



Intangible Asset Monetization

The Promise and the Reality

Executive Summary

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About Athena Alliance

Athena Alliance is in the vanguard of identifying, understanding, analyzing, and educating on the information, intangibles, and innovation (I³ or I-Cubed) economy. Information, knowledge, and other intangibles now power economic prosperity and wealth creation. Intangible assets—worker skills and know-how, informal relationships that feed creativity and new ideas, high-performance work organizations, formal intellectual property, brand names—are the new keys to competitive advantage. Intangibles and information drive our innovation process, a combination of formal research and informal creativity. These elements combine to produce productivity and improvement gains needed to maintain prosperity.

While the economic rules have changed, public policy has not caught up. Governments are struggling with ways to utilize information, foster development of intangibles, and promote innovation and competitiveness in this new economy. Policymakers are grappling with the urgent need to frame policy questions in light of the changing economic situation.

Issues of developing and utilizing information, managing intangibles, and fostering innovation underlie discussions on a variety of subjects, such as intellectual property rights, education and training policy, economic development, technology policy, and trade policy. Crafting new policies in these areas requires infusing a better understanding of intangibles and the information economy into the public debate.

As a nonprofit public policy research organization, Athena Alliance seeks to close the gap between the changed economy and current public policy through activities to reshape the debate and craft new solutions. Recent activities include working with the District of Columbia to create an innovation-led economic development strategy; co-hosting Congressional luncheon briefings; co-hosting a DC-based conference on innovation in India and China with the National Academy of Sciences; co-hosting a New York City-based conference on the financial reporting and intangibles with the Intangible Asset Finance Society; and publishing policy reports on intangible assets, including *Reporting Intangibles* (2005) and *Measuring Intangibles* (2007).

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Executive Summary

The economy of the United States is now largely driven by intangible assets. These assets include worker skills and know-how, innovative work organizations, business methods, brands, and formal intellectual property, such as patents and copyrights. They are producing an economy very different from the one of the past. As the U.S. moves away from a manufacturing-based economy and toward a technology-and-innovation driven one, intangible asset investments are becoming vital to economic growth and sustainability. Just as physical assets were used to finance the creation of more physical assets during the industrial age, intangible assets should be used to finance the creation of more intangible assets in the information age.

Intangible assets show up in the financial system in various ways. They are valued—often implicitly, sometimes explicitly—in financial markets by analysts, in stock prices, in ratings by credit agencies and for private lender programs. Mechanisms for raising capital based on intangibles already exist, including securitization, lending, licensing, and outright sale. Recent financial innovations have better captured intangibles in the financial markets.

But the evolution of robust capital markets that both utilize and support intangibles has been slow. Intangibles are still not can be considered on the balance sheet nor given due credit for playing a vital role on the income statement. Intangible assets have no standardized financial tools to capture their value. Each intangible asset financing deal seems to be a unique, one-off event employing differing models to determine the assets' value. The associated perceptions of risk—in some cases exacerbated by actual events, such as the subprime mortgage meltdown—have greatly hampered the utilization of intangibles in capital markets.

As a result, companies are missing substantial capital resources that could be used for business expansion or innovation investment. To effectively realize the significant potential of intangibles, industry standards and government regulations need to promote the acceptance, use, and dissemination of intangible assets in the economy.

A number of factors must be considered by the financial markets to determine the suitability of an asset, including asset recognition, valuation, separability, transferability, duration, and risk. However, management and capital markets have failed to solve the very real problem of valuation, which severely undermines attempts to create financial leverage for the asset. This valuation deficit must be remedied for businesses and the economy to remain fully viable and sustainable over the long term.

Despite these drawbacks, intangible asset monetization could be the key that unlocks a vault of unexplored, exciting, and extremely useful sets of financial risk-mitigation instruments.

A secure, open, transparent, fair, and efficient capital market for intangible assets depends on government and independent regulatory bodies playing an active role. Yet

very little public or private research exists that clearly explores this asset class. Thus, the greatest potential contribution from public policy may be to raise awareness and encourage utilization and better understanding of all facets of intangibles.

Beyond this basic need, numerous other actions are required to change the situation. There is no magic bullet; no single government or industry action will resolve all the issues. But policymakers play a key role in promoting acceptance, use, and dissemination of intangible assets in the market. Areas in need of attention include patent reform, securities definitions, banking regulations, perfection and bankruptcy laws, technology policy and tax policy. Industry standards and procedures also need attention, especially in valuation.

Some key policy actions include:

- Reinstating the joint Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) research project on expanded disclosure guidelines for intangibles.
- Convening a special FASB/Securities and Exchange Commission (SEC) task force on the valuation.
- Creating a safe harbor in financial statements for corporate reporting of intangible assets.
- Exploring the creation of an Intangibles Mortgage Corporation (Ida Mae) to regularize the intangibles-backed securities market, either as a limited government-sponsored enterprise (GSE) or as an independent organization.
- Creating a national central registry of intellectual property security interests.
- Creating a permanent knowledge tax credit that would increase investments in intangibles.
- Exploring lowering the tax rate on intangible asset royalties, in conjunction with stricter regulations on international transfer pricing mechanisms and cost-sharing arrangements and on passive investment companies.
- Enacting patent reform legislation and including a review of patent litigation and patent liability insurance.
- Reviewing how the federal technology transfer system, including Bayh–Dole, does or does not facilitate the creation of intangible assets.
- Reviewing the Basel II Accords to better understand their implications for intangible-backed lending.
- Reviewing federal government business loan programs, especially in the small business arena, to ensure that intangible assets can be used as collateral.
- Coordinating with ongoing efforts at market reform, such as the President’s Working Group on Financial Markets, to ensure that intangible-backed assets are properly included.

Perhaps the single most important step is the recognition that intangible assets are not covered in existing financial structures. Our economic policies and regulatory systems, public and private, are still largely set up to accommodate the tangible assets of the industrial era—buildings, fixed resources, and machinery. This is not surprising; these systems have evolved over the past couple of centuries as the industrial revolution unfolded.

Today, intangible assets—knowledge, ideas, skills, relationships, and organization—have come to underpin value creation; their monetization is now essential. But this will require newly relevant policies and structures that unleash the economy from the strictures of the past and pave a new way forward for financial success in America and around the world. The opportunities they portend make the recognition, valuation, and utilization of intangibles essential to the success of U.S. enterprises and prosperity of the U.S. economy.

The complete report is available at www.athenaalliance.org.