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Piece of mind

Getting all intangibles onto the balance sheet should be the long-term goal, but while we wait for that to happen there are other options that may facilitate the monetisation of IP rights

The world gets better every day – then worse again in the evening.
Kin Hubbard

St Louis, Missouri, 10th September 2007: Is globalisation good for innovation and, if so, who benefits? Globalisation means doing business globally with business activities dispersed among multiple foreign enterprises. Research, technology transfer and commercial development are just such activities, so globalisation, fully implemented, should include these functions as well. One theory is to follow the quality and competency gradients to best practitioners wherever they are in the world.

Once knitted together with seamless IT capabilities, this results in a multinational enterprise without peer in innovation, implementation and customer satisfaction. This can be called strategic globalisation. Another theory, more aptly labelled global capitalism, follows a different gradient – one based on cost and profit – to establish the most competitively robust multinational. Today the tendency is to preach the first theory but to do the second.

Behind most business opportunities there are three options. Do we want the best quality, the quickest result or the cheapest solution? Naturally, we want all three but more often they are mutually exclusive. In the case of innovation, quality and cost are the most frequent drivers, because creative processes usually take the test of time to prove their worth. Of course, if innovative solutions exist elsewhere, an alternative is to borrow them. In global markets this tends to take the form of licensing or piracy. Which route is taken depends jointly on the local rule of law and the time value of money. The first element is a function of political institutions. The second is drawn from the financial description and dissection of businesses expressed in terms of money.

We are most certainly living in a global knowledge economy. But we are also living in a finance economy. What does this mean exactly? It means that knowledge is the dominant asset that drives local and global economies. But it also means that financial management processes dominate the command and control mechanisms of these economies. The two are inter-related; financial tools, such as derivatives, are knowledge assets that are used by business leadership to monetise virtually every activity of the business world.

The float of financial derivatives on world financial markets is enormous. In a March 2006 interview with Harvard Business School, Professor Robert Merton (a Nobel laureate who pioneered much of the economic science of derivatives) indicated that the Federal Reserve estimated the float at a staggering US$270 trillion in notational value. That sum is approximately six times the world's annual GDP. Stated differently, the globe re-monetises itself every 60 days. According to Merton, placing a renewing current monetary value on assets, obligations and receipts makes it possible to identify the value at risk to a business that is associated with its business activities. And reduction to numbers is a central lemma of financial management philosophy.

With such an emphasis on the short term monetisation management of our financial affairs it is easy to see how global innovation strategies might get lost in the shuffle. Accounting rules in the US and elsewhere still struggle to find effective ways to post intangible (eg, knowledge) assets to the balance sheet. The absence of such numbers in turn makes it impossible to monetise these assets effectively in the derivatives marketplace.

Of course there is no lack of anecdotal evidence indicating huge values associated with intangibles. In the US, it is even a point of consensus among political partisans. In an October 2005 white paper, *The Economic Value of Intellectual Property*, think tank economists Robert Shapiro and Kevin Hassett agreed that US intellectual property alone has a fair value of between US$5 trillion and US$5.5 trillion or 45% of the US GDP. These number magnitudes are being repeated with increasing frequency (by this writer included). By itself, US intellectual property would constitute the second largest GDP in the world. Although unmarked assets, these intangibles represent an irresistible gradient to global markets which, according to Shapiro and Hassett, results in an unprecedented piracy of private wealth through unlicensed borrowings in emerging and sometimes developed economies.

Still the evidence is indirect because failure to monetise intangibles results is a failure to manage the risks. A recent PricewaterhouseCoopers' survey, *2007 Technology Marketplace Licensing Study*, suggests that failure to enforce licensing rights is virtually endemic in many US companies. The authors state that, according to consensus surveys, companies are willing to forgo an average of US $25 million in annual licensing revenues, representing as much as US $895 million in market capitalisation, because of the inability to mark intangibles to market. Even the *New York Times*, in a recent (10th September 2007) editorial by Denise Caruso, is recognising the necessity of recording intangible assets so that they can be properly accounted for as resources in solving both private and public sector challenges.

So what will it take to begin properly accounting for piece of mind in the global marketplace? Accounting standards is a laudable goal but it will be slow in coming. A more practical short term solution may be in monetising intangibles though financial instruments. This can be done in several ways, including an increase in collateralised leveraging of intangibles that can participate in the collateralised debt options (CDO) marketplace or asset monetisation using sale license-back contracts.

Once intangibles are part of the financial mainstream, the ability to manage them for value, both globally and locally, will increase. And for those of us in intellectual asset management it would begin to give us peace of mind about piece of mind.

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