



THEMED PAPER

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Assessing the relevance of intangible asset valuation, reporting and management initiatives

Robert Watson

Instituto de Empresa Business School, Madrid, Spain

Abstract

Purpose – The growth of the so-called “knowledge economy”, whereby the primary sources of firm value are claimed to be an increasing reliance upon the exploitation and management of intangible assets that are not reported in company balance sheets, has led to a questioning of the continued relevance of conventional financial reporting and internal management information and control systems. The purpose of this paper is to evaluate the criticisms and proposed alternatives to conventional financial reporting and management control practices. As public policy makers appear to be increasingly convinced that there is an economically damaging “gap” in terms of small and medium size enterprise (SME) stakeholder understanding of intangible asset management, the paper also evaluates the arguments and evidence concerning the applicability and relevance of the problems and proposed alternatives to SMEs.

Design/methodology/approach – The paper reviews the criticisms, empirical evidence and proposals to improve financial reporting and internal management control practices by incorporating information on the value of intangible assets and in developing tools for better managing these assets.

Findings – The problems associated with identifying and valuing intangible assets and the fact that capitalising income (net profit) using an appropriate risk-adjusted cost-of-capital provides an adequate estimate of value, appears to make most accounting researchers highly sceptical of either the need or desirability of including intangible asset values in the balance sheet. Moreover, the suggestion that firms – particularly SMEs – could increase their value by adopting more formal and comprehensive intangible asset management systems is highly suspect and appears not to be borne out in practice.

Research limitations/implications – The case study evidence in relation to the benefits to SMEs from adopting such tools – even when such tools have been specifically designed for SMEs and, along with consultancy advice, are made freely available to firms – is not encouraging and, in the view of this writer, does not provide any firm justification for significant further public involvement beyond considering including the topic in business start up course syllabuses.

Originality/value – The paper provides the first review of the relevance to the SME sector of the by now extensive conceptual and empirical body of work on the valuation, reporting and management of intangible assets.

Keywords Knowledge economy, Financial reporting, Small to medium-sized enterprises, Intangible assets

Paper type Case study



1. Introduction

The notion of the “knowledge economy” has motivated much recent research (by academics, professional accounting bodies and various European Union (EU) and national government and international agencies), into why information relating to investments in intangible assets, might be important in terms of better assessing and managing the sources of value generation and the sustainability and risks associated with corporate strategies[1]. The argument typically put forward by policy advisors appears to be that greater recognition, reporting and management of intangible assets could lead to significant improvements in corporate performance and that this information could provide both inside and outside stakeholders with valuable and relevant information concerning corporate risks and prospects (Eustace, 2000). It has also been suggested that apparent market failures in the provision and costs of small and medium size enterprise (SME) finance could be mitigated if greater information regarding internally generated intangibles were available as this could result in lowering transactions costs, say by providing collateral or reducing the cost and/or increasing access to external financial capital[2].

Evaluating the relative costs, benefits and feasibility of producing and using information on intangibles is, of course, greatly complicated by two factors: first, the wide range of possible resources that qualify as intangible investments and the degree to which it is possible to identify their unique contribution to current and future business cash flows[3]; and, second, the riskiness and other resources of the business entity involved. With regard to the first issue, at one end of the scale are intellectual assets protected by Patent or Copyright Laws that generate identifiable cash flows from licensing and other servicing fees. These types of intangible investments can generally be easily separately identified, valued and hence, are capable of being marketed and sold to a third party. However, at the other end of the intangibles investment scale are resources where neither property rights nor future benefits are easy to identify or evaluate, i.e. the very existence of the asset is in doubt. For example, the construction of legally enforceable contracts, and the identification of future benefits on the residual value of the firm will often not be feasible in cases where:

- Intangibles such as customer satisfaction and employee loyalty are not separate, saleable, or discrete items, i.e. where their value, the identification of their unique contribution or costs is largely dependent upon a host of other interrelated corporate activities and investments.
- Human capital investments such as employee training, know how and supply chain networking make it difficult to reliably estimate fair values, particularly given employee turnover and the possibility that value-decreasing staff turnover may actually increase if such human capital investments enhance employees external labour market prospects.

These types of – essentially speculative – intangibles are of particular importance to many SMEs[4], not least because their most important intangible asset is often the entrepreneur’s inputs (business plan) and personal relationships built up with suppliers, customers and employees. Indeed, as can be seen from Table I, long before the advent of the “knowledge economy”, these “market-making” abilities and activities were recognised as being central to the economic definition of “entrepreneurship” irrespective of the nature of the business.

Table I.
The economic
(market-making)
function(s) of the
entrepreneur

Obstacle to trade	Market-making activity
No contact between buyer and seller No knowledge of reciprocal wants	Contact-making via search or advertisement Specification of the trade and communication of the details to each party
No agreement over price Need to exchange custody of goods and pay any taxes or tariffs due on the transaction	Negotiation Transport and administration
No confidence that goods correspond to specification	Monitoring, that is, screening of quality, metering of quantity, timing of installments, observation of contingent events
No confidence that restitution will be made for default	Enforcement

Source: Casson (1982)

The second factor that needs to be considered when evaluating the costs and benefits of intangible asset identification, valuation and management, are the resource constraints and the riskiness of the business entity, both of which are typically much higher for SMEs than for large public companies[5]. In fact, a corollary of intangible asset values being largely contingent upon future business outcomes is that this value may be totally destroyed in the event of business failure, financial distress, or simply the closure/scaling down of operations due to sickness, retirement or worsening economic circumstances. These uncertainties, along with the associated costs of obtaining, valuing and using the information, are likely to put severe limits on the feasibility or desirability of encouraging SMEs to devote significant resources to the identification, valuation and reporting of their intangibles.

The remainder of the paper is structured as follows. In Section 2, the arguments put forward for significantly increasing the current reporting requirements in regard to intangible assets are reviewed and some implementation and cost-benefit considerations regarding the relevance and feasibility of including SMEs in a more extensive statutory reporting regime are presented.

This is followed by a discussion of the most relevant aspects of intangible asset management for SMEs – in particular, circumstances such as when seeking outside finance suppliers or when selling the business where entrepreneurs may be expected to find it useful to have information regarding intangible asset valuations and/or their business's key value drivers. A brief review of some recent case studies relating to the experimental use and reporting of intangible asset management techniques is undertaken in Section 4 and Section 5 provides a summary of the issues and some concluding remarks.

2. A review of intangible asset reporting and management ideas

The motivation for the valuing and reporting of intangibles generally revolves around the claim that contemporary businesses are now predominantly “knowledge based”, in that they generate their main cash flows from their investments in intangibles rather than primarily from the traditional exploitation of physical assets and relatively low-skilled labour[6]. For example, Lev (2001), one of the primary advocates for the reporting on intangibles suggests that “intangibles” are now the primary drivers of economic activity and that as a consequence of the absence of intangibles reporting in traditional financial statements, users have insufficient information on which to base

rational investment decisions. Indeed, Lev goes further and claims that the lack of reporting on intangible assets has probably led to insufficient investments in intangibles, i.e. the “systematic undervaluation of intangibles” by investors, and that radical reforms to the reporting model might be the catalyst for generating a higher and economically worthwhile level of investment in such assets.

In Chapter 5, Lev (2001), in the tradition of Kaplan and Norton’s (1996), “balanced score card”, suggests that the dysfunctional behavior that is often a consequence of managers not being aware of the importance of non-financial performance indicators can be addressed by the use of what he calls a “value chain scorecard” based on what he identifies as the fundamental, three-stage, economic process of innovation. Lev’s Figure 5.1 represents this process, beginning with the discovery of new products or services, their subsequent development and technological feasibility, and finally their commercial exploitation as follows:

(1) *Discovery and learning:*

- Internal renewal (e.g. R&D, workforce training and development).
- Acquired capabilities (e.g. technology purchase, capital expenditures).
- Networking (e.g. R&D alliances and joint ventures, supplier and customer integration).

(2) *Implementation:*

- IP (e.g. patents, copyrights and trademarks).
- Technological feasibility (e.g. clinical tests, FDA approvals and beta tests).
- Internet (e.g. alliances, online purchases and traffic).

(3) *Commercialisation:*

- Customers (e.g. brand values, online sales and marketing alliances).
- Performance (e.g. knowledge earnings and assets, innovation revenues).
- Growth prospects (e.g. product pipeline and launch dates).

Lev claims that it ought to be feasible for firms to develop specific indicators designed to measure these attributes and which could fulfill the following three criteria:

- (1) they are quantifiable;
- (2) they are standardised to facilitate across-firm comparisons; and
- (3) they are capable of empirical testing to establish their usefulness to users.

Lev is certainly not alone in making these claims or in calling for accounting reforms to more adequately disclose firms’ investments in intangibles. For example, the CEOs of the six largest accountancy firms have also suggested that because the market values of firms typically far exceed their book values this provides “strong evidence of the limited usefulness of statements of assets and liabilities that are based on historical costs” (DiPiazza *et al.*, 2006, p. 16). This same report calls for more “forward looking”, i.e. “predictive” information relating to:

[...] how well a company will perform in the future: innovative success [...] measures of customer satisfaction, product or service defects or awards, and measures of employee satisfaction (perhaps approximated by turnover) (DiPiazza *et al.*, 2006, p. 17).

However, what many advocates of reform appear not to take sufficient account of is that the conventional balance sheet is not (and never has been) intended to provide the basis for valuation. In fact, if valuation is the primary objective of the user of the financial statements, then, as shown by Penman (2007, 2009), even for firms that derive a high proportion of their value from their intangible assets, the profit and loss account (income statement) contains most of the information required to conduct an acceptable valuation analysis, e.g. information by which to estimate future revenues, earnings, and cash flows. Indeed, the focus on earnings by valuation practitioners could not be clearer. Wrigley (2008, p. 260), for example, having heard all the arguments of Lev and his academic critics at a recent workshop on the issue, concluded that:

The question is: "What is value-relevant?" To answer the question, we looked at the level of the S&P 500 compared to reported S&P 500 EPS going back over the last 130 years. This analysis gave us an R^2 of 96 per cent over this period, which seems to indicate that "earnings" are value-relevant. I appreciate that defining earnings is complex but most analysts, investment banks and fund management groups that I talk to have a very similar view on what constitutes earnings that they are "prepared to put a multiple on". The IASB should focus on giving us earnings numbers, robustly defined and clearly presented.

Nevertheless, there are many firms that appear to have experimented with both reporting the value of their intangible assets and/or have found it worthwhile to adopt some version of Kaplan and Norton's balanced score card methodology which incorporates value drivers and key performance indicators relating to intangibles for their internal control and management purposes. In his review of the empirical evidence relating to the performance of firms that utilize such tools and/or have voluntarily disclosed information relating to their intangible assets, Ittner (2008, p. 269) concluded that:

Although the bulk of studies provide at least some evidence that intangible asset measurement is associated with higher performance, many are limited by over-reliance on perceptual satisfaction or outcome variables, inadequate controls for contingency factors, simple variables for capturing complex measurement practices, and the lack of data on implementation practices. Future studies must take account of these research design issues if our understanding of the performance benefits from intangible asset measurement is to improve.

Whilst such firms remain a minority of the corporate population, their existence suggests that sufficient incentives already exist for firms to disclose information on intangibles without the need to impose additional reporting requirements on the majority of firms for whom the lack of intangibles reporting is not considered a significant issue. Even skeptics regarding the desirability of mandatory disclosures do not argue that firms, e.g. Scandia, that have invested heavily managing and reporting their intangibles have not found the exercise worthwhile or that firms ought to be discouraged from engaging in some experimentation with voluntary disclosures concerning their intangible assets if they perceive that this would be helpful in communicating more meaningful and relevant information to their stakeholders. An obvious and low-cost initiative that could encourage further voluntary disclosure experiments in this area might be for financial reporting standard setting bodies to consider developing some "safe harbor" provisions that offer a measure of legal protection from claims of potentially misleading investors.

A recent review by Skinner (2008), though accepting that the current financial reporting model does not adequately deal with the reporting of intangibles, argues that it is untrue that technology-based companies have experienced problems in raising capital for investments in intangibles – he cites the cases of Google and Cisco, two US firms that have very high-market values and which rely largely on their intangibles to generate profits. Indeed, he concludes:

[...] it seems to me that a major shortcoming of mandating disclosures in this area is to sensibly weigh the benefits of disclosures against their costs. Even if we could reach conclusions about how to measure the benefits of disclosure [and I would argue that we cannot] it would seem very difficult for accounting rule-makers to assess the costs of those disclosures. Moreover, these costs are likely to vary considerably across different firms and industries, depending on many factors. For example, the largest category of costs is likely to be proprietary costs, which are likely to vary greatly depending on the competitive position of different firms and industries. All of these issues may explain why standard-setters' current conceptual framework largely ignores disclosure, especially when not tied to recognition (p. 191).

3. SME cost-benefit considerations

As noted above, the case for reforms to the financial reporting model to take account of firms' use of intangibles is weak – particularly if valuation is the primary objective since the capitalisation of income provides this information. Given that firms are already at liberty to report such information voluntarily but that only relatively few actually choose to do so suggests that for the majority of large firms the likely benefits are not perceived to be sufficient to compensate for the complexities and the costs in managerial time and effort needed to produce the required information. Given the managerial and resource constraints typically confronting SMEs, it seems unlikely that the negative cost-benefit conclusions arrived at by most large firms in regard to greater disclosure of intangibles will be any less stark. Managerial and other limitations within SMEs make the measurement, management and development of knowledge and other intangible assets difficult and costly to achieve because of the absence of the necessary formalised systems of feedback, reporting and the detailed statistical information and monitoring systems necessary to underpin these practices. The high set-up costs associated with developing the above managerial infrastructure tends, therefore to result in most SMEs concluding that such intangible management systems will “not find a suitable home in a SME environment, and will typically be deemed ‘unworkable’ by SME management” (Huggins and Weir, 2007).

Coupled with the above characteristics is the frequent inability to separate out the owner-managers', typically central, multifaceted and often informal inputs from the high-risk business environment. With any significant non-zero probability of firm failure, the value of these owner-manager-related intangibles are clearly just as contingent upon the future prospects of the firm as the future value of the firm is dependent upon the ability to generate value from the intangible assets. Thus, these complexities over the identification and measurement of important intangibles and their relationship to changes in firm value tend to render the successful application of formal intangible management systems highly problematic, time consuming and seemingly capable of generating unreliable and meager outputs.

In summary, it is fairly evident that SME business strategies are typically largely dependent upon the intangible management skills, strategies and motivations of their owner-managers. These resources are, however, typically severely constrained and

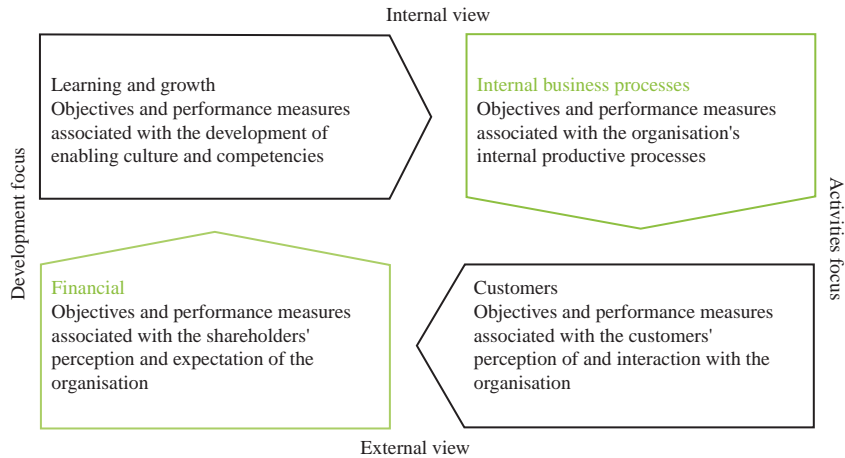
the identification and valuation of their specific components is fraught with conceptual and practical difficulties due to their highly uncertain and contingent nature, i.e. being largely inseparable from the current business environment and opportunities (as perceived by their owner-managers) confronting the firm.

Thus, whilst the current relatively low financial reporting environment may suggest that requiring SMEs to produce information concerning their holdings and usage of intangible assets increases the potential incremental value of such reporting to stakeholders, this presumed benefit needs to be considered alongside the likely costs, particularly the opportunity costs of the owner-managers time, and reliability of the resulting information. Moreover, as discussed above, the alleged feasibility and benefits to be gained from more extensive reporting of intangible assets, even for large high technology or “new economy” businesses, may be grossly overstated.

The above discussion suggests that extending the financial reporting regime to include the valuation and reporting of SME intangible assets is likely to produce few benefits whilst potentially being very costly in terms of its usage of scarce resources, namely the owner-manager’s time and energy and the financial costs of engaging outside professionals. Nevertheless, the general point that creating and growing any form of successful businesses today involves significant investments in intangible assets and requires their efficient management is fairly uncontroversial. It is also evident from the growing use of more inclusive management control and performance evaluation methods, such as the balanced score card and enterprise resource planning software, that the management of intangibles is seen as an increasingly important issue by businesses of all sizes. Moreover, the growing presence of specialist contractors that claim to be able to provide the tools and training for identifying, valuing and managing SME intangible assets suggests that there is a market for such services. At least some SMEs appear to have been persuaded that these services may be capable of passing the cost-benefit test. Survey evidence also suggests that some firms have achieved positive outcomes from the adoption of a balanced score card type management framework along the lines of that shown in Figure 1. The balanced score card has been found to be helpful and relevant in situations where cause and effect relationships and relevant key performance indicators relating to the four perspectives can be relatively easily identified and utilised as inputs and targets for achieving corporate goals. The fact that the survey evidence also seems to indicate that relatively few SMEs have actually adopted the balanced score card should not be surprising given the anticipated high set-up costs and limited incremental information benefits accruing to the majority of SME owner-managers over what their current decision support systems provide. The management and better exploitation of intangible resources is most likely to be a priority only for SMEs that are having to fundamentally alter their strategies and management practices as a result of growth and/or life cycle changes such as:

- prior to the initial business formation (start-up) stage;
- when new outside financial (equity and debt) capital is required;
- when the entrepreneur is seeking a public listing; or
- when she/he is attempting to sell the business, say when wishing to move on or retire.

Prior to actually setting up the business, potential entrepreneurs are much more likely to have the time to devote to thinking and planning their business idea than after the



Notes: Balanced Scorecard quadrants: the balanced scorecard consists of four interrelated quadrants, each containing measures for a distinct perspective; these perspectives are: financial; customer; internal processes; learning and growth; these four perspectives are designed to cover the whole of the organisation's activities, both internally and externally, current and future

Source: CIMA (2007, p. 4)

Figure 1.
Overview of the balanced score card framework

business has commenced trading. In addition, setting up and managing intangibles asset registers, the initiation of key performance indicators and the training of employees all ought to be relatively unproblematic if done from the outset of a business's life. With an intangible asset management programme already in place, further enhancements to an existing working system ought to require relatively little in the way of incremental costs or management resources as the business develops. The potential entrepreneur could therefore probably greatly benefit from educational initiatives that provided at least an introduction to a systematic framework that allowed them to focus on how to determine precisely the dependence of their anticipated business model upon the efficient use and management of intangible assets. Such educational initiatives could, of course, be relatively cheap to engineer. For example, it could simply consist of an additional module to an existing business start-up training programme and could usefully include access and training using the commercially available decision support software. As many governments and local authorities already believe that educational assistance along these lines is a good use of public funds in the expectation that it encourages new firm formations and/or enhances innovation and employment growth, the addition of an intangibles measurement and management module should be fairly uncontroversial.

Perhaps, the circumstances where an intangible asset valuation and management programme could be expected to produce the most significant benefits to an SME concerns the raising of new equity and debt finance from formal outside financiers. This is most obvious in the case of SMEs seeking new venture capital or when seeking a public listing for the first time. In both situations, potential investors will be particularly interested in the quality of the management team, the firms' primary sources and the sustainability of its competitive advantage and its potential for profitable growth. The existence of an already functioning intangible asset valuation

and management programme would clearly be reassuring for such outside investors and could also significantly reduce the costs and time involved in undertaking their own due diligence work in this area.

In contrast, the relative lack of easily sellable and clearly defined intangible assets that either generate an identifiable income stream and/or are adequately protected by patent or copyright laws, tends to increase the cost of obtaining debt capital. This is because, given its correlation with business risk, the owner-manager's human capital inputs cannot realistically constitute a reasonable form of loan collateral by potential debt suppliers. Similarly, in the situation where the owner-manager is wishing to exit the business via a trade sale, the existence of a credible intangible asset management system ought to be helpful in achieving the best possible price for the business and for highlighting the areas where the loss of the former owner-manager is most likely to require new investments in intangible assets such as developing new supplier and customer relationships. Finally, whilst relatively few of an SMEs intangible assets are likely to consist of intellectual property or patents for which it might be realistic to expect that there is a ready market for, where the firm does in fact have such assets then it is possible for these to be used as collateral for obtaining cheaper and more plentiful debt finance (EU, 2006) and/or obtaining favourable credit terms from suppliers.

In each of the situations described above post the commencement of the business, it is clear that the owner-manager(s) can be expected to have strong incentives to seek out and to provide the required information to potential outside parties. Moreover, it is also the case that outside vendors are available and willing (admittedly for which may seem like a high price) to produce the information and to supply the management software and training of employees. Hence, in contrast to the pre-start-up situation where educational initiatives to encourage potential entrepreneurs to take seriously these issues may constitute a reasonable use of public funds, it is unclear whether there is a strong case for supposing that there is a significant market failure, unmet demand for or some other reason which would justify public policy initiatives to encourage the use of or to subsidize such services to established SMEs that are simply wishing to increase their access to external finance or to assist owner-managers to obtain the highest possible price upon exiting the business.

4. SME case studies of intangible asset management practices

In this section, a recent study by Huggins and Weir (2007), which applied intangible-intellectual valuation and management systems to SMEs in Scotland, is summarised and its implications discussed. Huggins and Weir (2007) examine "the role of public policy in stimulating both the supply and demand for intellectual asset management amongst the SME community in Scotland". Based upon the results of their "Regional Intellectual Asset Index for the UK", Huggins and Weir hypothesize "that a deficit in the IA capabilities of firms in Scotland is having a detrimental impact on the overall economic competitiveness of the region". They then describe the, largely experimental, public policies that have been initiated to encourage SMEs, to identify, exploit and manage their IA. The particular policy initiative that they focus on was managed and implemented by the "Intellectual Asset Centre in Scotland" (IACS), which was established by the Scottish Executive in 2004[7] "as means of alleviating a perceived market failure in the area of IA management in the region".

The initial motivation for this initiative seems to have been some notion of market failure; basically, due to the undoubted complexities and difficulties associated with intangible asset valuation and management practices, “a plethora of measurement methods, indicators and approaches” had developed which SMEs found confusing and hence were unwilling to invest the necessary time and effort in mastering. The IACS had the objective of helping SMEs to identify, exploit and manage their IA and the programme Huggins and Weir were involved with consisted of:

[. . .] a series of projects designed to assess current levels of IA awareness and understanding among Scotland’s SME community, and to develop innovative tools that could help SMEs better understand the value drivers within their business. Furthermore, the projects were designed to provide a suite of tools for use in stimulating the IA advice supply market. Overall, the programme is necessarily closely aligned with the overall objectives of the IA Centre to champion and support issues relating to IA and their importance to Scotland.

The programme had two main phases of activity; Phase 1 was concerned with “the scoping and development of a variety of IA tools, with a strong focus upon IA awareness raising amongst the Scottish SME community. These activities included the benchmarking of Scottish SME awareness and understanding of IA, and the development of a suite of audit, benchmarking, and know-how capture tools was open-ended and allowed for experimentation and creative thinking”. Phase 2 consisted of following up the participating firms to assess whether the IA management, tools were “coherent, consistent and offered SMEs a natural progression from IA identification to management support”.

One of the “key tools” that was developed and tested was an “IA audit tool” which required the participating SMEs to report “the criticality, applicability of protection, and levels of expenditure in relation to a range of IA factors, followed by an assessment of the utilisation of the various IA in relation to strategic objectives”. To supplement this Audit Tool, the programme included a “IA fast track audit” for a number of “invited” SMEs which provided “more intensive support and interaction in assisting them to correctly interpret their IA audit results. This process included producing a narrative form of IA capture, supporting the creation of IA initiatives and outcomes statement, as well as having face-to-face feedback from a visiting international team of IA experts”.

An “IA Benchmarking Tool [. . .] designed to satisfy SME needs for simple, intuitive and informative tools that could raise awareness of IA within an organisation, encourage consideration of its strategic importance, and aid companies in gauging their intangible value drivers, both currently and over time, as well as internally and externally” was then developed. The authors claim that this tool allowed “for a comprehensive score that assesses the extent to which a company holds or owns a stock of a certain asset, how effectively staff and managers use the asset in question, and finally, the importance of this asset to the current and future performance of the organisation”.

Huggins and Weir report that the final set of IA tools consisted of “inter-linked web-based know-how capture tools” which were developed with the specific aim of “assisting SMEs to identify those intangible assets that are of most value to their business, and allow them to drill down and prioritise their know-how/show-how and explore ways in which these may be exploited to create new value”.

Huggins and Weir then interviewed the SMEs that took part in the IACS programme to gauge the extent to which they felt that they had benefited from the exercise. Whilst IA knowledge and interest had clearly increased in both the

participating firms and more generally throughout Scotland it was clear that relatively few of the sampled firms had the intention of continuing using and developing the IA tools. Thus, even amongst these, presumably highly motivated, “early adapters” it was apparent that the perceived benefits in terms of positive business outcomes was limited. Indeed, the absence of any discernable performance improvements, the doubts about whether to continue with the IA tools, coupled with “positive feeling about the exercise” reported by the participating firms can probably be attributed to no more than the usual short-term “Hawthorn effects” arising from the attention these firms received from a wide range of “IA experts”, researchers and public officials.

Huggins and Weir seem aware of the above limited impact and suggest that these results provide “an important insight into the organisational and development processes that must accompany tool use before it might be confidently predicted that positive business results are likely to be accrued”. They go on to suggest, however, that the use of case studies may be particularly valuable in the event that such policy initiatives are rolled out elsewhere because “SMEs may be more likely to engage with IA where they are able to view case studies of companies in their sector that have effectively invested time and resources in the development of their IA, and have reported tangible benefits. It will only be possible to engage SMEs in devoting precious and limited time and resources to the subject if a business case can be made”.

5. Summary and concluding remarks

It is fairly uncontroversial to claim that, even amongst the SME sector, many contemporary business models rely upon the efficient exploitation and management of a wide range of intangible or intellectual assets. It also appears to be generally agreed that the current financial reporting framework does not generally include information on corporate intangibles unless such assets have been purchased from a third-party vendor, e.g. goodwill upon acquisition, purchased brands, etc. As we have suggested, however, the further claims that firms have been denied favourable access to finance and/or have otherwise underperformed their potential simply because of these financial reporting limitations and that this therefore justifies reforms to the financial reporting regime are somewhat more controversial[8]. The evidence of underperformance is not convincing, not least because the income statement tends to provide a reasonable degree of relevant information for estimating future cashflows and hence value.

SME capacity and other management resource constraints would seem to imply that encouraging SMEs to produce and report more extensive information on intangibles is unlikely to be welcomed, not least because much of the information would most likely not be either understood or be perceived as relevant to the majority of SME decision makers. Also committing corporate resources to the identification and reporting of intangibles may prove to be disproportionately costly for SMEs due to the high set-up and fixed cost components associated with supplying such services.

Whilst intangibles valuation and its implications for future performance are essentially what many active or sophisticated investors, such as venture capital or buy-out specialists, have to produce and evaluate, there is no compelling evidence of a market failure in this regard. Outside of situations that require the production of a financial prospectus, for example, when seeking outside investors or a first-time listing on a stock exchange, it seems that formal intangible valuation concerns are unlikely ever to be relevant for the majority of SMEs.

The typical ownership, management and motivations of SME owner-managers and the case study evidence from Huggins and Weir suggest that in the majority of cases the time and resources needed to produce and manage a viable intangibles asset management system tend to far outweigh the likely benefits to be derived from such an exercise. There are clearly circumstances where a sound knowledge of and evidence of the operation of a formal management programme in relation to a firms' intangibles may be worthwhile in order for the firm to obtain outside finance and/or to sell on the business to an outside party. However, none of these circumstances on the face of it suggest that the expenditure of public funds to facilitate or to subsidise such a service is required. Further research in this area would of course, be helpful in determining whether there are, as yet unidentified, long-term benefits in terms of job creation and/or innovation associated with exposure to such intellectual capital management programmes.

Notes

1. For a recent review of current thinking in the area, see Mahdon *et al.* (2007) and Blaug and Lekhi (2009).
2. This notion of a "finance gap" and other "market failures", as will become apparent later in the paper, appears to be one of the main justifications put forward by local development agencies for supplying educational and other intellectual capital consultancy services to SMEs.
3. For a detailed analysis of the practical issues associated with implementing an intellectual capital management programme (CIMA, 2003, 2007).
4. A recent paper by Huggins and Weir (2007) provides a summary of the types of intangibles most frequently found in SMEs and the ways in which they could be best managed and measured.
5. For a review of the unique governance and management characteristics of SMEs (Keasey and Watson, 1993).
6. Management accountants have long recognized that for many products, the proportion of indirect overhead costs has tended to increase as firms make greater use of intangible investments to produce their output and to manage their business strategies. Such observations, driven by increased product complexity and often arising from the adoption of mass customization strategies, led to the development of new costing and performance management techniques such as activity based costing and the balanced score card designed to produce more strategy relevant costing information and key performance indicators that recognized the intangible value drivers of the business (Kaplan and Norton, 1996).
7. This initiative was also partly funded by the European Development Fund.
8. The notion of a "finance gap" in relation to SME debt and/or equity finance is of long standing despite the fact that the empirical evidence suggests that SMEs with good collateral and/or good prospects do not generally experience acute difficulties in obtaining finance (Keasey and Watson, 2000).

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Corresponding author

Robert Watson can be contacted at: robert.watson@ie.edu

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