Interim Report
by Subcommittee on Management
& Intellectual Assets

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Subcommittee on Management & Intellectual Assets,

New Growth Policy Committee, Industrial Structure Council

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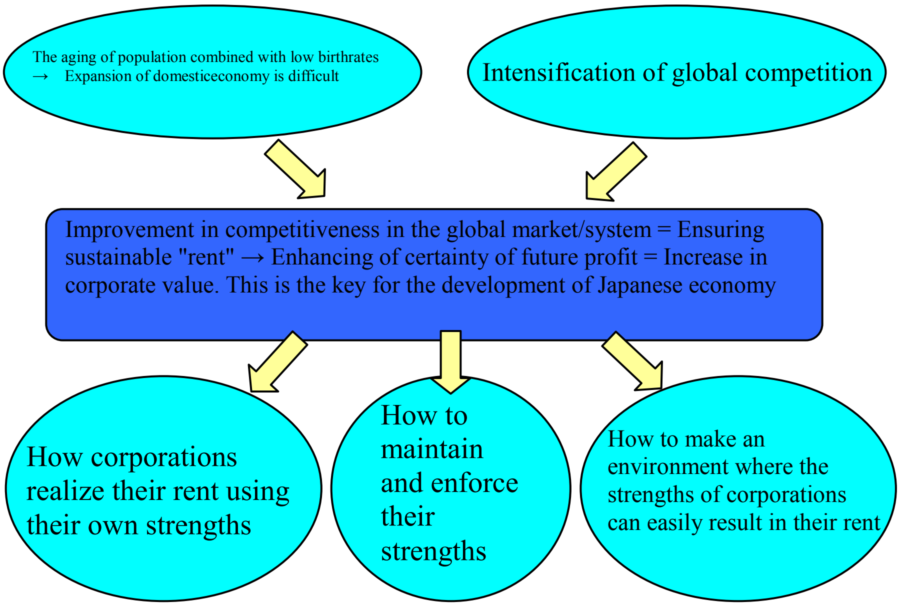
1 Background

In Japan, expansion of the domestic economy is facing difficulty with the aging of the population combined with low birthrates and it is very difficult for Japan to ensure profits that are based on a "scale economy". On the other hand, in the global competition, corporations cannot stay in business only by simple price competition due to the rise of the countries where the costs are quite cheap especially for production. Under such circumstances, for the Japanese economy to maintain medium term vitality, it is necessary for corporations to conduct management that can continually ensure their rent (excess profit) in the global market by using methods that are different from the conventional ways in "scale economy" and cost reduction by process technology improvement. The corporations that have such ability are recognized as really competitive ones.

For a corporation to continually ensure its rent, it is necessary to maintain and enhance its strengths, to differentiate from others by developing the specific feature of the products and/or services they provide, and to "keep themselves differentiated from others" by recognizing the differentiation as an important management resource and leverage point for competition. It is possible either by continuing to produce differentiation or by not letting others follow the source of differentiation, and the management that intentionally and strategically realizes this is required. If there is fair assessment of whether or not a corporation has the ability to perform management aimed at sustainable profit in such a manner, and if the corporation having such ability is highly valued, the number of such corporations will increase, resulting in such a situation where competitiveness of the entire country will be enhanced, and there will be a positive influence on the world economy through creation of new value.



On the other hand, looking at the actual situation of corporate management in Japan, they are strongly affected by the ideas of Western-style accounting. There is a concern that they are concentrating too much on short-term profit and that the investment on what would be the source of sustainable profit is neglected. At technological investment sites, for example, research and developments aimed at five years in the future became rare and investments are concentrating on those that result in products within one or two years. It goes without saying that earning profit is a requisite for corporate management but is not a sufficient condition when thinking of future growth and the management required in the future.

In the "New Industry Creation Strategy" METI formulated in May 2004, various corporations in Japan were studied and sources that can create strength sustainable for the mid-term were analyzed. There are many kinds but the important ones among them are, "adjusting and resolving issues," "network with customers," "human resources" and "ability to innovate," These are expected to be future profit, but these do not appear clearly and are not necessarily reflected yet as profit on the financial statements. These will result in economic benefit in the future, but are not tangible, and these can be generically called "intellectual assets" in the sense that they are brought about by the presence of intellectual activity in one way or another. It is considered that, if these are properly identified and used effectively for management, it is possible to achieve sustainable profit and leading to enhanced corporate value.[1]

Regarding corporate value, when looking at aggregate market value, corporations are dissatisfied about not being assessed adequately and about being undervalued in market recognition. Under these conditions, recent increases in M&As and the lifting of the ban on

[1] Regarding the increase of the importance of intellectual assets in corporate value:
Ito, Kunio and Tetsuyuki Kagaya. *Corporate Value and Intangible Assets Management* Hitotsubashi Business Review: 2001

triangular mergers using stock exchanges under Corporate Law to be enforced in 2007, there are growing concerns among corporations about the risk of being an acquisition target.[2] Against such a situation, if a corporation conducts management to recognize and utilize intellectual assets and can convince the market about the possibility of future profit, the corporate value is enhanced by solving the understanding gap. When underassessment is solved, the risk of being an acquisition target is thought to be much smaller.

The idea of management to identify intellectual assets and to use them effectively is different from management based on the principle of assigning first priority to short-range profit. Especially since the change to the profitable structure has been argued in the structural reform in corporate management after the bubble burst and with "Japanese management" disappearing in the process of becoming leaner and meaner in order to obtain short-term profits, such management emphasizing intellectual assets might be evaluated through reassessing the elements which could have been assessed by cool insight. At the same time, because it originates from correctly understanding the source of the corporation's own competitive superiority and the efforts to control it internally, it makes it possible to prevent the important technology or information that greatly influences a corporation's future profit from unintentionally flowing out to other countries. (Putting it the other way around, if management does not recognize clearly what is important technology and information, control would be insufficient and it results in unintentional flow-out.)

In financial areas as well, it is necessary to depart from exclusive devotion to mortgaged financing and "good judgment" for that is strongly required. To correctly understand and assess the management that enhances corporate value by paying attention to something other than tangible assets can itself be called a function of "good judgment".

Some corporations have already made a start by understanding the above. The parties in the capital market are individually conducting hearings about intellectual property management and trying to incorporate it into corporate assessment. However, with the condition that only some of the parties in the capital market have access to the information of good quality, there is a danger of excluding the people with information disadvantages such as individual investors from the market. There are also examples in other countries where insider trading was induced. From other countries' examples, we see it necessary to attract individuals into the capital market for the market to develop stably. At present, there is a worldwide trend of "fair disclosure" that is to supply the information with significant influence on corporate value equally to all the people concerned in the market. In fact, in Japan, there are some examples of corporations which gave important information only to a certain people being sanctioned by the entire market. There is also an issue regarding how to provide information regarding intellectual assets management to the public in a way that is easy to understand and, at the same time, without causing competitive disadvantages to corporations.[3] There are a variety of intellectual

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[2] *Hostile Takeover - Enterprises paralyzed for what to do, Dilemma for 'countermeasures', questionnaire made by Asahi Shimbun to 50 companies* on the front page of Asahi Shimbun, April 30, 2004 morning newspaper

[3] Refer to Okada, Eli. *Report on the regulations on fair disclosure and intellectual assets (non-financial information)* Accounting, Volume No. 162 No. 6: December 2002

assets. The movements of increasing interest in CSR (Corporate Social Responsibility) and of environmental reports are the result of more attention being paid to areas other than financial information, and intellectual assets reports are also to show not only to a certain people but also to the general public that a part of intellectual assets is emphasized in management. In addition, financing and investments that pay attention to intangible assets and management have appeared.[4] Furthermore, the result of corporate reorganization might depend on, the question of whether or not to adopt corporate management policy based on such intellectual assets. There are already some corporations among those that have faced major turning points that have considered the question of intellectual asset management for their reforms.

On the other hand, from a global viewpoint, as introduced in 2004 White Paper on International Economy and Trade, it has been recognized internationally that intangible assets are becoming more and more important for corporate value and management.[5] Regarding the analysis and disclosure, European reporting that explains management responsibility qualitatively and American disclosure that emphasizes the values of financial figures do not converge into one, but each of them has developed in various ways.

Japan has not sufficiently disseminated its views regarding intellectual assets-based management to the international community until recently, but taking the initiative on the common issue of economic structural change among developed countries, it proposed the project on the “Value Creation and Intellectual Assets” in the ministerial meeting of OECD in May 2004.[6] With this project, it is planned to hold a symposium in autumn 2005 to collect and summarize best practices and seek the possibility of formulating guidelines afterwards. Different countries have different ideas, but at least for the management using intellectual assets, it is important for Japan's unique ideas and best practices to be adequately input in such an occasion so that they can be properly assessed.

In Europe, there is a trend to value CSR based on the idea to improve three values of economy, environment, and society (triple bottom line) in a good balance[7]. In the United States, trend of instituting very strict internal control[8] has developed in the last several years from the

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[4] For example, there are corporate governance fund of Pension Fund Association (http://www.pfa.or.jp/jigyou/pdf/gov_fund.pdf) and system to support corporations that promote environmentally sustainable society of Development Bank of Japan (http://www.dbj.go.jp/japanese/environment/index.html).

[5] *2004 White Paper on International Economy and Trade*, Chapter 2 Section 1, pp 60 - 68

[6] Discussion at OECD

The project on the "Value Creation and Intellectual Assets" was launched by a joint proposal of six countries including Japan in the Ministerial Meeting in May 2004, and it was decided to examine internationally on the role of intellectual assets in corporations and on the policies including System of Corporate Information Disclosure.

http://www.oecd.org/document/39/0,2340,en_2649_34269_33725863_1_1_1_1,00.html

[7] Upsurge of CSR

Recently, due to environmental problems, increasing recognition of the safety of products and services, collapse of brand value by corporate misconduct, the expansion of Social Responsibility Investment (SRI) and “Corporate Social Responsibility (CSR)” are drawing attention. Internationally, ISO is expected to formulate by the spring of 2008 “SR (Social Responsibility) Guidance” (CSR Guideline) that does not rely on third party authentication.

[8] Internal control

viewpoint of the credibility of disclosed information. There is a possibility for both of them to be used as international standards in the future and there is a concern that, under either of them, another country's values would be imposed on Japan. Therefore, it is important to disseminate the important values from our country (for example, the "idea to value sustainable profit and a variety of stakeholders") regarding what is desirable in corporate management and disclosure, and to try to ensure that these values are incorporated into any global standard.

Thus, clarifying corporate management, corporate value, and intellectual assets that are the source of value, based on Japanese factors as well, and promoting the management that creates sustainable value by utilizing them is important from various viewpoints as follows:

- Continuous growth of corporations and the entire economy;
- Appropriate use of resources in corporations and the entire society;
- Enhancement of internal management and internal control of corporations;
- Reassessment of Japanese management;
- Prevention of corporate acquisitions caused by undervaluation of corporate value;
- Prevention of unintentional out-flow of Japanese technology and know-how;
- Corporations' contribution to society;
- Optimization of market function;
- Healthy development of the function of finance;
- Prevention of harmful influence of imposed international standards; and
- Strengthening Japanese ability to convey the important concepts for international standards.

On the other hand unless Japanese corporations make efforts to understand, manage, and utilize "intellectual assets" and unless stakeholders properly assess such measures by the corporations, it would be difficult for our entire nation to increase national wealth through efficient allocation of resources and vitalization and promotion of economy, namely to become a society where higher added value is realized.

Furthermore, these practices of value creation through effective utilization of intellectual assets are expected to contribute in many ways to the development of the economy of the whole world.

Based on this recognition, the "Subcommittee on Management & Intellectual Assets" was established under the New Growth Policy Committee, Industrial Structure Council in February 2005. The Subcommittee has summarized the present situations of corporate management utilizing intellectual assets and has examined the measures to promote such management in the future (in particular, focusing on disclosure mechanisms). The result of past

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In the United States, after the series of scandals involving big corporations such as Enron and WorldCom, the Sarbanes-Oxley Act (An Act to Protect Investors by Improving the Accuracy and Reliability of Corporate Disclosures) was enacted in July 2002, aiming at recovering credibility of corporate accounting and various reports, and the corporations registered with the US SEC, including Japanese companies such as Toyota and Sony, are required to strengthen internal control. For this reason, it became necessary for the corporations registered with the US SEC to incur large expenses to construct the internal control structure and to report on it. There is a strong possibility that American corporations will insist that they are at a disadvantage and that the same regulations should become an international standard.

discussions is explained in this Interim Report and further discussions will be made in the future.

2 IA Based Management and Corporate Value

(1) General

The transition to the era of a knowledge-based economy or society has been mentioned for some time.[9] Under such conditions, for a corporation to realize its rent continually, it is necessary to maintain its differentiation from other corporations. To do so, it is important to identify the corporation's unique "intellectual assets" including things that cannot be called "assets" from a traditional viewpoint, and to conduct the management to utilize such assets (this is called "intellectual assets based management"[10]). Realization of sustainable profit through such management leads to enhancement of corporate value.

(2) Relationship among Intellectual Assets, Management and Value Creation

After all, a corporation is a system to change various inputs to a value. If the input is x and the output is y, and a corporation is considered as a kind of function f, we have a function $y = f(x)$. Of course there are a variety of inputs, so generic x can be any of $x1$, $x2$, .. xk,.. xn and output y can also be of various kinds.

Conventionally, for the input x, the usual tangible assets such as raw materials, labor input, machinery, equipment, and capital have been emphasized. An economy of scale works in a steadily growing economy, and just paying attention to the quantitative expansion of such inputs will lead to consistent profit growth. When corporations try to create value under a knowledge-based economy, however, such a method is not sufficient. Invisible intellectual assets such as management's leadership, ability to innovate, quality of human resources, assessment by clients, and network with various people concerned have become important factors of input x.

In addition, the ways in which these various kinds of inputs are used, in other words, the method of management as the content of the function f, has become an issue. For example, even if a corporation has excellent technology and capable human resources, unless they are utilized properly, efficient output cannot be expected. That is to say, it is not only the

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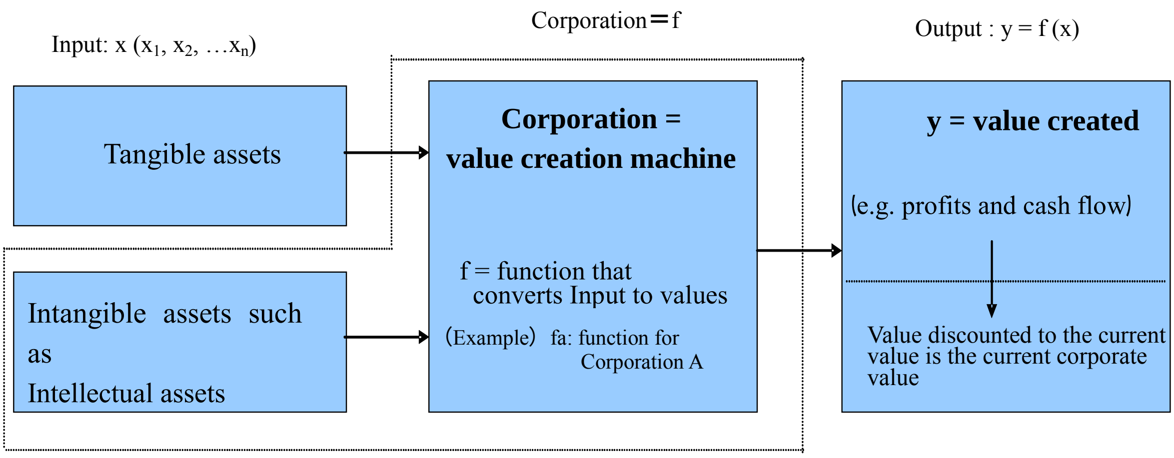
9 Polanyi, Michael (Hungarian physicist and philosopher). *The Tacit Dimension*: 1966. *The Tacit Dimension*: Kinokuniya Co., Ltd., 1980;
Itami, Hiroyuki (Professor, Graduate School of Commerce and Management, Hitotsubashi University). *Human Network Company*: Chikuma Shobo Publishing, 1987;
Nonaka, Ikujiro (Professor, Center for Knowledge and Innovation Research, Hitotsubashi University) *Knowledge Creation Management*: Nihon Keizai Shimbun, 1990;
Nonaka, Ikujiro et al. *Intellect Management*: Nihon Keizai Shimbun, 1995;
Nonaka, Ikujiro et al. *Knowledge Creation Enterprises*: Toyo Keizai Shimbun, 1996; etc.

10 Because the word "asset" has the image to emphasize positive aspects, the word "intellectual asset" seems to focus on only the positive aspects. We use the word "intellectual asset based management" which includes not only the positive aspects but also negative aspects and risks.

"intellectual assets" (content of *x*) itself but also the "intellectual assets based management" (content of *f*) that is important.

It means that if *f* properly utilizes the content of *x*, *y* will grow. Therefore, for a corporation to enhance *y*, it is important to increase or strengthen *x*, devise a combination of *x* which matches *f*, and create the *f* that effectively utilizes the strength of *x* (*xk*).[11]



In addition, regarding output (*y*) as well, the part drawing attention has become diversified. There is no doubt that the realization of immediate profit (short term profit) has been emphasized in Europe, the United States and Japan. In the case of Japan, especially in the economic structure reform after the latter half of 1990s, the focus has become enhancement of a corporation's profitable structure and this point has become of a particular importance.

It is greatly influenced by the principle to assigning first priority to short term profit emphasizing the profit per share, which appeared in the United States in 1980s. However, also in the United States, from around the end of the 20th century, the traditional idea of considering a shareholder as "the person who has a right to claim what is left over" has been reexamined. Instead, more attention has gradually been paid to the concept of "shareholder value", which is the idea that increasing the profit of shareholders with lower priority is further increasing the profit of the people who have higher priority rights (such as clients and employees), in other words, the idea is to strengthen midterm profit. In Europe, on the other hand, there have been growing discussions on the idea of strengthening corporate social responsibility, such as CSR, from the viewpoints of employment and environment; that is, corporate value is considered not only in terms of economic value but also in terms of social value and environmental value.

Under these circumstances, if we clarify the output Japan should strengthen by referring to the arguments in Europe and the Unites States with reference to the concept of values unique to Japan, it appears that the most appreciated value for each corporation is the maintenance of sustainable growth and development as a going concern while coping with the

[11] Expressed mathematically, this means to increase $\partial y / \partial xk$. For a simple $f(xk) = ak \times xk + bk$, it means increasing coefficient *ak*.

social problems of our nation (global competition, the aging of population combined with low birthrates, environmental problems, waste problems, declining populations in rural areas, decrease in public projects, etc). For sustainable growth and development, it is necessary to obtain profits, but what is important is not only the profit of the current term but to ensure sustainable profit. This idea is similar to thinking of corporate value as the present discounted value of future cash flow.

(3) Corporate Value

Regarding corporate value, it is becoming common to apply the concept of a present discounted value of the corporation's future cash flow. Assuming that the market is effective, (the situation in Semi-strong Form[12] that all publicized phenomena are immediately and fairly reflected on the share price), disclosed information is ultimately reflected on the current share price theoretically.

(Note) There is a strong recognition among corporations that there is a discrepancy between real share price (current share price calculated by real share price) and actual corporate value.[13] In addition to the asymmetry of information, the diversification of the content of the information to be assessed (including intellectual assets) is also considered to be a cause. When actual current share price is below the essential corporate value, the corporation tends to be a target of M&A. In contrast, when the corporation does not have an effective investment destination, it may counteract by increasing the distribution to shareholders and pushing up the share price in a short term, but fundamentally, making investments as a form of internal reserve that can be the source of future differentiation leads to the future profit and may contribute in the best way to enhance corporate value and shareholders' profit. In such a case as well, if the market is perfect, the shareholders intending to keep shares for a short period may buy the shares of such corporation and the adjustment should be made by the selling of shares by shareholders intending to keep shares for a long time. It is important for corporations fundamentally to show another strategy to improve corporate value and to protect the corporation from acquisition attempts instead of using such superficial methods.

In this case, it may be an issue what social value, organization value, and environmental value would be. Given that a corporation originally aims at making profits, the assumption is not that those values such as social value, organization value, and environmental value do not lead to profits at all, but that they would be reflected at some stage in future cash

[12] Semi-strong Form is the market efficiency in which all publicly available information is promptly and fairly reflected in the share price. Strong Form is the market efficiency in which all information including insider information is reflected and Weak Form, in contrast, is the case in which only the past information is reflected. (Ball, R. and P. Brown, "An Empirical Assessment of Accounting Income," Journal of Accounting Research, Vol. 6, No. 2 (1968)..)

[13] According to the Survey on the Information Required for Intellectual Assets Reports published by Japan Investor Relations Association in March 2005, 44% of the responding corporations think that their share prices are undervalued.

flow. Actually, there is research supporting the view that even at present, ethical aspects such as considerations for environment or human resources development are reflected in the investment value (current share price minus net assets) through relationship to other intellectual assets in an organization.[14]

(4) Concept of Intellectual Assets

(i) What are Intellectual Assets?

As described above, under the knowledge-based economy, intangible assets that are source of corporation's excess earning power or corporate value are generically called "intellectual assets." Therefore, the following items, for example, are included in "intellectual assets," that are often called the sources of the strength of Japanese corporations:

- Persistence regarding details of products, technology and know-how represented by "adjustment to resolve issues" during manufacturing process
- Rapidness in the development of products and services with which a problem is solved through communication with customers, and the organizations and systems that make it possible (including the request from client side for the development of the next-generation products)
- Existence of high level consumers who can provide feedback on high level demand, and the relationship between consumers and corporations (high quality network)
- Brand power of products, services, and corporation that is based on the credit proven by the quality, medium- and long-term stable presence, and medium-term business relationship
- Maintenance of motivation of and application of the abilities of high level employees, and the system for employment and the organization that has made it possible
- Ability of intellectual creation supported by a broad base of engineers and technicians

(ii) Related Concepts

In Europe, in the same context, the term "intellectual capital" is used, perhaps more often than the term “intellectual assets”, and the term "intangibles" is also used especially in the United States.

Intellectual assets are basically intangible assets, but the term "intangible assets" in accounting already has a common interpretation as intangible non-monetary assets, especially intangible fixed assets. To avoid confusion and to avoid misunderstanding with the narrower interpretation, the term "Mukeishisan (intangible assets)" is not used here. "Intangibles" is the concept broader than "Mukeishisan," but there is no concept in Japanese language that exactly means intangibles.

[14] There are
Likert, Rensis. *The Human Organization: Its Management and Value* New York: McGraw-Hill, 1967;
Wakasugi, Akira. *Human Resources Accounting*: Moriyama Shoten, 1973;
etc.

As for "capital," from the image of the capital on balance sheets, there is an impression that it is an aggregation of various factors that is assessed in monetary value, so the term "assets" is used here to make it clear that individual content and qualitative aspects are also considered.

In addition, "assets" has a static image but it includes dynamic content such as speed. Dynamic elements, however, are often one of the aspects of the utilization of intellectual assets for management. Management that utilizes and recognizes intellectual assets is called "Intellectual assets based management".

(iii) Value of Intellectual Assets and IA Based Management

Generically, intangible assets that become sources of corporate value are called "intellectual assets," but they are merely sources of value and the key for management is how to utilize them effectively. What is important is success or failure in "intellectual assets based management," i.e. how to maintain, manage, enhance and improve their own intellectual assets, how to combine them for business purposes, and how to realize value.

Intellectual assets represent the "possibility" to create corporate value but are not traded in public, and therefore they themselves do not have an absolute exchange value and "exchange" is not easy. Only when used in a management process, intellectual assets create value. Therefore, the content and size of value created by the intellectual assets naturally vary depending on the strategies and processes. Assessment of the "absolute value" of each intellectual asset is impossible and is not a worthwhile direction. The value of intellectual assets varies greatly depending on who has them and how they utilize them.

In relation with the accounting system, taking "network with customers" and "ability to innovate" for example as factors of intellectual assets, individual intellectual assets generally are not listed on a balance sheet, because intellectual assets themselves do not have independent value, are not bought or sold alone, and a corporation does not necessarily own or control the intellectual assets. However, it cannot be denied that a corporation can control intellectual assets as separable from other assets, internally assess the value of a certain group of tradable intellectual assets and use it for business decision-making, or for negotiation of transactions of single intellectual assets, or to display identifiable intellectual assets of an acquired corporation separately from its good name. If it is possible to summarize what type of assessment "method" can be used when what type of use is made, it would be meaningful.

(iv) Classification of Intellectual Assets

Regarding what type of corporate intellectual assets could exist, based on methods in Europe that go one step ahead in intellectual assets research, they can be classified roughly into three categories: human resources assets, organizational assets, and related structural assets.[15]

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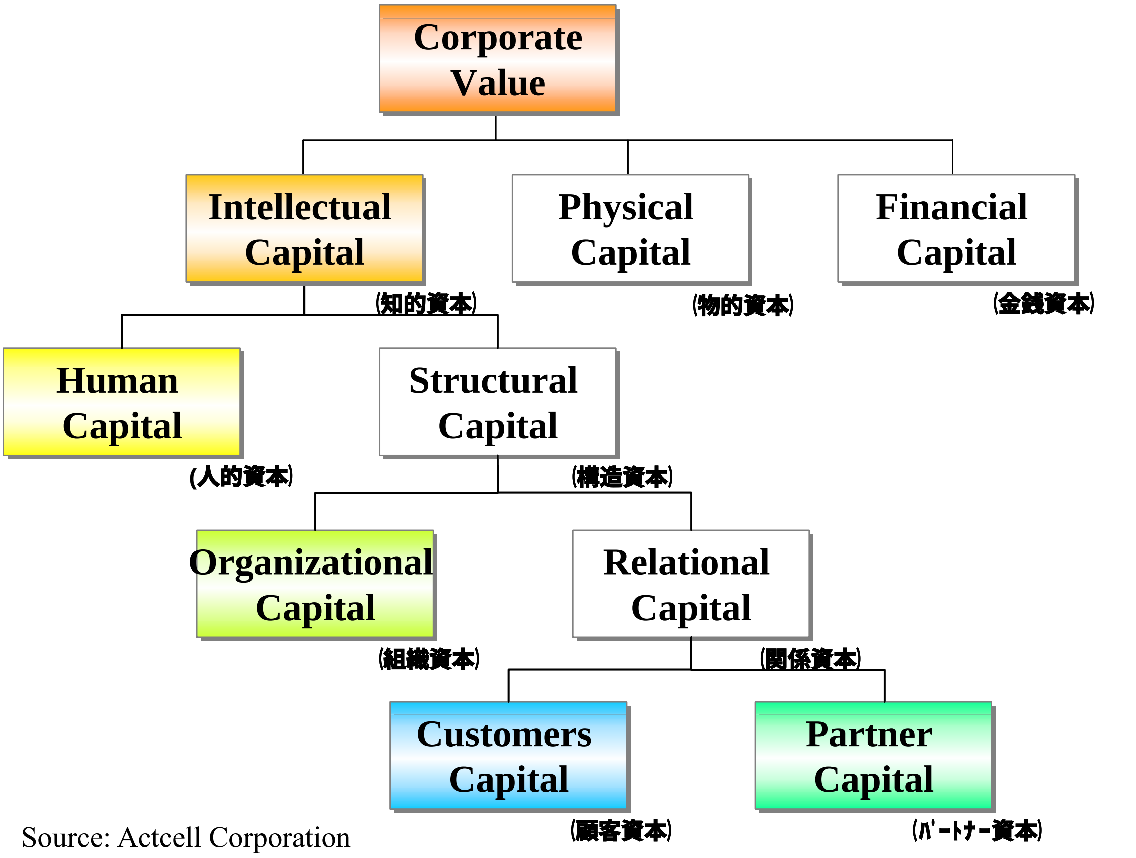
[15] For example, "IC Rating," which is a measurement and assessment system for intellectual assets developed by Skandia Insurance Co., Ltd., a Swedish insurance company (http://www.skandia.com/en/index/index.shtml), is used. Actcell Corporation

Such classification and is important for understanding elements of intellectual assets, but the classification itself does not have specific meaning.

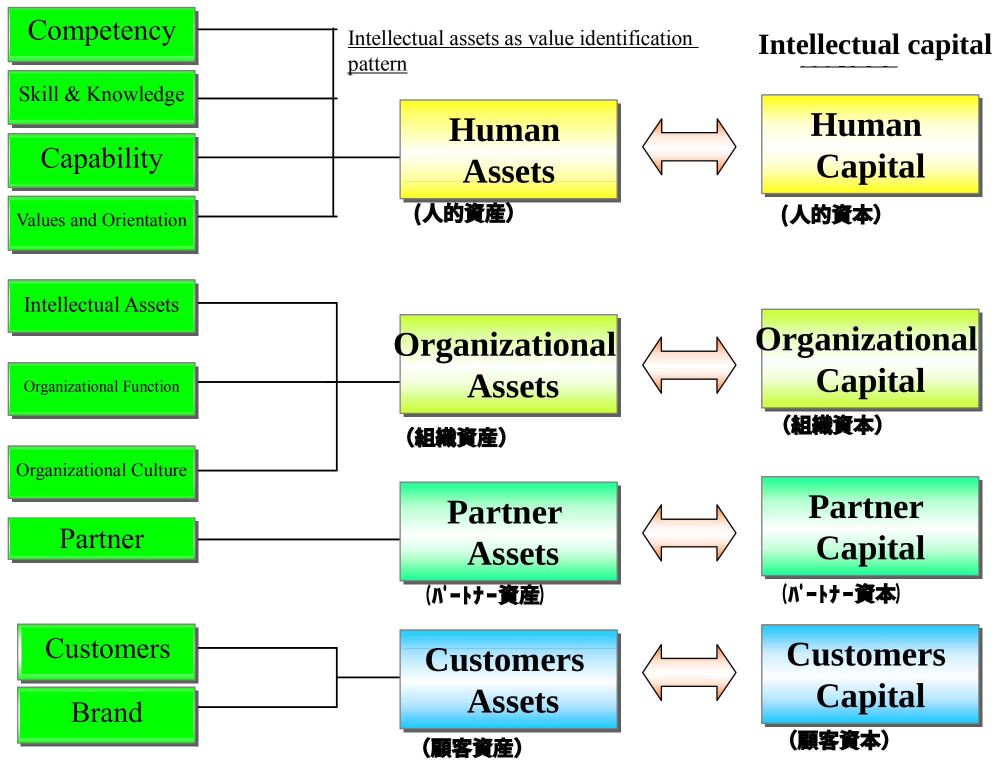
The following classification method was also introduced for discussion in this Subcommittee on Management & Intellectual Assets.



Source: Actcell Corporation

(http://www.actcell.com/) is conducting corporate reform by using "IC Rating".

Intellectual Assets System as Value Identification Pattern



Source: Actcell Corporation

(v) Intellectual Assets and Reputation

There is an idea that reputation is important as an intangible that influences corporate value.[16] Especially, in many cases, the reputation that has been built up over time collapses suddenly for some reason, and immediately influences the share price creating a large impact on aggregate market value. There is an idea that the character of such reputation is different from that of intellectual assets.

It takes a long time to build up and accumulate corporate reputation based on various factors, but when analyzing the sources of corporate reputation, it can be broken down to the factors of intellectual assets such as quality, sincerity, images of products and services, contribution through social activities, and thorough business risk management.

When a reputation collapses in an instant as a result of an occurrence of a problem, it is not easy to recover. The reasons for this are firstly, because a flaw in what was regarded as an intellectual asset supporting the reputation was suddenly exposed and the people who believed in the "reputation" tend to think of the exposure as a "betrayal," and secondly, because it results in a negative expectation that the same will occur again.

For these reasons, under such a situation the corporate value realized in the market (= aggregate market price) is subjected to a large negative influence due to the short-term reputation and it takes a long time to recover. Including such reasons, corporate value and "reputation" tend to have a gap. Therefore, "reputation" has an unmanageability of a different nature from that of intellectual assets that are backed by something.

However as described above, sources of "reputation" are accumulation of intellectual assets, and the situation in which a flaw suddenly becomes apparent and gives a shock is very similar to losing reserved savings due to the uncertainty of the accumulated intellectual assets. Furthermore, usually, corporate reputation cannot help dropping lower than the actual ability when there is such a shock, and the attempts to recover will be through accumulation of substantial intellectual assets over a long period of time. If good reputation is not substantial, "such a reputation is far beyond reality"; while, if it becomes substantial, medium term assessment may become better based on the substance.

Therefore, it is possible to say that "reputation" in a way is one of the advance indicators of intellectual assets that is fraught with uncertainties. Because of the uncertainties, it is necessary to pay the closest attention to "management." At any rate, though it has special characteristics, "reputation" can be considered as a part of the intellectual assets in a broad sense, in that it could be managed under the intellectual assets based management.

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[16] There are:
Sakurai, Michiharu. *Corporate Reputation*: Chuo Keizai, 2005;
Fombrun, Charles J. and Cees B.M. Van Riel. *Corporate Reputation*, translation supervised by Yasuhito Hanado, translated by Dentsu Reputation Project Team, published by Toyo Keizai Inc., 2005;
J. Alsop, Ronald. *Reputation Management*, translated by Tohmatsu CSR Group, published by Nippon Jitsugyo Publishing Co., Ltd., 2005;
Hannington, Terry. *How to Measure and Manage Your Corporate Reputation*, translation supervised by Michiharu Sakurai, Kazunori Ito, and Koji Oyanagi, published by Diamond Inc., 2005; etc.

(5) Success Factors of IA Based Management

(i) Significance of IA Based Management

As described above, it is not the intellectual assets themselves, but the identification and proper utilization of them that leads to sustainable profit and corporate value. Therefore, it is not an exaggeration to say that the identification and utilization of intellectual assets, namely whether or not intellectual assets based management can be performed, will decide the fate of corporations in the future and consequently the fate of the Japanese economy.

As there is increasing influence from intellectual assets on corporate performances, if such "intellectual assets" are not properly identified, managed, and incorporated in management strategies on the individual corporate level, and as a result the potential ability of intellectual assets is not effectively utilized, it means there will be a big waste in resource distribution on a corporate level. Corporations should not manage only by the figures of results of sales and profits but put emphasis on the management to clearly identify intellectual assets that can be the sources of its own strength, to appropriately manage them and maximize them. Intellectual assets based management includes strategies, governance, and products control, and should clarify what the corporation is based on, that is to say the corporation's raison d'etre. It makes what is called "selection and concentration" possible, which is to withdraw from the business and functions where the company has no strength, and to concentrate resources on the areas where its strengths can be utilized. It goes without saying that, unless optimal distribution of resources on the corporate level is made, the entire economy cannot effectively utilize limited resources. Therefore, from the viewpoint of the entire economy, such management should be recommended.

(ii) Strength/Weakness and Management of Intellectual Assets

Intellectual assets are the sources of corporate strength, but there is always a risk of the present "strength" of a corporation changing into a "weakness." This happens when intellectual assets become obsolete without being identified adequately or, though being identified, they were not maintained or strengthened enough so that another competitive company develops superior ability. To avoid such situations, as the first step, intellectual assets as the sources of strength should be properly identified and assessed, and the threat against them and their weakness should be analyzed (risk analysis). Further, when a risk appears through the appearance of competitive companies, etc., it is important to renew the company strength by reassessing the intellectual assets, thinking about new way of utilization, or creating new intellectual assets. Such factors of management of intellectual assets are an important part of intellectual assets based management.

In comparison, the elements a corporation identifies as its own "weakness" are considered to be due to either a lack of certain intellectual assets or mishandling of the existing intellectual assets. Therefore, if the cause is correctly investigated and a comparatively low cost remedy can be found, it is considerably easy to obtain higher performance than at present and to enhance corporate value. The management and utilization of intellectual assets in this form of identifying and overcoming the sources of weakness is also an important factor of intellectual assets based management.

Looking from a different angle at the essence of intellectual assets based management, which is the management and utilization of intellectual assets which are the sources of strength and weakness, it is possible to consider the whole of it as risk management, which intentionally includes a factor of intellectual assets. This point is described later.

(iii) Leadership of Top Management

Considering these strength and weakness together with an understanding of their sources, management could clearly shows the visions and strategies, integrates consciousness of employees by his/her leadership, and constructs and develops the mechanism of value creation (value chain) by connecting intellectual assets. By appropriate management, maximization and continuation of created value become possible and corporate value is enhanced. This is the essence of intellectual assets based management.

Therefore, intellectual assets based management can be called a compilation of unique management-led strategies. In the case of Japanese corporations in general, they are said to have an excellent ability in enhancing operational efficiency, such as cost reduction through bottom-up knowledge management by teams and by introducing the best practices in the world; but, are also said to be inferior to the corporations in Europe and the United States in enhancing competitiveness through the construction of unique strategies. Therefore, for intellectual assets based management to take root, it is necessary to establish the leadership of top management and organizational climate, which will enable corporations to take unique strategies based on a long-term view in making their own corporate strategies and policies instead of referring to and imitating those of competitive companies.

(iv) Sharing a Sense of Value with Stakeholders

Even if a corporation conducts intellectual assets based management that attaches special importance to sustainable growth and development, unless its values and activities are shared and assessed by the stakeholders, including the relevant market, such corporation's voluntary activities will not continue. Therefore, to continue such management, it is necessary that stakeholders or the entire society assess a corporation's approach to sustainable growth and development properly, and that the result be reflected in the economic value such as profit of the corporation through actual share price, sales, and customer's confidence.

The key for this is that a corporation should definitely establish its own management policy, improve and utilize usable assets under an appropriate management, and try to get sympathy of stakeholders regarding such management. It is also important that stakeholders properly assess a corporation's approach to sustainable growth and development. During the process, the sharing of the sense of value between the corporation and the stakeholders is enabled.

It is obvious that each corporation should decide itself on the concrete contents of the sense of value and to which stakeholders the emphasis will be made.

3 Movements related to Intellectual Assets in Japan

In Japan, the past measures related to intellectual assets have been in practice for quite long time, although the words intellectual assets and intellectual capital were not used.

The main measures related to intellectual assets in Japan are introduced below briefly.

(1) Past Study

The Corporate Management Ability Committee established in METI in 1974 (mentioned later) was a pioneer of trials to asses "management ability" by analyzing qualitative factors as quantitatively as possible, such as top management, organizational structure, research and development, and marketing, which are not taken into consideration in the analysis by financial indicators.

Among researchers, before the researchers in Europe and the United States, Dr Hiroyuki Itami, for example, wrote that "invisible assets" such as technological know-how, loyalty to customers, brand image, controlling power over distribution channels, high motivation of employees, and organizational climate were sources of competitive superiority, and it has often been cited by the researchers in Europe and the United States after his book was translated into English.[17] Furthermore, Dr Ikujiro Nonaka had a great influence on the scholars in Europe and the United States by making a model for organizational knowledge creation process using the SECI Spiral that is a mutual transformation of tacit and explicit knowledge.[18]

On the other hand, the Japan Quality Award established in December 1995 by Japan Productivity Center for Socio-Economic Development, is similar in concept to the Malcolm Baldrige National Quality Award of the United States and includes assessment standards to which the characteristics of Japanese management are added. This award is based on a concept of "management quality" consisting of the fundamental principles of customer-orientation, uniqueness, importance of employees, and harmony with society. It led to the movement to sublimate conventional "quality control" into "management quality" or "quality management." Movements similar to this include the "TQM Standardization Research Committee" (later renamed the "Quality Management System Standard Committee")[19], for which the secretariat is the Japanese Standards Association, established in December 1999 as a project sponsored by the Ministry of International Trade and Industry (present Ministry of Trade, Economy and Industry,

[17] Itami, Hiroyuki. *New Theory of Management Strategy*: Nihon Keizai Shimbun, 1984 (Translated by H. Itami and T.W. Roehl into *Mobilizing Invisible Assets*: Harvard University Press, 1987)
[18] Nonaka, Ikujiro. *Knowledge Creation Management*: Nihon Keizai Shimbun, 1990; Nonaka, I. and H. Takeuchi. *The Knowledge-Creating Company*: Oxford University Press, 1995 (translated by Katsuhiro Umemoto into *The Knowledge-Creating Company*: Toyo Keizai Inc, 1996)
[19] The results of its research were published in January 2003 as *TRQ0005 Quality Management System - Guidelines for Sustainable Growth* and *TRQ0006 Quality Management System - Guidelines for Self Assessment*.

METI), and the "Management System Assessment Study Group"[20] which started in October 1999 as research consigned by the Japanese Standards Association.

(2) Study Conducted under supervision of METI

The Ministry of Trade, Economy and Industry had a "Corporate Management Ability Committee" from 1974 to 2000. In order to properly understand management ability for a corporation to grow and develop by coping with the changes in management environment, the committee has developed, especially for the manufacturing industry, "new management indicators" to quantitatively assess the role of qualitative factors in relation with financial data, including factors such as top management, organizational structure, research and development, and marketing, which cannot be considered in the analysis of conventional financial indicators. Further, from 1981, in addition to the manufacturing industry, the retailing industry was added for the survey and the study has been promoted.

This research has been succeeded by the following research, and in the 21st century, the words "intellectual capital" and "intellectual assets" started to be used.

- “Comprehensive Management Indicator - Attempt of Quantitative Assessment on Qualitative Factor (Manufacturing Industry) 2000 Edition” by Corporate Management Committee, METI, published in April 2002
- “Comprehensive Management Indicator - Attempt of Quantitative Assessment on Qualitative Factor (Retailing Industry) 2000 Edition” by Corporate Management Committee, METI, published in April 2002
- “Report of Brand Value Assessment” by Corporate Legislation Study Group, METI, published in June 2004
- “Final Report of Intellectual Assets Study Group” by Policy Bureau, METI, published in September 2002
- “Report on the Research on New Management Indicators (Intellectual Assets)” by Waseda University Institute of Asia-Pacific Studies about the research entrusted by METI, published in March 2003

(Note) In addition, METI participated in the examination for “Survey Research on Creation and Utilization of Intellectual Assets”[21] with which Actcell Corpration was entrusted by the Japan Industrial Policy Research Institute.

Furthermore, in the 2004 White Paper on International Economy and Trade, the efforts related to intellectual assets inside and outside Japan were verified.[22]

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[20] The results of its research were published by Japan Standards Association in October 2001 as *Guide the Corporate Innovation - Self Assessment of Management System* edited by Hiroshi Nagata, written by Management System Assessment Study Group.

[21] *Survey Research on New Development of Industrial Policy (Survey Research on Industrial Structure Report) - Survey Research on Creation and Use of Intellectual Assets* by Japan Industrial Policy Research Institute (entrusted to: Actcell Corpration), published in March 2005

[22] Refer to Chapter 2 Section 1 of *2004 White Paper on International Economy and Trade*, METI

(3) Movements related to CSR, Intellectual Property, etc.

What are very relevant in view of corporate disclosure of non-financial information are the measures for CSR reports, sustainability reports, intellectual property reports, etc. From the viewpoint of using such information for corporate assessment, there are Social Responsibility Investment (SRI), "Environmentally Sustainable Management Promotion Project" by the Development Bank of Japan and others.

To summarize ideas on these measures, METI has published the Report of Working Group on Risk Management and Internal Control[23], Guidelines for Intellectual Property Information Disclosure[24], Interim Report on the Conference on CSR,[25] etc. In financial circles, there are the measures such as "15th Corporate White Paper"[26], and "Competitiveness Enhancement by Customer Value Creation and Efficient Management"[27] by Keizai Doyukai, Japan Association of Corporate Executives.

(4) Activities of Companies

When examining intellectual assets based management in this Subcommittee, in addition to the above research, it is also quite helpful to consider the measures of individual corporations that have taken the lead in practicing intellectual assets based management to identify, manage, and utilize their own intellectual assets. All the corporations attending this Subcommittee have been conducting management utilizing intellectual assets and their outlines are as follows.

○ Nissan Motor Co., Ltd.

Under strong leadership, Nissan Motor Co., Ltd. is performing intellectual assets based management. For example, being a manufacturing company, it focuses on research and development and owns intellectual property rights such as patents, trademark rights, design rights all over the world. By controlling them in an integrated manner, it makes an efficient and strategic management possible. Also, to enhance organizational power, measures are taken to implement thorough branding even with the detailed designs and colors of "NISSAN," "INFINITI," etc., and to form organization-wide cross-functional teams.

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[23] Working Group on Risk Management and Internal Control, METI. *Guidelines for Internal Control that functions together with Risk Management*: June 2003

[24] METI. *Guidelines for Intellectual Assets Information Disclosure - For Mutual Understanding between Corporations and Market by Voluntary Disclosure of Patent and Technology Information*: January 2004

[25] Corporate Affairs Division, Economic and Industrial Policy Bureau, METI. *Medium Term Report on the Conference on Corporate Social Responsibility (CSR)*: September 2004

[26] Keizai Doyukai, Japan Association of Corporate Executives. *15th Corporate White Paper "Market Evolution" and CSR Management - Toward Building Trust and Creating Sustainable Stakeholder Value*: March 2003

[27] Corporate Competitiveness Enhancement Committee, Keizai Doyukai. *Competitiveness Enhancement by Customer Value Creation and Efficient Management - Realization of Reform Executive Leads*: April 2004

○ Shiseido Co., Ltd.

As "THE SHISEIDO WAY", Shiseido Co., Ltd. has established guidelines for employees' activities for the stakeholders, i.e. customers, clients, shareholders, employees, and society (THE SHISEIDO CODE). In addition, its brand is enhanced based on the policies of "HIGH IMAGE," "HIGH QUALITY" and "HIGH SERVICE." In overseas markets such as China, measures are taken to use the know-how of brand enhancement in Japan.

○ Okaya Electric Industries Co., Ltd.

Okaya Electric Industries Co., Ltd. has introduced TRQ0005 (Guidelines for Sustainable Growth) and TRQ0006 (Guidelines for Self Assessment) on a trial basis. By these, management strategies, business strategies, products and service strategies are clarified sequentially and a total management system was constructed. As a result, it became possible to control the quality of products and services supplied all over the world and to infiltrate its management policy in a priority-oriented way into the points28 where values are supplied to a variety of stakeholders such as shareholders, employees and clients.

During such processes, by clarifying the competitive advantages to targeting only the figures for business achievements not only from supplier's side but also from market's side, the aim is to understand the market's potential needs and to perform realistic management that is not influenced by market economy. In other words, by using the competitive advantages (= intellectual assets) supported by a management system, management is conducted with the aim of being not just number one, but the only one.

○ Hitachi, Ltd.

Hitachi, Ltd. started to use BSC in 2003 and some divisions use it for assessment and control of intellectual assets. The company intends the management to enhance corporate value together with clients by maximizing the determined intellectual assets. In connection with such measures, a part of intellectual assets has been publicly disclosed already in "Environment Report" and "R&D and Intellectual Property Report."

○ Takeda Pharmaceutical Co., Ltd.

Takeda Pharmaceutical Co., Ltd. is cooperating within the company by using "MPDRAP Strategy."[29] In addition, "business value" is calculated for each pipeline (products, developed products, research subjects), and based on the business value, the value of related respective intellectual properties such as patent, know-how, trademark, and brand are all assessed numerically and used for internal control. Because the intellectual properties are controlled within the company, efficient intellectual properties based management with other organizations such as universities and TLOs is possible.

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[28] Points mean the respective key factors of employees and products, services, and the entire system.

[29] MADRAP is an abbreviation for Marketing, Production, Development, Research, Alliance, and Patent.

(5) Activities of Market/Stakeholder side

There are some advanced corporations that recognize the importance of intellectual assets and emphasize it in the management. Also on the side of the relevant market, a new movement has started to make corporations disclose not only their financial data but also management policies and to positively assess it.

As measures in the market, after 1999, stock exchanges such as the Tokyo Stock Exchange have been requesting the enhancement of the description of qualitative information[30] as requirements for financial statement letters and attached information. In addition, disclosure of corporate governance related information has been made compulsory (applied to the corporations that finish their fiscal year on and after March 1 2003) by the revision of the regulation for timely disclosure by the stock exchanges such as Tokyo Stock Exchange. Furthermore, in the “corporate information” such as annual security report based on the revision of Cabinet Office regulations on the disclosure of corporations and other institutions, descriptions on 1) business risks, 2) analysis of its financial conditions and management results (MD & A), 3) situations of corporate governance have been made compulsory (applied to the fiscal year beginning on April 1, 2003 and later).

On the other hand, as measures on the side to assess corporations, the Development Bank of Japan for example has implemented from 2004 a funding system with which corporations’ environmental management is assessed through questions on three categories[31] of 1) entire management, 2) business-related matters, and 3) environmental performances as "environmental rating" and, according to the results, three levels of interest rate are applied[32]. The Pension Fund Association has established "Corporate Governance Fund" at a scale of about 10 billion yen in March 2004, and there are 20 items for assessment such as whether shareholders are valued, conditions of disclosure, formation of directors, salary system, and compliance risk management, and most of these items are non-financial information.[33]

4 Activities in Other Countries

In various foreign countries, including those in Europe, there are two main trends in the research and study related to intellectual assets. The first involves a theory that states that as there is a transition to a “knowledge economy”, the intellectual assets that do not appear on financial statements will have an increasing influence on the competitiveness of a company. Many scholars in academia are focusing their studies on this theory,[34] and academicians,

[30] Information document describing the listed company's own viewpoint on the company's management policy, management result, financial condition, and expected financial information
[31] Manufacturing companies are assessed with 127 items and maximum points of 250.
[32] In FY2003, total 40 billion yen was funded to 30 corporations.
[33] In FY2005, 43 companies are assessed.
[34] Refer to the previously-mentioned “2. IA Based Management and Corporate Value”. For details about the historical development of the theories related to the concept of “intellectual assets management” see Sullivan P. *Value-driven Intellectual Capital, How to convert intangible corporate assets into market value* Wiley (2000) (pp. 238-244); Japanese translation also available from Toyo Keizai Inc. translated by K. Mizutani (2000) (pp. 249-257).

consultants, research institutes and international agencies are conducting analyses of intellectual assets and investigating policies to deal with them from the perspective of corporate competitiveness and sustainable economic growth.

The other trend is a concept of "Corporate Social Responsibility" (CSR) that is based on a belief that, in addition to the pursuit of economic profits, corporations have a responsibility to disclose information and explain their environmental and social activities. This is an idea that is receiving particular attention in Europe.[35]

In recent years there has been a gradual spread of the idea of a "triple bottom line" in which the business activities are conducted while maintaining a balance among the economic, social and environmental perspectives, and there has been empirical study on the compatibility of CSR and company profitability.[36] Furthermore, the stakeholders make evaluations regarding the CSR activities of a company; and, the disclosure of information by a company to the stakeholders enables the stakeholders to evaluate intellectual assets that are difficult to understand from financial statements. Since there is a lot of overlap in the information disclosed along with each mechanism, these two approaches has become similar.[37]

Such activities in various countries are presented in detail in the "White Paper on International Economy and Trade 2004" (Section 2, Chapter 1). Here, the activities of government agencies that are considered most relevant are briefly presented.[38]

(1) Movements in Europe

From a global perspective, the handling of intellectual assets and capital is quite advanced in Europe, including northern Europe. In particular, the most advanced countries in this respect are Denmark, Sweden and the Netherlands. The driving forces have been Swedish industry, the Congress of the Netherlands and the Danish government. The OECD has filled an important role in activities accompanying these movements.

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[35] European Commission, *Green Paper: Promoting a European Framework for Corporate Social Responsibility* (July 2001). The text can be obtained at http://europa.eu.int/comm/employment_social/soc-dial/csr/greenpaper_en.pdf

[36] Ministry of Economy, Trade and Industry *2004 White Paper on International Economy and Trade*, pp 75-84.

[37] For example, in March 2000 the EU parliament adopted the Lisbon strategy indicating that by 2010 Europe should become "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion". This can be regarded as an effort to construct a "European socio-economic model with sustainable economic growth and compatible environmental, social and employment policies.

[38] For a comprehensive survey of the past international activities, refer to European Commission, *Study on the Measurement of Intangible Assets and Associated Reporting Practices*, (April 2003); Financial Accounting Standards Board (FASB). *Financial Accounting Series Special Report – Business and Financial Reporting, Challenges from the New Economy* (April 2001). With regard to the activities in various countries regarding environmental reports, see the Ministry of the Environment **Survey of Trends Abroad Regarding Systems of Environmental Reporting**, (March 2005)

(i) Sweden

Interest and concern with intangibles has always been unusually high in Sweden. In 1989 a group known as the Konrad Group, consisting of 7 scholars and businessmen, including Karl Erik Sveiby, issued their final report, entitled "The Invisible Balance Sheet"[39]. This report has become the foundation of later discussion.

After seeing the report, in 1991 the Swedish insurance company, Skandia began a project on intellectual capital, led by Leif Edvinsson. In 1995 a supplemental "Intellectual Capital Report"[40] was issued with the company's annual report, representing the first such report in the world. The IC navigator introduced in this report has become a global model.

This kind of private sector activity is supported by government agencies, such as the Invest in Sweden Agency (ISA) and Statistics Sweden, through statistical studies and research projects.

(ii) Denmark

In Denmark the most advanced activities in the field of intellectual asset reporting are being conducted under the initiative of the government. The Danish government first established guidelines on intellectual capital reporting[41] in 2000. Revisions[42] to these guidelines were issued in 2003.

In the 2001 revision of the Danish Financial Statements Act[43] there is no obligation to disclose "intellectual capital reports", but for companies larger than a certain size it is required for them to disclose information such as their business concept and operating objectives, intellectual assets that are important to future profitability, the effects of business operations on the environment, and risk profiles and risk management situations, in the "Operating and Financial Review" (OFR) that is part of the annual report. It is acceptable to include more detailed reporting on intellectual assets, environmental issues, and social and ethical problems in the Supplementary Report included with the annual report.

(iii) Netherlands

In 1998 the government of the Netherlands started a project on intangible assets, and

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[39] The Konrad Group (editor: Karl Erik Sveiby), *The Invisible Balance sheet - Key indicators for accounting, control and valuation of know-how companies* (1989)

[40] Skandia Insurance Company, *Visualizing Intellectual Capital in Skandia: Supplement to Skandia's 1994 Annual Reports*, Skandia Insurance Company, Stockholm, Sweden (1995). Available on line: http://www.skandia.com/.

[41] Danish Agency for Trade and Industry, Ministry of Trade and Industry, *A Guideline for intellectual capital statements – a key to knowledge management* (2000).

[42] Danish Ministry of Science, Technology and Innovation, *Intellectual Capital Statements – The New Guideline* (2003); Danish Ministry of Science, Technology and Innovation, *Analysing Intellectual Capital Statements* (2003).

[43] Danish Financial Statements Act (Applicable for accounting years starting after Jan. 1, 2001)

the results were published[44]. At the same time, an OECD international symposium[45] on the measuring and reporting of intellectual capital was held in Amsterdam in 1999.

(iv) European Union (EU)

In the EU, corporate law is being modernized, and in June 2003 a revision of a directive on accounting[46] made the application of International Accounting Standards (IAS) mandatory. In addition, member countries were enjoined to require that companies above a certain size disclose comprehensive analyses of the balance between business processes, business results and current status in the annual reports for fiscal operating periods that start after January 1, 2005. As a result it has become mandatory to disclose non-financial information and indicators (KPI), including information related to the environment and employees, in addition to the financial statements in the scope needed to understand the business processes, results and current status.

Other activities of special note are described below.

- MERITUM Project (1998-2001). *Guidelines for managing and reporting on intangibles (Intellectual Capital Report),* Airtel-Vodafone Foundation, Madrid**.** (A joint research project involving universities and research agencies in six countries including Spain, Denmark, Finland, France, Norway, and Sweden. Supported by the EU and christened "Measuring Intangibles to Understand and Improve Innovation Management". The project focused on 4 main themes; classification, internal control, capital markets and guidelines.)
- PRISM Project (2000-2003). *PRISM REPORT 2003 – Research findings and policy recommendations*, Based on the final reports of the PRISM research consortium. European Commission's IST programme. (A broad-ranging EU project to obtain deeper understanding of the issues related to the assessment of intangibles management.)
- EU STUDY ON THE MEASUREMENT OF INTANGIBLE ASSETS AND ASSOCIATED REPORTING PRACTICES, Presented for the Commission of the European Communities Enterprise Directorate General (April 2003).

Recently in Europe a movement called the Enhanced Analytics Initiative (EAI)[47] has become active. This activity is conducted by means of a consortium established by a group of European investors in October 2004. In exchange for a 5% broker commission, a sell-side

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[44] Netherlands Ministry of Economic Affairs, *Intangible Assets, Balancing Accounts with Knowledge* (1999).

[45] OECD International Symposium (1999): Measuring and Reporting Intellectual Capital, Amsterdam, 9-11 June 1999. The symposium program, speeches and background materials can be viewed online at http://www.oecd.org/document/1/0,2340,en_2649_201185_1932737_1_1_1_1,00.html.

[46] DIRECTIVE 2003/51/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings.

[47] http://www.enhancedanalytics.com/

analyst is asked to analyze the extra-financial issues and intangibles to devise a more long-term, more complete evaluation of the company results[48]. It is reported that the effective total amount based on this has reached 380 billion Euros (about 50 trillion yen).

The following are the examples regarded as extra-financial issues and intangibles in EAI initiative. Although there are certain items that are common across industries, there are some items that are only relevant in certain sectors, or only become relevant during M&A activity.

- Corporate Governance
- Human rights, Health, safety and employment standards for work (ex: Construction, oil/gas, mining industries)
- Intellectual Capital Management (ex: Pharmaceuticals, IT)
- Compatibility between executive remuneration and long-range value driver strategy
- Carbon constraints (ex: Oil/gas, metal/mining industries, public works, construction materials, automobiles, transportation) and seasonal changes (ex: Insurance, construction, real estate)
- Consumer/Public health (ex: Food products, chemicals, communications, food & drink, retail industry)
- Product end of life (ex: Consumer electronics, automobiles)
- Reputation risk and operating license (ex: Food products, pharmaceuticals, tobacco)
- Project environment and impact on society (ex: Oil/gas, mining industries, public works)
- Creation/Destruction of value during M&A

(v) Other European Countries

● British government

Upon receiving the revision of the EU accounting directive mentioned above, the British government established a revision to the accounting statutes[49] that companies above a certain size be required to create and disclose “Operating and Financial Review” (OFR) documents (March, 2005) (This obligation is entered into force for accounting periods that start after April 1, 2005.)

The Operating and Financial Review is similar in concept to the Danish intellectual capital report mentioned previously, in the sense that it describes the long-range value creation of a company. The OFR is somewhat more comprehensive because it also incorporates clarifications of the items related to corporate social responsibility (CSR). In addition, the companies are obligated to disclose the future performance with Key Performance Indicators (KPI). Furthermore, ASB (Accounting Standards Board) made the “Reporting Standard” based

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[48] Press release dated October 18, 2004 (PR - 18/10/2004, Enhanced Analytics Initiative: changing the way the broker community analyses extra-financial issues and intangibles). http://www.enhancedanalytics.com/Fiesta/EDITORIAL/20050531/CommPresse/PR1_EnhancedAnalyticsInitiative_181004_VA_99.pdf

[49] Draft Statutory Instrument 2005 No. , The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005.

on the law[50].

● Germany

In 2004 the German government issued guidelines[51] recommending the creation of intellectual capital statements to clarify and improve company strength and innovation for mid to long-range survival, with particular focus on small to medium-sized companies. In these guidelines the intellectual capital statements were seen as an external communication tool, and it was expected that banks and investors would make use of them in the future when making financing or investment decisions.

On the other hand, regarding accounting standard, GAS15 was adopted in December, 2004, and a framework for the disclosure of non-financial information has been developed.

● Austria

In Austria the Universities Act of 2002[52] made it mandatory for institutions of higher education to submit intellectual capital statements starting in 2004.

(2) Movements in North America

(i) United States

In 1991 the American Institute of Certified Public Accountants (AICPA) formed a Special Committee on Financial Reporting[53] (Jenkins Committee) headed by Edmund L. Jenkins. This committee issued its final report[54] in 1994, proposing that business reporting should satisfy the following requirements in order to meet the changing needs of the people utilizing the information.

(1) Greater disclosure of more forward-looking information, such as business plans, opportunities, risks and uncertainties.
(2) More emphasis on the factors that lead to long-term value, including non-financial measurements that indicate how the important business processes are functioning
(3) There should be a closer connection between the information used internally for management of the company and the information that is publicly released.

The Financial Accounting Standards Board (FASB) received the report and in 1998, decided to conduct a research project on business reporting, established a Steering Committee, and began investigating methods for voluntary disclosure of information that is useful for the

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50 An implementation guidance including 23 examples of KPIs was published acompanying with the reporting standard. Furthermore, a discussion paper will be published soon by the WG of management commentary in IASB.

51 German Federal Ministry of Economics and Labour, Intellectual capital statement - Made in Germany, Guideline 1.0 on the preparation of an intellectual capital statement (2004)

52 Federal Act on the Organisation of the Universities and their Studies (Universities Act 2002), Section 13 “Performance agreement.”

53 AICPA SPECIAL COMMITTEE ON FINANCIAL REPORTING

54 American Institute of Certified Public Accountants (AICPA), Special Committee on Financial Reporting (Jenkins Committee), *Improving Business Reporting—A Customer Focus: Meeting the Information Needs of Investors and Creditors*. USA (1994).

users of business information in making investment decisions. In the 2001 report[55] by this Steering Committee, a framework for this voluntary disclosure was presented, which included 5 required elements. (1) Identify the critical success factors of the company's business (2) Identify management strategies and plans for managing the critical success factors (3) Identify metrics (operation performance measures) used by management to measure and manage the implementation of strategies and plans (4) Consider whether the expected benefits from voluntary disclosure are greater than the potential adverse effects on the competitive position of the company (5) If disclosure is deemed appropriate, determine the best way to present the information.

As a result of episodes like the Enron scandal in 2001, there was less debate on business reporting. In 2002 the discussions focused on ensuring the credibility of financial reporting. However, in 2004 the AICPA once again took the lead to form the Enhanced Business Reporting Consortium[56] enabling promotion of the discussions on business reporting.

On the other hand, with regard to institutional disclosure, since 1980 the US Securities and Exchange Commission (SEC) has required disclosure in the current MD&A (management's discussion & analysis) format in order to provide readers of financial reports the information necessary to understand the financial situation of the company, changes in financial situation and business results.[57] The purpose of this requirement is to ensure that business operators disclose the impact of any known trends or relevant business circumstances on future business results, and to raise the awareness among investors that the current financial statements do not necessarily indicate future business results and financial situation. However, in recent reviews by the SEC it became clear that the MD&A disclosures by many companies do not adequately fulfill this purpose, so the SEC issued guidance on MD&A disclosures asking for improvements.[58]

5 Disclosure Mechanism of IA Based Management

(1) Objective

As explained in 2(5)(iv), one of the prerequisites for continuous effort of corporations' intellectual assets based management is to share the concepts with stakeholders regarding management methods based on the values each corporation selects. In order to share concepts, corporations need to publicize information (reports and disclosure). They need to inform

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[55] Financial Accounting Standards Board (FASB), Business Reporting Research Project, Steering Committee Report, *IMPROVING BUSINESS REPORTING: Insights into Enhancing Voluntary Disclosures*, USA (2001)
[56] http://www.ebrconsortium.org/
[57] Final Rule: Amendments to Annual Report Form, Related Forms, Rules, Regulations, and Guides; Integration of Securities Acts Disclosure Systems, Securities and Exchange Commission, Release No. 33-6231 (Sept. 2, 1980) [45 FR 63630].
[58] Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities and Exchange Commission, Release Nos. 33-8350; 34-48960 (Dec. 19, 2003)

stakeholders of the existence of intellectual assets and intellectual assets based management which cannot be fully shown by already disclosed information, such as financial statements (in relation to capital markets, this refers to IR, which assesses corporations' potential to create value).

Currently, there is not a sufficient exchange of such information, and corporations are not satisfied with the current situation where only financial indicators receive attention. Confirming the results is no longer enough, and it is important to disclose "management information" for the future. In such a situation, it will become possible for corporations not only to cope with regulatory disclosure but also to proactively present information in a strategic way. In PR and IR, explanation and dialogue is to cultivate common understanding of the past, present and future with the stakeholders, with a strong emphasis on the probability of future profits rather than on the past results.

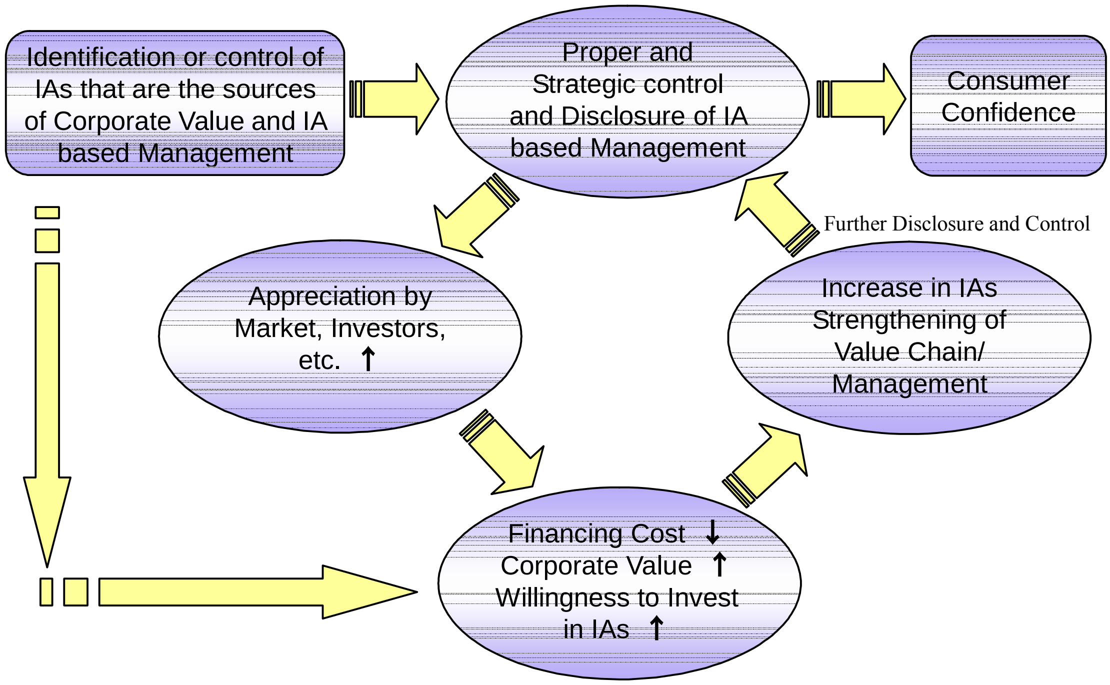
If a corporation receives a proper assessment from its stakeholders by such disclosure, it will create a virtuous cycle: the value of the corporation realized in the market will increase (such as an increase in the aggregate market value), financing of the corporation will become easier; efforts for and investment in the creation and utilization of intellectual assets will increase; corporate value will further increase and intellectual assets based management will be further strengthened; and it leads to the next disclosure.[59] This will also make it possible for a corporation to realize optimal distribution of resources by increasing investment within the corporation that will lead to the efficient value creation and consequently realize the optimization of resource allocation and the maximization of value creation capacity of the entire economy (Note). Enhancement of intellectual assets and efficiency of value creation will lead to increases of national wealth and vitalization of economy, and this will eventually contribute to development of the world economy.

（Note）In this process, the optimal distribution of resources is expected by appropriately reflecting each corporation's intellectual assets and evaluating the corporations. For example, capital is assessed in a financial market, and human resources are assessed in a labor market.

Meanwhile, there are various kinds of disclosure to consumers. However, financial information is not enough, and they do not know which information to trust or how to make a decision using the information. Also, Japanese corporations are thought to be behind ones in other countries in terms of disclosure. Corporations are expected to work on comprehensive disclosure of their management information by organizing items which are related to the safety and security of consumers and local communities. This is expected to increase a sense of security.

[59] Baruch Lev, *Sharpening the Intangibles Edge*, Harvard Business Review, June 2004, 109-116 (As a result of a research for bio-related corporations, it was found out that voluntary disclosure of intellectual assets and information related to products will create lower capital cost and lower volatility of stock price.)

The following shows such a virtuous circle.



Strengthening of Competitive Power and Increase in National Wealth by Realization of Virtuous Cycle

(2) Present Situation of Disclosure of Management Information

In the past, for assessing performance of corporations or business, what have been valued are indicators that show confirmed results of the past performance, i.e. indicators created based on the traditional and historical financial information such as current profits, ROE and EVA. However, investment decisions and project management in corporations need to be made based on future profits. Making a judgment only by historical indicators is similar to trying to drive a car only by looking into the rearview mirror.[60]

In addition to that, other stakeholders such as external investors etc. are mainly interested in the profit corporations will continuously make in the future, and it is hard to make a rational judgment based on mid/long term profitability mainly by the historical information which is currently offered by corporations. To improve these circumstances, various measures have been taken: the Commercial Code now provides for improved disclosure mechanisms through business reports; the Securities Exchange Law introduced new disclosure items (including "(Management's) Analysis of Financial Condition and Results of Operations")[61], and stock exchanges require enhancement of the disclosure contents of qualitative information[62]. In

[60] EU STUDY ON THE MEASUREMENT OF INTANGIBLE ASSETS AND ASSOCIATED REPORTING PRACTICES, Presented for the Commission of the European Communities Enterprise Directorate General (April 2003), pp. 143, 149.
[61] Ordinance by the Cabinet regarding disclosure of corporate information etc. (Enforced from the business year starting from April 1, 2003)
[62] Tokyo Stock Exchange has been continuously requesting the disclosure of qualitative information

addition, disclosure of information has started to be made in a positive manner through various vehicles such as financial statement letters, annual reports, environmental reports, CSR reports and intellectual property reports.

Meanwhile, some corporations still think that they should focus on making quality products/services, and efforts for intellectual assets based management have just started. Some of them also think there is a big gap between their goal and reality.

A recognition gap between corporations and the market still exists; many corporations, which have made advanced efforts, are not satisfied with the assessment made by the market[63]. In short, the virtuous cycle as stated above has not been created yet. One of the reasons appears to be the there are no means or assessment practices through which intellectual assets and their utilization can be indicated with some objectivity[64], which are essential for forecasting the future realization of values. At present, disclosure and assessment is still focused on the traditional and historical financial information that objectively shows the results of "value realization."

Internationally, global corporations are requested to provide additional information. For instance, in the United States, the Sarbanes-Oxley Act[65] aiming to strengthen the internal control was enacted for the enhancement of credibility of financial information, and in Europe, there has been a movement to make the disclosure of important non-financial information including CSR mandatory.[66]

When Japanese corporations are required to disclose information by the market etc., they attempt to receive a passing grade in every aspect and focus on a style rather than content. This is one of the issues. Another issue is that different departments create information on different items on their own.[67]

If the content of intellectual assets based management is clearly provided, core areas

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in attachments such as financial statement letters since 1999.

63 According to "Research for the information requested in intellectual assets based management report" by Japan IR Association (March, 2005), 44% of the corporations replied that their stocks were under-evaluated.

64 Not an assessment by absolute values such as the items on a balance sheet, but some kind of objectivity.

65 In order to cope with frequent corporate scandals such as Enron's etc., the Sarbanes-Oxley Act (corporation reform act) was created on July 30, 2002 to enforce the internal control for the corporations which are listed in the stock exchanges in the United States. It regulates the independence of auditors, corporate responsibilities, enforcement of financial disclosure, and enforcement for white-collar crimes etc. This is expected to recover the trust for corporate accounting and various reports.

Especially, some sections will impose large costs on those corporations, such as the section 404 to asses the internal control for financial reports from management and the section 906 to regulate managements to certify the validity of reports when they submit regular repots, and hold them for criminal liability if they fail to do so, and so on. These are considered to be important issues.

66 In the trend of modernization of the Corporate Law, disclosure of non-financial information/indicators (KPI) became mandatory in the Revised Accounting Regulation (2003/51/EC) (January 1, 2005 was the deadline for each EU country). See 4(1)(iv) for details.

67 Refer to *Study report for patent/technical information disclosure*,(March, 2004) by Intellectual Assets Research Institute foundation

of disclosure become clear. That enables Japanese corporations to appropriately disclose important information for those core areas, and decreases the pressure for information disclosure. Also, stakeholders can receive information which is comprehensive and easier to understand, allowing them to make appropriate assessments.

(3) Overall Picture of Disclosure Mechanism (IA Based Management Report)

(i) Necessity

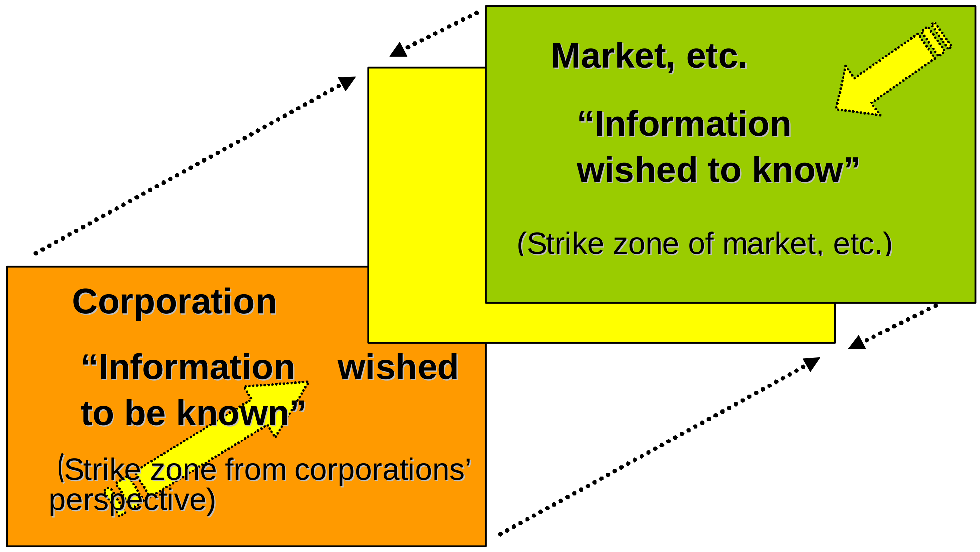
When disclosing management information, corporations wish to inform their stakeholders of information they wish to reveal and to obtain high confidence in their future capacity to create profits and values. On the other hand, stake holders judge corporations' future based on the information disclosed to them and use such judgment for their actual activities including investment etc.

Although both parties are interested in corporations' capacity to create future profits and values, the current situation of the disclosure system has not been satisfactory for either party, and more improvement is necessary. Under the current situation, management information is disclosed based on corporations' own decisions, and stakeholders do not fully understand the varying methods and contents of disclosure. Even if intellectual assets based management is actually conducted and disclosed, this may not create a virtuous cycle under the current situation.

It is desirable, in order for the needs of both parties to match, to create a fixed system of disclosure that organizes the way to explain intellectual assets based management. Through such a system, both parties can communicate on an equal footing and exchange knowledge including information and data, and then they can adjust their activities with deeper knowledge and understanding of each other. These will further improve the intellectual assets based management and increase the corporate value. This is expected to eventually increase national wealth.

Toward this end, it is beneficial for the government to play a role as an intermediary between stakeholders and corporations and indicate the strike zone for the ball corporations throw to the stakeholders, i.e. define the point of interests of stakeholders.

Corporations consider a recognition gap between stakeholders, and devise a good way to submit information to them. The analogy is that they throw a ball aiming at the strike zone. If a ball is thrown to the strike zone or around it, the catcher can most likely throw the ball back. This will initiate the process of deepening mutual understanding. Even though the ball is not thrown to precisely the center of the strike zone, if the catcher moves a little bit (i.e. makes some adjustment and thinks), he may be able to throw the ball back. For better communication, the catcher should not refuse to catch or throw the ball back only because the ball was not thrown to the center of the strike zone. This way, dynamic information exchange is created between corporations and stakeholders. Disclosure of intellectual assets based management is necessary as a strategic communication tool between corporations and stakeholders.



(ii) Core Contents of Information to be Disclosed (Story of Value Creation)

The "information that stakeholders wish to know" is based on corporation's future profits and cash flow and feasibility thereof. Therefore, the information is mainly about a management story regarding the corporation's future profits and cash flow, and the story's credibility.

For the story to be highly credible, its logical composition must be convincing. If corporations disclose their information in accordance with the format of "introduction, development, turn and conclusion," the ball is likely to be thrown to the area close to the strike zone of stakeholders.

Needless to say, each corporation will have a unique story to write and stories cannot be standardized. However, it is possible for the government to present guidelines regarding the minimum logical composition of "introduction, development, turn and conclusion" in consideration of stakeholders' viewpoints, which will ensure the credibility of stories and avoid excessive costs for both parties.

After a careful study with reference to the information other than financial information contained in business reports previously disclosed by various corporations, the recommended logical composition of a corporate story is as follows:

A. What kind of management policy was created through concentration in the past;

B. What kind of, how much investment was conducted based on A;

C. What kind of intellectual assets unique to the corporation and strength was accumulated as a result of A and B;

D. What business performance including corporate profit was realized;

E. How intellectual assets was rooted within the corporation as the possible sustainable value chain;

F. How to respond to future uncertainty/risks (based on clear recognition on them), and how to manage them and to establish a direction of management utilizing intellectual assets and the value chain; and

G. What kind of investment to make for the maintenance and development of necessary intellectual assets or based on valid assets that have not expired, in accordance with F.

Through the compositions listed above, corporate profit in the future profits (improvement of corporate values) can be predicted in this amount.

As for A through D, which are information from the past to the present, it is necessary to focus especially on explaining how corporations can analyze their information so that it becomes easier for the receiver of their information to understand.

The above applies to the case where a transition from the past to the present was relatively smooth and successful. If the past performance is not quite satisfactory, then for A, B and C, "what was desirable and what was lacking" and "what mistake was made in the selection" should be stated instead. In such a case, for E, F, and G, modifications to be made based on the lesson learned from the past mistakes and responses to the future uncertainty should be stated.

However, regarding forward-looking information, it is required to state there are uncertainties that the presumed situations might change as it is warned in "Issues regarding the future" section of annual reports.[68]

When issues regarding the future are explained in the above format, since stakeholders and analysts are interested in when the cash flows will be realized and when the intellectual assets will be turned into cash flow, it becomes more convincing if explanation of the time horizon, such as short-term, mid-term, or long-term, be given.

If we apply the comparison of corporations with functions as described in 2. (2), the story above can be translated as follows.

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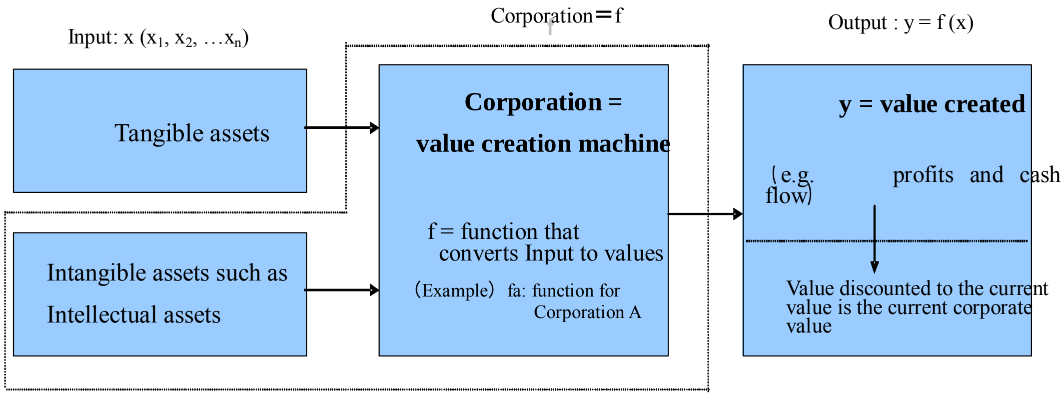
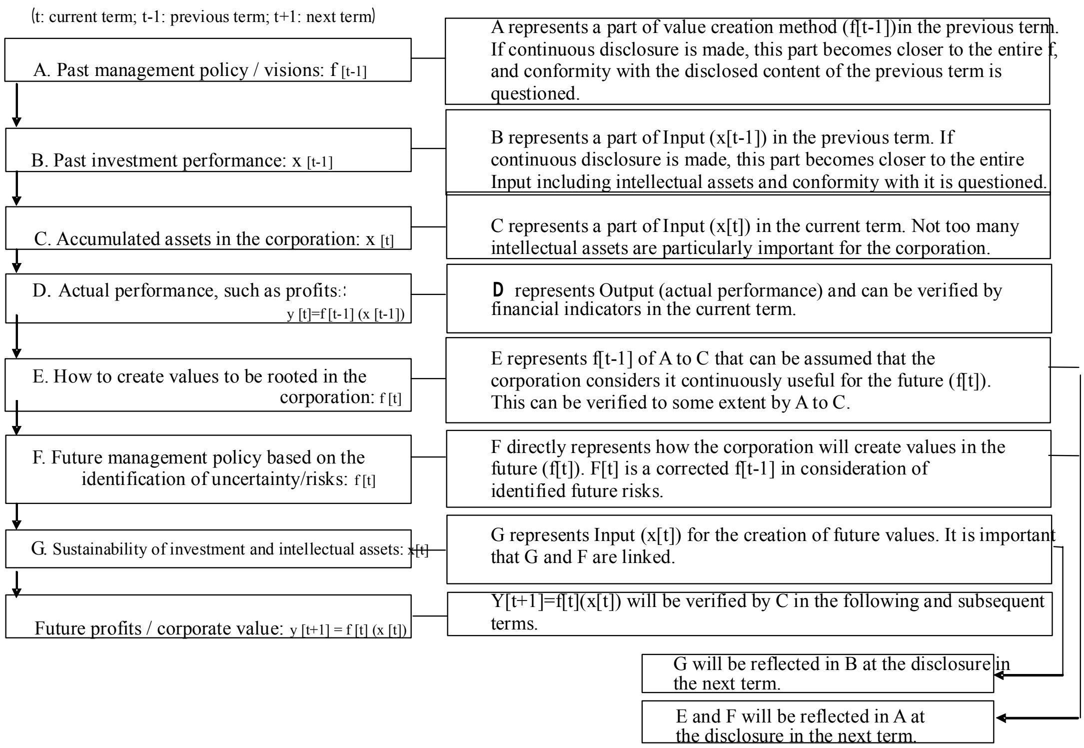
[68] Financial reports "must state that items regarding the future are judged as of the date which those reports are submitted".





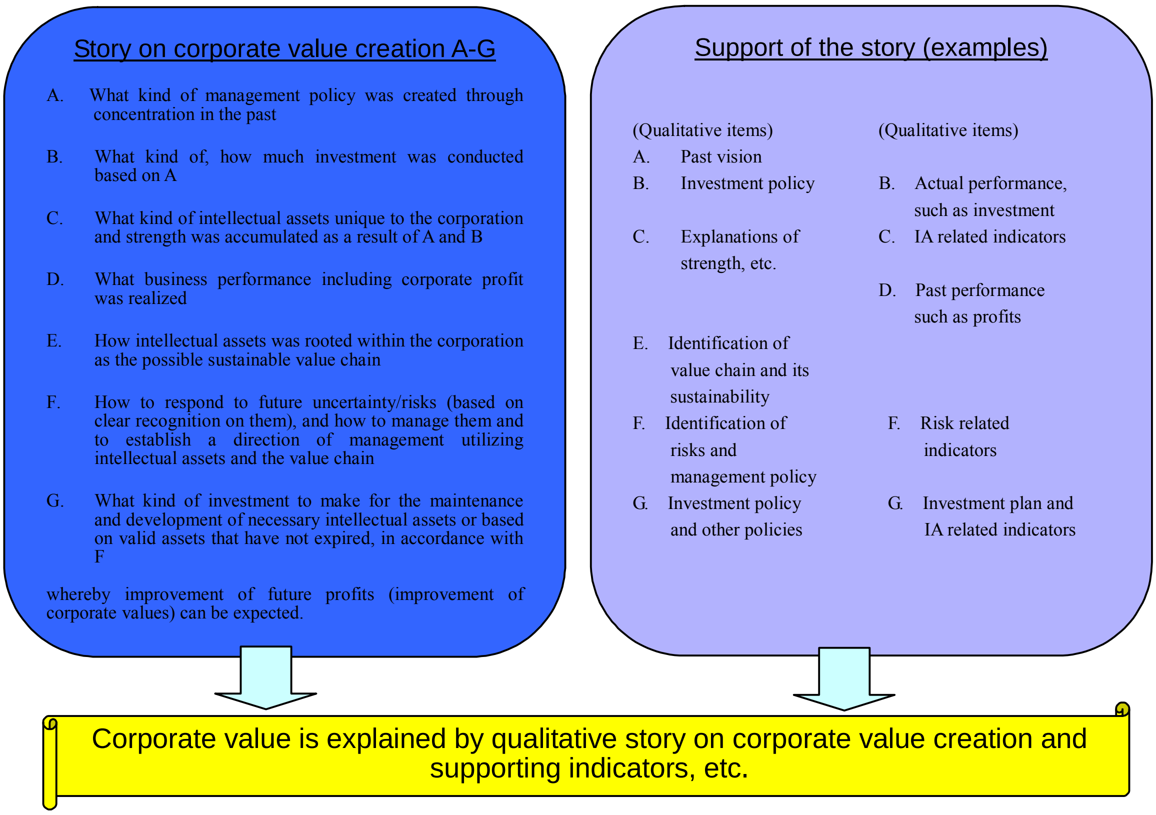
(iii) Back-up information of Story

In terms of stakeholders' better understanding, it is very meaningful to disclose stories of value creation as described in (ii), but there is a possibility that those stories are only plans, and they are not realistic.

Therefore, in addition to these stories, information including quantitative information is needed to support each factor of a story. The following information could support each factor of a story.

Quantitative indicators for intellectual assets are particularly notable. These indicators are not meaningful if they are just included in a story. They need to be well controlled internally in order to become a factor for intellectual assets based management in a true sense. For example, considering that the number of main indicators, which are used for internal management in the BSC method, is between 7 and 9 for a whole corporation[69], the number of truly important indicators for a corporation is considered to be from 5 to 10.

Also, it is meaningful to compare historical changes (including indicators etc.) over several years so that stories can be supported. That needs to be considered carefully in the process of continuous disclosure. Past performance needs to be very carefully explained especially in the first disclosure to ensure credibility.



(iv) Two Basic Challenges

This mechanism of information disclosure has the following two challenges. First, since each corporation has indicators for each story, even if supporting indicators. are clearly shown in a story, the specific figures of those indicators cannot be easily compared with those of other corporations. The second challenge is that some corporations do not want to disclose important figures, etc.

The first issue is how to explain that supporting indicators are at a "meaningfully different level" from other corporations', and they are different enough to show the content of each corporation's story. Unless indicators of other corporations equivalent to the supporting

[69] *Balanced score card* by Michiharu Sakurai p105 (Doubunkan publication 2003)

indicators of the said corporation are available, it is difficult to be sure if the supporting indicators in fact explain the story of the corporation well enough to. Therefore, it is desirable to have indicators which companies disclose commonly (kind of "common indicators") and to be used by many companies regardless of how important they are in each corporation's story.

Here, "meaningfully different level" does not mean judging "good/bad" by how big or small an indicator is. The most important thing is whether indicators are consistent with the story presented by a corporation and whether corporations can differentiate themselves from others by showing consistent indicators to their stories.

For example, a R&D driven corporation that writes a story emphasizing the registration of their own technology will suggest that the number of international patents registered during the current fiscal year is more than in other corporations, and that fact is consistent with their story. On the other hand, some corporations set their focus on technology strategies under which they put more on trade secrets and black box methods without disclosing their technologies. Such corporations do not show that the number of their registered international patents in the current fiscal year is more than in other corporations, because it is contradictory to their stories. Therefore, there is no such idea of "excellence in all indicators" apart from each corporation's story.

Meanwhile, it is not practical to require corporations to disclose too many indicators reflecting the diversity of corporate stories. Therefore, common indicators should be narrowed down. If certain elements of intellectual assets that are the sources of the value chain of corporations can be classified, supporting indicators can be chosen in a limited number as "most frequently used ones." If these common indicators are narrowed down to a certain number and are listed for each corporation to disclose as much as possible (they do not have to be included in the story, but only listing in the attachment, etc.), it becomes possible to judge whether the supporting indicators in the story have any significance through comparing them with those of other corporations, and stakeholders may be able to make a decision more easily.

In addition, if there are supporting indicators other than common indicators that well support the story ("indicators specific to an industry," and "individual indicators"), such indicators along with other corporations' activities situations and average relating to the said indicators, if any, might be stated in the story. This will enable the stakeholders to better understand the story.

Second, there might be cases where the disclosure of indicators that are indispensable for the corporation's story, such as trade secrets, will cause strategic problems. In such a case, it is necessary not to disclose such indicators, and to be replaced by some abstract explanation. In addition, it might also be chosen by corporations not to disclose certain indicators or to disclose alternative indicators, if costs incurred for the disclosure or measurement are high or alternative indicators are readily available.

For both challenges, it is important to allow discretion and flexibility in the mechanism since each corporation has a different story for value creation, as well as different core intellectual assets.

(v) Reminders for Analysts/Stakeholders

On the basis that the content of disclosure will change as stated above, those who receive the information and make an assessment should also handle it in ways that are quite different from the handling of uniform information such as financial one.

First of all, the absolute value of the corporation cannot be measured based on a special indicator or formula, nor can a relative corporate ranking be determined by comparing such indicators. Receivers of information should eliminate such idea (but this does not mean research corporations should not process disclosed information based on their own method).

In addition, as previously described, information such as intellectual assets indicators in (4), etc. is intended to enable those who assess the credibility of the corporate story on value creation to compare the indicators with those of other corporations. They are not intended to be used to know superiority or inferiority of the corporation vis a vis others. Without proper understanding of this point, there is a possibility that investors, etc. will pay too much attention to the horizontal comparison by numbers between corporations and consequently fail to make a proper assessment as to what capabilities the corporation has to create values and profits in the future.

Disclosed information is not as easy to compare as financial information which can be easily compared by anyone. It can be compared only by those who can "intelligently" analyze. Therefore, receivers of information need to have very sophisticated capability of understanding so that this mechanism can function, and it is vital to improve the capability of evaluators' understanding. Also, assessment results may be different depending on evaluators. If a corporation and an evaluator have common values, the corporation will be highly assessed, or the opposite may occur. At the same time, this will consequently raise the standard for analysts, and analysts will be more strictly selected.

Corporations can choose not to disclose information which needs to be confidential secret. In that case, evaluators gather reference information and analyze corporations' abstract explanations so that they will have a better idea of what those corporations really are.

There is a concern that some corporations will not disclose core management information, and that it will not be possible to obtain useful information. However, such corporations will not be sympathized by stakeholders and the assessments for them will become lower since they do not offer convincing information. Evaluators need to be strongly aware of this fact.

Even if it is not necessary to make the information confidential, some indicators may not be disclosed due to availability and calculation costs. In that case, it is possible for evaluators to put much on the fact that a corporation does not place importance on the information. To explain reasons such as "They do not want to disclose them because they want to keep them in secret" could avoid misunderstanding.

Moreover, it is advised that those who make an assessment exchange information with the corporation (i.e. "play catch" with the information) by indicating to the corporation ambiguous points and any improvement to be made. This has a possibility to create dynamism to promote awareness and lead to the improvement of management and to the quality of disclosed information for the corporation as well as the improvement of quality of analysis by the assessors. Frequent bilateral exchanges of information will improve the corporation and the whole economy as well.

(4) Intellectual Assets Indicators

(i) Past study

Intellectual assets indicators are very important to enhance the credibility of the stories of intellectual assets based management.

Europe is a leader in terms of research on intellectual assets (or intellectual capital). They categorize intellectual assets in to three groups; (a) Human resources assets (b) Organizational assets (c) Related structural assets. Those items are subcategorized and analyzed in various ways. There can be as many as 200 or 300 of items.[70]

This categorization and organization of intellectual assets is important. However, we may lose a mechanism to create corporate value which is based on a value chain if too much focus is placed on segmentation. In other words, we may lose the overall picture of value creation.

Therefore, it is important to clarify horizontal aspects to realize sustainable profits and value in addition to such vertical segmentation because a value chain normally consists of several intellectual assets related to a certain horizontal aspect. A framework for more realistic analysis and discussion can be made by analyzing those horizontal aspects and considering characteristics which are unique to Japanese corporations.

(ii) Key Elements of Intellectual Assets

Japan Industrial Policy Research Institute Foundation held a joint workshop with corporations, the government, and universities[71], and picked up following seven horizontal aspects.

(a) Existence and penetration of corporate philosophy, and the manager's (management group's) leadership based on it;
(b) Allocation of resources to the areas with competitive advantage based on the selection and concentration from various perspectives
(c) Negotiation power and price control power vis-à-vis trading partners (in upstream/downstream relationship)
(d) Capability and speed (efficiency) of creating new knowledge;
(e) Collective organizational power realized by team work;

[70] "Workshop for intellectual assets and corporate value" by Japan Industrial Policy Research Institute (2004)
[71] Same as above

(f) Identification and control capability of risks
(g) Social acceptance such as coexistence in the society

Various existing standards and cross sectional information are helpful to understand the validity and characteristics of these aspects.

EFQM (European Foundation Quality Management) and the Malcolm Baldrige Award standard are two major awards for management quality which have high international reputation. The assessment standards of the Japan Quality Award[72] is based on these two awards, and the list of items and order of weighting[73] to assess quality of management is shown below. Intellectual assets are the core of management and a value chain. Therefore, it is equally useful to consider these items of management quality when intellectual assets are analyzed.

Japan Management Quality Assessment standard（2004）		ＥＦＱＭstandard		Malcolm Baldrige standard	
Standard	Weight	Standard	Weight	Standard	Weight
Leadership of management	12%	Leadership	10%	Leadership	12%
		Human factors Result of human factors	9% 9%	Focus on human resources	8.5%
Formulation and development of strategies	6%	Direction and strategies	8%	Strategic planning	8.5%
Understanding and support of customers and markets	10%	Partnership	9%		
Improvement of capability of individuals and organizations	10%	Process	14%	Process management	8.5%
Process in customer value creation	12%	Result with customers	20%	Focus on customers and markets	9%
Social responsibilities of management	5%	Result in society	6%		
Result of activities	40%	Major performances	15%	Business performances	45%

72 "2005 Japan Quality Award" by Japan Productivity Center for Socio Economic Development
73 Refer to http://www.jqac.com/WebSite.nsf/0/A534E42EB5F4C5B449256E4600320517?OpenDocument for Japan Quality Award assessment standard, and refer to "Balanced score card" By Michiharu Sakurai p279 (Doubunkan publication 2003) etc. for EFQM standard and Malcolm Baldrige standard.

Information management	5%			Information and analysis	8.5%

"Study of excellent companies in Japan"[74] found the following six common items of the characteristics of excellent corporations in Japan.

1 If there is any unclear thing, separate it from others.
2 Think by him/herself as much as possible
3 Be objective enough to find unreasonable things
4 Turn risks to corporation opportunities
5 Attempt to grow within its own resources, and face with risks of business
6 Imprint the corporate culture of "For the society. For the people"

Many of these seven points are used for the management of quality and management quality control in a certain way. Also, there was little or no assessment of organizational power in the past analyses. In addition, risk management was not clearly shown, and it seems to be included as part of planning and direction of strategies.

However, organizational power, especially the ability create a good environment for workers to flourish their talents, is especially important in our country, and risk management cannot be overstressed. Management is risk management itself, and it is meaningful to emphasize these perspectives in our country. Therefore, it is appropriate to consider the seven perspectives listed above as horizontal cross-sections.

"Risk management" has two meanings. In a narrow sense, it is about how to decrease clearly negative effects in the future. In a broader sense, it is virtually management itself and is about how to asses the best investment opportunity based on probabilities while forecasting various uncertainties. The 6th item on the list covers the narrow meaning of risk management. The broader meaning covers all seven items, and it is more than just about daily operation; but is more strategic.

(iii) Embodiment of Intellectual Assets Indicators

By overlapping these horizontal cross-sections with traditional vertical classifications of intellectual assets, a value chain for each corporation and sources of future corporate value can be visualized and clarified. Some examples of indicators which have been proposed based on the seven horizontal aspects through the combined efforts of corporations, government, and universities are shown below.

With the changes in times and social conditions, the expected intellectual assets and corporate values may change. Therefore, they need to be flexible based on actual reviews of disclosure.

Several issues were pointed out regarding the seven points of view regarding Japanese corporations.

[74] By Hiroaki Niihara (Nihon Keizai Shimbun 2003)

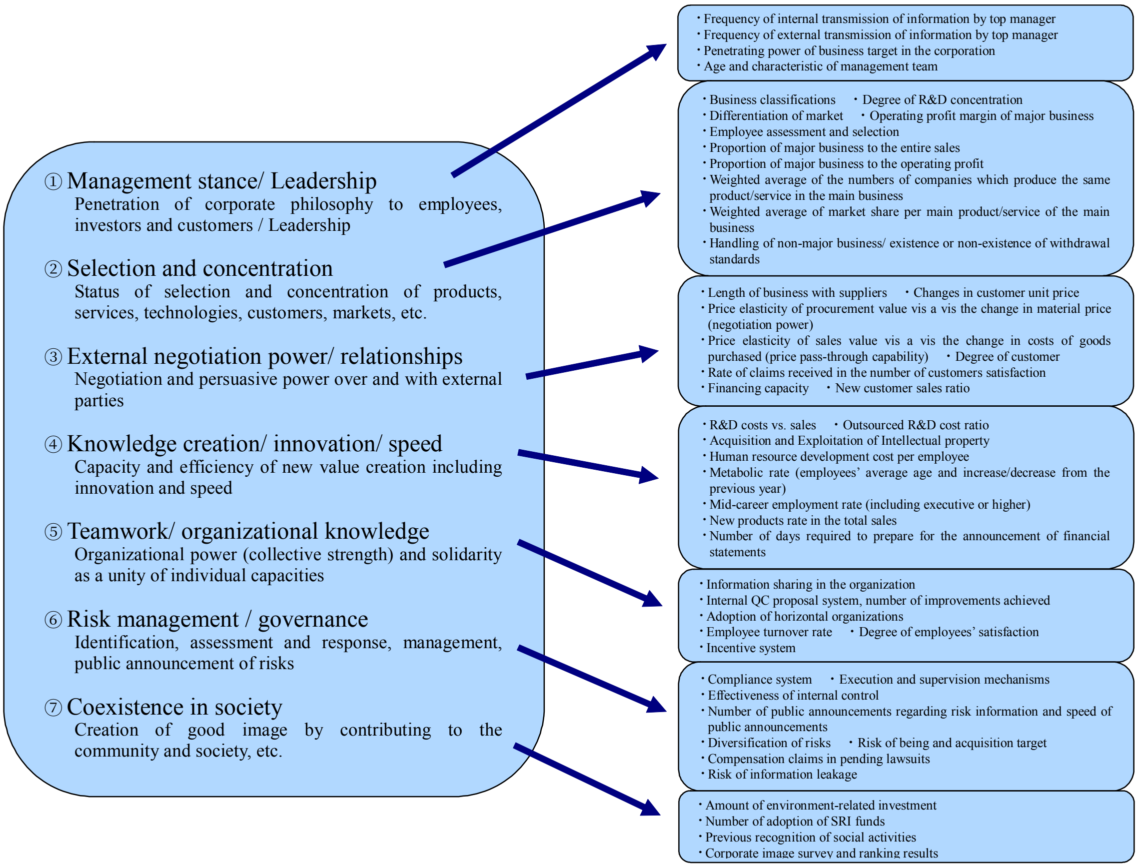
Some of them are as follows.

- Regarding ability to innovate: Japanese corporations create many patents and inventions for research and development expenses. However, those patents and inventions do not always create profits.[75]
- Regarding teamwork: Japanese corporations have many internal ideas for improvement, and they are good at creating products through cooperation of many people. Mr. Koichi Tanaka, a Nobel Prize winner in chemistry, worked with a team of people with skills in different technologies, which created a unique idea. [76]
- Regarding coexistence with society: Japanese corporations had many viewpoints for assessments. They were not only interested in increasing profits for a certain term, but they also tended to show strong interest in sharing the profits with communities, employees and society. In addition, many people with technologies and skills find it highly valuable to create “something useful to society”, as it is represented by the word “craftsmanship”.

When each corporation uses these indicators, it may encourage them to make their indicators “look better”. Also, evaluators may simply compare those indicators. Such easy-going activities by corporations and evaluators ruin the overall effort for intellectual assets based management. Corporations, markets, stakeholders, and the government should cooperate to avoid such activities as well as become skeptical about them, and it is very important for them to use the indicators appropriately. Corporations do not need to make their indicators “look good” if those indicators are not related to their stories. Such kind of activities are the very proof of investment/management by selection and concentration.

[75] Refer to *Interim report for formulation of intellectual assets strategy indicators* (June, 2004) by Industrial Structure Council Intellectual Assets Policy Department Management/Information Disclosure Subcommittee

[76] “OHM” magazine for general technology p22 (December, 2004)



It was previously stated that there are approximately 5 to 10 intellectual assets indicators which corporations will show in their stories. If a corporation selects 5 indicators out of 30 to explain in its story, there are about 150 thousand possible combinations to select. If a corporation selects 5 indicators out of 40 to explain in its story, there are about 500 thousand possible combinations to select. If a corporation selects 5 indicators out of 50 to explain in its story, there are about 2 million possible combinations to select. This shows how various stories can be, and how flexible this disclosure mechanism is.

(iv) Indicators Specific to an Industry

Regarding indicators used for intellectual assets based management, there might be indicators reflecting the nature of each industry's business, as well as common indicators demonstrated in iii). Those industry specific indicators could play an important role when corporations' value chains are explained.

For example, "the number of annual recalls" in automobile industry, "sales per store space" for retail industry, "the number of remaining years for commercialized patents" for pharmaceutical industry, and "a rate of RoHS (Restricting the use of Hazardous Substances) supported products" for electronic component industry etc are candidates of them.

These indicators specific to each industry are useful for corporations with business only in a certain industry. If corporations cover more than one industry, common indicators need to be used for an overall picture, and industrial indicators can be used to explain specific business segments. Also, it is ideal for corporations to create their own style of intellectual assets based management reports in the process of creating and reviewing their reports. This would be better than specifying a certain style by cross-sectional discussion. This will be examined as necessary while considering how widely intellectual asset reports are accepted.

(5) Verification of Proposed Disclosure Mechanism

(i) Results of Survey

Here is an example of a fictitious corporation's story for intellectual assets based management which was similar to the ones described above by using some intellectual asset indicators. Please see Annex 1.

As part of consigned research by the Ministry of Economy, Trade and Industry, IR Japan corporation conducted a survey in March, 2005 targeting buy side analysts and investors in order to study the effectiveness of a framework of this disclosure mechanism, intellectual asset indicators, and disclosure examples, and 123 people replied.[77]

As for the effectiveness of the intellectual assets disclosure guideline and disclosure examples, some people were concerned about costs on the corporation side. However, the effectiveness was approved by more than 70% of people, and highly assessed.

Meanwhile, regarding the effectiveness of the intellectual asset indicators, the indicators which are highly related to the future cash flow are highly assessed. For example, change in sales per customer, operating margin ratio of main business, requests for damages from pending lawsuits, concentration on R&D, price elasticity of sales compared with changes in the cost of goods produced, and differentiation in the market are highly assessed. On the other hand, majority of replies suggested that 10 indicators which are not directly related to corporate profit were not considered very effective. These 10 indicators include mid-career employment rate, the number of years of business with suppliers, annual capacity development and education/training costs per employee, adoption of cross-sections organizations, information sharing in the organization etc.

In March 2005, Japan Investors Relations Association conducted a survey of corporations, analysts, and institutional investors in the chemical industry. They took a survey for "information which corporations consider important to promote themselves" and "information which investors consider important for creating an analyst report", and received 54 replies from corporations and 34 replies from analysts and investors.[78] As a result, competitive situation (too many competitors etc.), amount of profits, position in the market, growth rate of the product market, growth rate of profits, and segment information of each business were considered important by investors and analysts while those were rated lower by corporations.

[77] *Survey for intellectual assets and corporate values* by IR Japan, Inc. (March, Heisei 17)
[78] *Survey for the necessary information for intellectual asset reports* by Japan Investor Relations Association (March, Heisei 17)

Management policy, management's opinions, growth rate of product market, mid/long-term management strategies were considered important by corporations, while those were not highly acknowledged by investors and analysts. This survey clarified that there is a recognition gap between corporations and investors (Annex 2).

(ii) Analysis of Results of Survey

This result suggested that analysts tend to highly assess the indicators which are closer to the currently disclosed financial indicators and clearly related to the current cash flow. Meanwhile, corporations rather set their target to mid-term improvement of corporate value, and some of the indicators listed in this report also focus on corporation's sustainable profits and mid/long-term profits. Such a difference in a time horizon is shown in this survey. If management and policy of our nation move more towards mid-term improvement of corporate value, it may become more important for analysts to be able to correctly understand and analyze mid-term information.

In fact, institutional investors for corporate pensions, who focus on mid-term performance, have started focusing on mid-term indicators, rather than short-term ones. They essentially have a different impression from the result of the survey. Meanwhile, some investors must focus on short-term profit in their actual operation of corporate pension funds because "results" are so important (assessed by annual profit and loss). Analysts are influenced by such a trend, and they tend to prefer shorter-term indicators.

Investors and analysts are normally very interested in information such as management policies and management's ideas because they can lead to mid-term performance even though Japan Investors Relations Association's survey suggested that investors and analysts do not place high emphasis on them. This may be because not all corporations are actually disclosing information, and also because investors and analysts are somewhat suspicious of mid-term information disclosure. Therefore, some people point out that they cannot but rely on the indicators which are more certain and directly connected to the profit of near future.

It is also pointed out that corporations' recognition is not high enough for some information which is important to the investor side and is helpful in understanding mid-term profitability (such as competitive situation and negotiation power etc.), even it is close to financial information. Corporations need to change their recognition for such information.

When this survey is analyzed from more objective view by using artificial intelligence, some indicators are clearly valuable in a relation with other items even though they were not considered highly valuable in the survey.

In the survey of Japan Investors Relations Association, the main question was the validity of indicators themselves, and it was not necessarily intended for indicators in a story of overall management. Therefore, there is a strong possibility that it will have a very different impression if each indicator is shown after each story is explained.

(iii) Future Prospect

Therefore, it is not possible to conclude that certain indicators have less meaning. Provided that the efficiency of indicators needs to be assessed by actual practice in various ways, current indicators can be examined to create better indicators. However, as described above, it is extremely important for corporations, analysts, and institutional investors to modify their approaches little by little in order to fill a gap. A disclosure mechanism including common indicators is expected to provide opportunities for changes, and also a platform for discussion.

In addition, as pointed out in the replies of the survey, it is helpful for corporations to understand how to self-evaluate indicators and set target values in order to judge the possibility of improvement of corporate value in the future.

(6) Disclosure Vehicle

(i) Regulatory Disclosure vs. Voluntary Disclosure

This section discusses how to set a certain style for such disclosure, as well as whether it should be regulatory disclosure or not.

Under the current system, the following information must be disclosed. (a) Statutory disclosure which mainly consists of financial documents (including business reports) based on the Commercial Code (b) Statutory disclosure which mainly consists of financial reports based on the Securities Exchange Law (c) Timely disclosure based on the Timely Disclosure Regulations by Stock Exchange. On the other hand, voluntary non-mandatory disclosure is based on each corporation’s decision. Information disclosure should be strategically conducted so that corporate value can be properly assessed by shareholders and investors etc. IR (Investor Relations)[79] is generally a concept of both regulatory disclosure and voluntary disclosure, but here, the focus is voluntary disclosure.

The disclosure of corporate information regarding intellectual assets which was previously described is not intended to be made by assessing absolute values of individual assets and putting such assessments on a balance sheet. They are to be disclosed in a strategic way for corporations to let their stakeholders including shareholders and investors understand how the top management of the corporation identifies, controls and utilizes the hidden strength of the corporation, etc., that cannot be seen in financial statements. Therefore, the disclosure of intellectual assets apparently has a nature of IR.

However, the targets of IR should not be restricted to shareholders and investors. It is more appropriate to publicize to the whole society including trading partners and consumers. Today, even communication with employees can be discussed in the scope of IR. Therefore, the most important thing for corporations is to consider what will be the best thing for stakeholders (including users and clients), and sincerely and logically describe their “raison d’etre” as a

[79] According to the National Investor Relations Institute, “Definition of Investor Relations is a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between companies, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair evaluation. (March, 2003) (Translation is from the website of Japan Investors Relations Association)

corporation.

IR/PR is not currently well appreciated even if its detail is described in annual reports, while some people indicate that stock price improves when corporations clearly explain their corporate values in their annual reports. By learning from good examples like this, it is desirable to disclose information in order to help evaluators understand better.

Some people think such disclosure should be freely and voluntarily made by corporations. However, since the disclosure would reveal corporate value itself, disclosed information would be extremely important for many stakeholders, including investors. Therefore, the accountability of corporations will improve their evaluation. Further, the disclosure of such information will be assessed and will improve corporate management, which will enhance corporate values and competitiveness. Therefore, disclosure should be actively supported by the nation as a whole in order to increase national wealth. Though disclosure should be a voluntary one at the beginning, the possibility and necessity of making the regulatory disclosure system should be considered at the time the disclosure is widely diffused.

(ii) Targeted Companies

The important fact is that improvement of corporate value is basically an issue for all corporations. Based on that, regulatory disclosure for all corporations by the Commercial Code could be logically considered. Detailed items (enforcement code 103) in Financial Documents (section 281) could be disclosed based on the Commercial Code. On the other hand, such disclosure is considered to be necessary especially for listed firms which collect attention from general investors. Therefore, it might be desirable to put the possible regulatory disclosure mechanism under the Security Exchange Law. Stock exchanges can also promote disclosure of corporate information as an operator of markets. So they are expected to be actively involved in improving the understanding for “intellectual assets based management” in the stock markets by encouraging listed firms to actively disclose management information and by market participants including listed corporations and general investors concerning the importance of “intellectual assets based management”.

However, conditions for realization of the mandatory disclosure system under the Securities Exchange Law in the future are as follows. Information, including voluntary information

- should be important as investment information and widely known among investors,

and

- should not mislead investors.

In order to meet these conditions, information needs to continue to be disclosed while receiving appreciation from the markets as an important information for investors..

If there is any materially false information in annual securities reports, a corporation could be punished under the Security Exchange Law even though such information was voluntarily disclosed. Therefore, corporations should be careful when they disclose such information, and they should not disclose more information than they can be responsible for.

Whether public corporations or not, implementation of intellectual assets based management and PR of their corporations, and strict internal control will become an important tool for a big leap forward. Closed corporations are also expected to voluntarily disclose in the same manner by using various vehicles.

(iii) Specific Means of Disclosure for Listed Companies

As for disclosure under the Securities Exchange Law, in "Risk of Business etc." of prospectus etc., corporations can voluntarily describe the items which could affect investors' decision.[80] They can also use "Risk of Business etc." or "Analysis of financial condition and Results of Operation" (MD&A in Japan) of their annual securities reports to write about items/factors which could make an important impact on investors' decisions and management results. [81] Internal management and internal control are deeply related to such disclosures. It can be disclosed in "Status of Corporate Governance" in order to improve credibility of disclosed information. CEOs can also add a statement to confirm such information to reinforce credibility.

To provide more concrete information by the current disclosure system, information regarding intellectual assets and management can be clearly described. A new format can be made by covering the items in financial statements and reorganizing them (if such format can be clearly presented, closed corporations can also use it).

According to the Timely Disclosure Regulation of Stock Exchange such as Tokyo Stock Exchange etc., it is mandatory to disclose any information which could have a material impact on investors' investment judgment. For example, the annual report must disclose a basic idea regarding corporate governance and status of actual implementation. [82] Management policy, management strategy, and other issues etc. are included in the qualitative information which is recommended to be described in an attachment of financial statement letters. [83] In addition to such information, listed corporations can actively disclose information regarding intellectual assets and management which is not shown in financial statement. That would be useful for investors.

(iv) Future Prospect

With possibility of future regulatory disclosure in mind, it is desirable to voluntarily

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[80] Ordinance by the Cabinet regarding disclosure of corporate information etc. (Enforced from the business year starting from April 1, 2003)
[81] Same as above
[82] Regulation Regarding Timely Disclosure of Corporate Information by the Issuer of Securities of Listed Corporation, Article 2 Section 2 Paragraph 11
[83] Tokyo Stock Exchange, Section 342 Review of Necessary Items for "*Financial Statement Letter Attachment*. The attachment is not fully utilized, and corporations have various opinions about how financial statement letters should be used.

disclose information with certain media in accordance with this interim report or guideline which will be published. For example, disclosure in mid-term earnings report in November, 2005 could be a target of the near future. At that time, it is not necessary to publish a book of "intellectual assets based management report." It is also acceptable to disclose such information on the beginning of the annual report, for instance. If that becomes widely known to a certain extent, credibility could be improved by regulatory disclosure while acceleration of international movement is considered. If it is widely known that this disclosure might be upgraded into a regulatory disclosure in the future, corporations will be more serious about working on information disclosure and positive support can be expected even during a voluntary disclosure period, which will be a sort of a trial period. If we can take an initiative to suggest the details of our regulatory disclosure mechanism to the world, that will have a big impact in the worldwide trend. Also, it may be possible to set a de facto standard.

If the conditions mentioned in (ii) are eventually met, it is desirable to disclose intellectual assets based management report through regulatory disclosure of securities reports etc., disclose the same content from an IR point of view in annual reports, and add additional explanation if necessary.

Today, there is a growing need for disclosure of CSR reports, environment reports, and intellectual property reports, etc. It is necessary to respect the fact that those reports were created reflecting the needs in each era. However, from now on, intellectual assets based management report will be a comprehensive disclosure document which covers overall management, and other reports could be attached to it separately. The contents of the intellectual assets based management report could also be written on the beginning of every report such as CSR report. In other words, each report is used to explain more details for the intellectual assets based management report. That will show each corporations emphasis more clearly, and maintain an overall unity at the same time. In addition, this will improve appropriate management regarding the whole information disclosure of corporations.

(7) Disclosure and Cost

(i) Concerns and Merits of Disclosure

These days, corporations are required to disclose more information through various regulatory disclosure or voluntary disclosure. This intellectual assets based management report also requires new disclosure, and corporations and even some analysts claim that we should consider the fact that this disclosure will bring new cost.[84] Also, concerns still exist for various types of disclosure, and some corporations are not satisfied because they are not properly evaluated even though they also provided a certain level of disclosure in their annual reports and other reports.

The objective of the intellectual assets based management report is not disclosure itself. Through disclosure, it is expected that stakeholders can properly assess corporate management, that resources can be properly distributed, and that corporate value can be improved. At the

[84] *Survey for intellectual assets and corporate values* by IR Japan, Inc. (March, 2005)

same time, in order to maintain proper assessments, disclosed information needs to be actually implemented and controlled by corporations. The biggest point of this report is not the disclosure itself, but whether corporations can appreciate the merits of management innovation and business management through the process of feedback of disclosure and control. Therefore, the costs for disclosure should not be considered solely.

If corporations attempt to reap the advantages of assessment through disclosure without providing meaningful information, or providing non-realistic information, they will soon lose credibility, as has been proven by past disclosure experience. The bottom line is that disclosure itself is not enough to receive good assessment if corporations do not actually understand which elements are important, and how they manage those elements in an uncertain future.

If corporations have been conducting business management for sustainable profits as well as proper control of internal tangible/intangible assets, there should be no additional large amount of cost specifically for this disclosure. Others will incur a special cost for disclosure, but it is desirable for them to realize its positive effect. This disclosure will enable them to internally organize and control what they have not properly controlled in the past, which will increase the possibility for sustainable profits.

For the disclosures based on the Security Exchange Law, it is considered to impose the requirement of showing management policy on corporations which are going to acquire other corporations by M&A. Meanwhile, it is also possible for corporations being acquired by M&A to clearly show their management policy in advance and gain understanding/agreement of stakeholders. That will be the best preventive measure (described in 7. (1)).

(ii) Additional cost

As previously pointed out, annual reports already have similar information, and some corporations already made efforts to control and improve intellectual assets as part of their management strategies. Those corporations just need to rearrange their information according to the format which is specified by this disclosure. Also, some corporations already realize important management issues, conduct risk management, and manage their business. They already disclose the necessary information in several parts when they provided regulatory disclosure based on the Security Exchange Law, and they only need to rearrange such information. However, the intellectual assets based management report requires the format of introduction, development, turn and conclusion for a story of value creation. At the same time, it basically requires indicators from the group of common indicators to support such story, and all or some common indicators chosen by corporation will be shown in an appendix. These are the new requirements this time (this will enable evaluators to make comparison among corporations to a certain extent).

As for common indicators, they may emphasize the cost issue. However, the following points also need to be considered.

- About half of those indicators can be created by combining existing indicators, etc.
- As for the most important indicators which each corporation needs to include in its story, it

is highly likely that they are strictly controlled on a daily basis as target values, etc. In that case, there should be no additional costs.

- If corporations decide not to disclose those indicators which are not considered very important, it should not be harmful to the credibility of their stories.
- As for the indicators which are hard for corporations to calculate by themselves. They may disclose data from research by other institutions etc.

When these points are considered, it is not likely that the cost becomes a major problem for corporations. Some corporations think that there is more merit than cost by making the best use of the flexibility of this system.

In addition, although it is desirable to disclose as many indicators as possible, corporations can choose the indicators to disclose depending on confidentiality, costs of disclosure and so on. Therefore this system is well concerned about corporation's costs.

(iii) Relationship with Other Disclosures

In addition, there are some concerns about the relationships with various existing disclosures such as CSR reports, environment reports, intellectual property reports, and corporate governance reports, etc., how to organize such disclosure, cost to disclose, and overlapping information, etc. It is certain that disclosure of these items has been discussed individually, and not so much attention has been paid to their relationships and overlapping information.

On the corporation side, there is nervousness about international trends etc., and attempts are being made to receive a perfect score in all areas of disclosure. In addition, different departments handled each disclosure, and cross-sectional cooperation was not fully performed. Therefore, there may have been overlapping investments.

Corporations are not certain about what kind of strategic disclosure they should do because the required information is not consistent and there are too many communication tools. If there is a common framework for a management report for each corporation, the reports on CSR, environment, sustainability, intellectual properties etc. can be all unified, and the overall strategy can be clarified.

For this reason, the basic objective for disclosure of intellectual assets based management report is to clarify the fundamental basis of management judgment. If basic strategies are clarified, corporations can decide how they can disclose each field's information in those strategies. In other words, they can clarify the complicated disclosure mechanism (clarify their corporate management philosophies), and they can decide what is really important for them. It will become possible for them not to disclose the information which does not need any further explanation, but to choose the areas which need more disclosure. Therefore, intellectual assets based management reporting could decrease the overall cost for corporations' disclosure.

For example, the intellectual property report describes how corporations utilize intellectual property in their management, and intellectual assets based management report can be used to describe a corporation's strategic positioning of intellectual property in their management. If the essence of the strategic positioning is explained in the intellectual assets based management report, the intellectual property report can have a clear positioning in overall management to describe it in detail, which will enhance the value of the intellectual property report itself. On the other hand, it is less meaningful to create and disclose intellectual property reports if corporations do not have a strategic positioning of intellectual property in their intellectual assets based management report.

(8) Accountability Concerning Disclosed Information

As previously described, an intellectual assets based management report explains the probability of future cash flow by using intellectual assets as sources of future profits as well as historical performance and accumulated intellectual assets. Therefore, there is a problem of responsibility regarding disclosed information that includes uncertain factors such as future profits etc.

Corporations are responsible for all information even if it is IR through their voluntary disclosure. However, they are not responsible for the uncertainty of disclosed information if a disclaimer is added (Safe Harbor Rule).

On the other hand, a disclosure policy can be used, which is the opposite of a disclaimer. This policy specifies "who will be responsible for certain content under a certain policy" when information is disclosed. For example, they could make a policy not to disclose any information that is confidential, or any details of strategically important information etc. By disclosing their disclosure policies, the meaning of disclosed information becomes clear and credibility is expected to increase.

If information for intellectual assets becomes more important, it can be meaningful for both corporations and stakeholders to create a system for some kind of guarantee.

If the disclosure of intellectual assets becomes mandatory, it is necessary to keep in mind that financial information is already audited and guaranteed by certified public accountants and auditors in order to protect investors, etc. However, there is a concern that disclosure will be shrunk if audits become stricter. These are important themes which should be considered more seriously in the near future, along with the issues of internal control regarding intellectual assets based management, audit to secure credibility, and absolute liability of top management.

6 Management of IA and IA Based Management

(1) General

As discussed in 2.(5)(ii), appropriate control of intellectual assets is an important element of intellectual assets based management. Also, as briefly mentioned in 5.(7), even if intellectual assets based management is disclosed, its credibility can be easily compromised if it is not supported by internal control systems. Therefore, it is necessary for corporations first to pursue the sustainable improvement of values, to identify visions and missions, which are the core components of the corporate identity, and finally to identify the intellectual assets needed to achieve the missions and visions and the framework of the value chain that utilizes intellectual assets (identification). Further, it is necessary to examine how to maintain and develop intellectual assets, and how and what to control in order to achieve that purpose.

Furthermore, in order for high-quality internal management to be achieved, the following actions seem necessary: to improve manageability by focusing on certain management targets, to define the system that allows sharing of the perception of intellectual assets and the process of value chain within the corporation, and to adopt easily comprehensible objective management by visualizing and quantifying the system (measurement) within the corporation.

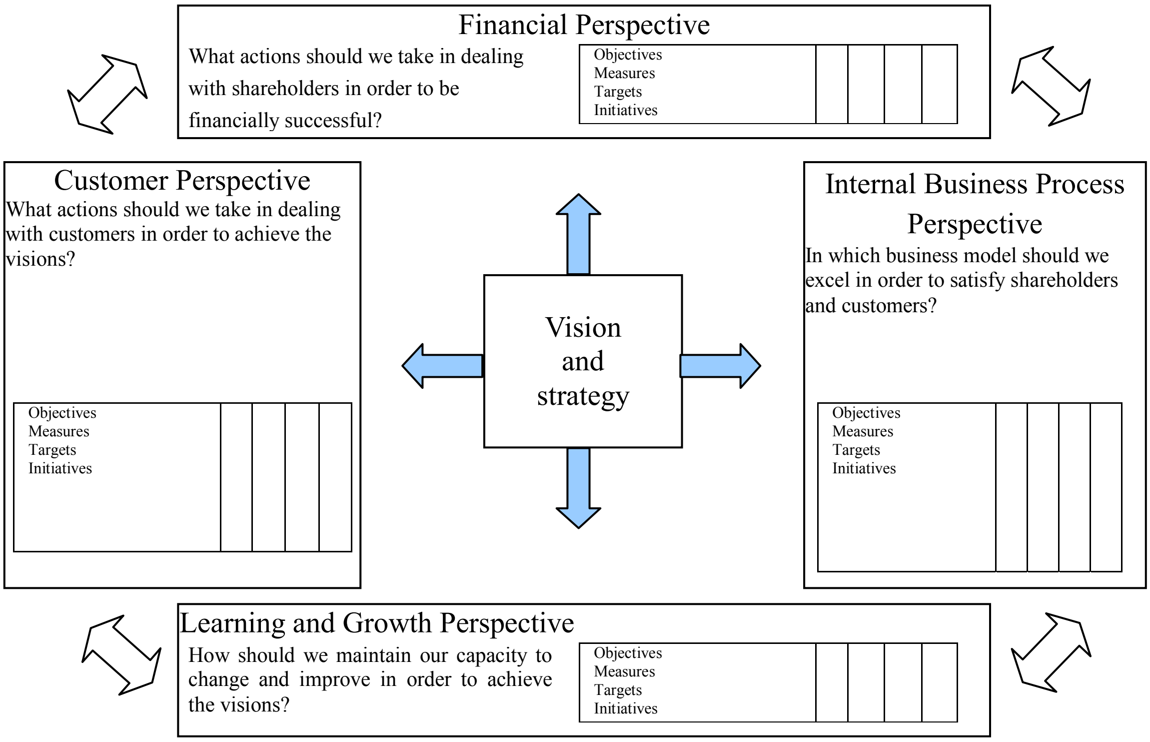
Balanced Scorecard (Kaplan and Norton, 1996), Skandia Navigator (Edvinsson and Malone, 1997), and Intangible Asset Monitor (Sveiby, 1997) are currently known tools for identifying and visualizing intellectual assets and intellectual assets based management.

(2) Utilization of Balanced Scorecard

Balanced Scorecard (BSC) is a performance measurement tool most frequently used in Europe and the United States. According to this system, in addition to financial data, various factors such as internal control and process, customers, and learning are added and balanced in creating the target, and converted into numerical terms. Through these visible numbers, it attempts to manage and improve the performance of business and individuals.

Framework of the Balanced Scorecard

- Balanced Scorecard is the framework to assign missions and strategies to each of the performance measurement indicators in the four perspectives (financial perspective, customer perspective, learning and growth perspective, internal business process perspective).



Source: Robert S. Kaplan and David P. Norton, *"Using the Balanced Scorecard as a Strategic Management System,"* Harvard Business Review (Jan-Feb 1996) *p.76*

The BSC method was originally developed as a performance measurement tool based on the "Start Small" approach and is characteristically suitable for performance control by individual departments and divisions[85].

Japanese corporations are good at the start small approach and have already performed various types of field management and many do not need to adopt the BSC for performance management at each department level. Consequently, not many corporations have adopted this tool.

On the other hand, no matter how good the Japanese corporations are at carrying out field management, overall management has not necessarily been sufficient. Such insufficiency needs to be declared in the form of intellectual assets based management reports to identify basic story of value creation in the corporation, and then this will hopefully make it possible to formulate the BSC by breaking down the report, and to perform management tasks at an

[85] Michiharu Sakurai, *Balanced Scorecard*, p.363, Dohbunkan, 2003

individual level, serving as an internal management tool. By taking advantage of the characteristics of the BSC, adding more weight to the factors related to the indicators described in the story of value creation in the BSC approach for internal management, and including other necessary indicators for smaller management units, integrated management will be made possible, which reaches to the individual operations through several steps, while keeping some relationship with the overall story of value creation.

In contrast, in Europe and the United States where many corporations have clear overall strategies in a top-down sequence, when the approach from the strategic side is linked with the BSC as a performance management tool, the BSC is assigned the role of a management tool to implement strategies.[86] However, what is especially taken into consideration here is the fact that the BSC does not serve as a tool in its own right to prepare strategies, and thus it is still necessary to separately develop strategies at the highest level of management.

In other words, the BSC alone is not sufficient. Yet what is truly necessary is to identify strategies in some form, such as the intellectual assets based management reports. When this is integrated into the BSC framework, management for the implementation of strategies will be made available. In many cases in Japan, such holistic strategies are rarely disclosed either internally or externally, and therefore, it is fair to conclude that there is a huge opportunity to make innovative improvements through intellectual assets based management.

(3) Simplified Method

The level of difficulty of creating a story on future value creation accompanied by indicators would significantly vary depending on corporations.

In the case where corporations have already taken control measures to combine strengths or weakness with performance measurement: for example, the introduction of BSC, etc., it may be relatively easy to set up such stories. (However, even if the BSC is adopted, there may be cases where it is still difficult to draw the whole story since there are far too many departments). Corporations which already disclose intellectual assets reports on intellectual properties, such as patent rights (one of the intellectual assets), will be able to use that experience for story writing.

On the other hand, for corporations or top management with only a vague awareness of the existence of the intellectual assets that give strength to the corporation and are the sources of competitiveness, it might be difficult to create an understandable story with supporting data in a short period of time.

In such a case, the first step of preliminary work in creating the story on value creation is to organize and analyze (SWOT analysis) the strengths and weaknesses identified in the business process from the past to present, and the areas of future business opportunities with high degree of profit earning expectation and associated threats. Since these items are mutually related to each other, it is useful to make a matrix in which all items can be viewed, such as the one presented below.

[86] Same as above, pp.525, 555

＜Strength＞	**＜Weakness＞**
＜Opportunities that are highly likely to produce future profits＞	**＜Threats that are highly likely to adversely affect future profits＞**

The matrix developed for Kikkoman Co., Ltd, is listed in Annex 3[87] for reference.

The importance lies in the fact that such organization and analysis demonstrates the significance of non-numerical elements which do not appear in financial statements for the value creation of a corporation. It is expected that sources of corporate values, which have been on the verge of extinction during the financial restructuring of the 1990's, will be re-acknowledged.

(4) Relationship between Risk Management and Internal Control of IA Based Management

The term "Risk Management" has many uses in corporate management. Risk Management, in the broadest sense, encompasses the concept that "the essence of management (selection) lies in how you manage uncertainties", because various events surrounding companies are fraught with uncertainties in general.

It is certainly true that risk management is the essence of management itself in some respect; however, this seems to be based on an assumption that how important the response to each risk is determined by the priority of a given event in the management. Without this assumption, every corporation must deal with every potential risk in a uniform manner. In other words, risk management requires identification of what sense the relevant event holds uncertainty with respect to the value chain emphasized by the management, and then to manage the uncertainty. Therefore, risk management is the other side of the coin of managing

[87] Formulated at the discussions of the Study Team for Market Values and Intellectual Assets in which Kikkoman participates.

intellectual assets in the intellectual assets based management, and as a consequence, it is difficult to implement effective risk management without a yardstick of intellectual assets based management.

Nonetheless, general arguments in intellectual assets based management focus on the approach from the overall perspective of the framework of corporate value creation, whereas arguments in risk management tend to focus on the responsive approach to individual events as to how to manage individual events which may bring negative impact to the management. Further, arguments in risk management tend to focus on the means to resolve uncertainty, and it is therefore necessary to avoid the risk management itself from becoming self-objectifying.

In other words, arguments of risk management may fall into a trap of management for management's sake, which is detached from the overall corporate management. If one adheres to such risk management which has nothing to do with important management decisions, it brings nothing but costs.

Since costs are still involved even in the risk management approach, it is necessary to have the concept of "risk management for returns", with due and constant attention to whether there are enough returns to justify the costs. Furthermore, it is insufficient to procede with the concept of "getting returns worthy of the risks taken", as in the method from the operation field. Instead, it is preferable first to have desired returns from the overall management perspective and then to manage the risks and costs needed to produce the returns.

Particularly in Japan, when ERM (See 6. (5)) is regarded as important for the overall management of the organization, for example, one would forget the primary importance of the method; it is important in a sense that it reduces the uncertainty embedded in the corporate value creation process. Actually, one tends to work painstakingly on ERM, leaving costs out of consideration, with a false belief that it is vital to fully execute the ERM method itself (Japanese managers are good at using established methods, and tend to feel comfortable when they fit in a fixed pattern. Once a pattern is established, they tend to implement the management measures without having sufficient regard to the practical importance. Thus, top management would stand on the safe side and the employees would only follow the orders given to them even if they were too extreme, consequently incurring massive costs.) The risk involved here is a significant decrease in the dynamism of corporate activities and profits. When implementing ERM, it is necessary to determine the threshold as to what is substantial for the value creation (value chain) of individual corporations.

Risk management is in nature a difficult realm to be generalized for application to many corporations, and to develop absolute indicators. The scale used to weigh the risks of each event is the degree of importance of each event for the management and value creation of each corporation, and as long as the methods of management and value creation are different in every case, there are as many ways of management and value creation as there are top management. Therefore, no common objective indicators exist to assess the weight of risks of each event that will commonly be found in many corporations. Nonetheless, even if the weight is different in each corporation, an event posing a risk can be generalized to some extent. At the same time, it is possible for each corporation to manage risks by developing indicators from the viewpoint of management priorities regarding the weight of risks associated with individual events.

As mentioned already, managing intellectual assets in the intellectual assets based management is regarded as risk management itself in the management approach, but it is important to bear in mind that significant costs could be incurred if a wrong approach is employed, particularly in Japan. In other words, it is possible that intellectual assets based management could be more effective if risk management is used as an internal control tool with clear management priorities. On the contrary, costs could be greater than otherwise if there are no such priorities.

Such management method can be connected with the BSC method, and it is desirable for many corporations to conduct effective management by combining both methods, based on a story of intellectual assets based management. Further, the disclosure of internal control methods could lead to greater credibility of the disclosed information pertaining to intellectual assets based management. More specific details are subject to further examination.

(5) Methodology of COSO ERM

The Enterprise Risk Management (ERM) framework was issued by COSO[88] in response to a string of scandals, including the Enron scandal, in order to address the issues concerning internal control and risk management. The objective of this framework is to arrive at a common definition of risk management to be used for decision making on how to improve corporate risk management and to be also used as guidelines for assessment of effectiveness of risk management.

The ERM framework consists of eight components of risk management: internal environment, objective setting, event identification, risk assessment, risk response, control activities, information and communication, and monitoring. These components are the ones to achieve objectives of an entity: such objectives as strategic, operations, reporting, and compliance. Therefore, they need to be carried out at all levels of the entity; namely, entity-level, department, business unit and subsidiary. ERM depicts the relationship in a three-dimensional matrix, as below.

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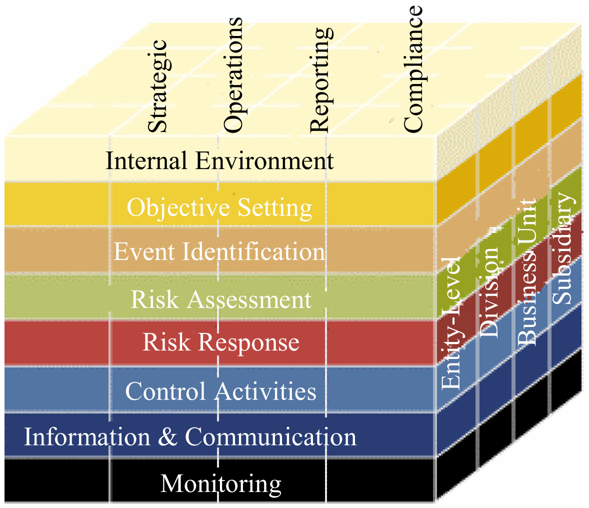
[88] COSO is the Committee of Sponsoring Organizations of Treadway Commission. During the first half of the 1980's, we witnessed the collapse of many corporations, including financial institutions, which was a serious social issue in the United States. In order to solve the problem, COSO was established, comprising the American Institution of Certified Public Accountants (AICPA), the American Accounting Association (AAA), Financial Executives International (FEI), the Institute of Internal Auditors (IIA), and the Institute of Management Accountants (formally the National Association of Accountants).



Source: COSO Enterprise Risk Management Framework

In the corporations adopting ERM, the board of directors, top management and other entity personnel are responsible for the following actions.

The board of directors should discuss with top management the state of the entity's enterprise risk management and consider seeking input from internal and external auditors, and others. The board should ensure that it is informed of the most significant risks, along with actions management is taking and how it is ensuring effective enterprise risk management.

The top management assesses the organization's ERM capabilities. In one approach, the top management can bring together business unit heads and key functional staff to discuss an initial assessment of ERM capabilities and effectiveness. Whatever its form, an initial assessment should determine whether there is a need for, and how to proceed with, a broader, more in-depth evaluation.

Managers and other personnel should consider how they are conducting their responsibilities in light of ERM and discuss ideas for strengthening ERM. Internal auditors need to acknowledge the efforts of employees in pursuing ERM.

Efforts of all parties based on a common ERM framework will bring about an effective risk management.

This method is one of the references for considering the way of internal control to achieve intellectual assets based management in the future; however, one should not misunderstand that achieving ERM itself is the goal. ERM is nothing but a management tool.

(6) Securing Credibility by Audit/Assurance

As intellectual assets based management reports spread and as their influence grows, who and how to ensure the credibility of the information listed in the reports become an issue.

With regard to the information in the financial statements or business reports and annual security reports that corporations are obliged to disclose to outsiders, and the information contained in the voluntary reports such as environment reports, audit corporations and so on express their evaluation about the credibility of the disclosed information as independent third-party agents[89].

The most significant part of intellectual assets based management reports is the value creation story supported by various indicators, showing corporate awareness of future uncertainties. Each element carries a significant meaning in itself. Among the many points of contention raised in this process are: whether conventional audits on accounting records performed by audit corporations are effective. ; whether credibility can be ensured by internal audits under the responsibility of the corporation; who is available and appropriate to implement third-party audits and in that case, what is the accountability of those who give assurance; and whether external audits should be limited to checking the figures, etc.

Some contend that the same type of third-party audits and warranties under the conventional disclosure regime should not be demanded when taking account of the very principle of this disclosure mechanism to identify concepts and policies of intellectual assets based management, which provides the top management with as much discretion as possible. On the other hand, enhancement of credibility by assurance could bring advantageous result to the corporation.

In the future, it is extremely important to discuss these issues without delay to substantively increase and ensure the credibility of intellectual assets based management reports, while paying attention to the degree of penetration of the reports.

7 Other Issues

(1) Shareholder Supremacy vs. IA Based Management

The takeover bid by LiveDoor for Nippon Broadcasting stirred up a controversy regarding ownership of a company. During the movement of economic restructuring in the 1990’s, the western style of management has rapidly become prominent in Japan, and it is certain that the benefits to shareholders are more emphasized than before. However, as many have already pointed out, this concept has already become obsolete even in Europe and the United States.[90] As mentioned earlier, the fact that management by BSC has been broadly adopted in Europe and the United States[91] indicates nothing but a stakeholder approach with an emphasis on elements other than finance (internal control and process, customers, and learning).

Many admit that the principle of shareholder supremacy in business management has been too much focused, judging from the actions of employees of Nippon Broadcasting and opinions of prominent figures appearing on the shows of Nippon Broadcasting[89].

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89 They would express information such as quantitative information and qualitative information, but they mostly express, in practice, about accounting records.
90 Lesson in Economics, Nihon Keizai Shimbun, April 19, 2005, etc.
91 The Corporate Value Study Group, *Corporate Value Report* p105, May 2005

Then, the question is whether there is any management that is based on something other than shareholder supremacy? One of the answers is represented by intellectual assets based management.

Identifying management philosophy, which is the core element of intellectual asset based management, and disclosing a value creation story may possibly mean that a corporation will be soliciting stakeholders who agree with its philosophy. A corporation does not value the relationship only with shareholders or investors. Instead, a corporation recognized that whoever agrees to or at least is aware of the corporate philosophy and its story, whether it is an investor, employee, creditor, customer or local community, gathers around and supports the corporation in a collaborative manner. Then, the corporation responds to expectations of these stakeholders by implementing corporate philosophy and the value creation methods. (In this respect, intellectual assets based management has a common nature in many ways with what the Japanese corporation has historically cherished.)

The way to respond to the trust of stakeholders is to create values and to increase corporate values by implementing its own intellectual assets based management, and different stakeholders gain various benefits in different forms during this process. Corporations strive for the implementation of intellectual assets based management in line with the corporate philosophy and the value creation story so as to secure future cash flows.

In Japan, as mentioned in 5. (7) (i), as long as the stakeholders with strong awareness of the value creation story are presented with more explicit explanations, they have empathy toward the corporation. Even if the corporation becomes an M&A target, the stakeholders would discredit a new, different management methodology of the takeover party, which would eventually enable the corporation to keep the existing management. In other words, using appropriate disclosure as a weapon, it is of great significance as a corporate management strategy to attract stakeholders, including shareholders, who share belief in the value creation story unique to the corporation. (And this could be a new measure to collect stable shareholders).

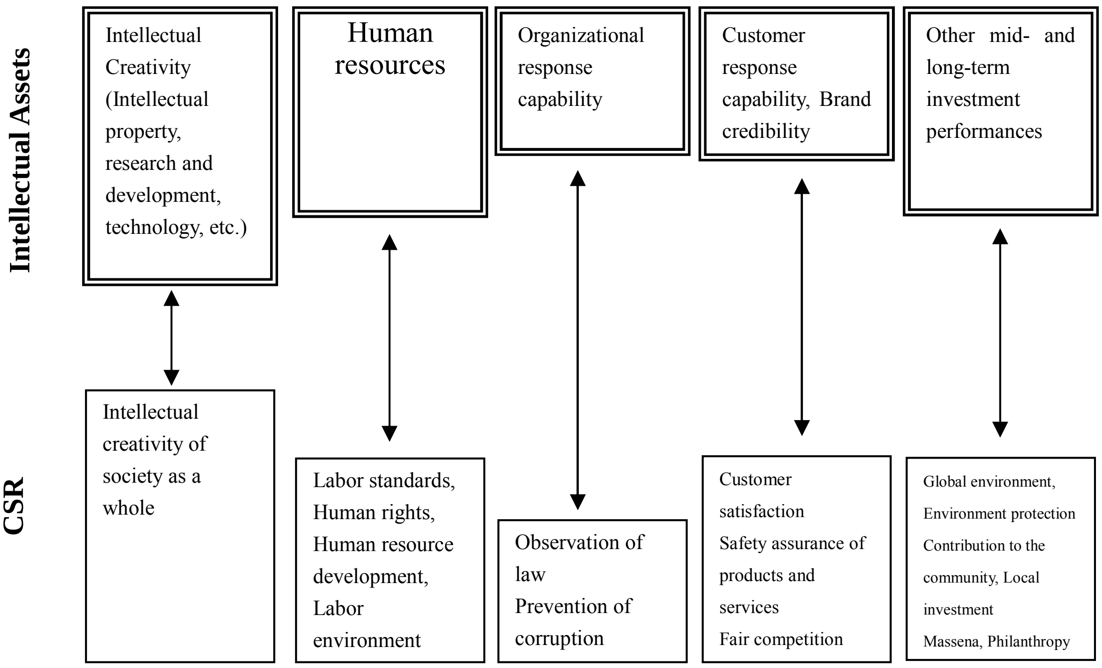
(2) CSR and IA Based Management

As mentioned earlier, Corporate Social Responsibility (CSR) has increasingly attracted attention and the discussions have started in Europe and the United States at ISO (International Organization for Standardization) conferences. There is no doubt that corporate activities have social aspects and there is a possibility to create a win-win relation in which society values corporate actions that fulfill a social responsibility, which would bring economic profits to the corporations and benefits to the society.

At the same time, discussions on CSR tend to evaluate the corporate actions in line with the views from society based on the perspective of social responsibility to be implemented by corporations. The evaluation criteria of society are different depending on era, national culture, sense of value of respective stakeholders, and therefore as a result, the social responsibility to be assumed by a corporation in CSR can have a wide diversity because it tends to be the sum of demand from different segments.

From the view point of corporations, the areas with strength among various activities are highly likely contributing to society in some way. For example, a corporation focusing on technology contributes to the innovation of the country as a whole, a corporation focusing on saving energy contributes to the environment, and a corporation implementing its business in collaboration with local companies contributes to the local economy and local community.

Thus, the difference between intellectual assets based management and the management emphasizing CSR, in the end, lies in the difference in evaluation viewpoints; whether the implementation of value creation and management based on the priority in value judgments of each corporation is evaluated from inside the company or from society (evaluation based on compliance or on relation). (See the figure below)



Therefore, corporations could conduct social contribution activities reflecting the events emphasized in the value creation process or in the approach of intellectual assets based management, which is not merely a response to the sum of demand that is described above.

In many cases, if a corporation overemphasizes CSR by self-objectifying it, and works on CSR in line with evaluation criteria forced upon it by society, it will impose a huge burden and costs on the process of corporate value creation, and at the same time, makes it difficult to carry out intellectual assets based management through optimal allocation of resources, resulting in difficulty in realizing compatibility with puruit of economic profit.

In an effort in CSR, each corporation should not aim for “straight-As”, but should rather focus its investment on value creation to be realized in its area of competence for the sake of optimal allocation of resources, should also increase corporate visibility by actively disclosing information including that of social contribution in the area of competence, and should work on gaining understanding of stakeholders. In short, it is to implement intellectual assets based management and to contribute and explain to society based on such management philosophy and missions.

Through intellectual assets based management, the core of selection and concentration in terms of the details of CSR is identified, and effective CSR activities are made possible. Then a corporation is able to strike a balance between economic and social objectives. Since activities regarded as one component of the management based on a fundamental corporate philosophy are infused with sustainability, it eventually leads to the sustainable implementation of CSR.

European nations have imposed an obligation to disclose priority items of management information including the CSR elements to comply with the EU Modernization Directive[93] for Accounting. Even in this case, corporations are to disclose items considered as substantive for them, and it does not cover all the items which may be CSR elements for society. Nonetheless, since the social conscience of corporate entities is inherently high in Japan, it tends to be interpreted that every corporation is required to earn straight-As, responding to all the elements of CSR. (700 Japanese companies are believed to have presented CSR reports.[94])

Therefore, both corporations and evaluators need to view the management emphasizing CSR and intellectual assets based management as two sides of a coin, and should not penalize by point deduction but should instead reward by point adding. It is particularly important to create an environment where corporations can make selections and concentrate on CSR in line with the core of the corporate value creation, and to acheive a balanced coexistence between social values and economic values.

8 Future Prospects

(1) Expected Effects

Once the framework described above is deeply rooted, the value of the corporation which promotes the management for sustainable growth will be highly recognized, and the growth of such corporations and optimization of resource allocation will vitalize and streamline the economy of Japan.

If a corporation implements management based on heightened awareness of intellectual assets supported by internal control, formation of a virtuous cycle is expected; a corporation will receive proper assessment from its stakeholders by such disclosure; the corporate sales and stock prices will rise, the corporation will be encouraged to take actions to further increase the corporate value; and it then leads to the next disclosure.

Needless to say, an increase in the value creation capacity of Japanese corporations not only contributes to the vitalization of the world economy as a whole, but also gives positive effects to the individual countries of the world through multi-national corporations and worldwide supply chains.

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[93] 2003/51/EC
[94] Ministry of Environment *Environment-Friendly Company Survey* (2003)

At the corporate level, selection and concentration in Japanese corporations are expected to make progress through implementing intellectual assets based management, enabling optimal allocation of resources, as well as promoting effective internal control in order to secure the quality of disclosed information with the backup of the relevant market. This process will potentially contribute to the defense measures against hostile takeovers, or appropriate management of important technologies and human resources.

Within this framework, the nature of the so-called Japanese-style of management will be re-acknowledged, and more and more Japanese corporations will regain confidence and be able to execute management policies in their own way, which will set a good example of corporate revitalization.

In addition, fostering the sentiment shared with stakeholders through the strategic disclosure of information will lead to the reduction of takeover risk.

At the same time, the capacity of market participants, particularly that of analysts, will drastically improve along with strict screening processes based on such guidelines, and a more sound and performance-based financial system will be made available by giving the guidelines to connoisseurs who are indispensable in the financial business.

When information is disclosed based on this framework, and its effectiveness is proven in the international arena, it will be possible to create a global framework on intellectual assets appropriately reflecting characteristics of Japanese corporate management.

Yet, no one can deny the danger of excessive emphasis on the intellectual assets and their utilization, which may induce actions aiming for an improvement of disclosed figures (numbers) without internal reform, may generate a trend to imitate the precedent winners, and may result in the prevalence of the straight-A management (without a focus) because of over-expectations based on indicator values. When responding to policy agenda such as formulation of guidelines, etc., due consideration must be paid to the risk of adverse effects of unexpected actions leading to the opposite of the intended direction, which is generated by misinterpretation.

(2) Roles of Government and Further Issues to Be Considered

As discussed in (1), wide penetration of intellectual assets based management will bring about various advantages to both the Japanese and world economy through effective utilization of management resources, and its promotion would be an important political issue. At the same time, the intellectual assets based management itself is basically a corporate issue. As mentioned above, proper assessment of intellectual assets and value chain (the sources of value creation) is not an easy task, and many top managers are in a situation where they have to make management decisions without a sufficient rational basis. Facing this situation, it is important for the government to support self-help efforts of corporations trying to achieve the ideal management. To that end, as mentioned already, the following actions are important for the government to take:

(a) To organize and present the role of corporate values and intellectual assets based management and to work on the diffusion and education of the idea for corporations and stakeholders;

(b) To promote corporate management and internal control of assets, keeping in mind the maintenance or improvement of corporate values; and

(c) To formulate the guidelines (including basic indicators), which are the message from corporations to stakeholders and would satisfy both parties, concerning corporate values and corporate management in order to bridge corporations and stakeholders including relevant markets, and to encourage the disclosure that is based on the guidelines, taking into account the possibility of future institutionalization.

Such concepts and guidelines will reflect the characteristics of management and assets of Japanese corporations, and therefore, it is important to lead the future international standards on the disclosure of corporate information and eventually to establish a framework that is advantageous to Japanese corporations (or management and assets) by promulgating the guidelines throughout the world. (In contrast, if there is a gap between national and international guidelines, it will impose a double burden on international corporations. If the Japanese-style of management is internationally recognized for its excellence, Japanese corporations will gain huge profits through further development of their respective areas of expertise).

As the content of disclosed information becomes significant, if its content does not reflect the current situation, it might inflict great damage to the reliability of the assessors and of the market at large. Therefore, it becomes important to have internal management or internal control in broader areas of corporate management, which assures the quality of disclosed information and upon which the content of disclosed information is based. Some of the issues in this regard include the coordination and institutionalization of concepts on internal management or internal control with respect to intellectual assets based management, and the promotion of investment to effectuate internal control. It is also necessary to examine some practical ways, while seeking consensus, on how and in what area third party audits and warranties are possible, and on how to perceive the accountability of management. Using them as a reference, it is the future task for the government to develop some type of statistical data on intellectual assets of the nation as a whole. In addition, there is still room for further consideration on critical indicators unique to individual industries.

(3) Closing Remarks

In knowledge-based society, intellectual assets based management, in which corporations accurately recognize and utilize their possessing power, is becoming increasingly important. There remains a gap between the current state of corporate management and ideal management; however, now is the time when top management must start responding to expectations of stakeholders by generating sustainable profits with a firm intention to continue intellectual assets based management.

A process to achieve shared understanding between corporations and stakeholders is essential, and for this reason, the Subcommittee focused its discussion on the disclosure mechanism of intellectual assets based management and compiled this interim report. It is desired that The Guideline for Intellectual Assets Based Management will be published as soon as possible by METI.

Intellectual assets based management report should not be something corporations present reluctantly and passively out of legal and moral responsibility, but instead, should be something to proactively express the whole management strategies with pride and confidence. It is desirable for corporations to make early decisions on management reform, for intellectual assets based management to be firmly established, for stakeholders to increase the capacity to accurately perceive changes, which would create a positive cycle of value creation in the economy as a whole, consequently realizing more effective management.

9 Outline of Subcommittee on Management & Intellectual Assets, New Growth Policy Committee, Industrial Structure Council

(1) List of Committee Members and Observers

Chairperson	
Masahiro Ikejima:	President, Asia University and Asia University Junior College
Commission members	
Hiroshi Akimoto:	Management Director, General Manager of Intellectual Property Department, Takeda Pharmaceutical Company Limited
Masashi Arita:	Director, Intellectual Assets Management Office, Nissan Motor Company Limited
Masayasu Ishida:	Ex-Director, Toppan Printing Company Limited (Recommendation by Japan Business Federation)
Eli Okada:	Professor, International Graduate School of Social Sciences Yokohama National University
Takeaki Kariya:	President, Graduated School of Global business, Meiji University
Yasuo Kuramoto:	Vice chairman, Fidelity Investments Japan Limited
Makoto Kobayashi:	Research Business Department, Intellectual Property Business Headquarters, NTT Advanced Technology Corporation (Affiliation transfer from Director-General, Department of Intellectual Property, Process & Knowledge Management Department, NTT Communications Corporation) (Recommendation by Japan Intellectual Property Association)
Michiharu Sakurai:	Professor, School of Business Administration, Senshu University
Yoko Shinagawa:	Ex-Intellectual Property Office, Business Development Department, Chuo Aoyama PricewaterhouseCoopers
Keiko Sekine:	Director, Executive Committee of Tokyo Consumer Month Project (Affiliation transfer from Head Office of National Liaison Committee of Consumers' Organizations since June 1st)
Shiro Tsuruno:	Representative Director, IR Japan Incorporated
Shozo Tokuda:	Director, Intellectual Property Office, KPMG AZSA & Co. (Recommendation by Japanese Institute of Certified Public Accountants)
Masaaki Toyoshima:	Executive Officer, AEON Co., Ltd.
Nobuhiro Nakayama:	Professor, Graduate Schools for Law and Politics, University of Tokyo
Eisuke Nagatomo:	Managing Director, Tokyo Stock Exchange
Takaaki Nimura:	Representative Partner, Ernst & Young Shin Nihon
Masato Hashikawa:	Director, IR Department, Shiseido Company
Yasuhito Hanado:	Professor, Graduate School of Asia-Pacific Studies, Waseda University

Hitoshi Funahashi:	CEO, Actcell Corporation
Masanao Maeda:	Director, Environment & Energy Department, Development Bank of Japan (Affiliation transfer from Head Office of Director General, Policy Planning Department, Development Bank of Japan, since June 1st)
Ritsuo Maruyama:	President, Okaya Electric Industries Co., Ltd.
Yasuhiro Morita:	Deputy General Manager, Management Planning Office, Hitachi, Ltd.
Takatoshi Yamamoto:	Ex-Vice Chairman & Managing Director, Morgan Stanley Japan Limited
Taku Yamamoto:	Vice Coordinator, Pension Investment Department, Pension Fund Association
Haruhiko Yoshida:	Executive Vice President and Director, Fuji Xerox Co., Ltd.
Observers	
Masaki Inoue:	Conformity Standards Division, International Standardization Activities Supporting Department, Japanese Standards Association
Taro Ohashi:	Economic Policy Office, General Policy Department, Japanese Trade Union Confederation
Yuri Okina:	Senior Researcher, Research Division, Japan Research Institute
Mitsuru Tagaya:	Professor, Graduate School of Professional Accountancy, Aoyama Gakuin University
Akifumi Nomura:	Business Accounting Coordinator, Office for Corporate Accounting and Disclosure, Planning and Coordination Bureau, Financial Service Agency
Tetsuzo Yamamoto:	Leader, Administration and Planning Group, Japan Machinery Center
Teruko Wada:	First Reader, Environment, Science & Technology Bureau, Japan Business Federation

(2) Meeting Schedules and Subject Matters of Discussion

meeting	Schedule	Contents of discussion
1st	February 25th, Friday	・ Establishment backgrounds and issues of Subcommittee ・ Arrangement of issues on corporate management and intellectual assets (Draft) ・ International performance related to intellectual assets
2nd	March 28th, Monday	・ Introduction of current status related to intellectual assets of each corporation (Current status of each corporation viewed in intellectual assets) (Quality Management System (TRQ 0005/0006)) ・ Arrangement of issues on concepts and frameworks of disclosure of intellectual assets (Draft)
3rd	April 18th, Monday	・ Rearrangement of issues on frameworks of disclosure of intellectual asset management ・ Intellectual assets indicators

		(Reports on Study Group on Intellectual Assets and Corporate Value) (Results of survey on intellectual assets and corporate value, etc.)
4th	May 13th, Friday	・ Disclosure/ Exploitation of non-financial information (CSR reports, etc.) ・ Simple internal information (SWOT analysis) ・ Arrangement of issues on disclosures of intellectual assets, etc. ・ Outline of Interim Report (Draft) ・ Outline of Guideline For Intellectual Assets Based Management Disclosure (Draft)
5th	June 10th, Friday	・ Interim Report (Draft) ・ Guideline For Intellectual Assets Based Management Disclosure (Draft)

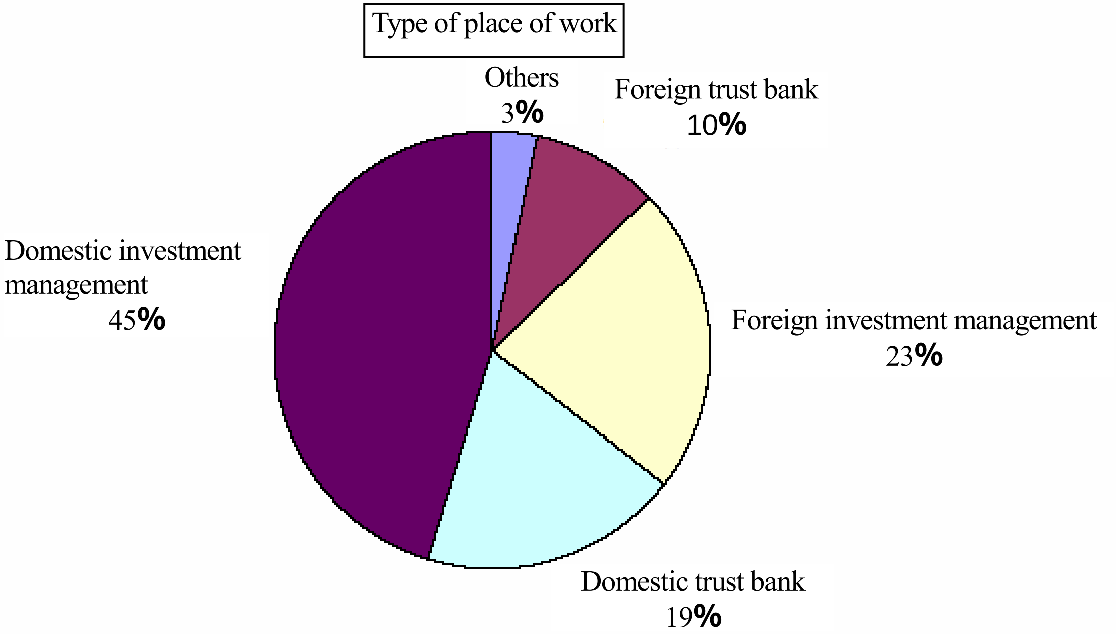
Annex 1

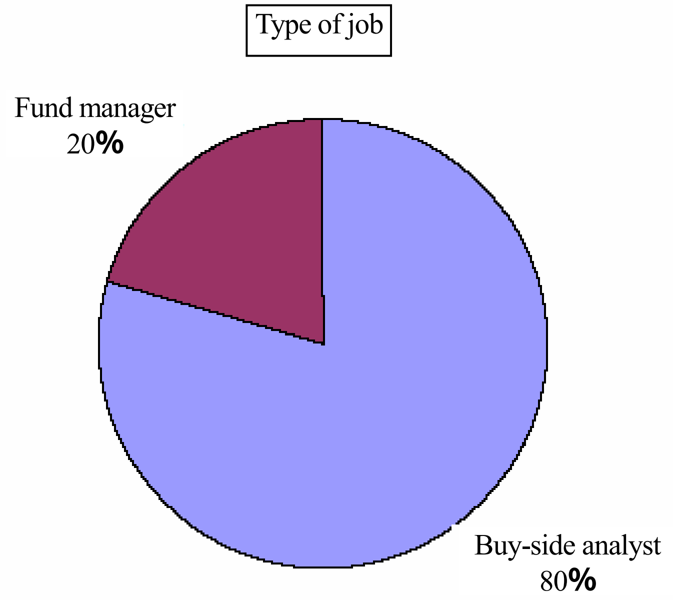
Survey on the Intellectual Assets and Corporate Value (Summary)

Results of Survey

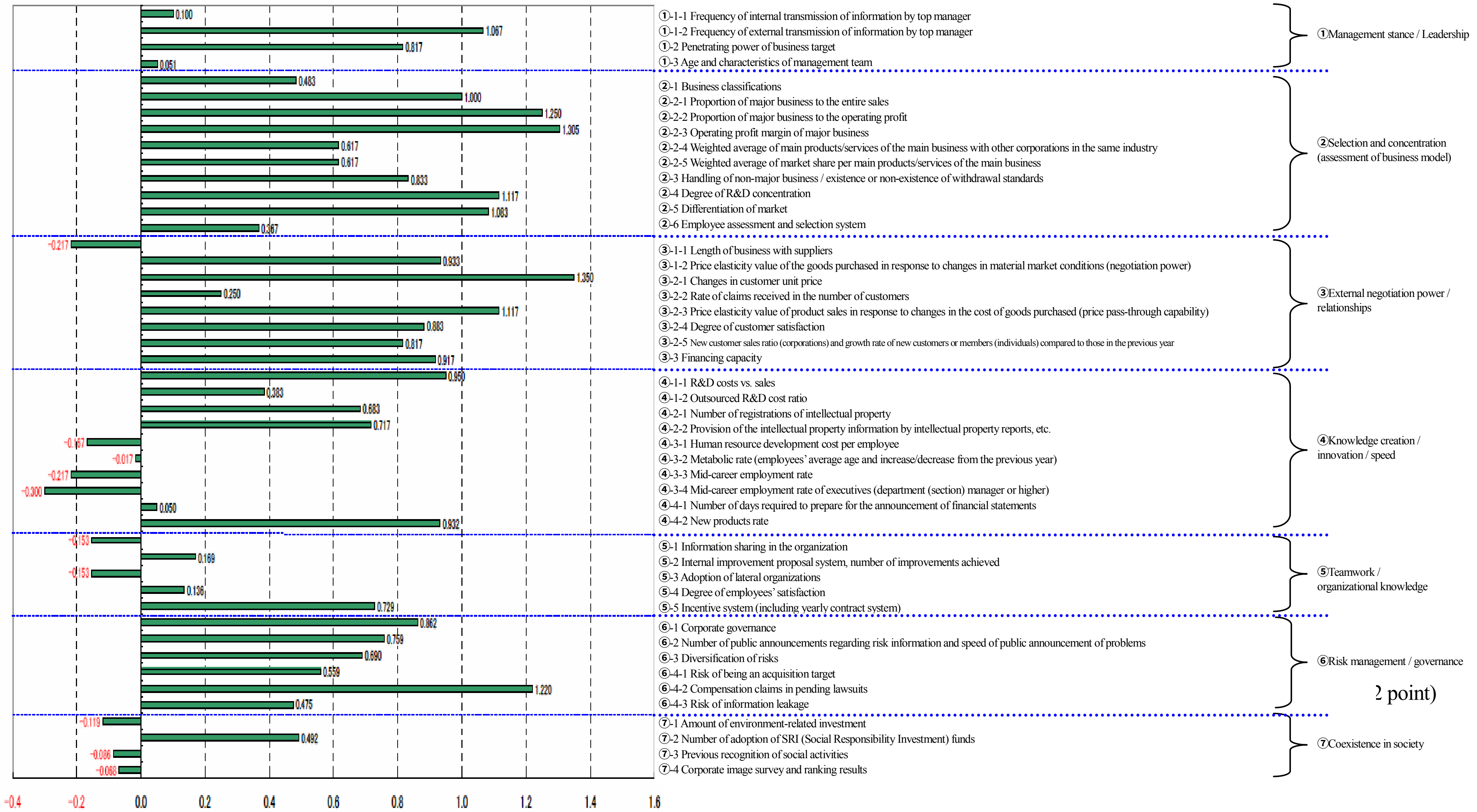
♦Survey period:	From January 24th to March 11th 2005 (1st survey) From March 14th to March 28th 2005 (2nd survey)
♦Survey agency:	IR Japan, Inc.
♦Persons in the survey:	Fund managers and analysts of domestic management agencies (Trust banks and investment advisory companies, etc.) at the upper levels in the Japanese stock investment (93 persons, see below on the breakdown)
♦ Responses:	62 persons (1st survey, response rate: 69%), 61 persons (2nd survey, response rate: 68%)
♦ Survey method:	Questionnaire and telephone interview

Breakdown of persons in the survey





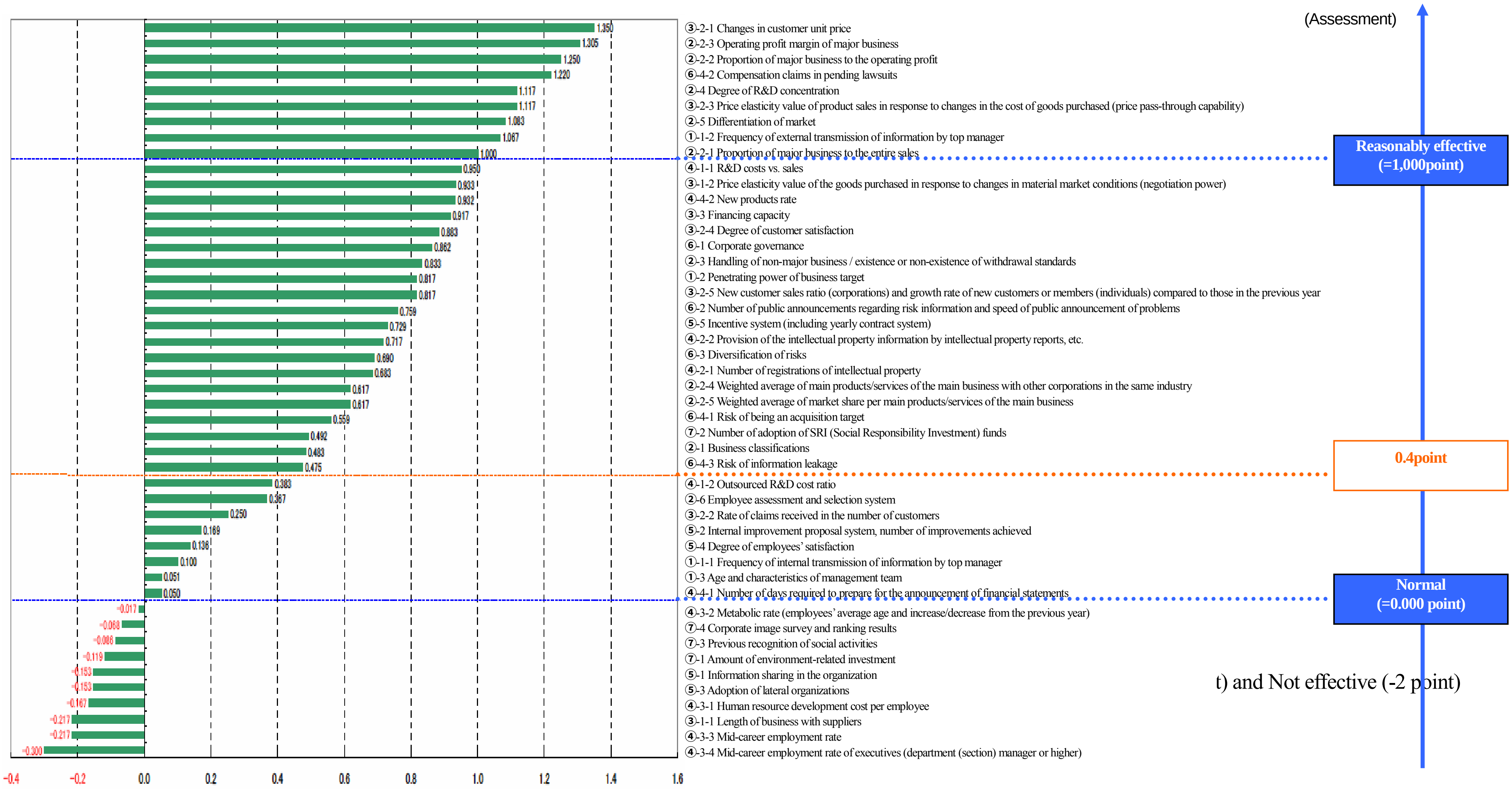
Assessment of intellectual assets indicators (draft) by investors (1)



The indicators such as ②-2-2, ②-2-3 and ③-2-1 were an extension of traditional corporate analysis and evaluated highly. The evaluation of indicator ⑥-4-2 was also high. This is thought to indicate that fund managers and analysts are leery of damage to corporate values (including intellectual property) caused by compensation claims.

The indicators such as ④-3-1, ④-3-2, ④-3-3, ④-3-4, ⑤-1 and ⑤-3 were evaluated low because of the difficulty of quantification and the concern over the discretion held by the individual corporations in making the indicators.

Assessment of intellectual assets indicators (draft) by investors (2)



Comments of investors on the "Disclosure Principles of Intellectual Assets Indicators"

Annex 1: "Overall picture of a Guideline for Intellectual Assets Based Management Disclosure" / Annex 2: "Overall picture of "Intellectual Assets Reports"	4 (Effective) (19%)	3 (Reasonably effective) (53%)	2 (Not very effective) (23%)
4 (Effective) (20%)	♦Since excessive disclosure can lower the competitiveness of corporations, it is necessary to consider stopping it at a certain level. ♦Thorough disclosure in principle is needed for objective analysis by comparing with other corporations. ♦Full disclosure is preferable if it isn't a competitive disadvantage. ♦It would be useful to have a satisfaction level, self-evaluation and a target value for current basic indicators. ⇨ Full disclosure in principle is requested while considering competitive conditions.		
3 (Reasonably effective) (48%)	♦Items which should be disclosed are too numerous. Common disclosure items should be minimized (20 items) and the rest of the items should be selected by corporations. ♦Corporations should not be forced to disclose their intellectual assets indicators in principle. ♦The number of items to be disclosed is too much. I'm worrying about the risk that necessary information is not disclosed and only unnecessary information is disclosed. ♦The comparison between corporations is difficult because each corporation will exercise their discretion in making indicators. ♦It is preposterous if system investment and special personnel are required for the disclosure. ⇨ There is a fear of increasing the burden on business of corporations.		
2 (Not very effective) (27%)		♦The balance between the effects of knowing and the effects of creating the indicators is poor. There are some items that will generate less output than input. ♦Indicators, etc. are overly detailed. It should be left to each corporation's discretion to choose the type of indicators and what is important for them. ♦I'm not sure whether or not corporate investors can utilize this in making an evaluation of corporations. ⇨ There are negative responses to cost-benefit performance and whether or not it can be utilized in an actual evaluation of corporations.	

※Percentage indicates each response rate (The reason percentage totals are below 100% is that Answer 1 (Hardly effective) is left out.)

<Reference Material> Annex 1: "Overall picture of a Guideline for Intellectual Assets Based Management Disclosure"

<Configuration of an Intellectual Assets Report>

[Principal part of intellectual assets based management reports: Story about value creation] (see Annex 2)

Management philosophy

Corporate philosophy and basic vision

→

Past to present

1. Past management policy and the status of selection and concentration
2. Past investment based on management policy
3. Intellectual assets utilized and accumulated in the past, strength and weakness, and value chains formed in the past
4. Actual performance up to most recently

→

Present to future

1. Visions for producing future profits in the future management environment, based on intellectual assets and value chains accumulated in the past
2. Future plans of various investments and policies of selection and concentration
3. Sustainability of accumulated intellectual assets and value chains

+

[Attachment: Intellectual Assets Indicators] (see Annex 3 and 4)

(Note 1): Stories on value creation are supposed to vary by each corporation.

(Note 2): Some intellectual assets indicators are quoted as supporting indicators in the story on value creation. Other indicators are listed only in Attachment and not quoted in the Principal part.

(Note 3): All the companies should submit all intellectual asset indicators in principle so as to make it possible to judge the credibility of indicators which are listed in the principal part by a certain corporation through relative comparisons regarding consistency of these indicators with its stories on value creation.

(Note 4): 51 types of intellectual assets indicators are picked out as concretizing following "Important Viewpoints (1)-(7) in increasing corporate value":

→ (1) Management stance (4 types) (2) Selection and concentration (12 types) (3) External negotiation power (8 types) (4) Knowledge creation (10 types) (5) Teamwork (5 types) (6) Risk management / governance (8 types) (7) Coexistence in society (4 types)

<Reference Material> Annex 2: Overall Picture of an Intellectual Assets Report (Example)

<Principal parts of intellectual asset reports (Example)
~The story on value creation->

Intellectual assets indicators supporting the story （※）

Corporate Philosophy

Since our foundation in [year], under the philosophy of "realizing comfortable fulfilling urban life" we have tried to establish our corporate image through dissemination of the philosophy widely to those concerned (※Frequency of IR) and penetrating the idea to employees as a code of action (※Penetrating power of business target)… We will continue our business to read today's trends or to go a step ahead of the times (※Average age of management team) by promoting technological development based on the technology we had developed in [year] in order for the development of products that meet users' needs.

Past to Present

(1) (Management policy) … With progress of urbanization and heightening demand for living environment in the background, we expect an increasing demand for … which can be used even in a relatively small living space. We have conducted our business aiming at gaining a competitive advantage in the field of products for urban residents which are low-noise and easy to handle.

(2) (Investment performance) … We have invested intensively on development of insulation technology, weight-saving technology, and space-saving design (※Decree of R&D concentration) (*A* yen, from [year] to [year]) … We also conducted the joint project with university to develop materials for that purpose (the joint project with *B* University, …yen, in [year]) (※Outsourcing R&D costs). …

(3) (Intellectual assets, value chain) We acquired the basic patent of *A* in the field of *B* in [year]. We expanded our rights in the related areas (※*C* cases) through improvement and invention based on it. We also acquired design rights (※*D* cases) and have continued development of raw materials (*E*) (※R&D costs per researcher). In order to incorporate these activities in marketing, we established the "product team" as an inter-corporate organization in [year] and have realized a new style of development and sales under a young leader that can meet market needs. This team has produced products such as *F* and *G*. We have succeeded in commercialization of *H* that other corporations cannot produce and have strengthened our lineup with various designs to meet our users' needs. As a result, our products account for *I* % (※Weighted average market share by item), … We have maintained the unit price even in the recent trend of deflation (※Changes in customer unit price), and have been trying to enhance our corporate image by increasing PR activities for consumers since [year] (※Corporate image survey).

(4) (Performance) As a result, sales increased from *A* yen in [year] to *B* yen in [year], and current profits decreased from *C* yen in [year] to *D* yen in [year]. The decrease in current profits in last year was due to …

Present to Future

(1) (Vision) With the rise of a Korean competitor, the management environment has become severer. However, based on our past performance, we will continue to remain differentiated from other corporations by enhancing our high credibility to meet the needs of customers. Concretely, we will maintain the current unit price, and promote product development focusing on our main product *A*, based on basic patent, in order to ensure our share in the domestic market. We will also enhance corporate image and further strengthen profitable structure by launching PR activities of our design capacity towards customers, especially PR activities by the president to show our contribution to society, and by ensuring that employees understand and work according to these ideals.

(2) (Investment plan) Since [year], we have adopted and trained the total of *A* designers, and will increase the number to *B* and enhance the contents of the training (Training expenses per person: At present *C* yen → 5 years later *D* yen). In order to enhance corporate image, our external PR activities will be focused on the points that our products improve the beauty of the environment and that we value human-friendly and eco-friendly aspects in deciding colors and materials of new products (Investment related to environment: *E* yen). Development of new raw material following our main product *F* will be finished in two years (Amount of investment: *G* yen), and commercialization will be started.

(3) (Sustainability) Basic patent is valid for *A* years, and relevant patents are to be valid until [year] on average. Our products have gained a high evaluation from buyers, and the figures are on an upward trend year by year (※Survey on corporate image, Customer satisfaction rate). In order to give higher incentive to the "product team," we will introduce the new system of *B*. Since we started to export our products to some big cities in China last year, expansion of the market is expected (Expected average growth rate *C*%). We expect *D*% growth in sales and current profit will be *E* in [year].

＋

<Attachment>

Intellectual Assets Indicator

- Number of IR
- Degree of employee satisfaction
- Degree of R&D concentration
- Customer unit price
- Degree of customer satisfaction
- Knowledge creation
- R&D costs vs. sales
- Mid-career employment rate
- New products rate
- Information sharing
- Effectiveness of internal control
- Lawsuit risk
- Corporate image

・・・・

・・・・

・・・・・

(51 types)

<Reference Material> Annex 3:Basic principle on the disclosure of intellectual assets indicators

○51 types of intellectual assets indicators should all be disclosed in principle.

○Intellectual assets indicators supporting value creation stories of individual corporations (e.g. 6) should be quoted in the text of the Intellectual Assets Report (Annex 2). All the intellectual assets indicators including those should be listed in the Attachment of the Intellectual Assets Report.

○If a different calculation method other than standard one was used for an indicator (including the survey results by an investigation firm instead of calculating by themselves), the method and the sources should be attached.

○Disclosure of intellectual assets indicators can be omitted by attaching reasonable reasons such as “being competitively disadvantageous” or “requiring too much costs for calculation.”

○In addition to intellectual assets indicators listed in Annex 4, indicators originally made by individual corporations can be used by attaching the calculation method.

<Reference Material> Annex 4: Intellectual assets based indicators (Draft)

①The degree of sharing and penetration of management stance and target is measured. The characteristic of a corporation is understood through the structure of management team.

● (Indicator ①-1-1)Frequency of internal transmission of information by top manager
● (Indicator ①-1-2)Frequency of external transmission of information by top manager (external PR activities)
● (Indicator ①-2)Penetrating power of business target
● (Indicator ①-3)Age and characteristics of management team

②Selection and concentration (assessment of business model)
Status of selection and concentration of products, services, technologies, customers, markets, etc. and characteristics of selection and concentration depend on the type of business and the selection of its strategy of each corporation. Therefore, degree of selection and concentration is understood after classification of business is defined.

(②−1) Business classifications
● (Indicator ②-1-1) Net asset book value and aggregate share market price
● (Indicator ②-1-2) Sales structure per B to B, B to C
● (Indicator ②-1-3) Business model classifications

(②−2) Competitiveness of major business (on consolidated basis)
● (Indicator ②-2-1) Proportion of major business to the entire sales
● (Indicator ②-2-2) Proportion of major business to the operating profit
● (Indicator ②-2-3) Operating profit margin of major business
● (Indicator ②-2-4) Weighted average of main products/services of the main business with other corporations in the same industry
● (Indicator ②-2-5) Weighted average of market share per main products/services of the main business
● (Indicator ②-3) Handling of non-major business / existence or non-existence of withdrawal standards
● (Indicator ②-4) Degree of R&D concentration
● (Indicator ②-5) Differentiation of market
● (Indicator ②-6) Employee assessment and selection system

③ External negotiation power / relationships
Degree of negotiation power and connections over and with external parties – suppliers (③-1), customers (③-2), funding sources (③-3) - such as upstream and downstream parties is understood.

● (Indicator ③-1-1) Length of business with suppliers
● (Indicator ③-1-2) Price elasticity value of the goods purchased in response to changes in material market conditions (negotiation power)
● (Indicator ③-2-1) Changes in customer unit price
● (Indicator ③-2-2) Rate of claims received to the number of customers
● (Indicator ③-2-3) Price elasticity value of product sales in response to changes in the cost of goods purchased (price pass-through capability)
● (Indicator ③-2-4) Degree of customer satisfaction
● (Indicator ③-2-5) New customer sales ratio (corporations) and growth rate of new customers or members (individuals) compared to those in the previous year
● (Indicator ③-3) Financing capacity

④ Knowledge creation / innovation / speed
Capacity and efficiency of new value creation, speed of business management is understood.

(④-1) Research and development
● (Indicator ④-1-1) R&D costs vs. sales
● (Indicator ④-1-2) Outsourced R&D cost ratio

(④-2) Intellectual property
● (Indicator ④-2-1) Provision of intellectual property rights
● (Indicator ④-2-2) Provision of intellectual property information (technologies, etc.) by intellectual property reports, etc.

(④-3) knowledge creation capacity in terms of human resources
● (Indicator ④-3-1) Human resource development cost per employee
● (Indicator ④-3-2) Metabolic rate (employees' average age and increase/decrease from the previous year)
● (Indicator ④-3-3) Mid-career employment rate
● (Indicator ④-3-4) Mid-career employment rate of executives (department (section) manager or higher)

(④-4) Speed of business management
● (Indicator ④-4-1) Number of days required to prepare for the announcement of financial statements
● (Indicator ④-4-2) New products rate

⑤Teamwork / organizational knowledge
Organizational power (collective strength) and solidarity as a unity of individual capacities is understood.

● (Indicator ⑤-1) Information sharing in the organization
● (Indicator ⑤-2) Internal improvement proposal system, number of improvements achieved
● (Indicator ⑤-3) Adoption of lateral organizations
● (Indicator ⑤-4) Degree of employees' satisfaction
● (Indicator ⑤-5) Incentive system (including yearly contract system)

⑥ Risk management / governance
Status of identification, assessment and response, management, public announcement and governance of risks is understood.

(⑥-1) Corporate governance
● (Indicator ⑥-1-1) Compliance (compliance to laws and ordinances) system
● (Indicator ⑥-1-2) Execution and supervision mechanisms
● (Indicator ⑥-1-3) Status of internal control
● (Indicator ⑥-2) Number of public announcements regarding risk information and speed of public announcement of problems
● (Indicator ⑥-3) Diversification of risks

(⑥-4) Risk information that might have significant effects on the corporate value and intellectual assets
● (Indicator ⑥-4-1) Risk of being an acquisition target
● (Indicator ⑥-4-2) Compensation claims in pending lawsuits
● (Indicator ⑥-4-3) Risk of information leakage

⑦ Coexistence in society
Status of good image by contribution to the community, society, etc. is understood.
● (Indicator ⑦-1) Amount of environment-related investment
● (Indicator ⑦-2) Number of adoption of SRI (Social Responsibility Investment) funds
● (Indicator ⑦-3) Previous recognition of social activities
● (Indicator ⑦-4) Corporate image survey and ranking results

Summary of results of survey

<Overall assessment>

♦Though there are issues at each level, in general, investors hope that a disclosure makes further progress by the disclosure of intellectual assets information.
♦It should be noted that this survey is not an absolute assessment of intellectual assets indicators but an assessment of effectiveness of indicators from an investors' point of view.
→It is possible that indicators being similar to the method of corporate analysis used by traditional financial analyst tend to win more affirmative vote.

<Indications which investors give low assessment>

♦It could be in need of review about following indicators for which the weighted average assessment was negative (Not very effective)".
④-3-2: Metabolic rate
⑦-4: Corporate image survey and ranking results
⑦-3: Previous recognition of social activities
⑦-1: Amount of environment-related investment
⑤-1: Information sharing in the organization
⑤-3: Adoption of lateral organizations
④-3-1: Human resource development cost per employee
③-1-1: Length of business with suppliers
④-3-3: Mid-career employment rate
④-3-4: Mid-career employment rate of executives (department (section) manager or higher)

♦In addition to above indicators, how should we think about the indicators for which the weighted average assessment is relatively low (e.g. the indicators which are less than 0.4 points)?
④-1-2: Outsourced R&D cost ratio
②-6: Employee assessment and selection system
③-2-2: Rate of claims received in the number of customers
⑤-2: Internal improvement proposal system, number of improvements achieved
⑤-4: Degree of employees' satisfaction
①-1-1: Frequency of internal transmission of information by top manager
①-3: Age and characteristics of management team
④-4-1: Number of days required to prepare for the announcement of financial statements

<Disclosure burden on corporations and solo creation of "Intellectual Assets Report">

♦There is a concern about increasing a corporation's burden and opinions questioning the cost effectiveness of the disclosure, although there is already a move to disclose CSR reports and to discuss an announcement on the MD&A Item of an annual report. Therefore, there could be a need to clarify the relation between intellectual assets and these movements.

Annex 2

March 29, 2005

Japan Investor Relations Association
Nikkei No. 2 Annex Bldg. 1-6-6
Uchikanda, Chiyoda-ku, Tokyo 101-0047

NEWS RELEASE

The gap between "intellectual property report" companies and investors
– Survey in the chemical industry

Survey outline: The Japan Investor Relations Association (Chairman: Katsuhiro Utada, Ajinomoto special consultant) made a request to ChuoAoyama PricewaterhouseCoopers to conduct a survey on the information required in intellectual property reports, and has summarized the results. The subjects participating in the survey were institutional investors, analysts working on the chemical industry, and companies associated with the chemical industry. Responses were obtained from 54 companies and 34 analysts / investors (response rate 17.7%).

Gist of the results:

- **Both companies and investors responded that intellectual property information contributes to company assessment**
  76% of the companies responding indicated that intellectual property information "contributes to proper valuation by the market", and 24% of investors replied that it "contributes significantly to the assessment of a company", while 73% stated that it "contributes somewhat to the assessment of a company". However, the level of awareness and active use of intellectual property reports was not necessarily very high.
- **There is a gap between what companies and investors think is important information**
  .The top 3 items of information considered important by companies were "management policies", "frank opinions of management", and "rate of growth of product markets". The top 3 items considered important by investors were "current competition situation", "profit amounts", and "position in the market". There was a also a tendency for investors to consider information on business results to be important, while corporations, especially top managements, tend to convey overall capability.
- **There is a large gap for "date of expiration of important patents" and "status of technology-related lawsuits" for information on intellectual property**
  Investors place importance on the risks to business results from patent expirations and lawsuits. Even when companies disclose this kind of risk information, there is a demand for explanations of how the intellectual property contributes to competitiveness and business results.

Please visit the association web site for more details. https://www.jira.or.jp

Annex 3

Example of SWOT Analysis Kikkoman Co.

<Strength>

★ **Brand strength domestically and abroad**

★ **Fully-developed internal QA system**
- Maintain image of reliable, safe, high-quality products

★ **High capability in brewing technology**
- Know-how and technology accumulated over a long time
- Product development ability related to seasonings

★ **Technical cooperation with group companies**
- Japan Del Monte, Manns Wine, ・・・

<Weakness>

★ **Mature industry (food products industry)**
- Patent rights expired, many technologies are public knowledge
- Hard to obtain basic patents
- Much of the know-how is not protected by patents

<Items that are highly likely to produce future profits >

★ **Cooperative network with cooperating companies**
- Joint product development, use of distribution channels, ・・・

★ **Merger with a famous US nutritional supplement maker company**
- Joint research and product development on health foods
- Manufacture and sale of nutritional supplements and health foods in the USA

★ **Obtaining patents in new business areas**
- Bio, organic foods, ・・・

<Areas of likely risk of threats from rivals>

★ **Patents obtained on know-how**
- Patents on know-how obtained by other companies

★ **Imitation products (China, Asia)**
- Decline in brand image due to imitators and similar products