

THE INTELLECTUAL CAPITAL REPORTING FOR THE ENTERPRISE VALUE CREATION

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. INTRODUCTION

The term ‘enterprise value’ came to be in the spotlight these days. What creates the enterprise value? It was once a value driver to built large plants and to make the most of ‘economics of scale.’ That is, the mass production and the reduction in products prices made an expansion of market share and an increase in profit. Recently, however, an intangible asset has been the value driver. The enterprise value has been dependent on not tangible but intangible assets.

Nowadays, among intangible assets, intellectual property attracts a great interest. Intellectual capital is not a tangible asset, but it creates the enterprise value. So, the management of intellectual capital is a very important problem for managers. Among tools of managing and reporting intellectual capital is Skandia Navigator. Skandia is a famous insurance and finance company in Sweden. Skandia’s intellectual capital management approaches are ones “to managing the intangibles that underlie knowledge-intensive service companies; but they are applicable to most organizations as a model for creating and extracting value from their investments in knowledge and other intangibles” (Edvinsson 1998, 279). Skandia Navigator is a pioneer work in this field, and had much effect on managing and reporting intellectual capital from then on.

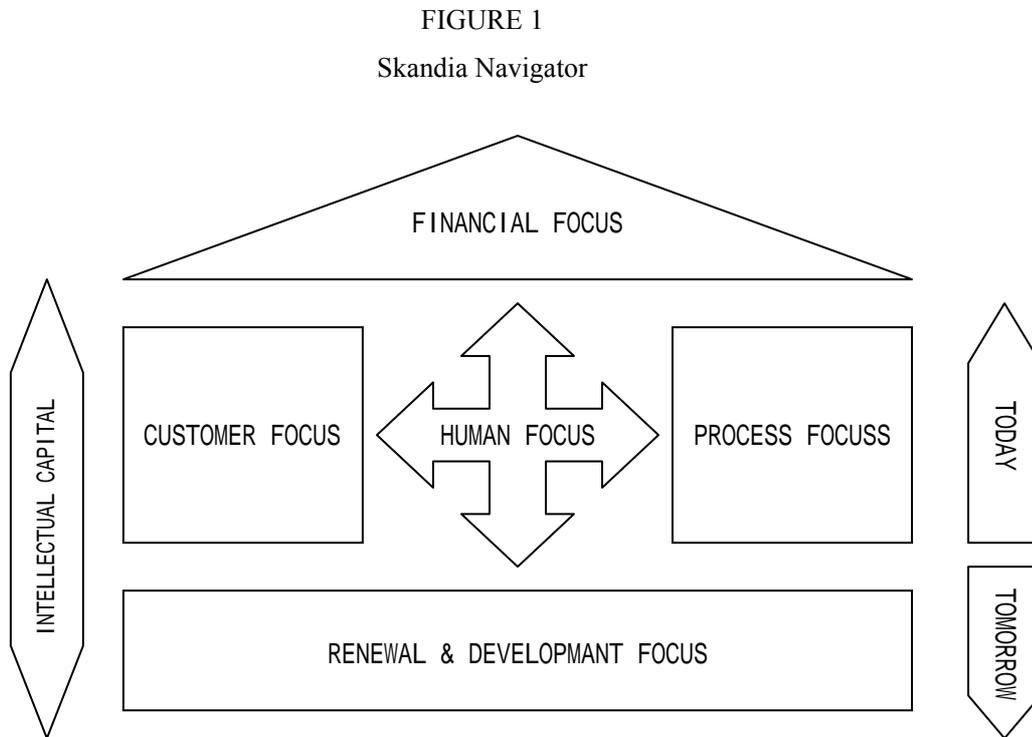
Most papers on Skandia Navigator are no more than introduction of Skandia’s intellectual capital management, and papers which examine the significance of Skandia Navigator are rare. So the purpose of this paper is to study the usefulness of Skandia Navigator, and to examine the significance of Skandia Navigator as an external reporting device. The following sections are organized by five parts. The next section surveys some features of Skandia Navigator. Section surveys the usefulness of Balanced Scorecard (hereafter BSC) in which Skandia Navigator has its origin, and examine the usefulness of the latter on the analogy of that of the former. Section examines the usefulness of Skandia Navigator as an external reporting device. And last section gives a conclusion.

. SKANDIA’S INTELLECTUAL CAPITAL REPORTING

1. Skandia Navigator

In the 1980s, Skandia innovated its management to cope with the diversity and complexity of customers’ needs. After this reformation, Skandia’s management felt that new management system “resulted in ‘hidden value’ for Skandia (.....) that was not reflected in traditional financial statements, and they wanted a way to ‘visualize’ that value within the company and to communicate it to the stock market” (Ashton 2005, 64). To do so, they defined intellectual capital as difference of

market value and book value of stocks, and developed Skandia Navigator, shown in FIGURE 1.



Source: Skandia 1994 , 7

Skandia Navigator is a tool of visualizing its value. It consists of five areas, namely a financial area and four non-financial areas. The financial area, i.e. “the financial focus is the past of the firm, a precise measure of where it was at a specific moment” (Edvinsson and Malone 1997, 68). And not the financial area but the other areas, i.e. the non-financial areas designate intellectual capital. The customer focus is “measuring a distinct type of Intellectual capital” (Edvinsson and Malone 1997, 69), and “involves a broad set of relationships with customers, based largely on aspects of the human and process areas” (Ashton 2005, 64). The process focus is “part of the larger measure of structural capital” (Edvinsson and Malone 1997, 69), and “concerns the efficiency and effectiveness of internal processes that support customer needs” (Ashton 2005, 64). The renewal & development focus is “the other part of structural capital” (Edvinsson and Malone 1997, 69), and “concerns investments made to support the human, process, and customer focus areas for the present and to improve them for the future” (Ashton 2005, 64). That is, this focus “looks at the future” (Edvinsson and Malone 1997, 69). The human focus is the rest of the overall intellectual capital excluding structural capital, and “concerns the knowledge, skills, and abilities of employees that enable them to meet the needs of customers or provide other value-adding services to the organization” (Ashton 2005, 64).

As FIGURE 1 shows, these five focuses are compared with a form of house. That is to say, the

financial focus is likened to a roof. The customer and process focuses are likened to walls. The renewal & development focus is likened to foundations of a house. And the human focus “lies at the center of the soul of the organization. Moreover, as the only active force in the organization, it touches all of the other I(ntellectual)C(apital) regions” (Edvinsson and Malone 1997, 69). “With such a metaphor, renewal and development becomes the critical bottom line for sustainability” (Edvinsson 1997, 371).

2. Navigator as a Type of BSC

The basic idea of Skandia Navigator is based on BSC. As you know, with BSC, performance is measured in terms of four perspectives; financial, customer, internal-business-process, and learning and growth. The financial perspective shows a company’s past. “Financial measures are valuable in summarizing the readily measurable economic consequences of actions already taken. (Moreover,) financial performance measures indicate whether a company’s strategy, implementation, and execution are contributing to bottom-line improvement” (Kaplan and Norton 1996, 25). Both the customer perspective and the internal-business-process perspective show a company’s present. The customer perspective “includes (.....) measures of the successful outcomes from a well-formulated and -implemented strategy” (Kaplan and Norton 1996, 26). The internal-business-process perspective shows “the critical internal processes in which the organization must excel” (Kaplan and Norton 1996, 26). That is, “the internal-business-process measures focus on the internal processes that will have the greatest impact on customer satisfaction and achieving an organization’s financial objectives” (Kaplan and Norton 1996, 27). The learning and growth perspective shows a company’s future. This “identifies the infrastructure that the organization must built to create long-term growth and improvement” (Kaplan and Norton 1996, 28). These perspectives of BSC are very similar to focuses of Skandia Navigator. This is because the latter was developed on the basis of the former. That is, Skandia Navigator is a type of BSC.

However, BSC and Skandia Navigator are not completely same. Ashton (2005, 87) points out following two points as the difference.

- The human focus (.....) does not constitute a separate Balanced Scorecard category, but is included in learning and growth.
- Some aspects of the Navigator’s renewal and development focus would be subsumed under the Balanced Scorecard's internal business processes category, specifically in the subcategory of ‘innovation processes.’

Mochiduki (2006, 31) also points out following two differences.

- BSC is a top-down structure, while the Navigator is a bottom-up structure.
- The learning and growth perspective in BSC corresponds to two focuses, renewal & development and human in Navigator.

Among these differences, it is worthwhile to note that both point out independence of the human focus. “In Skandia there were several arguments for adding this focus to the model. One was that a separate human focus was needed in order to emphasize that the human resources were seen as the most important resources in the organization. (.....) Another argument regarding the human focus was that management at Skandia argued that there is a multiplier function built into the human focus that enhances the other focus areas’ value” (Olve et al. 2003, 40-41).

. THE USEFULNESS OF SKANDIA NAVIGATOR ON THE ANALOGY OF THAT OF BSC

In order to consider the usefulness of Skandia Navigator, firstly I would like to investigate the usefulness of BSC. TABLE 1 is a summary of prior empirical researches on the usefulness of BSC.

TABLE 1
The Usefulness of BSC

Banker et al. (2000)	Purpose: To examine the financial effects of incorporating non-financial measures in incentive contracts. Data: hotel chain, from January 1991 to December 1996 (72 months) Results: <ul style="list-style-type: none"> ● Customer satisfaction impacts the future rather than the current financial performance (Banker et al. 2000, 82). ● Nonfinancial measures of customer satisfaction help predict future financial performance (Banker et al. 2000, 86).
Davis and Albright (2004)	Purpose: To determine whether an improvement in financial performance occurred after implementing a BSC and whether the change in financial performance is significantly greater than performance observed in a similar setting where a traditional performance measurement system using only financial measures is employed. Data: bank branches, from June 1999 to June 2001 Results: <ul style="list-style-type: none"> ● The treatment effect of the BSC produced a significant and positive effect on the (.....) (financial) measure (Davis and Albright 2004, 149). ● Branches in the BSC group outperformed non-BSC branches on a common composite financial measure (Davis and Albright 2004, 150).
Hoque and James (2000)	Purpose: To examine the relationship between organization size, product lifecycle stage, market position, BSC usage and organizational performance. Data: 66 Australian manufacturing companies, July 1997 Results:

	<ul style="list-style-type: none"> ● Results support the hypothesis that greater BSC usage is associated with larger organization size and businesses with products at the early/growth stage (Hoque and James 2000, 10). ● Results do not support the hypothesis that greater BSC usage is associated with businesses with a strong market position (Hoque and James 2000, 10). ● Greater BSC usage is associated with increased organizational performance, but this relationship does not significantly depend on organizational size, product life cycle, or market position (Hoque and James 2000, 12).
Ittner et al. (2003)	<p>Purpose: To examine how different types of performance measures were weighted in a subjective BSC bonus plan.</p> <p>Data: major American financial services firm, 1990s</p> <p>Results:</p> <ul style="list-style-type: none"> ● We find little evidence consistent with the hypothesis that the weights placed on nonfinancial measures are a function of their ability to predict future changes in performance (Ittner et al. 2003, 746). ● The use of subjectivity in weighting the measures in a BSC bonus plan allowed supervisors to ignore many performance measures, with financial performance became the primary determinant of bonuses (Ittner et al. 2003, 753).
Lipe and Salterio (2000)	<p>Purpose: To examine judgmental effects of the BSC—specifically, how BSC that include some measures common to multiple units and other measures that are unique to a particular unit affect superiors’ evaluations of that unit’s performance.</p> <p>Data: 58 M.B.A. students, experiment</p> <p>Results:</p> <ul style="list-style-type: none"> ● The pattern of performance on common measures affects the managers’ evaluations, while the pattern for unique measures does not (Lipe and Salterio 2000, 293). ● The unique measures in a business unit’s BSC may be underweighted in performance evaluation (Lipe and Salterio 2000, 293). ● Under-weighting nonfinancial and leading measures undermines the goals of the BSC, which was expressly designed to incorporate such measures into managerial thought and decision making (Lipe and Salterio 2000, 294).
Malina and Selto (2001)	<p>Purpose: To examine the effectiveness of the BSC as a strategy communication and management-control device.</p> <p>Data: U.S. Fortune 500 company, mid-1999</p> <p>Results:</p> <ul style="list-style-type: none"> ● Managers react favorably to the BSC and heed its messages when: <ul style="list-style-type: none"> • BSC elements are measured effectively, aligned with strategy, and reliable guides for changes, modifications, and improvements; • The BSC is a comprehensive measure of performance that reflects the needs of effective management; • The BSC factors are seen to be causally linked to each other and tied to meaningful rewards;

	<ul style="list-style-type: none"> • BSC benchmarks are appropriate for evaluation and useful for guiding changes; and • Relative BSC performance is a guide for improvement (Malina and Selto 2001, 75). ● The following factors were found to negatively affect perceptions of the BSC and cause significant conflict and tension between the company and its distributors. <ul style="list-style-type: none"> • Measures are inaccurate or subjective; • Communication about the BSC is one-way (i.e., top-down and not participative); and • Benchmarks are inappropriate but used for evaluation (Malina and Selto 2001, 75).
Moers (2005)	<p>Purpose: To examine the impact of performance measure diversity and the use of subjective performance measures on performance evaluation bias.</p> <p>Data: a privately held Dutch industrial firm focused on maritime activities, 1998</p> <p>Results:</p> <ul style="list-style-type: none"> ● It is questionable whether a BSC that includes a large number of performance measures is effective as a performance measurement and reward system, if the superior has discretion in weighting these measures (Moers 2005, 79). ● If more subjectivity is used in evaluating and rewarding employees, superiors give higher performance ratings and compress these ratings. As a result, the firm is unable to separate the highly skilled employees from the less skilled employees (Moers 2005, 79).
Speckbacher et al. (2003)	<p>Purpose: To provide systematic research-based evidence on the usage of the BSC concept in German-speaking countries, by developing three primary types of BSC usage reflecting the successive phases in the evolution of the BSC concept and of its implementation in practice.</p> <p>Data: 174 companies among all DAX100 companies in Germany, all listed ATX and Midcap companies in Austria, and the 50 largest companies quoted on the stock exchange of Switzerland, from 2000 to 2001</p> <p>Results:</p> <ul style="list-style-type: none"> ● Almost all of the companies questioned use the three proposed perspectives “Financial”, “Customer”, and “Internal Business Process” (Speckbacher et al. 2003, 370). ● Fewer than two-thirds of the companies use the perspective “Learning and Growth” (Speckbacher et al. 2003, 370). ● The users of the BSC in everyday company practice dismiss the view that the BSC supports stakeholder management and/or investments in intangible assets (Speckbacher et al. 2003, 370).

As to the usefulness of BSC, Banker et al. (2000); Davis and Albright (2004); Hoque and James (2000) are positive, but Ittner et al. (2003); Lipe and Salterio (2000); Moers (2005) are

negative. Malina and Selto (2001); Speckbacher et al. (2003) are neutral. As far as these results are concerned, we cannot make an immediate decision that BSC and, moreover, Skandia Navigator are useful.

The positive effect of customers' satisfaction on a financial performance (Banker et al. 2000) is consistent with the opinion of several disciplinary studies that "customer satisfaction is found to be associated with increases in both customer retention and revenue" (Ashton 2005, 78). Several disciplinary studies show "R&D spending to be positively related to financial outcomes such as sales growth, share returns, and book-to-market values" (Ashton 2005, 84). But, according to Speckbacher et al. (2003), the learning and growth perspective is not made so much of as the other perspectives, and "the users of the Balanced Scorecard in everyday company practice dismiss the view (.....) that the BSC supports (.....) investments in intangible assets" (Speckbacher et al. 2003, 376). This is a controversial point. Because Hoque and James (2000) indicates that product lifecycle stage is related to use of BSC, BSC is expected to be useful for companies with many products in an early product lifecycle stages. Moreover, Problems about the subjectivity of performance measures, the use of multiple measures, and the use of particular measures can ruin Skandia Navigator's advantage to use non-financial measures. On this point, more deliberate consideration is needed.

On a basis of above discussion, the following considerations are needed to enhance the usefulness of Skandia Navigator. Firstly, I would like to give some comments on the human focus, which is unique to Skandia Navigator. Ashton (2005, 75-77) emphasizes the distinction between human resources and human resources practices, and says that recent research focus gradually moves from the former to the latter. Besides, human resources practices are categorized into two aspects; technical and strategic. Several disciplinary studies suggest "that strategic activities are more strongly associated with firm performance" (Ashton 2005, 77). Therefore, in designing Skandia Navigator in practice, smooth communication is needed to enhance the support of strategic management control. Besides, the technical aspect of human resources practices includes individual performance evaluation and rewards. By analogy with Malina and Selto (2001), which investigates the rewards system on BSC, Skandia Navigator is expected to be useful, if its "factors are seen to be causally linked to each other and tied to meaningful rewards" (Malina and Selto 2001, 75). But, as Ittner et al. (2003) shows, Skandia Navigator may be useless when there is large room for subjectivity.

Secondly, I would like to give some comments on subjectivity in implementing Skandia Navigator. According to Ittner et al. (2003); Malina and Selto (2001); Moers (2005), if there is large room for subjectivity, performance is affected negatively. We must admit that there is room for subjectivity in Skandia Navigator, because it includes qualitative information, non-financial measures. But, if non-financial measures were omitted, Skandia Navigator's advantage of non-financial measures would be denied. Therefore, in implementing Skandia Navigator, the effort

will be needed to remove subjectivity as much as possible. For example, evaluation by multiple managers will be useful.

Thirdly, I would like to give some comments on the use of multiple measures in designing Skandia Navigator. According to Moers (2005), the use of multiple measures has negative influence on the usefulness of BSC. As well as the problem on subjectivity, the use of multiple measures is one of advantages for Skandia Navigator. So, a deliberate consideration is needed about the optimum number of performance measures.

Fourthly, I would like to give some comments on the usefulness of Skandia Navigator as an external reporting device. As to this point, Banker et al. (2000, 86) shows positive result, but Ittner et al. (2003, 746) shows negative result. We cannot make an immediate decision from these researches. Moreover, Banker et al. (2000, 86) focuses only on customers' satisfaction, and Ittner et al. (2003) is based on bonus plan adopted by a financial services firm. Their scope of study is quite limited. Therefore, more empirical studies are needed.

. THE USEFULNESS OF SKANDIA NAVIGATOR AS AN EXTERNAL REPORTING DEVICE

In this section, I would like to consider the usefulness of Skandia Navigator as an external reporting device from a theoretical point of view. As mentioned above, intangible assets came to be taken note of these days. For example, AICPA (1994) shows the importance of intangible assets disclosure as follows:

Although users oppose expanding the recognition of intangible assets, users are aware of the importance of those assets and the competitive advantage they may create for a company. Thus, they would welcome improvements in disclosures about the identity, source, and life of both purchased and internally generated intangible assets.

Besides, not only intangible assets information but also the following information came to be made much of these days (AICPA, 1994):

To meet users' changing needs, business reporting must:

- (a) Provide more information with a forward-looking perspective, including management's plans, opportunities, risks, and measurement uncertainties.
- (b) Focus more on the factors that create longer term value, including non-financial measures indicating how key business processes are performing.
- (c) Better align information reported externally with the information reported to senior management to manage the business.

As to the importance of non-financial information, FASB (2001, 106) says as follows:

Users value disclosure of nonfinancial information. Presentation of nonfinancial performance information in metrics that can be tracked from period to period would enhance the usefulness of that information. Presenting a “suite” of nonfinancial metrics would enhance both the usefulness and accessibility of that information.

One of what satisfy these factors is Skandia Navigator. Needless to say, Skandia Navigator shows intellectual capital, which is a part of intangibles. On this point, Skandia Navigator satisfies users’ needs for intangible assets disclosure. As FIGURE 1 shows, the renewal & development focus is related to tomorrow, that is, Skandia Navigator includes forward-looking information. All focuses except for financial focus are non-financial. So, Skandia Navigator satisfies users’ needs for non-financial information. Skandia Navigator is not only a external reporting tool of intellectual capital, but also “a management tool that aids in operative planning and strategic innovations” (Edvinsson and Freij 1999, 196). On this point, Skandia Navigator satisfies users’ needs for alignment of external and internal reporting. Because Skandia Navigator satisfies all of users’ needs listed above, it is expected to be useful for them.

However, there are dissenting opinions to Skandia Navigator. For example, Rutledge (1997) says as follows:

(Edvinsson) and his colleagues at Skandia built a model that at last count had 164 different variables, not including subcategories, to explain and measure intellectual capital. It must have been a long night when they thought all those things up, because toward the end they had to use “share of employees under age 40 (%),” “number of women managers,” and “average age of employees” to pad the list. I can’t even imagine what they had in mind with those ideas.

Indeed, the election of variables is a difficult problem for the usefulness of Skandia Navigator. But, Rutledge’s dissent is not substantial, because we can adjust the number and the content of variables. As you know, it is one of the advantage of Skandia Navigator to incorporate non-financial measures into external reporting. Concerning to the usefulness of non-financial information, Bryan (1997, 287) says that “certain MD&A disclosures, particularly the discussions of future operations and planned capital expenditures, are associated with future (short-term) performance measures and investment decisions. Therefore, in conjunction with the financial statements, the MD&A can assist the investor in assessing a firm’s future prospects.” This proves that non-financial information coupled with financial information may be useful for investors. So, in conjunction with the financial statements, Skandia Navigator is expected to be useful for users. But, as Lipe and Salterio (2000)

finds out, if common measures are made much of in performance evaluation and non-financial measures unique to a business are not, BSC's advantage of incorporating non-financial measures may be denied. So we must elect variables deliberately. There is not yet a determinant answer to what and how many variables are appropriate. More empirical studies are needed on what variables are useful.

. CONCLUDING REMARKS

“The research strongly supports the contention that the kinds of intangible value drivers encompassed by the Skandia Business Navigator are positively associated with financial outcomes at both the firm and market level” (Ashton 2005, 67-68), according to “research conducted over the past 20-plus years in several areas, including marketing, operations, accounting, information systems, human resource management, economics, and strategy” (Ashton 2005, 68). Indeed Skandia Navigator is expected to meet the Users' needs, but it is not the only and best device to meet them. There is room for more research for intellectual capital reporting.

The examination in this paper, especially as to section , has the following limitations. Firstly, the number of prior research which we examined was quite limited. There are few studies which examined the usefulness of BSC, let alone Skandia Navigator. The learning which was gained from few studies is no more than provisional. Secondly, the prior studies which we examined are based on a data of specific countries. Because culture and social system etc. are different from country to country, the learning in this paper cannot be generalized without deliberation. Thirdly, the examination of the difference between BSC and Skandia Navigator may be insufficient. The concepts of BSC and Skandia Navigator are multiple in detail. The differences which we overlook may affect the discussion of the usefulness of Skandia Navigator.

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