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A REPORT ON Case Study on Measuring Intangible Assets – Indian Experience – 1 – BEYOND BALANCE SHEETS… Measuring Intangible assets- an Indian case study “ Just as you can’t measure what you can’t describe, you can’t manage what you can’t measure…

” While many companies have strived to differentiate their annual reports and make them informative, attractive and easy to read, most still take a rear-view-mirror approach, focusing almost exclusively on history and analyses of past performance. But in today’s world, as we have advanced into the Information Age, more companies will find that those assets most easily measured are not necessarily most valuable; increasingly they will be forced to measure intangible assets in a predictive way that is more reflective of how the company is actually run. Today, even traditional manufacturing companies are finding themselves not simply selling a product, such as a car, but selling customer service, a lifestyle, convenience, and so much more. If we take the example of airline industry, it also provides another clear example of this phenomenon. Where airlines once had large tangible inventories of aircraft on their books, they now lease the equipment, changing the nature of the business to one built on intangible assets – landing rights, booking systems, customer service, and brand.

Unfortunately, knowledge itself cannot be “ managed. ” But knowledge that is captured and converted into an asset (tangible or intangible) is indeed a commodity one can count on, literally, to improve the performance of the company and help generate profits. No company can own either of the critical assets, neither the employees nor the customers.

The value they provide to the company is only temporary and cannot be considered a measurable asset unless it is captured and converted into something the company can own – any new knowledge or skill that can be reused or applied in other areas, be it a new learning process or a new operating policy. There is a three grid system in any organization that can be measured as intangible assets. They are Customers, People and organization. Customers People OrganizationAdopted from: www. celemi. com – 2 – – 3 – However, there are also factors that may be revised during the years, such as certain investments and initiatives we need to focus on as they are implemented and developed.

For example, the development of our IT capabilities, which at one time was a key measure when establishing new offices, is now monitored in relation to other investments in R&D and marketing. In the future, we expect other factors will periodically be measured to give an accurate assessment of our intangibles as the business evolves. Before any company starts measuring their intangible assets, everyone has to be helped to understand what their intangible assets are, and what impact they have on the performance of the company. With this knowledge of the “ big picture,” employees can begin to see how individual performance affects organizational performance.

For example, the managers understand the importance of assigning a new employee to a competence-enhancing client rather than an image-enhancing client. In any case, the companies should use caution before jumping in and measuring the intangible assets. First, there must be a shared understanding internally of what the intangible assets are and what they mean to the overall performance of the company. With this knowledge, people are able to interpret the information and make effective decisions in line with the strategic plan. At the same time, they are developing their own extraordinary business sense – an essential key to how companies and employees can face challenges as an innovator in a global environment. Reasons of initiating Intangible asset measurement The pressure for more disclosure is already significant.

A growing number of academics, consultants, and regulators see the lack of information on intangible assets as a major deficiency in the GAAP regime. And this has been one of the most important reasons of initiating the measurement of intangible assets in the balance sheet. Leading companies in India are actively seeking ways of leveraging their “ human capital” to develop a strategic advantage. They are moving from a departmental focus on human resources to a far more strategic and expansive focus on human capital management. Roles and responsibilities are in ever-changing as companies explore new ways of building and leveraging talent. But Human Capital Assessment/Management is not limited to the enterprise itself. This new perspective also draws on the networks of talent that lie beyond immediate corporate boundaries.

It is a key element of the ongoing drive toward “ collaborative commerce” or “ enterprise relationship management. ” – 4 – The payoff by using this method promises to be quite powerful. Watson Wyatt, a management consulting firm that has developed a Human Capital Index based on 30 key indices of effective human capital management, has observed that a significant improvement among the 400 publicly traded companies it studied was associated with a 30 percent increase in market value. Watson Wyatt monitored five key dimensions of effective HCM: recruiting excellence; clear rewards and accountability; a collegial and flexible workplace; communications integrity; and prudent use of resources.

Companies that demonstrated the highest ratings on the index generated returns of 103 percent over five years. This proves that Human accountability is certainly important. But the question arises of which department would be responsible for it. This is still a challenge that cannot be delegated to any person or department; in fact it becomes the responsibility of everyone in the organization. While HR has taken its share of criticism for not being business-focused, it’s reasonable to assume that HR professionals generally have not been incentivized or encouraged by top leadership to play the strategic role that is now being sought. It’s a matter of organizational design. It still remains an enigma about whether the top level executives or lower level executives would be responsible for the accounting of the Human talent in the organization. Measuring intellectual assets These are some general techniques that are used to value intangible assets, specifically Human Valuation.

The techniques change from company to company related to its importance in the functions. 1. Balanced scorecard. Supplements traditional financial measures with three additional perspectives — customers, internal business processes, and learning/growth. It was originated with a couple of Harvard Business School professors. 2. Competency models. By observing and classifying the behaviors of “ successful” employees (“ competency models”) and calculating the market value of their output, it’s possible to assign a dollar value to the intellectual capital they create and use in their work.

3. Benchmarking. Involves identifying companies that are recognized leaders in leveraging their intellectual assets, determining how well they score on relevant criteria, and then comparing your own company’s performance against that of the – 5 – leaders. Example of a relevant criterion: leaders systematically identify knowledge gaps and use well-defined processes to close them.

4. Business worth. This approach centers on three questions. What would happen if the information we now use disappeared altogether? What would happen if we doubled the amount of key information available? How does the value of this information change after a day, a week, a year? Evaluation focuses on the cost of missing or underutilizing a business opportunity, avoiding or minimizing a threat. 5. “ Calculated intangible value.

“ Compares a company’s return on assets (ROA) with a published average ROA for the industry. Brand valuation techniques that are usually in use by the Indian companies are as follows. A number of authors and consulting firms have proposed different methods for brand valuation. 1. The market value of the company’s share 2. The difference between the market value and book value of the company’s shares (market value added) other firms quantify the brand’s value as the difference between the shares’ market value and adjusted book value or adjusted net worth (this difference is called goodwill). . The difference between the market value and book value of the company’s shares minus the management teams managerial expertise (intellectual capital) 4.

the brand replacement value a. Present value of the historic investment in marketing and promotions b. Estimation of an advertising investment required to achieve the present level of brand recognition 5.

the difference between the value of the branded company and that of another similar company that sold unbranded products (generic products or private labels) 6. The present value of the company’s free cash flow minus the assets employed multiplied by required return. – 6 – ROLTA INDIA PVT LTD Rolta India limited is an Indian company operating in India and overseas. It provides software/information technology based engineering and geospatial solutions and services to customers across the world and has executed projects in more than 35 countries. Rolta is headquartered in Mumbai and operates through a network of twelve regional/branch offices in India and seven subsidiaries located in USA, Canada, UK, The Netherlands, Germany, Saudi Arabia and UAE. It is listed on the Bombay Stock Exchange and National Stock Exchange in India. Rolta is India’s leading provider of GIS/GeoEngineering solutions and services and one of the major AM/FM/GIS photogrammetry service providers in the world for segments such as Defense, Environment, Electric, Telecom, Gas, Emergency Services, Municipalities and Airports.

The company’s customer base for GIS projects is spread across 17 countries with multi million dollar projects executed in various parts of the world. Rolta is also leading provider of plant design automation solutions and services in India and one of the major plant information management services providers worldwide. The company’s customer base for such business is spread across 22 countries with over 500 projects executed in various parts of the world.

To move up the value chain in the engineering domain, the company has established a joint venture with Stone & Webster Inc. , USA, namely SWRL- Stone & Webster Rolta Limited. SWRL has access to Stone & Webster’s proprietary technology. This joint venture provides high quality engineering services worldwide and undertakes selective refinery, petrochemicals and power projects in India. The company provides eSecurity implementation services, rapid application development and software testing services to its customers worldwide. In on-going partnership with CA’s, the company has executed over 350 projects globally in 18 countries. Rolta globally has around 2500 employees. Nearly 75% of the company’s workforce has engineering qualifications, including significant umbers with master’s degrees or doctorates and Rolta ensures constant ongoing training to its professionals.

The annual IDC-DQ best Employers Survey has consistently ranked the company as one of the top employers in the IT industry in India. Rolta quality standards are benchmarked to world class levels, with top quality certifications such as ISO 9001: 2000, BS 7799, and SEI CMM level 5. The British Standards Institution (BSI) has awarded Rolta the BS15000 certification for its entire range of IT service management processes. This unique accreditation has been bestowed on less than 25 companies globally. Measuring the intangibles – 7 – A company’s balance sheet discloses the financial position or rather health of the company.

The financial position of an enterprise is influenced by the economic resources, financial structure, liquidity, solvency and its capacity to adapt to changes in the environment. However, it is becoming increasingly clear that intangible assets have a significant role in defining the growth of a company. So often, the search for the added value invariably leads us to calculating and evaluating the intangible assets of the business. A Concept of Economic Value Added (EVA) Economic Value Added (EVA) is the financial performance measure that aims to capture the true economic profit of an enterprise. EVA is developed to be a measure more directly linked to creation shareholder wealth over time. Hence, it focuses on maximizing the shareholders wealth and helps company management to create value for shareholders. EVA refers to the net operating profits of the company which is opportunity cost. EVA is calculated as Net operating Profit after tax (NOPAT) – (Capital\*Cost of Capital) Generally, all intangible assets are being measured in terms of economic value added by those particular intangible assets.

Brand Value – an important intangible asset Brands are more than just a name, a trademark for a product or a service mark for a service. A brand is a complex concept that creates organizational value and performs number of important functions for every enterprise. Brands and their combined Brand equity constitute a major economic force within the entire global economy, delivering market place value, shareholder ealth, livelihood, prosperity, and culture. Successful brands are recognized as rare and valuable assets that must be exploited carefully, with wise and knowledgeable management that retains their financial value, their economic power and their social significance. A brand is a very special asset and in many businesses it is the most important asset. This is due to the far reaching economic impact that brands have on enterprise. Brands usually influence the choice of customers, employee’s, investors and government authorities.

In a world of abundant choices such influence is crucial for commercial success and creation of shareholder value. Brands have also demonstrated a unique durability and sustained competitive advantage unmatched by any other corporate asset. Brand is an intangible asset and there are several methodologies suggested and prevalent for valuing brands.

Some of these methods are cost, market value, economic use and royalty relief. Rolta utilizes “ Economic Use” model. This model is one of the standard methodologies in brand valuation by companies in the software industry. 8 – This method is basically a combination of market factors and financial parameters to arrive at the value of the brand. It uses Brand Strength Model which arrives at a brand strength score based on various market parameters. This score is multiplied by the net brand earnings to estimate the brand value. The Brand strength Model is used to determine the value of a brand based on the assumption that a strong brand is more reliable for future earnings with lesser risk. Rolta has used the following method to calculate the brand valuation.

Table: 1 Calculation of Brand Value of Rolta India Pvt. LtdItem No. Particulars 2004-05 2003-04 2002-03 1 Profit Before Interest and Taxes 1, 226 1, 014 1, 504 2 Less – Non Brand Income 103 88 57 3 Adjusted PBIT (1-2)= 3 1, 123 926 1, 447 4 Profit for the brand and associated intangibles 1, 123 926 1, 447 5 Average capital employed 5, 723 6, 200 5, 410 6 Remuneration to Capital % 5 % 7 Remuneration to capital 289 8 Profit attributable to Brand and Associated intangibles (4 – 7) = 8 834 9 Income Tax 305 10 Profit after tax attributable to Brand and associated intangibles 529 11 Brand Multiple Applied 15. 15 12 Brand Value 8, 011