

There are many benefits on offer for companies that disclose information about their intellectual assets, say **Eiichi Yamamoto** and **Toshimichi Matano** of Japan's Ministry of Economy, Trade and Industry

Why intellectual asset management is crucial

Japan's economy faces the challenges of an aging population, globalization and the transition to a knowledge society. As a result, Japanese corporations need to plan ways that they can differentiate themselves from their rivals.

The foundation for differentiation consists of capabilities that cannot be copied by others. For a company to become increasingly profitable, such capabilities must be sustainable to some extent. Examples include IP, know-how accumulated by a company, leadership by the management, corporate culture, and in-company and external networks, all of which are assets that are not visible to the eye. These are capabilities that are unique to each company and last for a fixed period of time. They are collectively referred to as intellectual assets. Combining these intellectual assets in a way that is suitable to each company and applying these assets (intellectual asset-based management) is linked to differentiation, which is what is now desired of Japanese corporations.

A model for growth

Think of the following simple model: Tangible and intangible assets (x) are considered as being input, and the function (f) to convert these into output (y) is considered as being a corporation. The input (x) and corporation (f) differ depending on the corporation. The key to producing differentiation lies here.

In order for a corporation to increase (y), it can (1) invest in areas within (x) that are unique to the corporation and that have relatively high priority, (2) optimize the contents of (f) so that it matches the (x) that is thought to be relatively high priority for the corporation, or (3) build an (x) that is suitable for

the contents of (f). Operations in the past consisted mainly of those that focused on areas that are visible, tangible assets (and y). However, the areas that cannot be seen and that serve as the foundation for differentiation are also important. This is intellectual asset-based management.

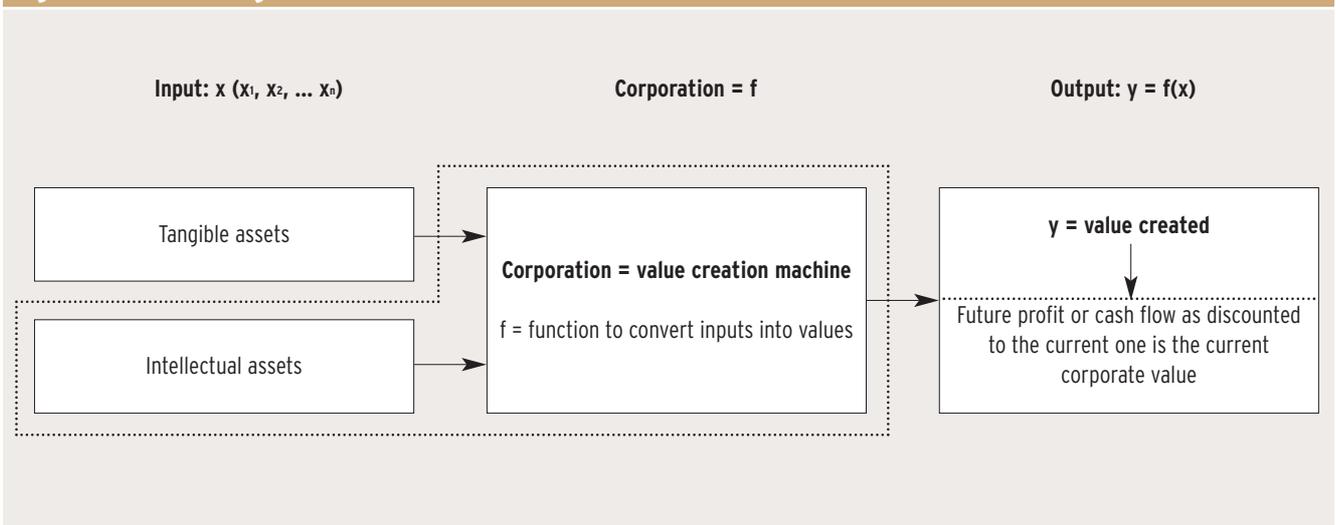
The importance of disclosure

Even if intellectual asset-based management is put into practice, it does not necessarily mean that appropriate corporate values will be realized in the capital markets. This is because the people who determine the accuracy of future cash flow are external corporate evaluators. Unfortunately, present-day business valuations place a great deal of importance on financial information, and there are only a few corporate evaluators who analyze the dotted area in figure 1. However, the key to predicting future profits more accurately is in this portion, even though it cannot be seen visually.

In Japan, there is a tendency to evaluate corporations based on fluctuations of short-term profits, such as those for quarterly periods. Since corporate managers respond to these in a sensitive manner there is a tendency for management decisions to be made in response to short-term concerns.

To overcome this tendency and realize continuous growth, it is necessary for corporations to convey the contents of f and x that are unique to themselves, or the process for value creation based on intellectual assets, together with persuasive proof of this process. Companies can get more information about how to disclose relevant information from the Guidelines for Disclosure of Intellectual Assets Based Management (www.meti.go.jp/policy/intellectual_assets/pdf/

Figure 1: Accounting for intellectual assets



GuidelineforIAM.pdf). These were formulated by METI in October 2005 in response to submissions from the Industrial Structure Council's Subcommittee on Management & Intellectual Assets. So far, 23 companies have provided case studies on how they disclosed IP-related information.

If a company shares this kind of information with stakeholders through disclosure, the level of trust between relevant parties such as shareholders, employees, partner companies and customers will increase. As a result, since it no longer becomes necessary for corporate managers to take short-term management decisions, it becomes possible to optimize the allocation of management resources within the company. This will benefit the Japanese economy as a whole.

Management manual

Because small and medium enterprises often possess limited management resources, policy officials developed the Intellectual Asset-Based Management Manual (http://www.meti.go.jp/policy/intellectual_assets/english.html) to promote intellectual asset-based management by SMEs.

The manual outlines the meaning and significance of "intellectual assets" and "intellectual asset-based management", and includes details of 17 companies that are implementing the system. It then explains the procedures for creating intellectual asset-based management and provides examples of intellectual asset-based management reports for four model companies. An additional guide for SMEs is included in the manual's appendix.

Corporate report

In April this year, the Financial Services Agency's Financial System Council released a report on relationship banking. The report described intellectual asset-based management as a strategy that assists in the evaluation of qualitative information.

If reciprocal approaches between corporations and financial institutions can be promoted through these actions, effective dialogue becomes possible.

Analyzing the data

Many corporate evaluators conduct short-term corporate analyses that emphasize financial information and do not sufficiently analyze the intellectual assets (management) that represent a company's potential. To help them effectively analyze companies' intellectual assets, they should address the following points:

- Clear presentation of management policies, together with vision and consistency
- Relevancy of financial information and non-financial information
- Deepened recognition of intellectual asset-based management based on discussions with corporations through interviews and factory tours
- Link between corporate value and prior investments in intellectual assets
- Comparative assessment of intellectual asset-based management based on comparative analysis
- Confirmation of resources for profit
- Evaluation of understandability and brevity of contents

Preferred approaches for evaluators

It is important to conduct corporate evaluations while placing importance on the management's vision, R&D, personnel and governance, as well as considering financial information, or the results of past corporate activities.

Preferred approaches for corporations

Since the time that corporate evaluators devote to analyzing one company is limited, it is useful for corporations to analyze the gap between the information that is being sought by the market and the information that the company provides. It should provide focused information to ensure that the reader does not suffer from information overload.

Efforts in Japan

The Ministry of Economy, Trade and Industry (METI) is conducting reviews so that effective disclosure of non-financial information can be carried out globally based on its Guidelines for Disclosure of Intellectual Assets Based Management. It is doing this through discussions with interested parties, and by preparing for XBRL (Extensible Business Reporting Language) of disclosure of non-financial information.

METI has also established the Act on Promoting Business Activities of SMEs Utilizing Intellectual Assets in Communities. This supports commercialization using regional resources (such as local technology and tourism resources) as local intellectual asset-based management. METI also supports the establishment of new businesses.

The New Energy and Industrial Technology Development Organization judges the effectiveness of research from the perspective of intellectual asset-based management in reviewing support for the practical application of innovation.

In addition, operations for promoting intellectual asset-based management will be implemented in Kyoto prefecture this year, while evaluations of intellectual asset-based management techniques that make use of Kyoto's traditions as well as low interest loans are underway.

At the Kyoto Institute of Technology, associate professor Takafumi Nakamori is leading efforts on ways of using intellectual asset-based management reports as educational materials for business administration, and to link these to producing excellent human resources.

Collaborative efforts

Officials from around the world took part in the final event of the intellectual asset-based management week 2006 – the OECD Conference on Intellectual Asset-Based Management: Toward Innovation and Sustainable Growth. In Intellectual Assets Week 2007, which will be held from November 5 to 9, discussions regarding the key to success for businesses, and how intellectual asset-based management should be promoted are planned to be held as part of the Intellectual Café.

In September this year, a round table on Japan-German intellectual asset-based management systems will be held in Germany.

Since 2004 the OECD has also been working on a project named Intellectual Asset-Based Management and Value Creation. The project was initiated by Japan and follow-up work is now being carried out.

Nowadays, there is an increased risk of undervalued corporations being subject to hostile takeovers. Making efforts to disclose intellectual asset-based management information can be an effective hedge against such takeovers, by accurately evaluating a company's merits.



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