



Valuing Intangible Assets in SMEs

THE ISSUE

The rise in the knowledge-based economy has led to an increase in the importance of Intangible Assets. Intangible Assets include human capital (proprietary knowledge and assembled workforces), reputation, customer relationships as well as formal intellectual property. This is particularly relevant for small and medium-sized enterprises (SMEs) considering it is estimated that 90% of SMEs are in the service sector, which typically generate income from their Intangible Assets.

But these assets are not usually included in accounting balance sheets because they do not comply with accounting conventions and invariably their value cannot be measured with reasonable certainty. However, they often represent the basis of individual SME's uniqueness and competitive advantage. ACCA research into Intangible Assets¹ found that many small businesses are not able to value their intangibles effectively; preventing them from transferring their business for its true value or accessing much needed finance.

ACCA research also shows that Intangible Assets are broader than those identified as part of the Gowers Review of intellectual property (IP) framework. Whilst Gowers correctly identified that some Intangible Assets are part of this framework, for example trade marks, brands, licenses and other protected intellectual property, ACCA commissioned research shows that Intangible Assets tend to be less well defined, a lot more varied and difficult to identify.

ACCA's UK Small Business Committee meeting in September 2006 examined the findings from ACCA's research on *SME Intangible Assets*, and considered issues which the Government, business support organisations, banks, IP professionals and accountants should address in order to create an environment in which SMEs can effectively value, transfer and protect their intangible assets. ACCA's UK Small Business Committee* is a unique voice on small business issues. It has a wide membership including accountants, leading academics and representatives from the main small business organisations.

ACCA SMALL BUSINESS COMMITTEE RECOMMENDATIONS

1. Raising awareness amongst SMEs of the importance of Intangible Assets should be addressed by Government, accountants, banks and other relevant institutions that work with SMEs. Small business owners must recognise that the competitive advantage of their business may well be based upon Intangible Assets that have value and need to be protected.
2. Lack of recognition of the value of Intangible Assets adversely affects SMEs' access to finance, particularly debt finance. The European Commission argue that "for high-tech and research intensive SMEs... this presents a problem as they often have no other collateral to offer to financial institutions."² Financial institutions should be made aware of this issue as it influences lending decisions and SMEs should seek to value their Intangible Assets to facilitate accessing finance.
3. Protection is not always achieved through Intellectual Property Rights. Clusters of Intangible Assets and carefully designed commercial practices may play an important role in sustaining and protecting such assets. These and other alternative protection methods should be recognised by SME owners and encouraged by professionals who work with them.
4. There is a need for a management tool to be developed through collaboration between professions such as accountancy, law and IP and with the support of government. A diagnostic tool which would enable owner-managers to identify and maximise the value of their intangible assets would provide a good basis for getting small business owners and their advisers to begin to consider this important issue.
5. Research has shown that the lack of recognition of Intangible Assets affects the successful transfer of a business because owners, especially those in the service sector, do not recognise their business' true value. The Government and other institutions working with SMEs should consider how Intangible Assets affect SMEs' position in relation to business transferability, with the objective of achieving a greater level of formal recognition of the value of these assets. This will have a positive impact on Government policy of increasing the rate of business transfers and should therefore be actively addressed in Governments' business support programme.

6. The accountancy and other professions should explore how the commercial value of intangible assets is conveyed to stakeholders, for example through the medium of financial reports. Financial reports are an important source of information for financial institutions when making credit decisions. These documents need to reflect the true value of the business including the value of Intangible Assets.
7. When dealing with Intangible Assets, small business owners would demand a range of skills which are likely to be provided by varying professions (e.g. accountants and lawyers). Therefore greater collaboration between these professionals would enhance the service SMEs receive and improve mutual understanding between professions of the issues involved.
8. Small business owners should be encouraged to seek out professional advice on Intangible Assets. Currently, the perceived cost of such advice may be acting as a deterrent but enhanced engagement with professionals could improve SMEs' management of these assets. For example, accountants play a crucial role in succession planning advice³ and are in an ideal position to help small business owners consider the transferability of their Intangible Assets.
9. Relatively few SMEs use formal Intellectual Property Rights⁴ preferring to rely on other means such as sustaining close customer relationships or utilising employment contracts, as referred to in point two. Government, the accountancy and legal professions should consider whether a need exists for new forms of protection of intellectual property to enhance the value of businesses at the same time as encouraging more widespread use of formal protection methods.

ACCA'S INVOLVEMENT

ACCA (the Association of Chartered Certified Accountants) is the largest and fastest growing global professional accountancy body, with over 105,000 members and 245,000 students in 170 countries. Independent research shows consistently that qualified accountants are the first choice advisors of small businesses. ACCA has over 100 years' experience of working with and providing professional advice to small and medium-sized firms. In the UK over 56% of ACCA members (over 25,000) work in or for SMEs.

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REFERENCES

¹ Martin, C (2006), *SME Intangible Assets*, ACCA Research Report No.93

² European Commission (2005), *More Research and Innovation – Investing for Growth and Employment: A common approach*, COM(2005) 488 Final

³ Martin, C. (2005), *Accountancy Practices and the Provision of Ownership Succession Advice*, ACCA Research Report No.85

⁴ Blackburn, R. (2003), *Intellectual Property and Innovation Management in the Small Firm* (London: Routledge).