

# UNRECOGNIZED INTANGIBLES AND VALUE RELEVANCE: AN EMPIRICAL STUDY OF LUXURY INDUSTRY

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## ABSTRACT

*The objective of the study is to compare the impact of Self-Generated Goodwill on the “Market Valuation in Luxury industry” and “Market Valuation in Non-Luxury Industry”. The Ohlson Methodology (1995) is extended to total intangible assets and self-generated goodwill variables. A set of six regression models has been analyzed to measure the impact of Intangible (independent variables) on Market valuation in Luxury and Non-Luxury Industry. The findings suggest that the Market valuation of Luxury industry is found to be less value relevant than the Market valuation of Non-Luxury Industry in the absence of Intangibles. The Value Relevance of Non-Luxury Industry can be further increased by incorporating the factors like Intangible Assets, Goodwill and Age of the firm. However, the Value Relevance of Luxury industry can only be increased by including Intangible Assets in the model. The role of self-generated goodwill often goes unmeasured as per the available accounting standards. Hence, the impact of self-generated goodwill on market valuation (MV) is also overlooked from investors’ perspective. Therefore, the financial picture of a firm represented by MV is not a fair measure of its Financial Performance. The author has made an original attempt to study the impact of self-generated goodwill on the Financial Performance of Luxury Industry.*

**Key Words:** *Value Relevance, Self-Generated Goodwill, Ohlson Methodology, Luxury industry*

**JEL Classification Code:** C52, C58, E22, G3, M41

## INTRODUCTION

The process of investment decision-making involves a comprehensive evaluation of a company's financial indicators presented in its accounting documents. Savvy investors are perpetually in pursuit of opportunities that promise value augmentation and exceptional returns. Accounting information, specifically tangible variables, aids them in deducing a firm's financial health in terms of profitability, leverage, liquidity, and efficiency. Accounting norms primarily focus on tangible assets and liabilities disclosed on a balance sheet, as they signify a company's financial performance. However, are these tangible metrics all-inclusive and adequate for sophisticated decision-making? A candid affirmation might be overstated.

In this context, the Market Valuation (MV) of companies, as quantified by the Ohlson Model (1995), becomes noteworthy. The model categorizes MV's sources into two dependent variables, predicated on a clean surplus accounting approach. It implies the market valuation is governed solely by a firm's book value of equity and earnings. The present study intends to extend this model to encapsulate total intangible assets (like patents, copyrights, goodwill) and self-generated goodwill. Contemporary businesses have evolved, with a significant number focusing on delivering services or product-embedded services. This has given rise to a new asset type, self-generated goodwill, often overlooked in financial documents and investor analyses. It remains unquantified until a company undergoes a merger or acquisition. Similarly, internally developed expertise and skills, though intangible, contribute to a company's value but are not easily quantifiable or available as discernible variables. Therefore, their impact on market valuation remains largely unexplored, particularly in sectors like the luxury industry, where intangible assets are of pronounced explicit importance.

Appreciating the idea of Assets, then Intangible Assets, the Accounting Standards have seldom offered the due recognition to the "in-house" or "self-generated" Intangible Assets e.g. some Trade secret/Manufacturing process/Competitive advantage etc. However, as soon as a Merger/Acquisition takes place the companies are paid way above their Recognized Assets at times. What makes the Acquiring Companies offer beyond the Book Values. Is it the growth potential or something abstract persisting in the Company but lacking measurement. To proceed further, the unrecognized intangibles would be value relevant beyond what is already disclosed as happened in case of Tech-bubble in 1990s. Back then, the Technology sector was overpriced backed by the Softwares (again an Intangible Aspect). This led to overpricing of the Companies and later the bubble burst. So, any quantum of mis-valuation (be it undervaluation or overvaluation) would be depicting a hazy picture in the eyes of Investors and public at large. Investors persistently estimate and scrutinize a firm's financial performance. It poses the question of whether the available variables sufficiently portray a fair financial representation. This research, titled "Unrecognized Intangibles and Value Relevance (in Luxury Industry)," aims to unravel the role of intangibles, specifically the influence of self-generated goodwill on the luxury industry's financial performance. The study hypothesizes a higher prevalence of self-generated goodwill in the luxury industry compared to non-luxury sectors.

The value relevance of accounting information is central to this study, with the primary intent to investigate the factors contributing to the discrepancy between market value and book value of shares. The luxury industry has consistently outperformed non-luxury sectors over time, with intangible factors playing a potentially significant role, especially when the business extends beyond product markets. Accordingly, this study proposes to identify and analyze the intangible factors impacting the market valuation of both luxury and non-luxury industries, to compare their effects on market valuation, and specifically to compare the influence of self-generated goodwill on market valuation within these sectors.

Previous research has spotlighted sectors like banking, technology, and pharmaceuticals concerning self-generated goodwill. However, very few studies, if any, have examined self-generated goodwill in the luxury industry. This study seeks to fill this gap. Value relevance, measured as the proportion of adjusted R-square, informs investors' security evaluation and

decision-making process. Higher value relevance implies greater reliability of financial statements for investment decisions, as it indicates a stronger correlation between financial statement variables and a firm's market value. In this study, a lag of one quarter is considered in independent variables to reflect the delayed effect of investing in intangibles on market valuation. This research poses questions such as whether the financial performance of the luxury industry is less value-relevant than non-luxury sectors and whether certain intangible factors can explain this discrepancy. Additionally, it probes whether recognized total intangible assets and self-generated goodwill influence market valuation and whether this impact is uniform across luxury and non-luxury sectors.

## CONCEPTUAL FRAMEWORK

A general description of the Luxury begins as something which is beyond necessity. The ordinary of extraordinary people and the extraordinary of ordinary people is Luxury (Kapferer & Bastien, 2009). However, Appadurai, lists five characteristics of Luxury (Appadurai, 1986),

- (1) *Restriction to elites by law or price*
- (2) *Complexity of acquisition – which may or may not reflect real “scarcity”*
- (3) *Semiotic virtuosity*
- (4) *Codes for “appropriate” consumption demanding specialized knowledge*
- (5) *High degree of linkage of their consumption to person and personality.*

### Intellectual Capital

The literature has observed various models and methodologies to define the concepts of Intellectual capital. The Intangibles can be classified into innovation (may be protected by patents, trademarks and copyrights), unique organizational structure, brand value and Human Resource practices (Lev, 2001). According to Sveiby (1997), the essentials of Intellectual Capital consist of employee competencies and internal and external structure. The list has been further extended to the fourth component i.e. *intellectual property*. Edvinsson (1997) in his research defines the Intellectual Capital as the sum of human, organizational, and customer capital. His research has also been supported by Edvinsson and Malone (1997); Bontis (1998); Sullivan (1998). Lev (2001) has somehow broadly classified Intellectual Capital(IC) into innovation (discoveries and knowledge), Human Resources and organizational practices. From strategic management perspective, the studies of Kaplan and Norton (2004), the relevance of IC has been put within the framework of value creation process. The approach of critically analyzing the balanced scorecard highlights the financial concepts and non-financial measures of value creation. The impact of IC is measured on value creation to define the corporate success of the firm. However, the definition by the IAS ( Indian Accounting Standard) and US GAAP are as follows:

*IAS 38:* An Intangible Asset is an identifiable non-monetary asset without physical substance. An asset is identifiable if it either is separable; (capable of being separated from the entity and sold) arises from contractual or other legal rights. Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

*US GAAP 350:* The Topic 350 of GAAP by FASB has defined Intangibles—Goodwill and other Intangible Assets. The Goodwill as detailed under the Subtopic 350-20 provides guidance on the measurement of Goodwill after acquisition, derecognition of some or all of Goodwill allocated to a reporting unit, other presentation matters, and disclosures.

Predominantly, the accounting statements are prepared following the accounting principles. These principles do not pay any attention to different issues pertaining to Self-generated Assets. These principles viz. Monetary measurement, Full disclosure principle, Matching principle, Cost principle, Relevance, Reliability, and Consistency and Principle of conservatism overlook the role of self-generated assets. All these principles have been consistently ignoring the recognition of Self-generated Assets despite available alternatives.

Firstly, the *Monetary measurement* principle believes that accounting records of any economic entity should capture only the quantifiable transactions. Here, the self-generated assets are totally ignored as far as measurement process is concerned. The accounting principles justifies it as these assets may not be easily quantified in monetary terms. Hence, they do not appear in the company's accounting records. Methodology may be designed to find the intrinsic value of self-generated assets instead of ignoring them and making easy escape.

Subsequently, the *Full disclosure* principle also ignores the importance of self-generated assets. This disclosure could be done in the form of Footnotes in order to report the complete information about the business developments. However, the inventory (stock) is also valued as Work-in-progress before the actual sales, then why these self-generated assets are denied space under the Full Disclosure practices.

Thirdly, the *Matching* principle asserts that the costs of doing business are to be recorded in the same period pertaining to the revenue generation. By overlooking the cost of self-generated assets, the cost estimates for potential merchandise (sold) will be utterly unfair.

Fourthly, the primary reason of restricting the use of *Cost principle* for self-generated assets is unavailability of actual cost for these assets. However, the measurement of costs of these assets is quite possible like the way the cost of human capital is measured as the cost to company in the name of salary and other benefits.

Fifthly, the Principle of *Conservatism* is very crucial while preparing financial statements of corporate entities. In case of self-generated assets, accountants can use their judgment to estimate its value. Currently, their judgement tends to be over-conservative to analyze this group of assets. Hence, this eliminates the role of in-house assets until they undergo Merger and Acquisition. *If an outsider company (during M&A) can assess the value of Goodwill, then certainly the Accounting Standards can also design a parameter to valuate and validate these assets.*

Lastly, the principles of *Relevance, Reliability and Consistency* are put under the lens, if these unacquired (inhouse generated) assets are skipped from the financial statements. The financial picture must be relevant, reliable and prepared in a consistent manner to be informative. If acquired assets are valued, then self-generated assets must also be given due recognition.

## REVIEW OF LITERATURE

The conceptual framework of Value Relevance is empirically tested by Ohlson Model (1995). The model has tested Value Relevance of accounting information in various industries across time period. Works of several researchers have been discussed below. Value relevance criteria are referred to the ability of accounting numbers (independent variables) to explain the stock prices in capital markets (dependent variable). Value relevance of recognized Intangible Assets has been often tested using an accounting-based valuation model developed originally by Ohlson (1995), in which a firm's Market Value is a function of the Book Value of equity and Earnings. This approach was also tested by Lev and Zarowin (1999); Francis and Schipper (1999); Friday, LiEng and Liu (2006); Bugeja and Gallery (2006); Al-Jifri and Citron (2009). Chen, Chen and Su (2001) examined empirically whether domestic investors in the Chinese stock market perceive accounting information based on Chinese GAAP to be value relevant. They evidently found that investors place more weight on accounting information in A-share companies. It was reported evidently consistent with the notion that accounting information is value-relevant to investors in the Chinese market despite the young age of the market and the perception of inadequate accounting and financial reporting in China. In another study with a data ranging from 1991-2003, Vazquez, Valdes and Herrera (2007) tested the Value Relevance of Mexican accounting variables. The aim of the study was to provide evidence of the ability of Mexican accounting numbers to summarize the information from 166 companies listed in the Mexican stock market from 1991 to 2003. The Value Relevance was operationalized using the *Ohlson model* criteria (1995). The original Ohlson model is tested with Mexican accounting data using Ordinary Least Squared (OLS) Regressions. In addition to Book value of Equity, Earnings and CFOA, the variables, EBITDA, Operative Cash Flow, Net Cash Flow and Dividends have also been tested in the panel data in the original Ohlson model.

In a Spanish study, it has been noticed that listed groups are now obliged to prepare consolidated financial information under IFRS. Callao, Jose and Lainez (2007) have studied the differences between accounting figures and financial ratios under the two sets of standards (i.e. Spanish accounting standards and IFRS). They observed that there has been no improvement in the relevance of financial reporting to local stock market operators because the gap between Book and Market Values is wider when IFRS are applied. Bugeja and Gallery (2006) investigated whether the Value Relevance of purchased Goodwill holds as the company ages. Using an Australian sample, they found that newly acquired Goodwill has information content for two years, but older Goodwill does not. However, Vincent (1994) found that the Value Relevance relationship can hold for up to five years after the Goodwill is purchased.

There is a consensus among academicians that information about Intangible assets is relevant to the firm's Value and more and more information about Intangibles needs to be

recognized or at least to be disclosed. However, analysts in the business community have a different view about Intangibles. They treat Tangible and Intangible Assets substantially different. It is concluded that whenever analysts evaluate a firm's financial structure or debt levels, they usually use a measurement of Total Liabilities to Tangible Assets. Intangible assets are excluded as core assets. As argued by Wyatt and Abernethy(2008), the questions raised in Intangible studies are: first, why Intangibles are not considered as core assets even if it is agreed that it is a very important category of investment, and second, whether the reliability of reported Intangibles is of major concern to analysts. This issue needs to be further investigated. The relationship between the reliability of reported Intangibles and their Value Relevance is the key issue of research on Intangibles.

Oliveira et al. (2010) proved in the study a distinctive feature of the accounting by the sample companies is that when they adopted IAS 38 and IFRS 3 in 2005, they were no longer required to recognize some Intangible assets (such as start-up costs and research expenditures) and were no longer required to amortize Goodwill. Regarding Intangibles, the values recognized as R&D expenditures did not appear to be value-relevant for investors, in the Portuguese GAAP context. Ji and Lu (2014) examined the Value Relevance of Intangible assets, including Goodwill and other types of Intangibles in the pre- and post-adoption periods of IFRS. The paper reported whether the adoption of IFRS improves the Value Relevance of Intangible assets. The results indicate that an Intangible asset is value relevant for Australian firms. However, capitalization of Goodwill and other identifiable Intangibles has different Value Relevance for different types of firms.

A study by Tapia, Tascon and Fanjul (2006) conducted on commercial banks from 29 OECD countries over the period 1997–2003 suggested that the empirical use of the Ohlson (1995) model in commercial banks might be improved with a contextual approach through the identification of factors representing non-accounting information explaining the future abnormal Profitability, such as the competitiveness of banks and the accounting system. Kohlbeck and Warfield (2007) tested the Ohlson model on the Banking industry listed in the US market over the period 1992–1998 found a significant positive association between levels of the unrecorded Intangible assets of banks and residual incomes, revealing that higher levels of unrecorded Intangible assets increase the pricing multiples for residual incomes. Agostino, Drago and Silipo (2011) adopted the Ohlson model to verify the impact of IFRS on the Value Relevance of the accounting data of listed banks from 15 European Union countries over the period 2000–2006. They suggested that the introduction of IFRS increased the Value Relevance of both Earnings and Book Value for banks. Applications of the Ohlson model in the emerging markets can be found in the studies by Abuzayed, Molyneux and Fayoumi (2009); Dahmash (2013) who used it for investigating the Value Relevance of banks' accounting data in Jordan over the periods 1993–2004 and 2007–2011, respectively. Abuzayed et al. found that bank Earnings and their components are value relevant and able to explain the gap between Market and Book Values.

The literature has instances that Intangibles are value relevant. Scholars like McCarthy and Schneider (1996); Francis and Schipper (1999); Lev and Zarowin (1999); Goodwin and Ahmed (2006) have supported the statement that Intangibles are value relevant and that there

exists a statistically significant association or link between firms' Market Value and information about the value of Intangibles.

This study aims to find out the value relevance of the Self-Generated Goodwill of Luxury companies (LI) and S&P 500 companies (MP). To examine the same, a comparison of financial performance of the companies listed under S&P 500 and S&P Luxury index has been made. This study has examined the value relevance Ohlson model. The OLS (Ordinary Least Square) regression has tested the effect of variables such as Earning, Book Value of Equity, Intangible Asset, Goodwill, Age of the firms, Percentage Management's shareholding (PMS) and PB ratio on the dependent variable Market Valuation (in presence of control variable, Cashflow from Operating Activities). In this study, the returns of Luxury industry firms are hypothesized to be less explained than the returns of their counterpart Non-Luxury Industry companies.

### DATA AND VARIABLES

A market Index representing Non-Luxury market portfolio and a Luxury Index representing luxury industry has been considered to study the financial Performance of Intangibles. The sample comprises of members of S&P 500 Index (505 companies) and S&P Global Luxury Index (76 companies). The data has been collected from Bloomberg Financial Database for the calendar year 2008-2019 (Q4:2008-Q2:2019). The quarterly data has been used for the study. It has been taken on the last day of every quarter of the calendar year i.e. 31<sup>st</sup> March, 30<sup>th</sup> June, 30<sup>th</sup> September and 31<sup>st</sup> December. The total observations for Non-Luxury Industry are 21,715(505x43)i.e. 505 companies for 43 quarters for each variable. Likewise, the observations collected for 76 companies for 43 quarters are 3,268(76x43) for each variable in the Luxury segment. These observations are compiled for the study, and then some missing values and extreme values are eliminated.

The data is compiled in MS-Excel format and **Stata** Software is used for data processing and statistical testing.

All the variables are denominated either in millions US dollars or in ratios. The two exceptions are: Age of the firm which is in quarters and Market Valuation which is in billions US dollar (See Table 1). The relevant variables used in the study always form the base of the results of study.

<b>Ratios</b>	<b>Descriptions</b>
<b>Earning BV of equity Market valuation</b>	Omokhudu & Ibadin (2015); Ji & Lu (2014); Jifri& Citron (2009); Friday, LiEng& Liu (2006); Goodwin & Ahmed (2006); Bugeja & Gallery (2006); Lev &Zarowin (1999); Francis & Schipper (1999); McCarthy & Schneider (1996)
<b>Age of the firm</b>	Loderer et al. (2009); Liargovas& Skandalis (2008); Wang & Chang (2005); Agarwal &Gort (2002); Sorensen & Stuart (2000)
<b>PMS</b>	Eisenhardt (1989); Rosen &Quarrey (1987); Rosen, Blasi &Quarrey (1986); Green & Berry (1985); Walking & Long (1984); Rich & Larson (1984); Jensen &Meckling (1976)
<b>PB Ratio</b>	Rose & Thomsen (2004); Roberts & Dowling (2002); Stewart (1998); Luthy (1998)

*Source: Author's compilation*

**Market Value (MV):** The Market Value of firm is the sum of the equity share (at Market Price), preference share (at Book Value) and long-term Debt (at Book Value).

$$MV = \text{EQUITY SHARE}_{MP} + \text{PREFERENCE SHARES}_{BV} + \text{LT DEBT}_{BV}$$

**Book Value of Equity:** Book value is the amount that investors would theoretically receive if all company liabilities were subtracted from all company assets.

**Earning:** Earning refers to the undistributed part of profit, which is retained in the company.

**Intangible Assets:** Intangible Assets as disclosed in the Balance Sheet (excluding Goodwill).The assets which lack physical existence like licenses, trademarks, patents, copyrights, rights, trade secrets, trade formulae, brand equity.

**Goodwill:** The variable Goodwill is referred to the book value of Goodwill as disclosed in the Balance Sheet.

**Age of the Firm:** Age of the firm refers to Age of existence of firm beginning, from the date when that entity was incorporated, registered, or established.

**Percentage Management's shareholding:** The PMS as a variable shows the proportion of shares held by the management (BODs, executives, senior officials) of company.

$$PMS = \left( \frac{\text{Shares held by management}}{\text{Total number of outstanding shares}} \right)$$

**Price to Book ratio:** The Price to Book Ratio (P/B Ratio) is the proportion of stock price to Book value per share. Simply stating, it is calculated as:

$$P/B \text{ Ratio} = \left( \frac{\text{Current Market Price}}{\text{Book Value Per Share}} \right) \times 100$$

**Cash flow from Operations (CFOA):** Cash flow from Operations is the total amount of cash a company generates from its operations (Operating Activities).

CFOA = Net Income + Depreciation & Amortization + Other Non-Cash Adjustments + Changes in Working Capital + Other non-operating adjustments

## RESEARCH METHODOLOGY

All the statistical tests are run separately for the two portfolios viz. Luxury Index and S&P 500 Index. Initially, the OLS (Ordinary Least Square) is run to test the significance of the independent variables on the dependent variable. After running the OLS, Hausman Test (1978) is run to select among Fixed effect (FE) model or Random Effect (RE) model of Individual Specific Effects. The null hypothesis of the Hausman Test is “RE Model is an appropriate model” as against the alternate hypothesis of “FE Model is an appropriate model”. The statistical tests are interpreted at significance level of 0.05 and 0.10.

The study attempts to test the hypothesis that the accounting information that appeared in Balance sheet is not value relevant for Luxury companies. The impact of **Intangible Assets** on the financial performance (MV) of the firms is presumed to be higher in Luxury industry. Further, the impact of **Self-Generated Goodwill** on the financial performance (MV) of the firms is also higher in Luxury industry. The entire methodology has one dependent variable and a set of independent variables. The models are based on a set of assumptions mentioned below.

*Assumption 1: The general market factors are influencing all the listed sample data companies (Non-Luxury Industry and Luxury Industry).*

*Assumption 2: The general market factors have some impact on the accounting variables which may vary from industry to industry.*

*Assumption 3: The companies with higher Percentage Management’s Shareholding are assumed to have higher Self-Generated Goodwill.*

*Assumption 4: The experienced companies (Age-old companies) are assumed to have higher Self-Generated Goodwill.*

*Assumption 5: The companies with higher Price to Book Ratio are assumed to have higher Self-Generated Goodwill.*

<b>MODEL</b>	<b>Independent variable</b>	<b>Dependent variable</b>	<b>Control variable</b>	<b>Hypothesized Impact on MV</b>
<b>Model 1</b>	<b>Earning<sub>it</sub>, Book Value of Equity<sub>it</sub></b>	<b>Market valuation<sub>it+1</sub></b>	<b>CFOA<sub>it</sub></b>	<b>+ +</b>
<b>Model 2</b>	<b>Earning<sub>it</sub>, Book Value of Equity<sub>it</sub>, Intangible asset<sub>it</sub></b>	<b>Market valuation<sub>it+1</sub></b>	<b>CFOA<sub>it</sub></b>	<b>+ + +</b>
<b>Model 3</b>	<b>Earning<sub>it</sub>, Book Value of Equity<sub>it</sub>, Intangible asset<sub>it</sub>, Goodwill<sub>it</sub></b>	<b>Market valuation<sub>it+1</sub></b>	<b>CFOA<sub>it</sub></b>	<b>+ + + +</b>
<b>Model 4</b>	<b>Earning<sub>it</sub>, Book Value of Equity<sub>it</sub>, Intangible asset<sub>it</sub>, Goodwill<sub>it</sub> , Age of the firm<sub>it</sub></b>	<b>Market valuation<sub>it+1</sub></b>	<b>CFOA<sub>it</sub></b>	<b>+ + + +</b>
<b>Model 5</b>	<b>Earning<sub>it</sub>, Book Value of Equity<sub>it</sub>, Intangible asset<sub>it</sub>, Goodwill<sub>it</sub> , Age of the firm<sub>it</sub>, PMS<sub>it</sub></b>	<b>Market valuation<sub>it+1</sub></b>	<b>CFOA<sub>it</sub></b>	<b>+ + + + +</b>
<b>Model 6</b>	<b>Earning<sub>it</sub>, Book Value of Equity<sub>it</sub>, Intangible asset<sub>it</sub>, Goodwill<sub>it</sub> , Age of the firm<sub>it</sub>, PMS<sub>it</sub>, Price to Book ratio<sub>it</sub></b>	<b>Market valuation<sub>it+1</sub></b>	<b>CFOA<sub>it</sub></b>	<b>+ + + + + +</b>

*Source: Author's Methodology*

The study has a dependent variable (Market Value) to test the Value Relevance of the Earning, Book Value of Equity as given in the Ohlson Model (1995) controlling Cashflow from Operating Activities (CFOA). Ohlson Model is extended to analyze the impact of the Intangible Assets and Goodwill of the firm (together known as total Intangible Asset) on the Value Relevance of Market Valuation. These accounting variables are recognized in the books of accounts, but at the same time some variables go missing and unmeasured as well. They are termed as Intangibles in this study. The three proxy variables of Intangibles are Age of the firm, PMS and PB ratio. The justification of these variables can be noted as follows:

1) Age of the Firm: Mature companies often have had more time to develop their unique processes, customer relationships, and brand reputation, which are key components of self-generated goodwill. Experienced firms might have accumulated significant intellectual ideas

through continued investment in research and development over time. The longevity of a firm can also be indicative of sustained competitive advantages due to established intangibles that are not reflected on the balance sheet.

2) Percentage Management Shareholding: A higher percentage of management shareholding can signal stronger alignment between management and shareholder interests, potentially boosting an environment that values the creation of intangibles such as brand value or proprietary knowledge. Managers with substantial equity stakes might be more incentivized to invest in long-term strategies that enhance self-generated goodwill and hence growth potential, as these can contribute to a durable competitive edge and, ultimately, to the firm's valuation.

3) Price to Book Value Ratio: A high PB ratio often suggests that the market recognizes the presence of valuable intangibles within a company, as these assets are typically not recorded on the balance sheet. This ratio can reflect the market's assessment of a company's intangible assets, like brand equity, customer loyalty, or proprietary technology, which are critical drivers of a company's overall value. When the market perceives that a firm has significant self-generated goodwill, this is often reflected in a higher price to book value ratio, as investors are willing to pay more for the firm's shares relative to the recorded book value of its tangible assets. Therefore, the impact of proxies of Self-Generated Goodwill (referred as *Intangibles* in the further discussions) is also tested in the Model 4, 5 and 6 with the purpose of analyzing the value relevance of the model.

$$Y_{it+1} = \alpha + \beta X_{it} + \epsilon_{it}$$

The impact of one lag independent variables is also tested on dependent variable (MV). A control variable (cash flow from operating activities) has also been included in the regression model. Further, please note that an increase in working capital represents a cash outflow and should, under typical circumstances, may be subtracted when calculating cash flow from operating activities. The rule of parsimony has been followed as in the negative outflows are already individually termed negative as variable (as extracted from the Database), hence not in equation. The following regression models provide a statistical relationship between the dependent and independent variables. The regression test and Hausman test results have been interpreted from the p-value or p-statistics.

$$\text{Market Valuation}_{it+1} = \alpha + \beta_1 E_{it} + \beta_2 BVE_{it} + \gamma_1 CFOA_{it} + \epsilon_{it}$$

$$\text{Market Valuation}_{it+1} = \alpha + \beta_1 E_{it} + \beta_2 BVE_{it} + \beta_3 IA_{it} + \gamma_1 CFOA_{it} + \epsilon_{it}$$

$$\text{Market Valuation}_{it+1} = \alpha + \beta_1 E_{it} + \beta_2 BVE_{it} + \beta_3 IA_{it} + \beta_4 GW_{it} + \gamma_1 CFOA_{it} + \epsilon_{it}$$

$$\text{Market Valuation}_{it+1} = \alpha + \beta_1 E_{it} + \beta_2 BVE_{it} + \beta_3 IA_{it} + \beta_4 GW_{it} + \beta_5 Age_{it} + \gamma_1 CFOA_{it} + \epsilon_{it}$$

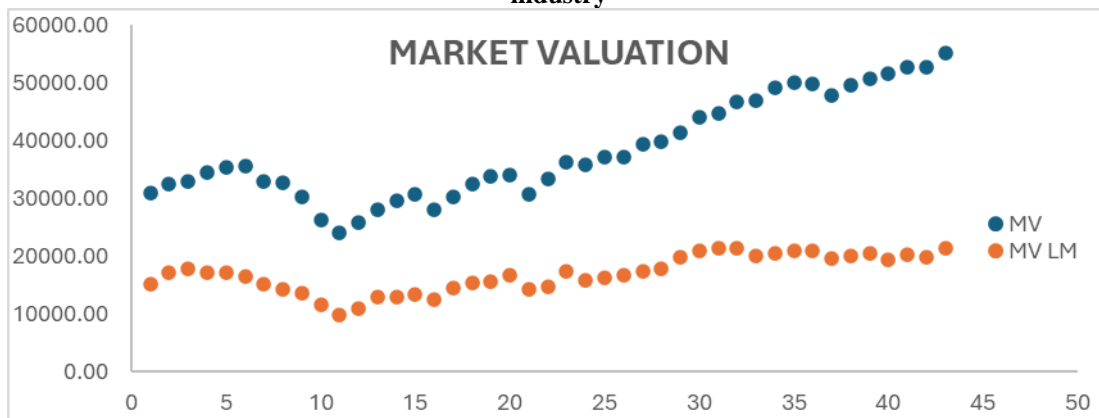
$$\text{Market Valuation}_{it+1} = \alpha + \beta_1 E_{it} + \beta_2 BVE_{it} + \beta_3 IA_{it} + \beta_4 GW_{it} + \beta_5 Age_{it} + \beta_6 PMS_{it} + \gamma_1 CFOA_{it} + \epsilon_{it}$$

$$\text{Market Valuation}_{it+1} = \alpha + \beta_1 E_{it} + \beta_2 BVE_{it} + \beta_3 IA_{it} + \beta_4 GW_{it} + \beta_5 Age_{it} + \beta_6 PMS_{it} + \beta_7 PB_{it} + \gamma_1 CFOA_{it} + \epsilon_{it}$$

Where:

- $MV_{it+1}$  = Market Value of firm i after 1 quarter of time t
- $\alpha$  = Intercept
- $\beta_j$  = Beta coefficient of the j<sup>th</sup> independent variable
- $E_{it}$  = Earnings of firm i at time t
- $BVE_{it}$  = Book Value of Equity of firm i at time t
- $IA_{it}$  = Intangible Asset of firm i at time t
- $GW_{it}$  = Goodwill of firm i at time t
- $Age_{it}$  = Age of the firm i at the time t (in quarters)
- $PMS_{it}$  = Percentage of Management’s shareholding of firm i at time t
- $PB_{it}$  = Price to Book Ratio of firm i at time t
- $\gamma_1$  = Coefficient of the control variable
- $CFOA_{it}$  = Cashflow from Operating Activities
- $\epsilon_{it}$  = Error term

**Graph 1: Quarter-wise average Market Valuation for companies in Non-Luxury industry as well as Luxury industry**



Source: Author’s compilation of data collected from Bloomberg Financial Database

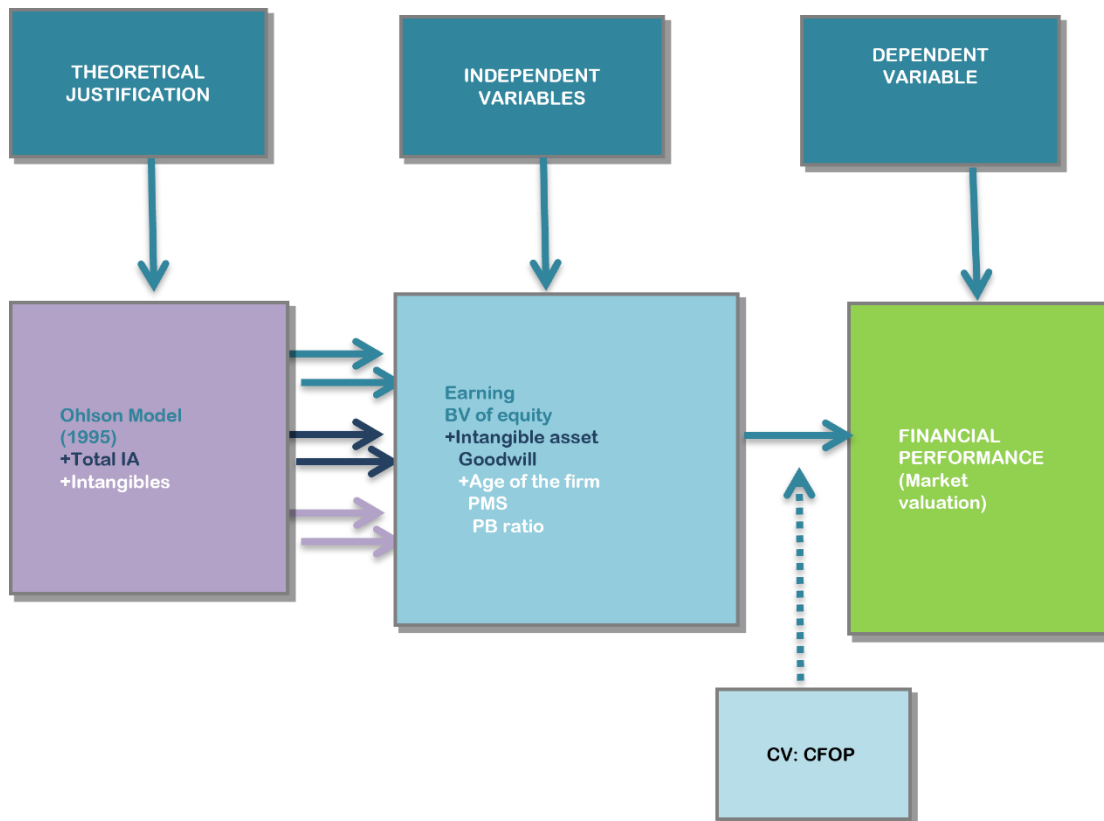
Whenever the *market factors* push the share prices up (or down), the trend is consistent for both the portfolios (See Graph 1). Factors causing further deviations in securities prices from their respective book values other than the market factors, could be two factors. These two factors could either be categorized as unrecognized missing intangible variables or the financial factors.

It is presumed that the impact of financial factors on both the portfolios is uniform. *Therefore, to study the impact of self-generated goodwill (and keeping the impact of market factors constant), a comparison of MV is made between Non-Luxury Industry and the Luxury industry portfolio for each model.*

The models are to test the beta coefficients of independent variables. The null hypothesis for every model is  $\beta_j=0$  as against the alternative hypothesis  $\beta_j \neq 0$ . If the null hypothesis is true,  $X_{it}$  has no effect on  $Y_{it+1}(MV_{it+1})$ .

The Models have tested the impact of Earning, Book Value of Equity, Intangible Asset, Goodwill, Age of the firm, PMS and PB ratio on MV for Non-Luxury Industry and Luxury industry portfolio. In the final model of value relevance, two more variables are tested over and above the basic Ohlson model: total Intangible Asset (Intangible Asset and Goodwill) and Self-Generated Goodwill (Age of the firm, PMS and PB ratio).

**Chart 1: Research Model**



Source: Ohlson Model (1995) and Author's Research model

So, seven-null hypotheses are tested in the final model. The first null hypothesis of this model is *there is no significant linear relationship between independent variable Earning and*

*dependent variable MV.* The second null hypothesis of this model is *there is no significant linear relationship between independent variable Book Value of Equity and dependent variable MV.* The third null hypothesis of this model is *there is no significant linear relationship between independent variable Intangible Asset and dependent variable MV.* The fourth null hypothesis of this model is *there is no significant linear relationship between independent variable Goodwill and dependent variable MV.* The fifth null hypothesis of this model is *there is no significant linear relationship between independent variable Age of the firm and dependent variable MV.* The sixth null hypothesis of this model is *there is no significant linear relationship between independent variable PMS and dependent variable MV.* The seventh null hypothesis of this model is *there is no significant linear relationship between independent variable PB Ratio and dependent variable MV.* This tells us that the beta coefficients of Earning, Book Value of Equity, Intangible Asset, Goodwill, Age of the firm, PMS and PB ratio are equal to zero in the regression model. The alternative hypothesis states that the beta coefficients are not equal to zero.

### **EMPIRICAL ANALYSIS**

Comparing the results of final models of the companies listed under of Non-Luxury Industry and Luxury index, the following observations have been drawn. *Firstly*, it has been ascertained that in Non-Luxury Industry, the variables viz. Earning, Book Value of Equity, Intangible Asset, Goodwill, PMS and PB ratio play significant role in determining the value relevance of accounting variables. These independent variables together explain 77.94% of MV. In the parallel market of Luxury industry, the variables Earning, Book Value of Equity, Intangible Asset, Goodwill, Age of the firm and PB ratio have shown significant impact on the dependent variable. *Secondly*, in both the industries, Earning of the firm is an independent factor with highest beta coefficients as .6506 and .5227 in the Non-Luxury Industry and in Luxury industry respectively. *Thirdly*, the variables Age of the firm and PMS are having negative impact on the MV in Non-Luxury Industry.

<b>Table 3: Comparative analysis of coefficient for the firms listed under Non-Luxury industry and Luxury industry</b>				
	<b>Non-Luxury industry</b>		<b>Luxury industry</b>	
<b>Market Value</b>	<b>Coefficient (Std. Err.)</b>	<b>p-value</b>	<b>Coefficient (Std. Err.)</b>	<b>p-value</b>
Earning	.6506365 (.0107611)	0.0000*	.5226504 (.0545876)	0.0000*
Book value	Omitted		Omitted	
Intangible Asset	Omitted		Omitted	
Goodwill	.1053603 (.0049348)	0.0000*	.1090562 (.0190767)	0.0000*
Age of the Firm	-.0071551 (.0054186)	0.1870	.27109 (.0541095)	0.0000*
Percentage Management's Shareholding	-.0685863 (.0060666)	0.0000*	.0051498 (.0189262)	0.7860
PB Ratio	.1015903 (.0081933)	0.0000*	.010779 (.0323608)	0.0739
Cashflow from Operating Activities: CV	.0057937 (.0047275)	0.2200	.0724784 (.0210816)	0.0010*
Constant	5.197179 (.0755206)	0.0000*	3.073121 (.4935484)	0.0000*
Adjusted R-square		0.7794		0.6607
Hausman Test		0.0000*		0.9058
FE/RE Model	Fixed Effect Model		Random Effect Model	
Earning	.1527985 (.0052315)	0.0000*	.1275551 (.0222781)	0.0000*
Book value	Omitted		Omitted	
Intangible Asset	Omitted		.1380283 (.0302009)	0.0000*
Goodwill	.3585802 (.0063075)	0.0000*	.1187813 (.0584879)	0.0420*
Age of the Firm	.2751324 (.0118101)	0.0000*	.5461908 (.1196214)	0.0000*
Percentage Management's Shareholding	-.0658913 (.0055389)	0.0000*	.04766 (.0464539)	0.3050
PB Ratio	.2919938 (.0062415)	0.0000*	.3193319 (.0388717)	0.0000*
Cashflow from Operating Activities: CV	.0158778 (.0035941)	0.0000*	.0095687 (.0137218)	0.4860
Constant	3.459793 (.1041419)	0.0000*	1.489718 (1.136835)	0.1900

*\*significant at the 5% level*

*significant at the 10% level*

*Source: Author's output table from data collected from Bloomberg Financial Database*

<b>Table 4: Beta Coefficients with standard errors in the six models of Ohlson model in the Non-Luxury industry and Luxury industry</b>						
<b>MODEL</b>	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>	<b>Model 5</b>	<b>Model 6</b>
<b>VARIABLES</b>	<b>E, BVE, CFOA</b>	<b>M1, IA</b>	<b>M2, GW</b>	<b>M3, AGE</b>	<b>M4, PMS</b>	<b>M5, PB</b>
<b>Adj. R<sup>2</sup> of NLI</b>	0.8155	0.8191	0.8216	0.8262	0.8091	0.7794
<b>Adj. R<sup>2</sup> of LI</b>	0.8058	0.8215	0.771	0.77	0.7617	0.6607
<b><math>\beta_1</math> (<math>\beta</math> coef. of E)</b>	0.516419* (0.010839)	0.512891* (0.011405)	.5180861* (0.0119155)	.5302423* (0.0119998)	.507669* (0.0136821)	.6506365* (0.0107611)
	0.5419272* (0.033053)	0.466268* (0.030579)	.4336956* (0.041874)	.4300488* (0.041645)	.4186427* (0.047052)	.5226504* (.0545876)
<b><math>\beta_2</math> (<math>\beta</math> coef. of BV)</b>	0.3307166* (0.01057)	0.276088* (0.010553)	0.2826716* (0.0110602)	.2719027* (0.0114031)	.2450525* (0.0120159)	Omitted  Omitted
	0.2857924* (0.031046)	0.2564666* (0.032128)	.2962002* (0.031666)	.306686* (0.034118)	.284121* (0.034539)	
<b><math>\beta_3</math> (<math>\beta</math> coef. of IA)</b>		0.060142* (0.003366)	Omitted	Omitted	Omitted	Omitted
		0.0467692* (-0.012134)	.0591671* (0.020859)	.0661533* (0.021715)	.0896924* (0.0257)	Omitted
<b><math>\beta_4</math> (<math>\beta</math> coef. of GW)</b>			0.0535306* (0.0034057)	.0592225* (0.0035733)	.0613584* (0.003794)	.1053603* (0.0049348)
			.0238056 (0.013701)	.0152502 (0.016275)	.0367014 (0.020676)	.1090562* (.0190767)
<b><math>\beta_5</math> (<math>\beta</math> coef. of Age)</b>				0.0063694 (0.0044612)	-0.0025282 (0.0050008)	-0.0071551 (0.0054186)
				-.0385786 (0.037573)	-.0416214 (0.053526)	.27109* (.0541095)
<b><math>\beta_6</math> (<math>\beta</math> coef. of PMS)</b>					-0.0534199* (0.0053127)	-0.0685863* (0.0060666)
					.0268008 (0.015445)	.0051498 (.0189262)
<b><math>\beta_7</math> (<math>\beta</math> coef. of PB)</b>						.1015903* (0.0081933)
						.010779 (.0323608)
<b><math>\beta_8</math> (<math>\beta</math> coef. of CFOA: CV)</b>	0.0147153* (0.003201)	0.016327* (0.003445)	0.0198171* (0.0035251)	.0188482* (0.0037339)	.0132585* (0.0044432)	0.0057937 (0.0047275)
	-0.0050657	.0344098*	.0443251*	.0449818*	.0495991*	.0724784*

	(0.01326)	(0.012826)	(0.014502)	(0.014568)	(0.017344)	(.0210816)
<b>Constant</b>	3.971942* (0.043591)	3.983476* (0.042682)	3.939406* (0.0430173)	3.865708* (0.0633022)	4.342185* (0.0718236)	5.197179* (0.0755206)
	4.140532* (0.136009)	4.363244* (0.128166)	3.892165* (0.170254)	4.183065* (0.292588)	4.263683* (0.382212)	3.073121* (.4935484)

*\*significant at the 5% level*

*significant at the 10% level*

*Source: Author's output table from data collected from Bloomberg Financial Database*

It may be interpreted as grown-up (or recently incorporated) companies have lower (or higher) MVs in Non-Luxury Industry. Whereas in Luxury industry, the relation between the Age of the firm and MV is positive. It can be inferred in the Luxury industry that a grown-up (or recently incorporated) company has higher (or lower) MV. This can probably be justified as the role of Intangibles increases with time. In Luxury companies, the impact of Age of the firm (as an intangible factor) is reflected in the company's MV later. Besides this, as higher PMS implies that a major Agency cost would be borne by the company, hence the Earning of the firm would go down, and thus the MV will fall in Non-Luxury Industry. In the markets of luxe, the shares are predominantly held privately, so the concept of ownership and management of the firm coincides. Therefore, the Agency cost theory may be exempted in Luxury industry. So, higher PMS in Luxury industry implies higher MV. *Fourthly*, the variables Book Value of Equity and PB ratio seem to explain the same underlying factor. Another multicollinearity has been observed between Intangible Asset and Goodwill of the firm.

On the other hand, the concept of the value relevance can be concluded by referring to the adjusted R-square statistics of the models. It could be observed from the Table that value relevance of accounting information is more recognized in Non-Luxury Industry whereas the Luxury industry still needs more factors to be included in the model to achieve parallel degrees of explanation.

In the study, *Value Relevance (Ohlson)* model has been estimated and examined. The test results are interpreted model wise. The research objective to compare the value relevance of Intangibles in Luxury industry and Non-Luxury Industry has been tested by the Ohlson Model (1995). The usefulness of accounting information has been conceptualized as Value Relevance. The value relevance is measured as a proportion of adjusted R-square. The extended Ohlson model has somehow a distinguished explanation comprising all the factors. Concluding all the six models tested by Ohlson methodology, the research question can be answered as follows:

- 1) The financial performance of Luxury industry is found to be *less value relevant* than the Non-Luxury Industry.

- 2) The value relevance of *Non-Luxury Industry* can be increased by the factors *Intangible Assets, Goodwill and Age of the firm*.
- 3) The value relevance of *Luxury industry* could possibly go up by including *Intangible Assets* in the model.
- 4) The factors like *PMS* and *PB ratio* could not significantly contribute to the value relevance of the models in both the markets.

From the statistical analysis, the impact of *Total Intangible Assets (Goodwill and other Intangible Asset)* and *Intangibles (Age of the firm, PMS and PB ratio)* can be concluded as follows: -

- 1) The interpretations from *Ohlson model* can be drawn as the *Goodwill and other recognized Intangible Assets* are significant variables to explain the *MV*.
- 2) The *Goodwill and other Intangible Assets* are measuring the same informational content (*multicollinearity*) for *MV* in the *Non-Luxury portfolio* study. This finding is found to be similar in both the markets.
- 3) The proxy variable *PMS* is negatively influencing the *MV* in *Non-Luxury Industry*. Unlike the *Luxury industry*, where the *PMS* is more privately held and lacks the conflict between management and owners of the company.
- 4) The *PB ratio* is a significant variable to have explained *MV* in the *Non-Luxury Industry* as well as in the *Luxury industry portfolio*.

The preliminary *Ohlson model* has shown less value relevance in the *Luxury industry* than the *Non-Luxury Industry*. The value is even less relevant when the *Goodwill and other Self-Generated Goodwill (Age of the firm, PMS and PB ratio)* are included in the regression model. However, *the accounting information recognized by Luxury companies is found to be less value relevant than the Non-Luxury Industry in the study*.

The impact of (recognized) *Intangible Assets* on financial performance has been interpreted by the beta-coefficient of the dependent variables (*Goodwill and Intangible Assets*). The following two inferences could be drawn from the result of statistical models. The impact of *Intangible Assets* on *MV* of firms (as a measure of financial performance) is found to be higher in the *Non-Luxury Industry* than *Luxury industry*. The impact of *Goodwill* of firm is parallel to the findings of *Vincent (1994)* and *Bugeja and Gallery (2006)*. They found that merely the recently acquired *Goodwill* has significant information content. This study has also found similar results as the findings of *Ji and Lu (2014)*. They have analyzed the *Value Relevance of Intangible assets* and have shown that *Intangible assets* are value relevant in *Australia*. The literature has drawn instances to show that *Intangibles* are value relevant. Scholars like

McCarthy and Schneider (1996); Francis and Schipper (1999); Lev and Zarowin (1999); Goodwin and Ahmed (2006) have supported the statement that Intangibles are value relevant and there exists a statistically significant association between firms' MV and information about the value of Intangibles.

The three proxy variables of Intangibles are Age of the firm, PMS, PB ratio. The PMS is the only dependent variables which has shown higher impact on the financial performance in Luxury industry than the counterpart Non-Luxury Industry. On the other hand, Age of the firm and PB ratio are more significant in Non-Luxury Industry than the Luxury industry to impact the financial performance.

The Age of the firm has had a negative impact on the MV of Non-Luxury Industry, which has also been supported by Agarwal and Gort (1996, 2002). They found that the old age of the firm may make knowledge, abilities, and skills obsolete and induce organizational decay. Loderer, Neusser, and Waelchli (2009) concluded also favour the similar research findings. They advocate that only the better firms survive with Age of the firm. In the Luxury portfolio, a contrary outcome has been observed that is the age-old firm has a positive impact on the MV. It has also been backed by Hopenhayn (1992) who has proved that older firms enjoy higher MV. In the Luxury industry, this positive impact is probably contributed by the (less quantified) Intangibles. However, the impact of PB ratio on MV is found to be positive. The similar statistical results have been contributed by Fama and French (1991) who recognized that the PB ratio explains MV better than beta does.

## CONCLUSIONS AND RECOMMENDATIONS

The research entitled "Unrecognized Intangibles and Value Relevance" embarks on a journey to explore the determinants of market valuation within the luxury industry, benchmarking it against non-luxury sectors. The intention is to scrutinize the considerable influence of intangibles within the luxury industry. Despite observing parallels and sometimes opposite interpretations in the various models when comparing the two sectors, certain key conclusions are drawn.

Primarily, the value relevance statistic remains consistent across both markets. However, in the absence of intangibles, the financial performance of the luxury industry exhibits less value relevance compared to non-luxury sectors. Among the assessed independent variables, only recognized intangible assets emerged as a component that could further enhance the model's value relevance. Variables like goodwill and firm age appeared value relevant in non-luxury sectors but didn't hold true for the luxury industry. Profit Margin on Sales and Price-to-Book (PB) ratio did not further elevate the value relevance.

Secondarily, an important observation is that several intrinsic variables generated internally by the firm are omitted from accounting statements, though they are often mirrored in financial markets via fair equity pricing. This non-recognition tends to cause share prices to deviate from book values. These concealed self-generated goodwill often become quantifiable and public during mergers or acquisitions.

Thirdly, the findings hold substantial implications for corporate management and policymakers, urging the necessity for mandatory disclosure and reporting of intangibles within firms' accounting statements. This transparency will enable stakeholders to accurately assess a firm's true value.

Fourthly, unrecognized intangibles exert influence on financial performance, indicating that key variables may be systematically overlooked by accounting standard setters.

Fifthly, the success of an organization rests on its ability to utilize its workforce optimally to enhance the firm's value. Corporations should thus focus on intangibles to strengthen their financial statements and further increase the relevance of accounting information.

Sixthly, accounting standards have been framed in a way that consistently presents intangibles with recognition challenges.

Seventhly, prevailing biases and distortions in investors' perceptions can obscure the intrinsic connection between intangibles and subsequent financial performance.

Eighthly, to uphold the consistency principle for asset measurement, self-generated goodwill must be accorded the same importance as acquired goodwill. A balance must be struck between the principles of full disclosure and conservatism, particularly relevant to self-generated goodwill.

Finally, it is straightforward to adhere to the matching and cost principles for self-generated (not acquired) assets, especially before any third-party engagement for mergers or acquisitions.

### **LIMITATIONS AND SCOPE FOR FURTHER STUDY**

After coming across numerous research studies and studying the methodologies, this study has located the research gaps and attempted to fill the identified ones. Despite trying the best of efforts, it faces the following limitations. *Firstly*, many unlisted companies are there in Luxury industry, but due to non-availability of financial data of such companies, they could not be included in the sample data collected. *Secondly*, the selection of a portfolio to study Luxury industry has been made without many options to choose from. The S&P Global Luxury Index has maximum number of available listed Luxury industry companies. So, the study is based upon the data collected merely from these handful number of companies. *Thirdly*, the variables associated to proxy self-generated goodwill may not be easily quantified and because of which the Intangibles measurement is often left incomplete. The future research can revisit the three limitations of the study mentioned above.

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