

January 2004

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Recommended Citation

Abeysekera, Indra: The role of emotional assets and liabilities in a firm 2004, 35-44.
<https://ro.uow.edu.au/commpapers/581>

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Abstract

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Keywords

emotional, firm, role, assets, liabilities

Disciplines

Business | Social and Behavioral Sciences

Publication Details

Abeysekera, I. (2004). The role of emotional assets and liabilities in a firm. *Journal of Human Resource Costing and Accounting*, 8 (1), 35-44.

The Role of Emotional Assets and Liabilities in a Firm

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ABSTRACT

There is an absence of research addressing the process by which emotional (also called sensational) assets and liabilities interact with the intellectual and accounting assets and liabilities of a firm. This conceptual paper discusses the relationship between these types of assets and liabilities, and examines the way in which emotional assets and liabilities (emotional capital) influence the fair value, profits and cash flow of a firm. It outlines how the core emotions related to products and services can influence customers in making purchasing decisions that maximise the value of a firm. It also offers indicators for the managing and reporting of emotional assets and reviews several theories that attempt to explain the relationship between the emotional assets and liabilities and value of a firm.

Key words: emotional assets, emotional liabilities, emotional capital, intellectual assets, intellectual liabilities, accounting assets, accounting liabilities, core values, intangible assets, intangible liabilities.

The Role of Emotional Assets and Liabilities in a Firm

INTRODUCTION

The argument for the significant importance of emotional assets and liabilities in adding value to firms is acceptable but has not been widely addressed in the accounting literature. The literature on Balanced Scorecard (Kaplan & Norton 1996; 2001) and intellectual capital (Abeysekera 2003; Sveiby 1997) has attempted to address the issue of monitoring emotional assets and liabilities through non-financial performance measures but have been in a more superficial manner.

A number of authors have attempted to theorize about the impact of the emotional state of a firm's staff on work performance (Csikszentmihalyi, 1975; Goleman, 1995: 6-7, 289-290; Cooper, 1998; Tsai, 2001; Druskat & Wolff, 2001). However, there is little research done in conceptualising how emotional assets and liabilities affect other types of assets and liabilities, namely, intellectual and accounting. The dearth of research in conceptualising emotional assets and liabilities could be due to several reasons and some of which are common to assets and liabilities not recognised in financial statements. First, emotional assets and liabilities lack a uniform definition. Second, traditional financial reporting system recognition of assets and liabilities tends to exclude emotional assets and liabilities because they cannot be measured reliably. As a result, any costs incurred to enhance emotional assets in a firm are treated as an expense in the traditional financial reporting system (Backhuijs, Holterman, Oudman, Overgoor & Zilstra, 1999; Lev, Sarath, & Sougiannis, 1999).

Previous research has demonstrated that the absence of intangibles such as emotional assets and liabilities in traditional financial reports leads to a systematic undervaluation of firms (Boone & Raman, 2001a&b; Ronen, 2001). This has resulted in the production of unrealistic and unrepresentative financial statements (Wharton Alumni Magazine, 1997; Romer, 1998; Swinson, 1998, pp. 4-5; Horney, 1999; Petty & Guthrie, 2000, pp. 214-215). Several authors agree that without the inclusion of emotional assets and liabilities financial statements are unable to indicate accurately the economic efficiency of a firm (Hansson, 1997; Sveiby, 1998; Graham & King, 2000; Zambon & Zan, 2000).

This conceptual paper discusses the relationship between accounting, intellectual and emotional assets and liabilities, and attempts to show that emotional assets and liabilities are of significance in determining the value of a firm. It then offers some guidance on how certain emotional assets and liabilities are to be monitored and disclosed. The paper then includes theories from psychology that may help explain future empirical research findings to validate the impact of managing emotional assets and liabilities on the value of a firm.

This paper proposes to add an additional dimension to the current practice of monitoring the assets and liabilities of firms, by supplementing the existing 'accounting assets and liabilities' measure with a measure of 'intellectual assets and liabilities'. The need for this additional measure is discussed in the current literature on 'intellectual capital'. However, in the recent debates around the impact of 'postmodernity' and 'radicalized modernity' on accounting research, knowledge and skills are variously held to be ambiguous, contested, contradictory, incommensurable,

temporary and fragile (Martensson, 2000; Mouck, 2000; Zambon & Zan, 2000). Consequently, any attempt to define or limit the notion of a 'body' or 'stock' of knowledge is problematic.

To these two measures (accounting assets and liabilities, and intellectual assets and liabilities) the paper then proposes to add a third, namely 'emotional assets and liabilities'. This is to give due acknowledgement to the role of 'emotional capital', although the criteria of the conceptual framework of accounting do not allow their recognition in financial statements because of the difficulty of measuring them reliably. The inclusion of this third measurement widens the range of measures that are available for a firm to control its fair value effectively.

This paper is structured as follows. The next section discusses the impact of monitoring and reporting emotional assets and liabilities. It also describes the three types of assets and liabilities: accounting, intellectual and emotional. Moreover, the section presents reasons why a firm should pay attention to emotional assets and emotional liabilities. Section 3 discusses the relationship of emotional assets and emotional liabilities with the other two asset and liability types, namely, tangible and intellectual. It then proposes how emotional assets and liabilities can be monitored using non-financial indicators and reported in relation to the core emotional values of a firm. The last section offers suggestions as to theoretical approaches that can be adopted to examine the relationship between emotional assets and liabilities and their impact on the value of a firm.

2. MONITORING AND REPORTING EMOTIONAL ASSETS AND LIABILITIES

All firms have assets of one type or another or a combination of a few types of assets. A financial statement reports a firm's assets as current and non-current assets. The majority of non-current assets are tangible assets, except for goodwill, which is an intangible asset. All the current and non-current assets covered in financial statements are accounting assets in that they can be clearly traced back to an accounting transaction.

Although previous literature has proposed descriptions of emotional assets, these are not defined in relation to other asset types. This paper defines emotional assets as those assets that activate both intellectual and accounting assets, and emotional liabilities as those assets that de-activate both intellectual and tangible assets.

The paper argues that there are two types of intangibles: intellectual capital and emotional capital (sensational capital). Intellectual capital is an intangible regardless of whether or not it is recognised in the financial statements of a firm (Knight, 1999). Edvinsson and Sullivan (1996) define intellectual assets as the knowledge that can be converted into value. Intellectual capital can be divided into three categories: internal, external and human capital. Capital internal to the firm includes processes, systems, intellectual property and financial relations. Capital external to the firm includes brands, customer satisfaction, corporate image, quality standards, distribution channels, business partnerships, franchising and licensing agreements. Capital related to employees includes know-how, the educational levels of employees and relations between employees (Brooking, 1996:13-15,129; 1999:153-155).

Emotional capital comprises emotional assets and emotional liabilities. Emotional assets include attributes such as pride, delight, tranquility, passion, determination, commitment, care and trust provided by a firm to its customers. Emotional liabilities include attributes such as anger, hatred, anxiety and stress provided by a firm to its customers (Thomson, 1999; 22-25).

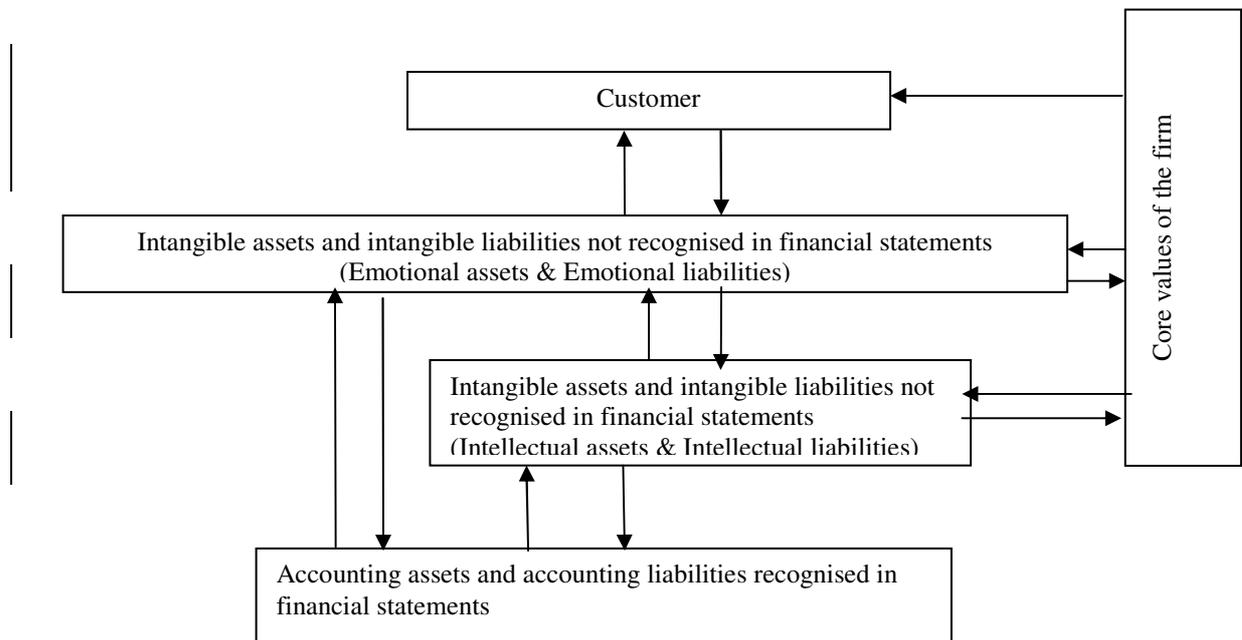
It is argued that all types of assets, whether tangible, intellectual or emotional, if managed badly can diminish in value and ultimately have the effect of reducing the value of a firm (Abeysekera, 2002). In many cases they can even translate into liabilities. For example, tangible assets such as plants and machinery that are not regularly inspected and maintained attract, in the end, greater expenditure for repairs because of breakdown. In a more emotionally positive environment such repairs could be avoided, which would reduce the expenses incurred by the firm.

Similarly, customer satisfaction, an intellectual asset, can turn into customer dissatisfaction if customer complaints are treated lightly or ignored. The trust between management and employees, an emotional asset, can turn into distrust if management does not effectively address employee conflicts. Further, the status of each category of assets impacts on the status of the other categories. For example, a low level of trust between management and employees can lead to bad morale of employees, which in turn, may translate into less attention and care being given to the maintenance of plants and machinery leading to lower production and quality levels. Accordingly, all of this may manifest in customer dissatisfaction, leading to a reduction in revenue for

the firm. Ultimately, the impact of the initial neglect can be as far reaching as fluctuations in market value, profits and cash flow of the firm.

Emotional assets interact with both intellectual and tangible assets and play an integral role in determining the financial value of those assets. If employees are less committed to taking care of plants and machinery, the actual life of this equipment is reduced. If sales staff is less motivated to help customers, this will reduce customer satisfaction and lower the revenue of the firm over time as shown in Figure 1.

Figure 1: Relationship of tangible, intellectual and emotional assets to the end user.



This paper takes the view that, in reality, firms transact emotions (sensations) to customers and that goods and services are simply the medium for this process (Abeysekera, 2002). These sensations help the customer to either reap some kind of

sensational pleasure or avert some kind of sensational displeasure (Dalai Lama, 2002: 117-118). According to Oatley and Johnson-Laird (1998: 85), emotions are typically caused by either conscious or unconscious cognitive evaluations. The current literature indicates that these emotions experienced by customers encompass elements of physiological (Averill, 1982: 36; Lange & James, 1922), behavioral (Averill, 1982: 36; Izard, 1977) and cognitive processes (Arnold, 1970). Experiences are perceived instinctively and are interpreted as social and environmental frameworks shaping future behavior (Izard, 1977).

This paper also takes the view that emotions, rather than moods, influence the buying decisions of customers. This is so for two reasons. First, moods of customers of a firm tend to be a longer lasting but often weaker state of uncertain origin, whereas emotions are often intense, short lived and have a clear object or cause (Forgas, 1991: 5; Frijda, 1993: 381-403). Second, emotions of customers of a firm cause a change in phase from one goal or plan to another but a mood involves the maintenance of a tonic state of concentration (Oatley, 1996: 312). Note that, when referring to groups of people, 'moods' are described as 'atmospheres'.

Emotions can be classified into positive and negative emotions. Although typologies of basic emotions are few, the emotional lexicon contains hundreds of terms (Averill, 1975; Fisher, 2000).

The role of emotions in customer behaviour can be illustrated by way of example. A customer buys a branded product and pays a premium price because the firm has built a trust relationship (emotional asset) with that customer or stakeholder (it could be an

individual or a representative of another firm) regarding the quality and consistency of its products. The second most significant asset types from the point of view of customers are intellectual assets. Brand names and customer satisfaction are significant factors but they are activated by sensations. The asset types that are most distant to the customer are tangible assets, which are found at the end of the customer's 'value' chain. For instance, although plants and machinery serve an important function in determining the level of quality and customer satisfaction, these assets are not of direct importance to the customer who only sees the final form of the product and/or service.

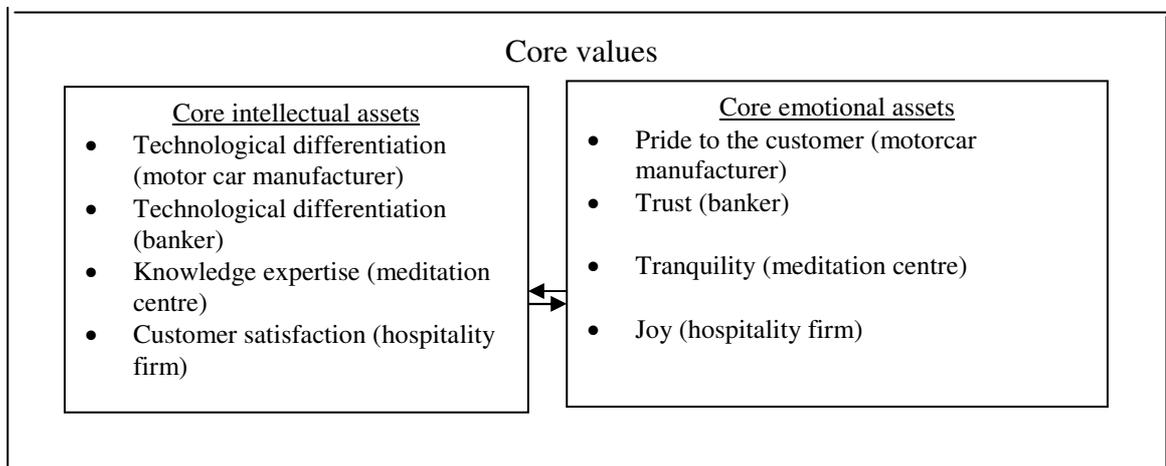
3. MONITORING AND REPORTING EMOTIONAL ASSETS AND LIABILITIES

A goal of a firm may be to maximise its assets and minimise its liabilities in order to increase the net value of its assets. Each type of asset and liability described in this paper (emotional, intellectual and tangible) requires a different management strategy because of its unique characteristics. However, it is the contention of this paper that firms should give priority to the development of emotional assets through which the firm's core values – that is, its intellectual assets - will remain energised. This is particularly so in the light of the recent decline in the relative importance of tangible assets as the core value of firms, which is due to the increased global competition over products and services, and resulting from the gradual removal of geographic barriers and easier access to financing (Daley, 2001). Figure 2 provides some examples of possible core intellectual assets and core emotional assets of firms.

Which types of emotions are to be considered ‘positive’ (and hence assets) and which ‘negative’ (and hence liabilities) depend on the nature of the product or service being delivered by the firm. Emotions develop when there is a match or mismatch between events and relate to the fulfilment of ‘concerned satisfaction’. Positive emotions can be said to result from events that represent a match, whereas negative emotions result from events that mismatch and interfere with concerned satisfaction (Frijda, 1986: 278). For example, ‘hatred’ may be an advantage among the members of some organizations, and ‘fear’ may have a positive effect on the product or service provided - an army would be one such organisation. In another organisation the reverse would be true - a primary school, for example. Several emotional assets and liabilities could have a direct impact on the final product or service of a firm.

Figure 2

Core values of firms



As outlined in Figure 2, the core intellectual assets of a food firm can consist of things such as brands or brand leverage, but for a motorcar manufacturer or retail banker it can be technological processes. However, the core emotions for a motorcar manufacturer to be conveyed to the customer can be pride in owning that brand of

vehicle. On the other hand, for a retail banker, the core emotion conveyed to the customer can be reliability and convenience. In most firms the core emotions, internal and external, are the same. However, where there is public disapproval towards a product or service, as in the case of tobacco-related products, there may be a coexistence of indirect and direct core emotions. An indirect core emotion might be caring for community concerns as a way of winning community support. A direct core emotion might be the promotion of smoking as a means of stress relief in order to win the customers to their products. The two types of emotion can co-exist within the firm to constitute the core emotions of the firm.

Different emotional assets can activate the same attribute of an intellectual asset in different products and services. Relief from pain activates customer satisfaction (intellectual asset) in a pharmaceutical firm, whereas in a cosmetic firm customer satisfaction is activated by an appeal to youthfulness. This also applies to different firms within the same industry. Firms that sell similar products and services can use different emotional assets to activate a given intellectual asset. For example, a firm that sells toiletries can sell one kind of soap to maintain soft skin and another kind of soap to clean a sweaty body after a hard day's work. However, the core emotional asset common to both is cleanliness.

Each firm has its individual set of core intellectual assets and core emotions that together make up the core value or values of the firm. Once these assets and emotions are identified, they should receive equal importance to the managing of the firm's market value, profits and cash flows.

In managing emotional assets it may not be practical for a manager to be constantly analysing the root cause(s) of successes and failures. Rather, it is more practical to watch for symptoms and then to find the root cause to address them, in the same way that a doctor treats a patient. In this instance, what is necessary is to measure these symptoms in a way that they can be managed with a consistent and cohesive approach. Because there are no widely accepted models to reliably measure emotional assets and liabilities, it is better to use indicators such as ratios or benchmarks so that their accuracy is not governed by monetary values otherwise assigned to them (Abeysekera, 2001). Further, according to Grojer (2001), changing the transaction base of financial accounting can cause confusion to the users of this information. Table 1 illustrates possible indicators that could be used to measure emotional assets and liabilities. However these should only be used taking a firm's specific situation into consideration.

Table 1

Monitoring core emotional assets

Organisation	Core emotional asset	Indicator
Motorcar manufacturer	Pride	<ul style="list-style-type: none"> ❖ Results of satisfaction surveys filled out by customers after 1 month, 3 months and 1 year ❖ Public perception in relation to image enhancement when owning a given make of motor vehicle
Banker	Trust	<ul style="list-style-type: none"> ❖ Proportion of new customers referred by existing customers ❖ Extent of reliance on the bankers advice by customers to make their decisions in relation to banking products and services
Hospitality firm	Joy	<ul style="list-style-type: none"> ❖ Number of customers extending their stay/total customers stayed ❖ Number of customers who reduced their stay/total customers stayed
Meditation centre	Tranquillity	<ul style="list-style-type: none"> ❖ Drop in stress level ❖ Change in productivity level of individuals before and while practising a meditation technique
Nursing home	Care	<ul style="list-style-type: none"> ❖ Number of letters of appreciation about the firm going an 'extra mile' ❖ Comprehensiveness of medical examination before a diagnosis is made

4. EMPIRICAL TESTING AND CONCLUDING REMARKS

There exist six predominant theories of organisational psychology which can be considered to interpret the relationship between managing emotions provided by a firm to its customers. These are mood theory, affect infusion theory, emotional labour theory, affective events theory, emotional intelligence theory and the communicative theory of emotions. Although there is a dearth of these theoretical approaches applied in accounting research, this paper briefly outlines the preferred theory in meeting the objectives of this paper.

Mood theory has led the way in the development of organisational psychology and has provided the foundation for the other five theories (Ashkinasy, Hartel & Daus, 2002). Table 2 highlights the distinctive methodological approaches and different stages of development of each of these theories. However, it should be noted that the existing literature has tended to focus on employees, and even such studies have been few and far between (Fisher, 2000). Further, there have been no systematic studies undertaken to examine the relationship between emotions and the buying decisions of customers regarding specific products and services.

For the purposes of the present argument, any theory of organisational psychology needs to offer a comprehensive, multidimensional explanation of the interaction between the emotions of consumers or the customers and their decision to buy a product or service to satisfy these emotions. In this respect, the phenomenon is more likely to explain the communicative theory of emotions. According to the communicative theory of emotions, emotions typically arise from evaluations of

events relevant to goals. These evaluations give rise to non-proportional signals within the brain that induce and maintain emotion modes. These emotional modes may last a long time depending on the cognitive changes that occur with the seriousness of the emotions (Oatley, 1996: 312-316; Oatley & Johnson-Laird, 1998: 84-97). The implication of this theory is that firms can manage emotions conveyed through their products and services to manage the flow of attention and readiness of customers to increase the value of the firm.

Table 2

Possible theoretical approaches

	<i>Mood theory</i>	<i>Affect infusion theory</i>	<i>Emotional labour</i>	<i>Affective Events Theory</i>	<i>Emotional intelligence</i>	<i>Communicative theory of emotions</i>
<i>Reference</i>	How moods determine behaviour in social and organisational settings (Ashkinasy et al. 2002)	How affect influences cognitive judgements (Forgas, 1995; Ashkinasy et al., 2002)	Situations where employees display emotions that differ from what they actually feel (Ashkinasy et al., 2002)	Moods and emotions underlie the way people think and behave (Weiss and Cropanzano, 1996)	Ability to read emotions of people and use that information for decision-making (Ashkinasy et al., 2002)	Most emotions are connected with either conscious or unconscious goals or plans of individuals (Oatley, 1996: 312)
<i>Level of interest</i>	Academics	Academics	Academics and practitioners	Academics	Both academics and practitioners	Both academics and practitioners
<i>Progress in the development</i>	Significant progress	Some progress	Some progress	Little progress	Very little progress	Significant progress
<i>Areas of research</i>	The effect of positive (Alloy and Abramson 1982; Isen and Baron 1991) and negative moods on work settings (George and Brief 1996)	Mood congruent effects on memory (Forgas 1995)	Customer care (Pugh, 2001; Kelly & Barsade, 2001); emotional labour effects on employees (Krumi & Geddes, 2000: 177-188); emotional dissonance and health problems (Grandey, 2000)	The effect of work environment on employee behaviour (Weiss, Nicholas & Daus, 1999)	As a catalyst to leadership (George, 2000); team work (Goleman, 1995; and interviewing (Fox & Spector, 2000)	Managing flow of attention and readiness of persons (Oatley, 1996: 312)

It may be argued that accounting would come into play when the company's success in managing emotions can be quantified and reported to internal and external users. However, given the current inability of the accounting profession to produce reliable measures of 'tangible' assets and liabilities, it is necessary to begin to investigate possible alternatives, even if they are initially less certain, with a view to finding ways to more effectively measure and manage the value of a firm.

One of the arguments that could be presented against the approach suggested by this paper is the contention that emotions are unpredictable and fleeting, with people perhaps experiencing such 'flashes' of affect for only a few seconds before they disappear. Emotion is also viewed as a self-contradictory phenomenon – 'mixed emotions' in vernacular speech. Thus, one's feelings of 'pride' in owning a luxury motorcar may be accompanied by feelings of 'guilt' about one's hedonistic extravagance in spending money in this way. Emotions may also be a win-lose phenomenon in that, when work teams are exhorted to compete against each other (currently a common management approach), feelings of pleasure experienced by the 'winners' may be balanced or outweighed by feelings of displeasure amongst the 'losers'. The simultaneous application of two emotional terms does not refer to mixtures but to two levels of analysis. These levels of emotion can be identified by the mode of action or by the nature of emotional object or event (Frijda, 1986: 72-73).

The central proposition of this paper concerns the core emotions that accompany a product or service delivered by a firm, where the product or service becomes the medium through which to maximise the value of that firm. However, maximising the value of a firm is a function of both firms selling and customers buying their products

and services. Therefore, the emotional state of customers (whether individual or collective) needs to be considered as a significant factor in maximising the value of a firm, and hence it is essential to foster favourable emotions within these customers at the time of purchase (e.g., through experience sample methodology) (Fisher, 2000).

A second argument that could be presented against the approach taken by this paper is based on the proverb: “Pride goes before a fall”. If this proverb is true, then presumably it is necessary to treat pride as a liability on account of its fickleness, in contrast with Thomson (1999) who asserts that it is an asset. Thomson also lists ‘trust’ as an emotion, and one may argue that it is treated as a cognitive (rational, deliberate and problem solving) factor. In a broader context, future research should identify emotions included in products and services and how they relate to other human attributes.

There are three limitations of this paper. First, this paper provides only a conceptual argument and needs empirical testing as mentioned in the paper. Second, the examples of core emotional assets and liabilities can be exhaustive and this paper confines the discussion only to a few of them. Third, the emotions may not typify the definition of an asset provided by the conceptual framework where the entity must have the ability to control the future benefits of customer emotions or deny access to customer emotions.

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