The intangibles decade: looking forward to 2020

We are entering the intangibles decade. At a meeting held earlier this year, experts from a range of disciplines predicted what this will mean

By **Mary Adams**

Despite representing some three-quarters of the average company's valuation, intangibles are still considered an emerging asset class in business today. This article summarises a panel discussion hosted by the Intangible Asset Finance Society (www.iafinance.org) on the future of the field of intangibles management. The discussion was held on 8th January 2010 as part of the society's regular Mission: Intangible Monthly Briefings. The panel included 10 experts from different disciplines within the field of intangible asset financial management. Each made predictions for the coming decade.

The experts were:

- Nigel Page, finance editor, *Intellectual Asset Management* magazine.
- Judith Giordan, managing director, Steel City Re.
- Jonathan Low, partner, Predictiv LLC.
- David Hetzel, director, IP transactions, mobile devices, Motorola.
- Cathy L Reese, principal, Fish & Richardson.
- Scott Childers, senior manager, integrated trade management, The Walt Disney Company.
- Andy Gibbs, CXO, IP Advisory.
- Marc Lucier, director, asset finance & leasing, Deutsche Bank Securities Inc.
- David Ruder, RPX Corporation.
- David Gould, Buchanan Ingersoll & Rooney PC.

The panellists in this discussion are leaders in this new field. All clearly believe that intangibles will receive increased attention from mainstream businesses in the coming decade. Their perspectives and experience range from the field of intellectual property to legal, operational and financial markets. Their diverse perspectives provided a prismatic view of the asset class, as well as views on how and why this will be the intangibles decade. Some of the most interesting variations in viewpoint came on the questions of definitions, standards and management.

Definitions

There is still a strong tension in the field between those specialising in intellectual property and those who see intangibles as a broader asset class. This is understandable, as IP is the most tangible of the intangibles and many specialise specifically in aspects of the creation and/or monetisation of IP, chiefly patents and trademarks. The other major camp focuses on reputation as a key intangible. Most members of IAFS are in these two camps, with a minority looking at intangibles holistically. Our organisation, as well as the field in general, needs to make a clearer connection between IP, other kinds of intangibles and reputation.

Standards

The need for standards was repeated throughout the discussion – standards for measuring, structuring and valuing intangibles. Yet many felt that traditional standards setters within the accounting and regulatory communities cannot and will not lead this effort. Several panellists suggested that the answers will emerge from the practices of businesses as they adopt and adapt to intangibles as a specific asset class.

IAFS

This article is sponsored by the Intangible Asset Finance Society's Trademark Committee. The objectives of the Society (www.iafinance.org) are to increase the visibility, transparency and value of intangible assets through education, advocacy and the promulgation of standards. *IAM* magazine is the media partner of the Society. In each issue, *IAM* magazine publishes a contribution from the Society on a noteworthy intangible asset finance matter.

Value, management and broadening views – Nigel Page

Nigel Page opened by citing an *Economist* cover article in January 2010 which asserted that low interest rates may be creating the next asset bubble – this time in the values of a range of physical assets. If a dramatic collapse in physical values happened, it would lead to a broader discussion of what real value is and lead to a more rigorous discussion of intangibles valuation.

This, among other reasons, motivates the need for cogent, empirically grounded discussions of the building blocks of intangible value. There is a need for far greater transparency in intangibles valuation and, in the case of IP, royalty rates. This will lead to the evolution of viable valuation standards that will enable the effective monetisation of intangible assets. This will not be easy, but we cannot ignore the need for standard approaches to support the creation of markets.

As intangibles grow more important, there will be an increasing need for the development within corporations of a centralised chief intellectual property officer (CIPO) role to oversee and coordinate intangible asset strategy (acquisition, protection and exploitation of IP rights). Although companies such Philips, Microsoft and GE are all trailblazing in this area, many mainstream business people – including CEOs, investors, the media and the general public – are baffled by and indifferent to IP as an asset class. We must help close this gap.

As a wider view of this space emerges, IP will become a key feature of an overarching intangible asset mindset. One place where this all comes together is in reputation management. The current crisis has led to the growing understanding of reputation. McKinsey is advising companies to increase reputation management focus. Reputation is where all intangibles management comes together.

Management

There were many cries for improved intangibles management approaches. These ranged from perspectives that focused on IP only ranged from to a call for management that cuts across all the silos of an organisation. There were fewer comments about how this would happen – although the continuing discussions of our society suggest that this, like standards setting, will be an organic, emergent process.

Many perspectives with one focus: leading business into the knowledge era. Here's what our experts had to say.

Green, human and open – Judith Giordan

The bottom line for Giordan in intangibles is reputation and brand. She sees three big areas of opportunity for improved reputation and branding in the coming decade. But she cautioned that each requires clarification of definition, value capture process, link to the overall brand, monetisation strategies and financial recording metrics.

The first is environmental, also known as green, sustainable, planet friendly. This cannot be converted to business value without definition, value and measurement, as explained above.

The second is human capital, specifically women in business. Giordan said that the data for women is in – there is no mistaking the potential value that they represent for an organisation. There is value in developing and creating wealth (money, mind, spirit, human) by engaging larger populations in the enfranchised groups and monetising this value.

In describing the third opportunity, Giordan declared: "Small is the new big!" She sees open innovation processes as an intangible asset. Have big companies been able to capture this value and link this process? Not always.

The crux of the matter with intangibles in general and these three opportunities specifically, ended Giordan, is how companies can build brand value around them. Indeed, all these opportunities demand a deliberate management strategy and process.

Operations and comparability but not accounting – Jonathan Low

Low opened by expressing his pleasure at seeing that the intellectual capital (IC) community continues to focus on determining IC's operational impact rather than wasting time with the vain hope of acceptance by the accounting industry. The work of the last 20 years demonstrates that accounting is largely irrelevant and the field of intangibles will evolve without the help of accountants. Nevertheless, the field needs to make more headway on comparability.

He also expressed concern about the fact that a number of players continue to try to patent approaches to intangibles management in the hope that they will be able to collect a toll from everyone in the market. These schemes have always failed in the past and they will continue to fail. He said he hoped that exclusivity and licensing will not be a focus of our community but rather, that we will focus on sharing methodologies, and that through this there will be broader acceptance and greater wealth for all.

The alternative, he suggested, is for the IC community to adopt an open source mentality rather than trying to corner the market in various methodologies, systems and processes.

Trolls, trolls, trolls – David Hetzel

Non-practising entities (called NPEs or trolls) are not going away, predicted Hetzel. According to Patent Freedom, well over 10% of the 3,000 or so patent infringement suits each year are from NPEs. These NPE suits are growing faster than the general market.

This trend has been fuelled by the growth of the transactional patent marketplace in the past five years or so. Probably 1,000 portfolios are traded each year through this marketplace for a total value of approximately US$1 billion. Live patent auctions are also growing. And there is a proliferation of brokers. This is where the trolls are getting their patents and their ammunition to take on product companies.

There are two maturing patent defensive models. The first is Allied Security Trust (AST). Hetzel described it as pursuing a catch-and-release, hub-and-spoke approach. In this model, a broad group of members make decisions about new portfolios. This can be great because it enables members to tap into the thinking of literally hundreds of engineers. The downside of this is the slowness of the decision-making process. The second model, which is employed by RPX Corp, is more of a buy and hold model. Here the decision making is centralised with a core leadership team that has a strong experience base. This can enable greater creativity for deal making and faster turnaround times, with some loss of control to the members.

Supply chain integration, optimisation and excellence – Scott Childers

Childers observed that a lot of companies protect brand and reputation in a siloed manner. Safety, security, environmental sustainability, regulatory and IP compliance are all addressed by different internal organisations in most companies. Yet to truly understand the risks facing large companies, there needs to be greater focus around integrated trade and supply management. Childers predicted a concerted effort in organisations to reach across silos and manage everything that touches on brand and reputation: enterprise reputation management through integrated global trade management.

This implies a need for more sophisticated systems. But optimising security through supply chain resilience isn't just a top-down exercise. Rather than trying to anticipate every risk, the question is how to create cultures that empower thinking and decision making at the lowest common denominator. To manage and react to events, companies need strong systems backed by a culture that embraces internal responsibility.

The challenge in the future is to raise supply chain excellence to a C-suite and board-level issue. To do this, corporate leaders must see the value in these efforts in order to protect themselves personally and to protect the brand of the organisation. The question for us all is how to position this to make it worth senior managers' time.

The move to standards – Andy Gibbs

What we have seen in the past decade, said Gibbs, is a struggle to increase quality over quantity, especially in the patent space. The patent office is trying to issue fewer, higher-quality patents. There are increasing numbers of rules in this direction. Corporations will hopefully take on this obligation as well.

Patent quality has a direct correlation to value. Gibbs stated that standards are needed to support both. Worldwide quality standards would equalise the discordant but commercially important performance, protection, enforcement and IP value metrics in use today. These measures will facilitate trading and lead to IP being viewed as a core corporate asset rather than being just about protection.

He mentioned that he was heartened by how frequently his fellow panellists were talking about valuation. The need for valuation is related to the need for objective metrics, he asserted. The goal is for the market to set pricing and value. This will demand transparency, quantitative measures and demand-based pricing. If the right kind of trading platforms are created, markets will be able to set the prices and remove litigation aspects by increasing the validity of pricing. All this will enable a more efficient mechanism to manage IP risk/reward decision support options relating to monetisation, and create a more efficient market for intangibles.

Intangibles value proposition and evolving markets – Marc Lucier

Lucier reported that he still gets a lot of vacant stares in the financial world when he brings up intangibles. Many in mainstream business still do not understand why intangibles matter. He hopes and predicts that the IA community will finally figure out how to articulate why intangibles do indeed matter and how they create value. This message has to reach those who don't already drink the proverbial IA Kool-Aid.

How to make intangibles real? The creation of IA-based financial products and investment vehicles – and the trading thereof, even in private transactions – enable the broader world to begin to understand IA's value on a more visceral, intuitive level. When people can make money (or understand how/why they are making money), it will be more real.

Information asymmetries in IP and other markets today make valuation difficult. This holds the markets back. Evolution will start with dealer markets in IA-based financial products in order to evolve into financial instruments and markets that are liquid and transparent.

Board oversight moves to the forefront – Cathy L Reese

Cathy Reese predicted greater management attention to intangibles in the US, given the evolving view of oversight obligations for officers and board members of corporations. The *Caremark* case in Delaware expanded fiduciary duty to include a duty of oversight and duty to monitor. Inaction isn't sufficient in this new world. A couple of years ago, the *Stone v Ritter* case took it a step farther, focusing on directors' duty of loyalty. This means that directors may be unable to get the benefit of the shields from liability which are being added to more and more corporate charters. The new case law creates an affirmative obligation for officers and boards to oversee risk and monitor potential liabilities. Failure to fulfil this obligation leaves them open to personal liability.

The legal issues should be a motivation for management teams and boards to put into place systems to identify risks and ensure that they are reported to the board. Under these legal standards, a board is obliged to ferret out risks. Note that this is an emerging set of concepts. To date, there have been no suits for personal liability against directors.

There are a number of ways that intangibles are related to this. IP infringement is a big one (awards and settlements routinely amount to hundreds of millions of dollars). Entire business or product lines can also be shut down. Other kinds of reputational risks can also lead to significant financial exposure.

Reese's view is that fear of legal obligation will be an important catalyst for increased attention to intangibles and will motivate management teams toward greater discipline and transparency in intangibles management.

Standards will evolve out of economic necessity when people realise the value of and the financial risks associated with intangibles. At that point, markets and transactions will demand that standards be created.

Organic solutions from emerging market practices – David Ruder

Ruder sees patents and trademarks moving from a niche to a more major market segment over time. Nevertheless, there have been a lot of repercussions from the economic downturn. Corporations were selling off patents because they needed the cash. As in other markets, a lot of assets were over-valued in the IP space. Nevertheless, he submits, there is too much happening here for mainstream investors to ignore.

Yet most that do enter the market will have problems with information and accounting. Investors are still learning what information they need. The entrance of more non-IP professionals to the market will force change and adaptation of the market. There are also many opportunities to improve the use of intangibles to manage business more effectively.

Ruder said he does not believe much help will come from the accounting world. Standards will not emerge until organic solutions have been developed by businesspeople on the ground. There won't be standards until best practices emerge.

The virtual, connected world is an intangible one – David Gould

Gould provided a good summary of the discussion. "Our world is going virtual," he said. "And when everything is virtual and virtualised, virtually everything will be intangible – this means that intangible asset management will be a virtual requirement."

At the same time, it is Googles all the way down. An internet which is an ultra-huge piped alwaysnet (accessible from everywherenet) will increase the resources needed for intangible asset management by orders of magnitude. This extraordinary amount of data we all handle makes intangible asset management more important than ever.

Nevertheless, Gould asserted that Nostradamus is right only in retrospect (if at all). The biggest intangible asset management issue in 2020 will be one no one predicts and, therefore, prudent managers will prepare to react to (and learn from) the unexpected.

Reputation. IP, IC, IA. Accounting and valuation. Standards for markets and standards for management. We are on the brink of great changes in the intangibles markets. Stay tuned for an exciting ride! *iam*

Mary Adams serves as moderator of the monthly Mission:Intangible Monthly Briefing hosted by the Intangible Asset Finance Society, including the call that is summarised in this article. Ms Adams is the co-author of *Intangible Capital: Putting Knowledge to Work in the 21st Century Organization*. She is also a co-founder of I-Capital Advisors and Trek Consulting.
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