

MANAGING INTELLECTUAL LIABILITIES USING RISK MANAGEMENT APPROACH – A CONCEPTUAL PAPER

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ABSTRACT

Most studies on intellectual capital (IC) seem to support the idea that it could create value to organisations through the development of linkages among its components. Therefore, it envisages that the more IC the better and hence, companies have to invest in it in order to increase their value. Others, however, suggest that this picture may be too optimistic, that investing in IC has both negative and positive effects. In fact, most studies tend to overlook the risk or destructive side of IC, if not properly addressed. Stemming from this, the concept of intellectual liabilities (ILs) was introduced into IC discussion, incorporating the potential of IC to destroy value. Based on the review of literature, this paper proposes to conceptualise the ILs associated with IC and the potential risk and value destruction to companies. In order to manage the ILs, organisations should apply the risk management approach in order to mitigate the risks. Risk management could be used to minimize the value destruction derived from the ILs. Since the studies on IC are now in their so-called “third stage”, this paper contributes to bridging the gap between theory and practice as there is still deficient understanding of ILs and their role within the value creation process or value destruction, if not properly managed.

Keywords: Intellectual capital, Intellectual liabilities, Risk management, Value destruction, Value creation

1.0 INTRODUCTION

The present wave and speed of information and technological change has significantly transformed the traditional business operation and competition globally. The economy is changing from a production-oriented economy towards a knowledge-oriented economy and intellectual capital (IC) is becoming more and more important. In order to make better products or deliver better services, a company needs to put in more knowledge and know-how. From this perspective, it can be said that knowledge is gradually replacing the labour and financial capital.

IC is typically classified to consist of three main components: human capital (HC), structural capital (SC) and relational capital (RC). After more than two decades of its existence, the academic and professional interest in IC is still debating the contribution garnered from it. Many studies support or argue that IC creates value to an organization through the development of linkages or interactions among its components, rather than by itself (Chen, et al., 2005). Therefore, it envisages that the more IC the better and hence companies have to invest in it in order to increase their value. However, the recent studies on IC are not too optimistic about this phenomenon (Giuliani, 2013). While studies on IC are now in their so-called “third stage”, this paper provides a conceptual discussion on the potential of IC to destroy value and hence create an operational or business risk to companies, if not properly addressed.

2.0 THE CREATION OF IC

In approaching IC, two main perspectives seem to dominate. The first perspective is “static” and the second one is “dynamic” (Meritum, 2002). The former perspective focuses on the properties of the three IC components, identifying their size through financial and non-financial indicators in company reports. The dynamic approach, on the other hand, assumes that none of the IC components alone are sufficient for successful performance, but rather, they need to be combined to generate value. Therefore, IC becomes a phenomenon of interactions, transformations and complementarities which can be understood by not only focusing on resources, but also on processes, rules, activities and connections (Giuliani, 2013). To illustrate, in order to make a company working in the best possible way, it will not only need the machines, computers, and production facilities but it will also need the ‘drivers’ that make the company function well. These drivers are the people (HC) with their know-how and experience, the internal processes (SC) to guide the business flow and also the interaction with alliances or partners and customers (RC). Without these drivers, the company would not function at all and therefore they are of “capital” importance. This is the company’s “intellectual capital”. The amount of IC will determine how good or bad a company will be able to perform. It is the difference between success and failure because no matter how good the product or idea, without enough IC, no outstanding result can be achieved.

3.0 IC CONSERVEVATION

Individuals' assets of knowledge and expertise constitute a company's competitive edge (Selby, 2010). Knowledge and learning management comprises a range of strategies and practices used in a company to identify, create, represent, distribute, and enable sharing and adoption of insights and experiences. It also helps to reduce redundant work, avoid reinventing the wheel, reduce training time for new employees, retain intellectual capital as employees' turnover in an organization, and to adapt to changing environments and markets. Thus, it is vital for a company to capture and conserve the so-called intellectual capital in the organization in order to safeguard its future actions/outcomes. Ocion Tomo (2012) discloses that only 15% of the knowledge in an organization is explicit from which only 3% is used and 85% is tacit. They also point out that most knowledge management systems only store knowledge and do not bother about capturing and making the captured knowledge re-usable. Therefore, it is important for a company to provide methods, methodologies and tools that capture, store and reuse the knowledge. So, even when key people leave the organization, the fundamentals for continuously providing high-quality services and innovative development are protected. Many stakeholders can make efficient use of this knowhow.

4.0 WHAT DESTROY IC?

IC is still considered as an elusive phenomenon (Choong, 2008). While there is a widespread recognition of the inter-relationships between IC components and the consequences for value creation, Giuliani (2013) points out that little empirical work on IC in practice has followed to offer more insights useful for interpreting reality (Cuganesan and Dumay, 2009; Dumay, 2012). Although these IC models and frameworks represent important advances within the whole IC discipline, they are silent on the fact that IC can have negative effects. The recent financial crisis has challenged several accounting concepts and methods (Humphrey et al., 2011; Magnan and Markarin, 2011). In the IC discourse, this has drawn attention to the problematic nature of IC, that is, that inter-relationships and their consequences for value-creation are unstable and precarious, being contingent upon the manner of their deployment and use within organizational processes (Cuganesan, 2005; Giuliani, 2013). Indeed, IC resources can also have negative value consequences, giving rise to intellectual liabilities (ILs) (Caddy, 2000). In other words, it seems that if knowledge is well managed, the value is added via IC and if it is badly managed, it may lead to ILs.

5.0 INTELLECTUAL LIABILITIES (ILS) AND IC RISKS

Generally, ILs can be defined as potential non-physical causes of organizational deterioration (Giuliani, 2013, p. 129). Literatures on ILs have variously described ILs as "negative value consequences" (Cuganesan, 2005, p. 360), "negative IC" (Brannstrom and Giuliani, 2009, p72), "negative drivers of value creation" (Viedma Marti, 2003, p. 221) and "contradictory value drivers" (Abeysekera, 2006, p. 64). Researchers have proposed two main conceptualizations of ILs: the first considers ILs a depreciation of the value of IC (Abeysekera and Guthrie, 2004; Caddy, 2000), while the other assumes that ILs is non-monetary obligations (Garcia-Parra et al., 2009; Harvey and Lusch, 1999). As a result of the negative connotations of ILs, they (ILs) may cause some operational or commercial risks to a company. For example, the risks may include the loss of human IC to a competitor, disclosure of structural IC to a competitor or disclosure of the company's commercial secrets. According to Selby (2010), there are three main ways in which secret information is lost: the most common one is when a company discloses information for one purpose and the other party uses it against the company's interests for another purpose. The second possibility is when the company's staff discloses information to others either deliberately or through the act of negligence; and the least common way is when the company's competitors actively steal the company's information. Therefore, the investigation and (risk) management of ILs deserve management attention.

6.0 INTELLECTUAL CAPITAL IN MALAYSIA

Globalization of the market place imposes serious threats to emerging economies of many developing countries such as Malaysia. Technological advancements, trade liberalization and global financial crisis have changed the Malaysian economic landscape tremendously. In order to be competitive and achieve sustainable economic growth, Malaysia has embarked on a mission to develop a knowledge-based society as highlighted in its Third Outline Perspective Plan, 2001-2010 (Economic Planning Unit, 2001). Subsequently, a Knowledge-Based Economy Master Plan was launched in 2002. The Master Plan outlines the various strategies to accelerate the transformation of Malaysia to a knowledge-based economy (ISIS, 2002). The shift to the knowledge-based economy is part of the wider plan to achieve the target of the nation's vision 2020 (Mustapha and Abdullah, 2004). Vision 2020 is a 30-year plan, announced by the Malaysia Prime Minister on 28 February 1991. It is a "bold and brave" plan to push Malaysia to achieve "developed nation status" in economic performance and technological capabilities by the year 2020 (Fisher, Dawkins and Akin, 1994).

Malaysia's development vision, as outlined in Vision 2020, is to become a fully developed nation with a "values-based society" (Wan Mohamad, 1999). Among the strategies adopted in order to realise national vision, Government encourages active participation by private sectors in the areas of high-technology and knowledge-intensive (Economic Planning Unit Report, 2009). Malaysia's conscious and deliberate shift to a knowledge-based economy has involved investment in research and development (R&D), knowledge-intensive activities, technology-related capacity and skills, innovation and high ICT penetration and internet usage. In order to remain competitive in the knowledge economy, Salleh and Selamat (2007) view that Malaysia can no longer rely on investment in capital or physical assets; rather growth must be driven by productivity and innovation supported by effective management of both tangible and intangible resources. The Global Innovation Index 2013 reports that Malaysia is ranked at 32nd place (out of 142 countries) in terms of the innovation. Eventhough Malaysia comes first among the upper-middle income economies in Asia, there are still lacking in human capital and research, besides institutional framework. In R & D,

Malaysia does less well although the involvement of the private sector in financing and performing R & D is noteworthy (The Global Innovation Index, 2013). Malaysia is still considered as 'inefficient innovators' (Learner Stage) among the upper-middle income countries. On the competitiveness issue, much remains to be done to put the country on a more solid growth path particularly to realize its vision to become a knowledge-based economy by the end of the decade. This is because the country records a low level of technological readiness, which is a prerequisite to become a knowledge-based economy (The Global Competitiveness Report 2012-2013).

As the country's economy is largely driven by private sectors, Malaysian companies must support the Government's development vision for Malaysia to become a knowledge-based economy by year 2020. In the knowledge-based economy, company's core assets are their IC made up of the combined knowledge of human, structural and relational resources (Salleh and Selamat, 2007). As more companies begin to realise the value of IC, it has taken the centre stage in company's efforts to create competitive advantages (Kaplan and Norton, 2004) and thus, the management of IC is imperative to the success of these companies. Accordingly, Lev (2001) opines that if intangible resources are assets that enable companies to gain sustained competitive advantage, stakeholders should be given appropriate information about those resources in order to understand the true value of a company.

In order to achieve and maintain a developed nation status, Malaysian's companies and government need to increase the knowledge contents in all activities to strengthen the country's competitive position (Goh and Lim, 2004). They also emphasised that in order to succeed in the emerging knowledge-based economy, it is essential for companies to exploit IC in order to create wealth for the company. The present Malaysian government has embarked on many plans to realise the vision. At the heart of the plan is the Government Transformation Programme (GTP), an ambitious broad-based programme of change to fundamentally transform the Government into an efficient institution. The Economic Transformation Programme (ETP) is another initiative by the Malaysian Government to turn Malaysia into a high income economy by the year 2020. The New Economic Model (NEM) which was unveiled on 30 March 2010 by Malaysian Prime Minister Najib Tun Razak aims to "transform the Malaysian economy to become one with high income and quality growth" by 2020. The goal of the plan is to stimulate economic growth by improving worker productivity across all sectors of society.

6.0 CONCLUSION

This conceptual paper suggests for more research on IC and ILs, not only centred on what IC and ILs do within companies but also from the risk management perspectives. Eventhough the general tendency is to consider ILs as a negative occurrence, researchers such as Stam (2009) argues that they are not necessarily bad; it can be interpreted as a "stimulus for innovation", as a boost to find creative answers to negative situations and to strengthen knowledge productivity. Thus, research investigating IC and ILs in real practice and how companies approach, perceive and manage IC and ILs will be interesting future research.

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