Impact of Intangible Determinants on ROE: An Empirical Study of Luxury Industry

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Abstract
The DuPont analysis guides the equity owners as well as the managerial team of company to find out the composition of financial return ROE which is contributed by three distinct variables (Profitability, Efficiency and Leverage of the firm). The determinants of Return of Equity have been extended from the DuPont model to Liquidity, Intangible Assets and Self-Generated Intangible(proxy variable). The statistical relationship is tested between the Intangible Asset variables and the financial performance (ROE) on the two comparative portfolios: S&P 500 and S&P Global Luxury Index. Paper examine whether the measured Intangible Assets and proxies of Self-Generated Intangible are contributing to improve the returns in a significant manner or not. The OLS statistical results have found that in the Non-Luxury Industry, PB ratio has been the most significant factor to determine the ROE. On the other hand, the Luxury industry's ROE is dependent majorly upon Efficiency of firm.

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Keywords: Intangibles, Luxury, Industry, ROE, DuPont Efficiency, Leverage, India

I. Introduction
THE FOCAL POINT of every investment is the returns accruing to them. This measure of Financial Performance (Return on Equity (ROE)) is often deep dived in finance to identify the rewards for these stakeholders. The DuPont model of Return on Equity has always drawn the attention towards the three component indicators of financial performance. The model has shown that the significant indicators of financial performance are Profitability, Efficiency and Leverage of the firm. The DuPont has often guided the equity owners as well as the managerial team of company to figure out the source composition of financial return (ROE) being contributed

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predominantly pinpoints towards measurement underestimation of Self-Generated Intangibles.

The variables created by the firm in-house are missing from the perspective of accounting measurement. These variables are often reflected by the financial markets in equity prices. This lack of recognition within the firm takes the share prices away from the Book value. Accounting standard boards advocate that Self-Generated Goodwill is missing the precise variables or scale for measurement. This disguised Self-Generated Goodwill variable is often quantified and made public information when these firms undergo a corporate merger and acquisition. The results are crucial for firms’ management and policy makers to make Self-Generated Goodwill disclosures and reporting mandatory in firms’ accounting statement. It seems to be a requisite and desperate avenue for the stakeholders to identify the true value of firm. The crucial variables may not have been taken well care of by the accounting standard setters. Companies should pay attention towards Intangibles to enhance the scope of Financial Statement and further enhance the relevance of Accounting Information. The accounting standard setters have devised the standards in such a way that the Intangibles have always been confronting the restrictive recognition problem. The contemporary biasness and distortions in investor’s perception tend to haze the intrinsic relationship between Intangibles and its subsequent financial performance.

References


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Annexure

Table A.1

Variables and Formulas

<table>
<thead>
<tr>
<th>Ratios</th>
<th>Descriptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>LIQUIDITY</td>
<td>Examine a firm’s ability to meet ST obligations</td>
</tr>
<tr>
<td>Quick ratio</td>
<td>LA/CL</td>
</tr>
<tr>
<td>Liquid Assets</td>
<td>(LA) = Cash + Cash equivalents +ST Marketable Securities +Accounts Receivable. Current liability (CL) = Accounts Payable +ST Borrowings +Other ST Liabilities. All liabilities falling due within one year. The QR indicates a company’s ability to pay its CL from its LA.</td>
</tr>
<tr>
<td>LEVERAGE</td>
<td>Examine the proportion of debt used to finance a firm.</td>
</tr>
<tr>
<td>Asset Equity Ratio</td>
<td>Asset Equity Ratio = Total assets*/Average Shareholder’s Fund.</td>
</tr>
<tr>
<td>EFFICIENCY</td>
<td>Activity ratios/ operating efficiency ratio indicate the firm’s operational performance.</td>
</tr>
<tr>
<td>Asset Turnover Ratio</td>
<td>Assets = The assets as reported on the Balance Sheet (total of all short and long-term).</td>
</tr>
<tr>
<td>PROFITABILITY</td>
<td>Explains the efficiency with which the economic activity is performed.</td>
</tr>
<tr>
<td>Net profit ratio</td>
<td>Net Income /Sales</td>
</tr>
<tr>
<td>RETURN ON EQUITY</td>
<td>Return on Equity in proportion to the shareholding.</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>ROE, in percentage shows the return earned on PAT/ Average shareholder Equity fund</td>
</tr>
</tbody>
</table>

Note: * Tangible fixed assets only as reported in the Balance Sheet  
Source: Self Computed