



A Dynamic Mechanism of Value Creation: A Model for Intangible Assets

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ABSTRACT

The focus of this paper is importance that intangible assets play in creating value. The model "A Dynamic Mechanism of Value Creation" presented in this paper shows how intangible assets create and extract value. In addition, the important role accounting must take in order to disclose the profit and loss and the financial state to all interested parties inside and outside of the company is brought out.

INTRODUCTION

Intangible assets, particularly knowledge-based assets are recently recognized not only as a motivator that enhance the achievement of an enterprise, but also are considered a part of the goods that an enterprise supplies. For goods and services value is added by the following: technological knowledge, innovation, customer relations, and these are all based on knowledge.¹ This knowledge is significant because investors and creditors use it to make decisions. When evaluating the high technology industry, the fact that human capital is related to the value of the intellectual property rights (IP) is recently gaining in importance.²

As for IP, a brand contains human property, a client list, employee, supplier and the leadership at the top. In addition it also consists of patents, trademark rights, design rights, and copyrights. These intangible assets should be disclosed in the financial statements. However, the International Accounting Standard 38 (IAS) only recognizes a few intangible assets. This paper looks for possible ways for intellectual assets, human capital and intellectual property to be recognized.

THE IMPORTANCE OF KNOWLEDGE ASSETS

Not only patent on goods, but also patent on business process plays an important role for competition predominance. The importance of intangible assets was a frequent topic of discussion in the 1990s. Itami & Roehl pioneered research in Japan on intangible assets and from their findings they defined intangible assets as follows: "Unattainable with money alone, are capable of multiple, simultaneous use, and yield multiple, simultaneous benefits."³

This paper details later how this definition is important for our model. The unlimited source of intangible assets is supported in "The Knowledge Company" written by the true pioneer on intangible assets, Karl-Erik Sveiby in 1986.

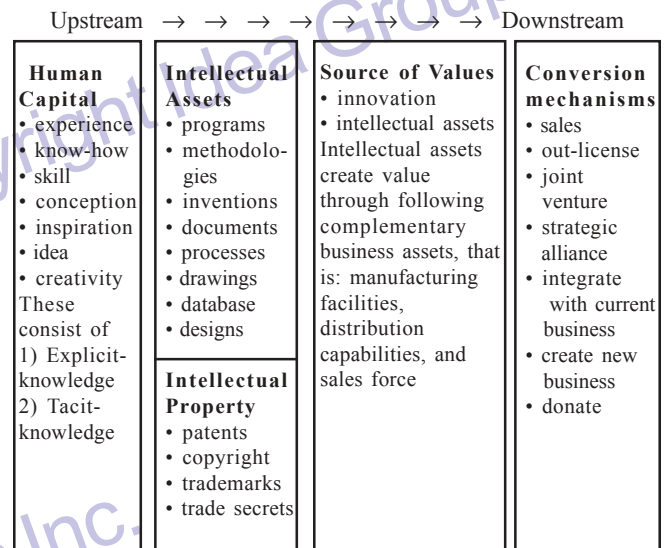
"Managers in some of the fastest growing and most profitable business focus on knowledge, see their business from a knowledge perspective, and act as if their intangible assets are real assets. By freeing themselves from the mental straitjackets of the industrial age, some of these pioneer managers have found, seemingly by accident sometimes, a wellspring of limitless resources arising from the infinite human ability to create knowledge and from the convenient fact that, unlike conventional assets, knowledge grows when it is shared."⁴

In the 1980s, the viewpoint of business strategy was based on the competitive forces generally proposed by M. Porter and others. The strategic form was considered as a relation with the enterprise and the competitor's environment. American researchers developed the viewpoint of efficiency on how to use the resources of the company and which of those resources to consider. Porter and others believed the driving force lies in what we refer to as the "downstream" of business strategy, but our model purposes that intangible assets at the "upstream" of business strategy provide the vital path to produce increased profits downstream.

THE MODEL OF THE RELATIONS BETWEEN INTELLECTUAL CAPITAL AND INTELLECTUAL PROPERTY THAT CREATES PROFIT

By the middle of the 1990s, it became clear that there were two paths related to the treatment of intellectual capital. The first focused on knowledge and intellect (up stream), with the idea of expanding and creating knowledge of the company. The other was based on a resource perspective (downstream) that focused on how to create a profit by combining the company's knowledge resources in a unique combination. The mechanism that intellectual property drives value is presented in the model in Figure 1 to show how the stream flows to create expanding profit potential.

Figure 1: Stream flow to create expanding profit potential⁵



Note that the debit side is intellectual assets and the credit side is human capital, however, they are not balanced. Imagine a convex lens; after the image passes through the lens, it expands at an ever-increasing rate as the distance increases. In terms of our model, the intellectual assets extract a larger sum from human capital, so we call this relation "A Dynamic Mechanism of Value Creation."

Human capital is Stewart's "collective brainpower" argument. Human capital produces a larger knowledge-asset, leading to increased profits. Human capital consists of explicit knowledge and tacit one. It becomes the source of the intellectual assets creation. Intellectual assets are the source of values and with this cause-effect relationship a

profit is realized. These are the starting points to classify the relations between human capital, intellectual property and creating profit.

ENDNOTES

1. "The Wisdom Wealth Account Reportage of the Shock: a central public argument" 2001 January issue Chuokoron-sha Inc. 2001 304 pages.)
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3. Itami H. and Roehl T.W. Mobilizing Invisible Assets. Harvard University Press, 1987. pp.12-13.
4. Sveiby K. E. The New Organizational Wealth: Managing and Measuring Knowledge-Based Assets. Berrett-Koehler Publishers, 1997 pp.x.
5. Sullivan, Patrick H. Value-Driven Intellectual Capital How to Convert Intangible Corporate Assets Into Market Value. Wiley/Arthur Andersen, 2000.

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