclosed.

The aim of this research proposal is to study the intangibles disclosure quality (IDQ) of entertainment companies by applying the content analysis method to their annual report. The reason for choosing this industry is that entertainment companies are typical examples of knowledge-intensive firms where intangibles disclosure may be very relevant.

2. Research questions

Based on the analysis of prior studies on IDQ, the present research proposal will attempt to answer the following questions:

- 1) Which intangible assets are disclosed in the annual report of entertainment companies and what is the quality of their disclosure?
- 2) Is the degree of the intangible asset disclosure affected by the location of entertainment companies?
- 3) Is the degree of the intangible asset disclosure affected by the size of entertainment companies?

3. Literature review

Recent literature on intangibles disclosure analysis highlights the importance of taking into consideration size and industry variables in explorative research (Guthrie et al., 2004).

Generally, the content analysis of intangible disclosure has focused on three main strands (Campbell, 2010). The first strand has empirically described intangible disclosure practice in corporate annual reports either in single country settings (Guthrie and Petty, 2000; Brennan, 2001; Bozzolan et al., 2003; Goh and Lim, 2004) or in international comparative studies (Vandemaele et al., 2005; Vergauwen and van Alem, 2005; Bozzolan et al., 2006; Guthrie et al., 2006). The comparative studies suggest that there is significant variability in intangible disclosure practice between countries.

The second strand has attempted to compare other variables with intangible disclosure practice to test for associations. Tested variables have included company size (Bozzolan et al., 2003; Bukh et al., 2005) industry membership (Bozzolan et al., 2003; Abdolmohammadi, 2005), ownership (Bukh et al., 2005; White et al., 2007) and company age (Bukh et al., 2005; Cordazzo, 2007; White et al., 2007).

The link between intangible disclosure and company size is the most common correlation examined. Prior studies detected significantly positive relationships between size and indicators of intangibles disclosure (Bozzolan et al., 2003, 2006; Guthrie et al., 2006; Oliveira et al., 2006) with the exception of William (2001) and Bukh et al. (2005), who observed insignificant associations. The literature suggests different reasons to explain this correlation. Large companies tend to disclose more information because they are likely to dispose of sophisticated information systems that generate extensive information at lower costs (Buzby, 1975; Firth, 1979; Inchausti, 1997). Moreover, large companies generally are exposed to a high level of public interest, so they deal with these pressures by reporting more extensively on their assets (Firth, 1979). Finally, many large companies raise equity on stock markets that require detailed information about their economic performance and future business prospects (Firth, 1979).

The third strand comprises papers that have attempted to find associations between intangibles disclosure and capital market consequences. Typically, these studies have sought to investigate the usefulness of intangibles disclosure on credit, investment decision making and capital market numbers (Abdolmohammadi, 2005; Guimon, 2005; Dumay and Tull, 2007; Singh and Van der Zahn, 2007; Gerpott et al., 2008; Petty et al., 2008). Findings of intangibles disclosure on market consequences are mixed. In contrast to Abdolmohammadi's (2005) finding that it was unrelated, for example, Vergauwen et al. (2006) found intangibles disclosure to be significantly and positively associated with market to book value.

4. Research strategy and method

The study of the IDQ will be conducted on the annual reports of a sample of listed entertainment companies. The decision to use annual reports for the research is due to several reasons. Many researchers chose annual reports to do content analysis because they are an appropriate vehicle for investigating the comparative positions of intangibles disclosure between firms, industries and countries (Guthrie et al., 2004; Abeysekera and Guthrie, 2005). Campbell indicated two main reasons to consider an annual report like a good barometer of a company's attitude towards social reporting. First, the company has complete editorial control over the document (except the audited financial section) and second, it is usually the most widely distributed public document produced by the company (Campbell, 2000).

The methods most commonly used to analyze the IDQ are the "content analysis" and the "disclosure index".

Weber (1985) defined content analysis as a research methodology that utilizes a set of procedures to make valid inferences from text. In other words, content analysis consists of dividing the text into meaningful entities and of coding these entities according to well-defined rules (Aerts, 2005). A central idea in content analysis is that many words of the text are classified into much fewer content categories. Each category may consist of one, several, or many words. Words, phrases, or other units of text classified in the same category are presumed to have similar meanings.

The disclosure index method is one that provides a quantification of the extent of disclosure for the items investigated (Marston and Shives, 1991). In reference to a list of items previously chosen by the researcher (like R&D expenses, number of patents, etc.), the disclosure index expresses the percentage of the items found in a document with respect to the total number of items contained in the list. Finally, the main difference between these two methods is that content analysis provides both a quantitative and a qualitative evaluation of the items analyzed; the disclosure index, instead, gives only a quantification. For this reason, content analysis is the chosen method for the research.

The companies for the study will be selected following three distinct, stratified random sampling procedures in order to select entertainment companies listed on The New York Stock Exchange, Euronext, The London Stock Exchange and The Tokyo Stock Exchange.

These stock exchanges have been chosen because they are the most capitalized stock exchanges of the three continents of America, Europe and Asia and their location permits investigating the third research question.

The study of this industry could help to identify what its specific intangible assets are. This identification may be useful in developing a standard to guide the development of an intellectual capital reporting system (ICRS) for firms in this industry.

5. Research Philosophy

From the philosophical point of view, the intended approach used in the research will be post-positivist.

On the ontological level, the post-positivist school recognizes the basic assumption of positivism of the existence of a single reality which is external to, and independent of, the people (Fattore, 2005). From the epistemological viewpoint, post-positivism philosophy theorizes that there are two main drawbacks that do not permit perfect knowledge of the real situation (Hussey and Hussey, 1997). Firstly, it is generally accepted that research activity is affected by the context in which it is conducted and secondly, that researchers may feel the influence of the social context and of existing theories. The second obstacle is the probabilistic nature of the mechanisms that govern reality.

6. Data Analysis

The companies for the study will be selected following three stratified, random sampling procedures, one for each stock exchange, in order to obtain three samples to analyze separately.

In each stock exchange, a first stratum will be created that considers the industry where the companies operate, and that is, the entertainment industry.

In this stratum, a sample of entertainment companies will be randomly selected and these will become the base from which to create the second stratum. The size of the three samples will be decided so they reflect the numerical composition of the entertainment company population operating on the stock exchange.

The third stratum, finally, will look at the size of the companies, distinguishing large companies from small and medium size enterprises (SMEs). There are different proxies to measure corporate size, like total assets (Bozzolan et al., 2003), market capitalization (García-Meca et al., 2005) and number of employees (Bukh et al., 2005). The choice of the proxy to use in the research will be made after a preliminary overview of the companies randomly selected, in order to use the most appropriate criteria. This second stratification permits a reply to the third research question. Also, the size of large companies and SMEs will be decided so as to reflect the dimensional composition of listed entertainment companies.

When the sampling procedure is finished, the content analysis of the selected companies' annual reports will begin.

Content analysis will consist of three steps: the choice of the framework used to classify information; the definition of the unit of analysis and the coding (Guthrie et al., 2004).

The framework consists of a list of intangibles that will be the object of investigation in the annual reports. The choice of the framework will be made through a literature review of the most popular

classification of intangibles. In each case, the choice should consider the peculiarity of intangible assets relevant for the industries analyzed. For instance, the framework should consider intangibles referred to copyrights, innovation and the collaborative network.

The unit of analysis is the specific segment of the report in which the correspondence will be found with the intangibles presented in the framework. Units of analysis can be words, sentences, paragraphs, portions of pages or themes. The choice will be made in favour of the themes. As previously suggested by Holsti (1969), Beattie et al. (2004) and Beattie and Thomson (2007), using themes as the unit of analysis enables meaning to be inferred from text of varying length, depending on where discussion of that particular sub-category begins and ends. This offers the advantage of categorising the totality of narrative without the constraints of having to allocate meaning by words, sentence or paragraph (Campbell, 2010). Nevertheless, choosing this kind of unit of analysis implies a manipulation of the text by the researcher. Consequently, searching for themes is often an ambiguous and subjective process (Fattore, 2005).

The last phase is the coding. It consists of an evaluation of the perceived information richness of the data found in the document for each intangible indicated in the framework. Evaluation will be made using a score on a three-point scale. For each intangible asset of the framework the following score will be given: 0 in the case where no information could be identified; 1 if only qualitative or quantitative information is found; 2 if both qualitative and quantitative information is found.

When all the information contained in the annual report is analyzed, it will be converted to numerical variables and statistical analysis will be done in order to answer the research questions.

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