

# Reputation is the new IP

Intellectual assets create the conditions under which corporate reputation can be developed in ways that will significantly enhance shareholder value

By **Todd Miller** and **Nir Kossovsky**

Last year, Alan Greenspan, a former chair of the US Federal Reserve Board, noted: “In a market system based on trust, reputation has a significant economic value.” In a previous issue of this magazine (“IA metrics for the other IP market”, *IAM* 36, June/July 2009, pages 47-51), we argued that the business processes which drive ethics – innovation, quality, safety, sustainability and security – create reputation and are intellectual properties (IP). These processes are also intangible assets (IA). In this article, you will learn why reputation is the new IP.

That provocative statement has different meanings based on whether your background is in IP, marketing or risk management. We challenge traditional ideas of how patents, trademarks, PR and insurance relate to corporate value because changing business conditions necessitate a shift in our collective thinking. We also show that reputation is valued and valuable, can be measured and quantified; and that those metrics can provide extra-financial feedback on business process management.

## **Demand for reputation protection**

Second to managing cash, managing corporate reputation is today’s primary business concern. According to a 2009 Harris Interactive Poll, corporate reputation is at a 10-year low. In an annual reputation quotient survey, 88% of respondents rated

corporate reputation “not good” or “terrible”. Additionally, The Conference Board reported this year that assessing reputation risks was the highest-ranked corporate challenge. Exactly 82% of risk managers surveyed said their companies are making substantial efforts to manage reputation risk and have increased focus in this area over the past three years. McKinsey & Company, in its June 2009 study, concluded that: “Companies must step up their reputation-management efforts.” It noted specifically that: “Reputations are built on a foundation not only of communications but also of deeds: stakeholders can see through PR that isn’t supported by real and consistent business activity.” Put another way, PR that is anything less than performance and reporting – doing something valuable and telling target audiences about it – is a waste of scarce resources (see Table 1).

## **Business activity and reputation risk**

Reputation is the impression that stakeholders form. It is based largely on how a company manages its IA – the business processes that:

- Create an ethical work environment.
- Drive innovation.
- Assure quality.
- Uphold safety.
- Promote sustainability.
- Provide security.

Collectively, these business processes and their embodiments in brands, trademarks and patents comprised about 70% of the median value of publicly traded companies through late 2008, and currently account for about 50% of their market capitalisations (“The reputation and intangible asset value crash of 2008”, *IAM* 34, February/March 2009, 38-41). As with

## **IAFS**

This article is sponsored by the Intangible Asset Finance Society’s (IAFS) Member News Committee. IAFS’s ([www.iafinance.org](http://www.iafinance.org)) objectives are to increase the visibility, transparency and value of intangible assets (IA) through education, advocacy and the promulgation of standards. The Member News Committee hosts a monthly call featuring, on a rotating basis, each IAFS operating committee. This paper is based on a presentation delivered by Nir Kossovsky, Executive Secretary of the Society, on 10 July 2009. An audio recording is available for purchase and download from the IAFS. *IAM* magazine, a Globe White Page Ltd publication, is the IAFS media partner. *IAM* magazine publishes in each issue a contribution from IAFS on a noteworthy IA finance matter. Visit the Society’s blog, Mission: Intangible, at <http://www.iafinance.org/BlogRetrieve.aspx?BlogID=419>

Definitions	
<b>Reputation</b>	<ul style="list-style-type: none"> <li>Perception owned by stakeholders</li> <li>Shaped by a company's IA stewardship</li> </ul>
<b>Intellectual property</b>	<ul style="list-style-type: none"> <li>Knowledge assets (patents and trademarks are artifacts)</li> <li>Includes the business process that comprise IA</li> </ul>
<b>Corporate value</b>	<ul style="list-style-type: none"> <li>Market capitalisation</li> </ul>
<b>Business processes</b>	<ul style="list-style-type: none"> <li>Intangible assets</li> <li>Critical ones guide behaviours affecting ethics, innovation, quality, safety, sustainability and security</li> </ul>
<b>Intangible assets</b>	<ul style="list-style-type: none"> <li>Roman arch assets subject to <i>Yellow Taxi</i> valuation</li> </ul>
<b>Risk</b>	<ul style="list-style-type: none"> <li>Adverse event arising from a business process failure</li> <li>Negatively impacts reputation</li> </ul>

Table 1. Reputation factoids

<b>Companies must step up their reputation-management efforts</b> McKinsey Quarterly, June 2009
<b>Risk management board committees – require boards to appoint special committees to oversee risk management</b> Draft legislation, US Senate bill S1074, May 2009
<b>Assessing reputation risks was the highest-ranked corporate challenge</b> <i>Managing Reputation Risk and Reward</i> , The Conference Board, Report number 1442-09-RR, 2009
<b>Corporate reputation is increasingly able to either generate or rapidly destroy shareholder value</b> The Conference Board Research Report number R-1412-07-WG, 2007

the stones in a Roman arch, however, the failure of any one IA can precipitate acute destruction of a company. There are myriad examples of how the loss of reputation destroys value, especially in the financial services sector, which has been top-of-mind lately. Casualties include Anderson, Bear Stearns, Lehman Brothers and AIG.

Business processes are intellectual properties and intangible assets. As IAs, therefore, business processes defy valuation by conventional accounting methods. Nevertheless, their value becomes manifest upon loss. Recognising the value of IAs only after they are lost is a miserable value proposition. The sorrow – as Joni Mitchell memorialised in her 1970 song *Yellow Taxi* with the words, “Don’t it always seem to go, that you don’t know what you’ve got ‘til it’s gone?” – has an impact on all stakeholders adversely.

**Reputation is the new IP**

If IP underlies all business processes and is also the source of value creation, why is reputation replacing IP as a measure of a company's value? The short answer is market interest. Figure 1 shows the evolutionary path linking IP to value over the past 40 years. In the first period, when IAs comprised only 20% to 30% of a traded company's value, IP was memorialised in patents that gave exclusive rights to their owners to extract value from the covered products and services. In the second period, when IAs rose to a median 70% of enterprise value, IP was linked directly to value and an entire industry grew up around IP monetisation. Now, we are beyond that phase and we see IP underlying business processes that support reputation. It is in the embodiment of reputation that IP now represents about 50% of the median value of publicly traded companies.

There are three pieces of evidence suggesting this evolution is taking place and reputation is becoming the new IP:

- One, Google offers an analytic service

that tracks global searches of terms and phrases, and ranks them on a normalised basis, adjusting for the total volume of searches. Since 2004, the frequency of searches for “patents” and “intellectual property” has been declining, while searches for “reputation” have been rising (Figure 2).

- Two, language used in print and online stories targeted to business and professional audiences shows a similar trend, in which stories on IP management are being outnumbered by stories on reputation management. Extrapolating annual trends, in 2009, there will be more than twice as many stories concerning the latter.
- Three, on the premise that patent filings reflect an expectation of emerging sectors of commercial value, the number of US patents filed containing the phrase “reputation management” has increased substantially in the past three years to an extrapolated annual filing in 2009 of nearly 20 (Figure 3).

**A good reputation is valued for good reasons**

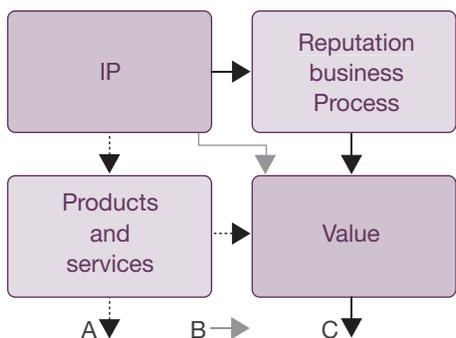
From a behavioural perspective, reputation creates an expectation for future behaviour. In a commercial context, it creates an expectation of behaviours among stakeholders. Exemplary expectations impact on cash flow and cash demand such that:

- Customers will be motivated to pay a premium.
- Employees will be attracted and will accept lower pay and non-cash compensation (options).
- Vendors will offer superior terms.
- Internal operations will occur with less friction.

The desired impact on enterprise value includes:

- Investors will bid up the earnings multiple.
- Uniformity of expectations is likely to reduce value volatility.

Figure 1. IP-based pathway to value



**A: Pre-1985**

Typical of the late '70s and '80s, value from IP arose through the exclusionary power of patents.

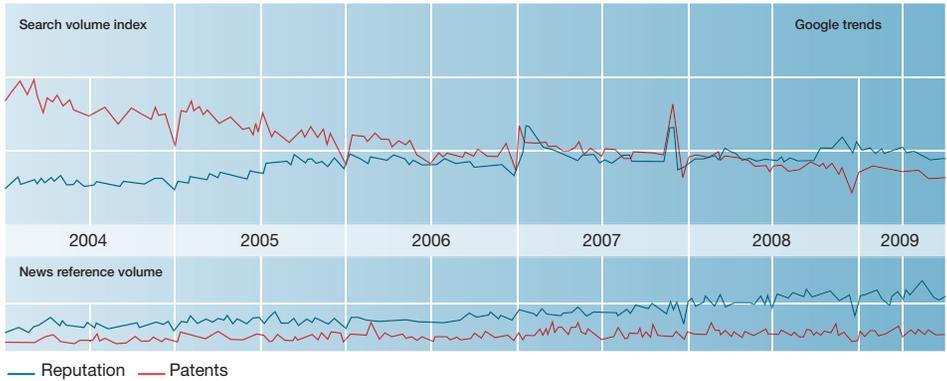
**B: 1985-2008**

Typical of the late '90s and early part of this century, value from IP was extracted through a host of monetization strategies, of which only some involved making or using IP.

**C: 2009+**

Arising in 2008-09, value in IP manifests through the business processes that create and uphold reputation.

Figure 2. Rising market interest in reputation



**Google search trends 2004-2009**

Frequency of searches (upper) and news items (lower) for patents and reputation

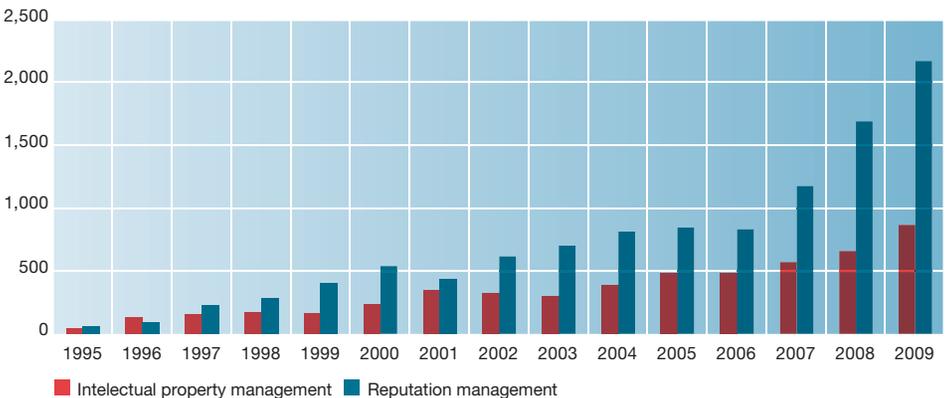


**Google search trends 2004-2009**

Frequency of searches (upper) and news items (lower) for intellectual property and reputation

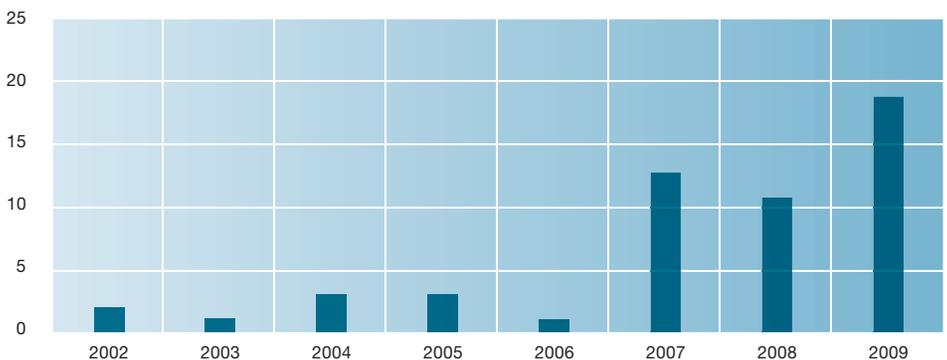
*The data show that both search interest and news reporting of reputation are on the rise while search interest in both patents and intellectual property is declining*

Figure 3. Rising market business focus on reputation



**Lexis term trend 1995-2009**

Lexis searches of the terms “Intellectual Property Management,” and “Reputation Management” in a combined database of major newspapers and periodicals. The number of times that each term appeared in a given year is shown (2009 values extrapolated from partial year data)



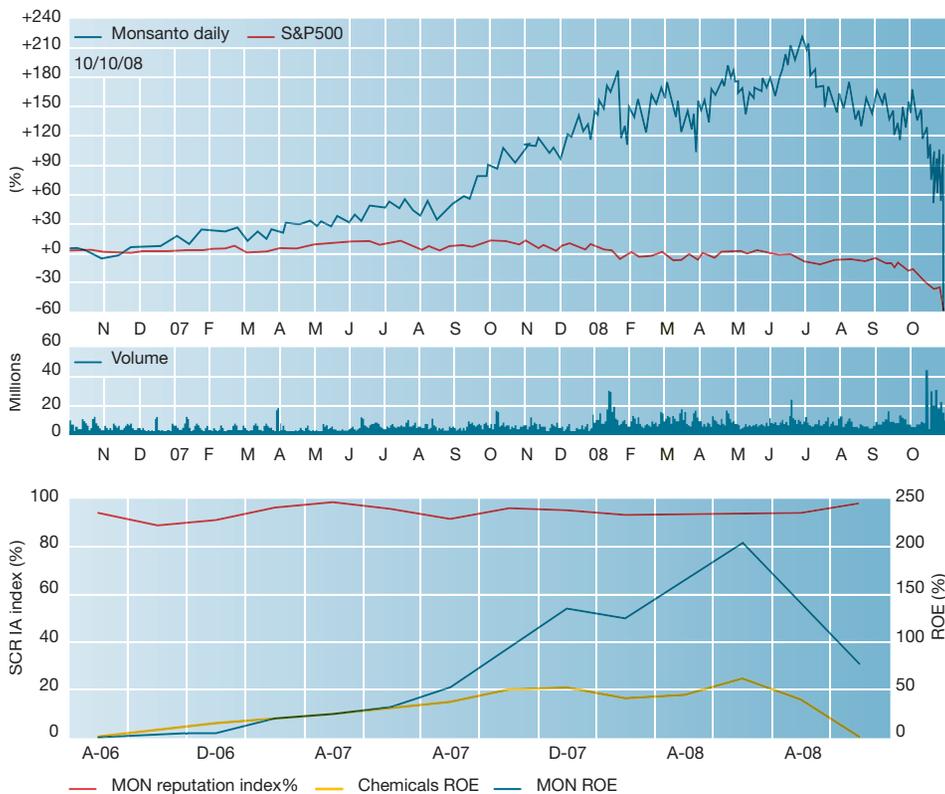
**USPTO patent application filings 1990-2009**

Patent applications filed with the USPTO containing the phrase “Reputation Management.” There are no filings prior to 2002

As reputation became a factor of increasing importance to Wall Street, Monsanto's performance relative to the S&P500 improved dramatically

The Steel City Re Reputation (IA) Index ranking for Monsanto (red line and left axis) which is at or near the top for companies in the Chemical sector, the financial return on equity (ROE) for Monsanto (blue line), and the chemical industry median ROE (yellow line)

Figure 4. Stock price and reputation index data, Monsanto (NYSE:MON)

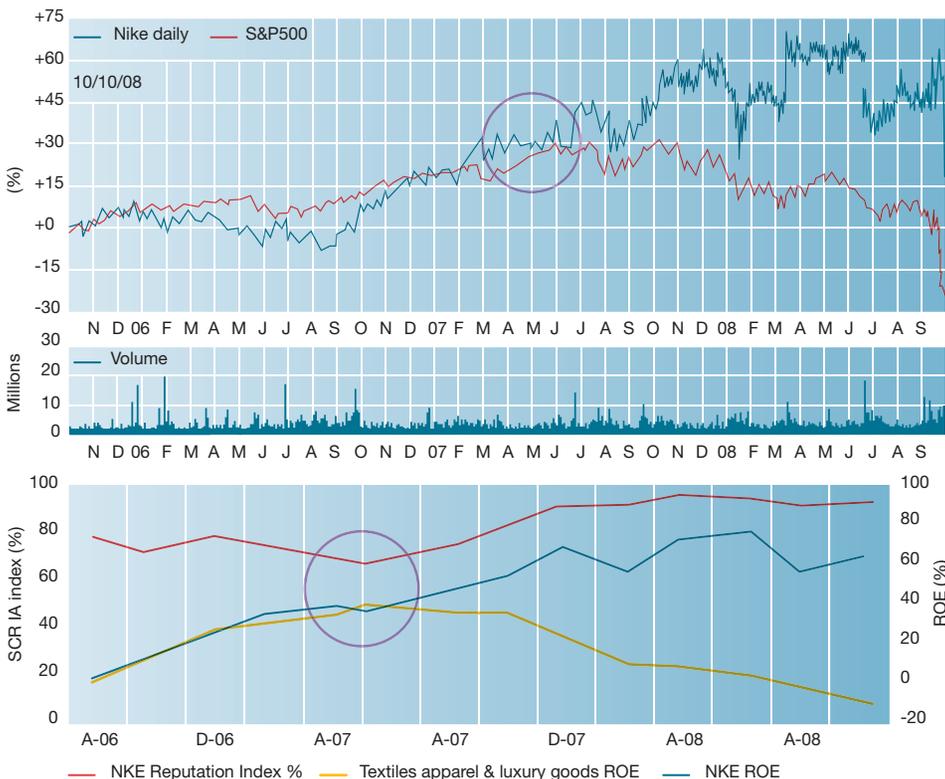


Data source: Big Charts; Steel City Re

Nike's stock price (in blue), under pressure from headline risk, tracked the S&P500 (red) until its dramatic announcement in May 2007, marked with the red circle

The Steel City Re Reputation (IA) Index ranking for Nike (red line and left axis) which jumped from the 70th percentile to the mid 90th percentile among firms in the textiles apparel and luxury goods sector, the financial return on equity (ROE) for Nike (blue line), and the textile apparel and luxury goods industry median ROE (yellow line). The announcement and deployment of underlying business processes (i.e., IP) boosted Nike's reputation ranking and enterprise value within weeks

Figure 5. Stock price and reputation index data, Nike (NYSE:NKE)



Data source: Big Charts; Steel City Re

## “ Holistic IP management comprises corporate reputation protection and operations-level monetisation of IP and other IA ”

Furthermore, these *expected* behaviours among stakeholders are linked closely to executive reward. For example, stock price, a basis for retention or dismissal, is forward looking. Similarly, equity-based compensation, such as options, is forward looking, and cash-based bonuses are affected by stakeholders' expectations, which correlate with cash flow and cash demand.

IP is at the heart of this model for creating a favourable reputation because it underlies the products and services which support a business. Consumer surplus, superior operations with lower costs and improved capital market performances that distinguish the competent from the incompetent and reward the outstanding are the results of superior IA management, which is synonymous with reputation.

### Case studies

Markets have rewarded companies investing time and effort to deploy new IP for increasing, protecting or restoring their reputations.

Monsanto (NYSE:MON), a global provider of agricultural products, provides farmers with seeds, biotechnology trait products and herbicides to produce foods for consumers and feed for animals. In days of old, this company's reputation was challenged by products such as Agent Orange, Roundup Herbicide and recombinant bovine growth hormone in milk. In 2002, the company announced an overhaul of its systems for managing ethics, sustainability and other key drivers of reputation. Its new and improved reputation for being a leader in corporate governance served it well and provided ample resilience this past year when the markets began collapsing (Figure 4).

Nike (NYSE:NKE) is engaged in the design, development and worldwide marketing of footwear, apparel, athletic equipment and accessory products. Nike also sells athletic footwear and apparel. As recently as early 2007, Nike was experiencing the effects of headline risk associated with charges of labour practices inconsistent with evolving notions of ethics and sustainability. On 31st May 2007, Nike released a landmark corporate responsibility

report in which it committed to bringing systemic change for workers' rights throughout its supply chain, and to the entire industry. By showing that Nike was managing its reputation proactively, the markets rewarded it well (Figure 5).

### From IA to reputation

Reputation has significant economic value and is a product of IA management. Numerous companies have experienced business process failures, demonstrating a need for measurement systems and management controls. Holistic IP management comprises corporate-level reputation protection and operations-level monetisation of IP and IA. The benefits of superior management and measurement of IP and IA are that they provide companies with the abilities to enhance, protect and recover value quickly if a business process failure occurs. *iam*

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