

# **INTANGIBLES' INFORMATION DEFICIENCIES: ADVERSE CONSEQUENCES AND REMEDIES**

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# At A Glance

- w Seriously adverse capital markets and managerial consequences of the information deficiencies of intangible assets.
- w The information needed by investors and managers.
- w How to generate this information.

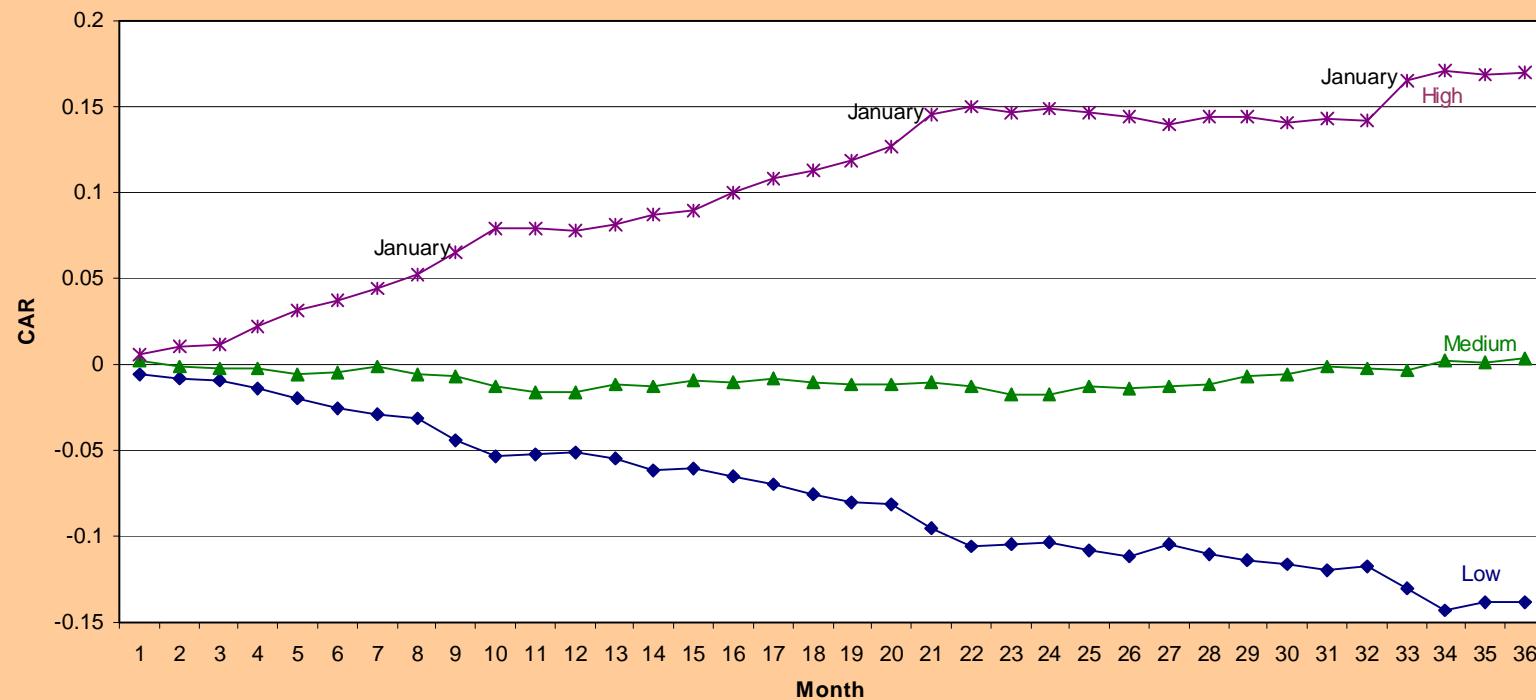
# In Capital Markets—No News Is Bad News (Or the Market for Lemons Revisited)

## w Empirical findings:

- § Shares of intangibles-intensive companies are systematically undervalued, causing:
  - " Excessive cost of capital.
  - " Suboptimal investment and growth.
- § High cost of capital and debt for R&D-intensive companies.
- § “Expect the worst”: excessive insider trading gains at R&D-intensive companies.

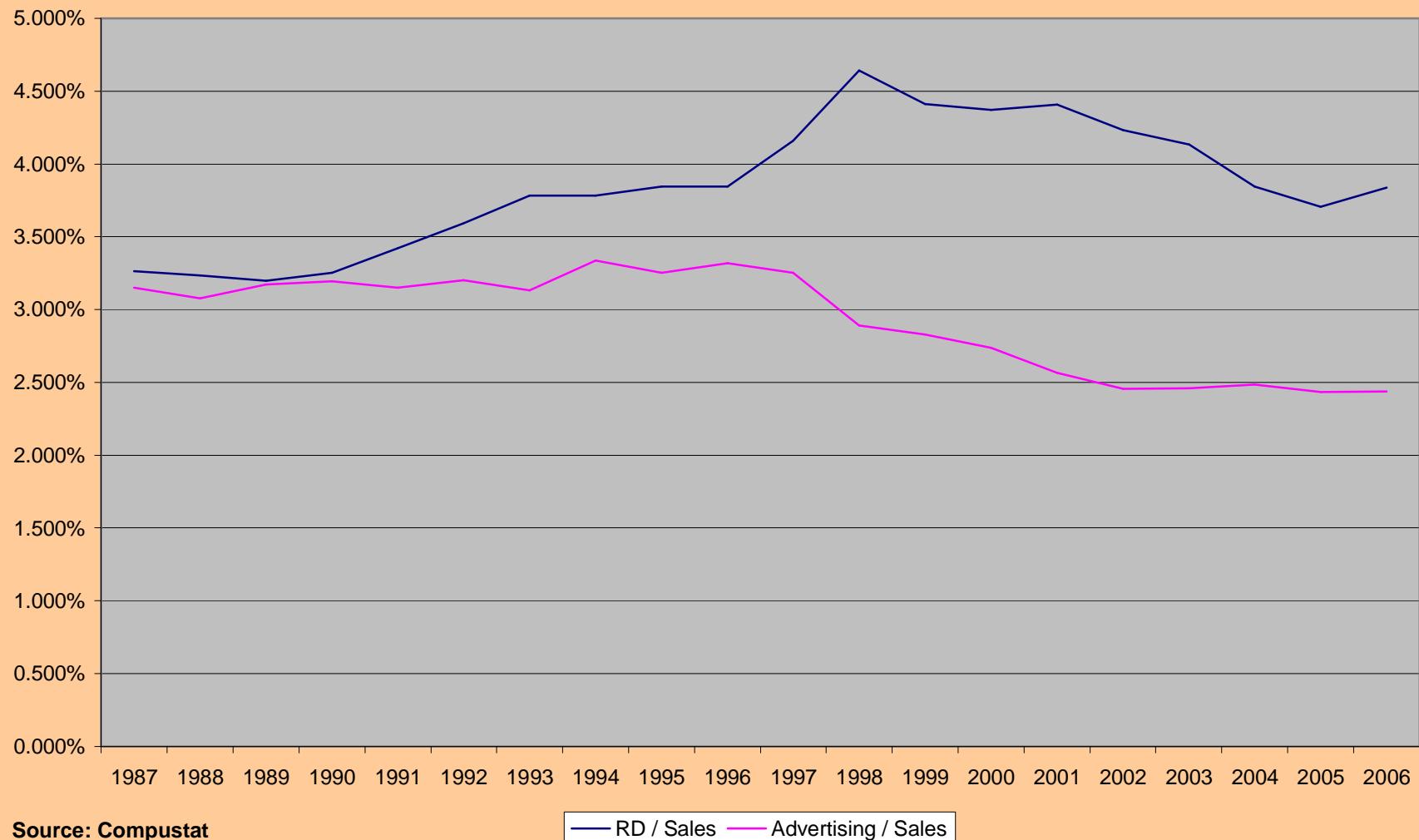
# Hard to Believe: R&D Is Unappreciated by Investors

The Performance of Shares of Companies with High, Medium and Low R&D Capital



Source: Lev, Nissim, Thomas, "On the Informational Usefulness of R&D Capitalization." (2007)

**Figure 1**  
**R&D and Advertising Intensities, 1987 - 2006**



Source: Compustat

— RD / Sales — Advertising / Sales

# What's Not Reported Isn't Measured and Isn't Managed

“Most large companies now have at least 30 alliances, and many have more than 100. Yet despite the ubiquity of alliances—and the considerable assets and revenues they often involve—very few companies systematically track their performance. Doing so is not a straightforward task... Our experience suggests that fewer than one in four has adequate performance metrics... Few Senior management teams know whether the alliance portfolio as a whole really supports corporate strategy.”

# Problems Caused By Information Or Risk?

w Information indeed:

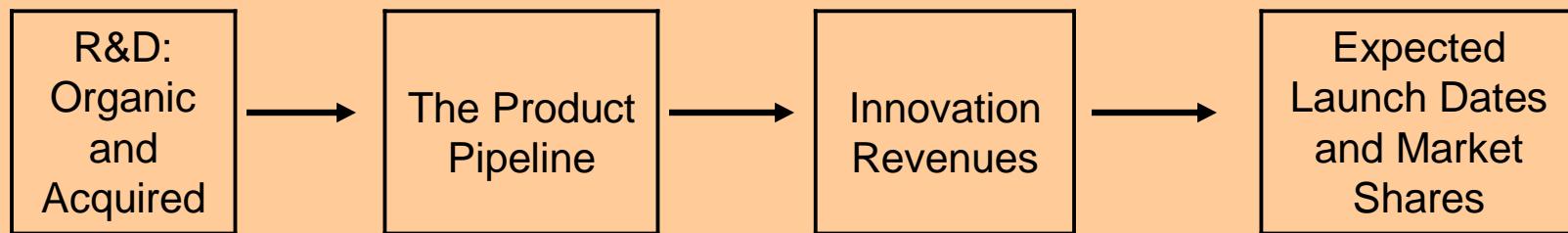
- Biotech prospectus disclosure reduces stock volatility and bid-ask spreads.
- Disclosing patent royalties increases R&D valuation.
- Managers' guidance mitigates share undervaluation.

# What Information Is Needed?

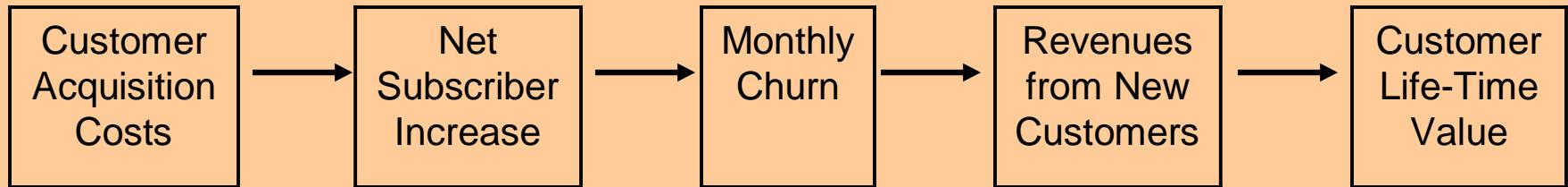
- w Not haphazard, nonstandardized measures like: employee/customer satisfaction, brand values, corporate reputation, or the triple bottom line.
- w What's needed is structured input-output information on performance of the major drivers of enterprise value.

# Examples:

## w Pharma/Biotech companies



## w Telecom/Internet enterprises



# How to Achieve Adequate Disclosure?

- w Organized effort initiated by government/SEC/FASB, and supported by accounting firms and managers' organizations to:
  - set up standardized disclosure templates for industry groups.  
(Essentially codifying successful voluntary practices)

Can Be Done!